Resolution No. 383/2008
of the Polish Financial Supervision Authority
of 17 December 2008

on detailed principles of functioning of the risk management system and internal control system, and specific terms of assessing internal capital, reviewing the assessment process and maintaining internal capital by banks

Pursuant to Article 9f and Article 128 (6) item 2 of the Act of 29 August 1997 - The Banking Act (Journal of Laws of 2002, No. 72, item 665, as further amended[1]) it is resolved as follows:

Chapter 1. General Principles

§ 1 Risk management, internal audit, assessment of internal capital, and reviewing the assesment process and maintaining the internal capital in a bank shall be carried out pursuant to written strategies, plans, procedures and analyses.

§ 2. A bank's risk management system and internal control system relate to the activities conducted directly by the bank and take into account the functioning of the bank in holdings referred to in Article 141f (1) of the Act referred to in the introductory sentence.

§ 3.1. The Supervisory Board shall approve the bank's operating strategy and principles of prudent and stable management of the bank.
2. The Supervisory Board shall supervise the compliance of the bank's policy with respect to risk-taking with the bank's strategy and financial plan.

§ 4. The Supervisory Board of the bank should ensure that persons elected to the Management Board are suitably qualified to exercise the functions assigned to them. The Supervisory Board shall assess whether the Management Board's actions related to the control of the bank's activities are effective and in line with the Supervisory Board's policy.

§ 5. Taking decisions related to the bank's management, the Management Board shall take into account the results of audits performed by the internal audit department and certified auditors.

§ 6.1. The Management Board shall be responsible for the effectiveness of the risk management system, internal audit system, conducting internal capital assessment process and audits, the process of assessing and maintaining the internal capital as well as for the supervision over the efficiency of these processes by introducing the necessary adjustments and improvements in case of a change in the risk underlying the bank's activities, business environment and irregularities in the functioning of systems and processes.
2. The bank's organizational structure, as well as the systems and processes referred to in § 6.1, should be adjusted to the size and complexity of the bank's activities.

§ 7.1. The bank's Management Board shall be responsible for the development, implementation and updating of written policies, strategies and procedures relating to the risk management system, internal control system, assessment of internal capital and review of processes of assessing and maintaining internal capital.

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[1] Amendments to the consolidated text of this Act were published in the Journal of Laws of 2002, No. 126, item 1070, No. 141, item 1178, No. 144, item 1208, No. 153, item 1271, No. 169, item 1385, and 1387 and No. 241, item 2074, 2003, No 50, item 424, No. 60, item 535, No. 65, item 594, No. 228, item 2260, No. 229, item 2276, 2004, No. 64, item 594, No. 68, item 623, No. 91, item 870, No. 96, item 959, No. 121, item 1264, No. 146, item 1546, No. 173, item 1808, of 2005, No 83, item 719, No 85, item 727, No. 167, item 1398, No. 183, item 1538, of 2006, No. 104, item 708, No. 157, item 1119, No. 190, item 1401 and No 245, item 1775, of 2007 No. 42, item 272 and No. 112 item 769, of 2008 No. 171, item 1056, No. 192, item 1179, No. 209, item 1315

2. The bank's internal procedures, referred to in § 7.1, specify in particular:
1) assignment of duties, according to the bank's organizational structure;
2) principles of cooperation between organisational units of the bank;
3) principles of appointment, remuneration and monitoring of staff performing essential functions for the bank and activities aimed at ensuring their continuity.

§ 8.1. The bank's Management Board shall implement the organisational structure of the bank, approved by the Supervisory Board and adjusted to the size and profile of the bank's risk.
2. The bank's Management Board shall introduce the division of tasks performed by the bank so that the functions of risk measurement, monitoring and control are independent of the operations, from which the risk taken by the bank derives.

§ 9 The bank's Management Board shall provide the Supervisory Board with periodic information, which shows the types and size of the risk underlying the bank's activity in a fair, transparent and synthetic way.

§ 10. The bank's Management Board shall be responsible for the transparency of bank's activities, in particular for the information policy concerning the bank's activities, making it possible to assess the Supervisory Board's and Management Board's effectiveness in managing the bank, monitoring the security of bank's activities and assessing the financial situation of the bank.

§ 11.1. The bank's Management Board shall ensure compliance of bank's activities with the applicable law, taking into account the bank's activities under the legal provisions of another country and bank's connections with other entities that could hinder the effective management of the bank.
2. The Management Board shall ensure that the bank pursues a policy which helps it manage all the significant risks underlying the bank's activities and has procedures in this regard.

Chapter 2. Risk Management

§ 12.1. Risk management in a bank is based on policies and procedures whose aim is to identify, measure, monitor and control risks, and which were developed in writing and approved by the bank's Management Board or appropriate committees appointed by the Board.
2. Bank employees involved in risk management should be familiar with the bank's internal procedures. The procedures are subject to regular reviews to adjust them to changes in the bank's risk profile and its business environment.

§ 13. As part of the strategies and risk management procedures currently in use the bank shall introduce in particular:
1) in the scope of credit risk and counterparty risk:
   a) criteria for evaluating the bank's customers' credit quality, so that the credit risk associated with products / services in which the bank is involved, can be reduced,
   b) a system of classifying credit exposures into risk categories and provisioning for risks associated with the bank's activities, pursuant to the Ministry of Finance's resolution of 10 December 2003 on the principles of provisioning for risks associated with the activities of banks (Journal of Laws No 218, item 2147) or with the system of identifying impaired credit exposures, making impairment charges due to the loss of balance sheet value of credit exposures, and provisioning for off-balance sheet credit exposures,
   c) principles for diversifying the portfolio of credit exposures, in accordance with the upper limit of credit risk as determined by the bank, and taking into account the markets, in which the bank operates;

2) in the scope of residual risk - written policies and procedures for managing risks arising from the smaller effectiveness of the bank's credit risk mitigation techniques, than the bank anticipated;
3) in the scope of concentration risk - written procedures for the management of concentration risk, referred to in § 1 item 1 of the Resolution No 384/2008 of the Polish Financial Supervision Authority of 17 December 2008 on the requirements for identification, monitoring and control of exposure concentrations, including large exposures (Journal of Laws PFSA No 8, item 38);
4) in the scope of risk arising form securitisation:
   a) procedures of risk management that allow a bank to assess the risk related to the finalised securitisation transactions, particularly with the aim of reflecting the economic character of the transaction - for the sponsoring or initiating bank, referred to in annex 18 to the resolution No 380/2008 of the Polish Financial Supervision Authority of 17 December 2008 on the scope and detailed principles of determining capital requirements for various types of risk, including: the scope and conditions of using statistical methods and the scope of information enclosed in the applications for an approval to use them; rules and conditions of taking into account the contracts on the assignment of receivables, subparticipation contracts, contracts on credit derivatives and contracts other than the assignment of receivables and subparticipation contracts, for the purpose of defining capital requirements; conditions, the scope and methods of using the ratings of external credit rating institutions and of export credit agencies; the method and detailed rules for calculating the bank's solvency ratio; the scope and method of including the banks' operation in holdings in the calculation of capital requirements and the solvency ratio and identifying extra items in the bank's balance sheet, presented together with bank's own funds on the capital adequacy account; and the scope, method and conditions of their inclusion (Official Journal of the PFSA No 8, item 34) hereinafter referred to as the "resolution on capital adequacy",
   b) plans to maintain liquidity, designed to address the implications of scheduled and early amortisation - for the bank initiating the revolving securitization transactions with early amortization provisions, referred to in Annex 18 to the resolution on capital adequacy;
5) in the scope of the risks arising from changes in macroeconomic conditions - principles of management and hedging against risks arising from changes in macroeconomic conditions and their impact on the level of minimum capital requirements in the future;
6) in the scope of the market risk - procedures aimed at measuring and managing market risk elements which the bank considers material;
7) in the scope of the interest rate risk in the banking book - procedures of managing the risk arising from possible changes in interest rates, with respect to items included in the banking book, including in particular the stress tests which measure the bank's response to a sudden and unexpected change in interest rates by 200 basis points;
8) in the scope of operational risk:
   a) operational risk management procedures, including the rules for identifying, registering and monitoring the loss due to operational risk, and the definition of operational risk adopted by the bank for the purpose of applying these procedures, which includes the elements referred to in § 1 of Annex 14 to the resolution on capital adequacy and taking into account events of low incidence but high loss,
   b) business continuity plans, which ensure continuous and uninterrupted operation of the bank and contingency plans, which enable the bank to carry out its current activity and limit losses in the event of unfavourable internal and external developments that can seriously disrupt that activity,
   c) policy on the choice, supplementing and monitoring of staffing needs and manpower planning,
   d) Principles on the management of risk related to outsourcing;
9) in the scope of liquidity risk:
   a) liquidity management procedures, taking into account the division of powers and responsibilities,
   b) methods of identifying, measuring and monitoring liquidity,
   a) contingency plans to ensure smooth conduct of business, including the maintenance of liquidity in the event of emergencies.

§ 14. The bank shall introduce management procedures of risks other than those mentioned in § 13, that were identified as important for the bank's business activity.

§ 15.1. The bank shall use methods (models) for identifying and measuring risks associated with its activities, tailored to the profile, scale and complexity of risk.
2. The frequency of risk measurement shall be adjusted to the size and nature of the different types of risk in the bank's activities.
3. Methods (models) of risk measurement used by the bank shall be applied to the current as well as planned activity.
4. The methods (models) or the risk measurement systems in use, in particular their assumptions, are subject to periodic internal evaluation which includes testing and historical back-testing.

§ 16.1. As part of its risk measurement, the bank shall carry out stress tests.
2. Stress tests shall be carried out in the bank and be based on assumptions that ensure accurate risk assessment.

§ 17.1. The bank shall introduce internal limits that reduce risk in various areas of the bank's activity, appropriate for the scale and complexity of that activity.
2. The bank's Management Board or appropriate committees appointed by the Board shall approve the types of the adopted internal limits as well as their values.
3. In its internal regulations, the bank shall determine rules for establishing and updating internal limits referred to in paragraph 1 and the frequency of monitoring whether they are being observed, and of reporting the results of such monitoring.
4. The values of limits referred to in item 1 shall be adjusted to the bank's overall risk level, approved by the Supervisory Board.
5. Analyses, based on which limit values are determined, shall be in writing.

§ 18.1. The bank shall describe situations in which the internal limits referred to in § 17 (1) may be exceeded, and define conditions on which exceeding the limits will be authorised.
2. The bank shall specify the procedure to be followed if the limits referred to in § 17 (1) are exceeded, including steps to be taken in order to explain the cause of exceeding the limits, except for the exceeding referred to in item 1. The bank shall also specify how to reverse the exceeding and what measures should be taken to prevent such situations in the future.

§ 19.1. Risk monitoring and reporting shall be part of everyday process of risk management at the bank.
2. The information included in internal reports shall support decision-making process in the scope of risk management at the bank and shall be reliable, accurate, up-to-date and cover an appropriate range of areas.
3. The internal system of reporting to the management, currently in use at the bank, shall provide information on the types and size of risk related to the bank's activities for risk management purposes. The system shall help to assess the results of risk management decisions and to monitor the compliance with internal limits referred to in §17 (1).
4. The frequency of risk monitoring shall be such as to make it possible to provide information about changes in the bank's risk profile.

§ 20. Prior to the introduction of a new financial product the bank shall carry out a preparatory process, which shall include in particular: analysis of compliance with the bank's strategy, identification of significant risks, taking the new product into account in the bank's methods of identifying and measuring risk, establishing internal limits, accounting and reporting rules, and approval by the bank's Management Board or committees appointed by the Board.

§ 21.1. The bank shall monitor risks associated with the activities of its subsidiaries.

i. The principles of risk management in the bank's subsidiaries, including the methodology of identification, measurement and reduction of risk, should follow the strategy adopted by the bank and be consistent with the principles set out in § 13, with due consideration of the type of activities conducted by these entities.
ii. The bank shall assess the size and profile of risk underlying the activities of its subsidiaries.
iii. The scope and quality of information used by the bank's management and concerning the risks underlying the activities of its subsidiaries, should be such as to make it possible to asses this risk reliably.

§ 22.1. The Supervisory Board shall monitor the management of the compliance risk, understood as consequences of non-compliance with laws, internal regulations and standards of conduct adopted by the bank.
2. The Supervisory Board shall approve the bank's policy guidelines on the compliance risk.
3. The Supervisory Board shall evaluate the effectiveness of the bank's compliance risk management at least once a year.

§ 23. The Management Board shall be responsible for the effective management of compliance risk in the bank.

§ 24.1. The Management Board shall be responsible for developing a compliance policy, for ensuring its observance and for reporting to the Supervisory Board on the management of the bank's compliance risk.
2. The compliance policy shall include basic principles of conduct for the bank's employees and explain the main processes identifying the compliance risk and enabling its management at all levels of bank's organization.

§ 25. The bank's Management Board shall be responsible for establishing a permanent and efficient compliance risk management unit in the bank.

§ 26. In the case of irregularities in the application of compliance policy, the bank's Management Board shall take corrective or disciplinary measures.

Chapter 3. The Internal Control System

§ 27. The bank shall have an internal control system appropriate for its organizational structure, which shall include the bank's organizational units and its subsidiaries.

§ 28.1. The bank shall have:

1) internal control procedures, setting out principles of internal control, developed in writing and approved by the Management Board and the Supervisory Board. The principles shall determine tasks performed at various job positions within the system of internal control (internal regulations);
2) internal control mechanisms, tailored to the bank's specific character and including:
   a) rules, limits and procedures of controlling nature, which apply to the bank's activities and function within the bank's operating system,
   b) actions designed to control the quality and accuracy of tasks performed in the bank by each employee and additionally by their immediate superior.

2. Internal control mechanisms and procedures shall be reviewed and evaluated by means of the internal audit unit referred to in Article 9c item 2 point 3 of the Act referred to in the introductory sentence.

§ 29. Within its internal control system, the bank shall identify the risks:
1) associated with any operation, transaction, product and service;
2) resulting from the organizational structure and the structure of the holding company referred to in Article 141f (1) of the Act referred to in the introductory sentence, in which the bank operates.

§ 30. The bank's Management Board shall take action to ensure continuous monitoring of the effectiveness of internal control mechanisms and to identify areas of the bank's business, operations, transactions and other activities which are meant to be continuously monitored.

§ 31. The duties of the bank's Management Board shall be:

1) to designate persons responsible for carrying out periodic verification of mechanisms operating in the bank and internal control procedures at least once a year;
2) to specify the form of documenting reviews and evaluations of effectiveness of internal control mechanisms and conclusions arising from these reviews;
3) to specify the mode of submitting the report within the bank, so as to take action to eliminate deficiencies found in internal control mechanisms, and the way of rectifying these deficiencies.

§ 32. Based on the review and evaluation of effectiveness of internal control mechanisms, the Management Board and the Supervisory Board shall receive:
1) information on material deficiencies found in internal control mechanisms immediately after their disclosure, and information on the effects of measures taken to remove these deficiencies;
2) periodic information on all areas subject to internal control.

§ 33.1. The bank's Management Board shall be responsible for organizing an internal audit unit.
2. The bank’s Management Board shall conduct periodic evaluation of the effectiveness of the internal audit unit, using documents prepared by head of the unit, protocols drawn up by the banking supervision authority and internal auditors.
3. Activities carried out as part of internal audit to achieve tasks defined in Article 9d (2) of the Banking Act should:
1) apply to business activity of the bank as a whole;
2) be carried out in accordance with the rules on conducting audits which specify an audit's objective, scope and detailed principles of operation as well as the organizational structure of internal audit unit, and be based on written methodology of conducting audits by the internal audit unit;
3) be carried out using appropriate, described methods for the selection of samples for inspection;
4) have the scope and frequency specified in audit plans and be adjusted to the identified areas of risk and its level of significance;
5) be properly documented;
6) include a verification of how effectively the recommendations made during an internal audit have been implemented.

§ 34. The bank's Management Board shall take action to ensure continuity and effectiveness of internal control, including proper cooperation of all the bank's employees with the internal audit unit as well as access to the necessary source documents including those containing confidential information for persons carrying out the audit.

§ 35. Persons performing inspection activities at the bank should have adequate qualifications, experience and skills in the area of evaluating risk underlying the bank's activities.

§ 36. The bank shall have mechanisms in place to ensure independence of its internal audit unit, in particular by means of:

1) direct contact of the head of the internal audit unit with the Management Board and the Supervisory Board of the bank;
2) detailed mode of appointment and dismissal of the head of the internal audit unit;
3) detailed mode of controlling the level of remuneration of the head and personnel of the internal audit unit;
4) participation of the head of the internal audit unit in the meetings of the Management Board and the Supervisory Board, if, among the matters on the agenda, there are issues relating directly to the tasks of internal audit unit and to supervision of internal control;
5) participation, at least once a year, of the head of the internal audit unit in the meeting of the Supervisory Board, during which the activities of the internal audit unit would be discussed;
6) protection of the internal audit staff against unfair dismissal.

§ 37. Based on internal control functions, the Management Board and the Supervisory Board receive information on:
1) compliance with applicable laws and the bank's internal regulations;
2) the functioning of the bank's management information system;
3) effectiveness in disclosing - as a result of functional control - errors and irregularities and in taking effective remedial or corrective action;
4) implementation of the bank's objectives and policy defined and required by the Management Board;
5) completeness, accuracy and comprehensiveness of accounting procedures;
6) quality (accuracy and reliability) of the accounting, reporting and operational systems;
7) suitability, functionality and security of the IT system;
8) efficiency of using available resources, including bank's own funds and resources in all areas of the bank's activities;
9) assessment of the bank's organizational structure, of division of responsibilities and coordination between various organisational units and work posts, and of the system concerning the creation and circulation of documents and information;
10) assessment of the functioning of internal systems with respect to improving efficiency of the bank's operation as a whole;
11) tasks outsourced by the bank.

§ 38. Chairman of the Management Board shall make decisions on how to use audit results and how to report them to the audited unit, which shall in turn inform the internal audit unit of the time and results of remedial actions, taken in connection with internal audit.

§ 39. The rules set out in § 34 - § 38 shall apply mutatis mutandis to cooperative banks, where, under Article 10 of the Act referred to in the introductory sentence, internal control is carried out by the affiliating bank.

Chapter 4. The process of assessing and maintaining the internal capital and review of the process

§ 40. The bank's Management Board is responsible for the preparation and implementation of the following processes:
1) internal capital assessment;
2) capital management;
3) capital planning.

§ 41. The bank's internal procedures relating to processes of internal capital assessment, capital management and capital planning shall be approved by the Supervisory Board of the bank.

§ 42. Internal capital assessment processes, capital management and capital planning shall be properly documented.

§ 43.1. The bank's Management Board shall be responsible for conducting regular reviews of internal capital assessment process, so that it is appropriate for the nature, scale and

complexity of the bank's activity. Internal capital assessment process shall be subject to review and verification at least once a year.
2. Regardless of annual reviews, the process of internal capital assessment shall be adjusted accordingly, in particular when there are new types of risks, significant changes in the strategy and action plans, and the external environment in which the bank operates.
3. The process referred to in § 40 item 1 and a review of this process shall be subject to independent evaluation carried out by the bank's internal audit unit.

§ 44.1. The internal capital assessment process should be an integral part of the bank management process.
2. The capital management policy and capital plans should be included in the management process.
3. The capital management policy pursued at the bank shall include in particular the following elements:
1) long-term capital objectives of the bank;
2) preferred capital structure;
3) capital contingency plans;
4) delegating the management of capital;
5) basic components of the process of converting risk measures into capital requirements.

§ 45. The internal capital assessment process should take into account reliable results of risk assessment. The assessment of capital adequacy should take into account quantitative factors (results of capital assessment methods) and qualitative factors, particularly in the scope of input data and results of the models used.

§ 46. The bank's Management Board shall be responsible for appropriate determination of the total required level of capital to cover all the relevant types of risk and its qualitative assessment.

§ 47. The internal capital assessment process carried out by the bank shall involve in particular:
1) written criteria for recognising particular risks as material;
2) written policy principles and procedures for the identification, measurement and reporting risk in the bank's activity;
3) the process of capital allocation depending on the level of risk in the bank;
4) the process of determining capital objectives with regard to capital adequacy (target capital level);
5) the internal control system in the area of estimating and maintaining internal capital.

Chapter 5. Transitional and Final Provisions

§ 48. The Resolution shall enter into force on 1 January 2009.

For and on behalf of the Polish Financial Supervision Authority
Chairman of the Polish Financial Supervision Authority
Stanisław Kluza