

**Republic of Poland: Detailed Assessment of Observance of Basel Core Principles for  
Effective Banking Supervision**

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# REPUBLIC OF POLAND

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING  
SUPERVISION

## DETAILED ASSESSMENT OF OBSERVANCE

MAY 2012

INTERNATIONAL MONETARY FUND  
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK  
FINANCIAL AND PRIVATE SECTOR DEVELOPMENT  
VICE PRESIDENCY  
EUROPEAN AND CENTRAL ASIA REGIONAL VICE  
PRESIDENCY

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## GLOSSARY

ALM	Assets and Liabilities Management
AMA	Advanced Measurement Approach
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCPs	Basel Core Principles
BGF	Bank Guarantee Fund
BIA	Basic Indicator Approach
BION	Polish Supervisory Review and Evaluation Process (SREP)
BIK	Credit Information Bureau
BSCEE	Banking Supervisors from Central and Eastern Europe
CAEL	Capital Adequacy, Asset Quality, Earnings Performance, and Liquidity
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CEBS	Committee of European Banking Supervisors
CPs	Core Principles
CRD	Capital Requirements Directives
EFDI	European Forum of Deposit Insurers
ES	Executive Summaries
EU	European Union
FATF	Financial Action Task Force
FINREP/COREP	Prudential Returns
FMSA	Financial Market Supervision Act
FSAP	Financial Sector Assessment Program
FSC	Financial Stability Committee
FX	Foreign Exchange
GIFI	General Inspectorate for Financial Institutions
IADI	International Association of Deposit Insurers
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Program
ICT	Information Communication and Technology
IFRS	International Financial Reporting Standards
IRB	Internal Rating Based
IRRBB	Interest Rate Risk in the Banking Book
IT	Internet Technology
KNA	Audit Supervision Committee
KNF	Financial Supervision Commission (Komisja Nadzoru Finansowego)
LOLR	Lender of Last Resort
MoF	Ministry of Finance
MoU	Memorandum of Understanding

NBP	National Bank of Poland
NPLs	Nonperforming Loans
PAS	Polish Accounting Standards
ROSC	Report on Observance of Standards and Codes
SREP	Supervisory Review and Evaluation Process
STA	Standardized Approach
STR	Suspicious Transactions Report
UBPR	Uniform Bank Performance Report

## I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

1. **The 2008 transition to the new banking supervisory architecture in Poland has been relatively smooth and the banking system has proven effective in weathering the financial crisis.** The Polish Financial Supervision Commission (KNF), in charge of banking supervision since 2008, has successfully managed the transfer of responsibilities from the Commission for Banking Supervision, which operated under the auspices of the National Bank of Poland (NBP). The agency's staff is highly professional and dedicated, the regulatory framework is comprehensive and aligned with emerging risks, and the KNF has well-developed supervisory methodologies and processes. The KNF has undertaken numerous proactive measures to preserve financial sector stability during the crisis, including successfully persuading banks to retain the 2009 profits and tightening prudential standards.
2. **Despite its strong performance during the financial crisis, the supervisory architecture needs to be strengthened to grant the KNF full independence.** The KNF's independence is subject to significant operational and financial constraints. The agency does not have the authority to amend its organizational structure, to make key staffing decisions, or to set its own budget. Moreover, the KNF's regulatory powers are constrained by the overly prescriptive requirements of the Banking Act which only allows it to issue binding resolutions in a limited number of areas. Finally, there is room to strengthen the legal protection of the persons involved in banking supervision and the governance arrangements for the KNF external commissioners. The assessors note that some of the recommended reforms require legislative changes and thus will need time to be implemented.
3. **Moreover, onsite supervision needs to become more frequent and better streamlined with the offsite supervisory processes.** The KNF should also intensify its dialogue with auditors, supervisory Board members, and home supervisors. The current supervisory cycle for commercial banks ranges from two to four years. During this period, the KNF performs a relatively limited number of targeted inspections. This supervisory approach is characterized by a rather high degree of reliance on the offsite monitoring process, which may hamper early identification of problems in banks. The assessors also identified opportunities for the streamlining of onsite-offsite coordination processes to make them more rigorous, timely, and forward looking. As a priority, KNF's dialogue with the banks' internal and external auditors, as well as with the supervisory Boards' members should also be strengthened. Similarly, given the predominately foreign ownership structure of the banking sector, KNF should step up its engagement with home supervisors.
4. **The KNF should also increase its staff to cope with the widening of its oversight perimeter and the upcoming regulatory developments.** The assessors recommend increasing the supervisory resources of the KNF to cope with additional pressures stemming from the pending enlargement of the scope of oversight and new regulatory developments (i.e., bringing credit unions under the KNF's supervision, putting in place Basel III);

increasing the frequency of onsite inspections, and implementing more sophisticated supervisory methods (i.e., the new risk-based SREP process for offsite bank supervision).

5. **The legal framework has to be improved, among others, in the areas of corporate governance, bank resolution, and major acquisitions.** The Banking Act is silent regarding fit-and-proper criteria for members of the banks' supervisory Boards and, moreover, the KNF does not have the power to remove them. The resolution framework is underdeveloped, and the assessors note that the number of KNF's enforcement actions is relatively low. Finally, major acquisitions by domestic banks require only 30-day ex ante notification to the KNF, and the agency has no adequate power to influence the banking group structures. In sum, the legal framework needs to be improved in a number of key dimensions to ensure sound and consistent requirements in the above-mentioned areas.

#### A. Introduction

6. **This assessment of the current state of compliance with the BCPs in Poland has been undertaken as part of a joint IMF-World Bank Report on the Observance of Standards and Codes (ROSC) mission.** The mission was led by Messrs. Fernando Montes-Negret (IMF) and Michael Edwards (World Bank). The assessment was conducted by Mmes. Oana Nedelescu (IMF) and Katia D'Hulster (World Bank). The assessment was conducted from February 22 to March 10, 2011. It reflects the banking supervision practices of the KNF as of the end of January 2011.

#### B. Information and Methodology Used for the Assessment

7. **The assessment is based on several sources:** (i) a complete self-assessment prepared by the KNF; (ii) detailed interviews with the KNF staff; (iii) review of laws, regulations, inspection reports, and other documentation on the supervisory framework and on the structure and development of the Polish financial sector; and (iv) meetings with individual banks; the Polish Banking Association; the NBP; the Bank Guarantee Fund (BGF); Ministry of Finance (MoF); two external auditors; and the Credit Information Bureau (BIK).

8. **The assessment was performed in accordance with the guidelines set out in the Core Principles (CPs) Methodology.**<sup>1</sup> It assessed compliance with both the "essential" and the "additional" criteria, but the ratings assigned were based on compliance with the "essential" criteria only. The methodology requires that the assessment be based on the legal and other documentary evidence in combination with the work of the supervisory authority as well as its implementation in the banking sector. The assessment of compliance with the CPs is not, and is not intended to be, an exact science. Banking systems differ from one country to the next, as do their domestic circumstances. Furthermore, banking activities are

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<sup>1</sup> Issued by the Basel Committee on Banking Supervision, October 2006.

changing rapidly around the world, and theories, policies, and best practices of supervision are swiftly evolving. Nevertheless, it is internationally acknowledged that the CPs set minimum standards.

9. **This assessment is based solely on the laws, supervisory requirements, and practices that were in place at the time it was conducted.** However, where applicable, the assessors made note of regulatory and supervisory initiatives, which have yet to be completed or implemented. In this respect, the KNF introduced a new supervisory methodology called Supervisory Review and Evaluation Process (SREP or 'BION' in Polish language) in December 2010. Each bank is required to complete a comprehensive SREP questionnaire on a yearly basis. The KNF prioritized the large and more risky banks for review. A first wave of banks has submitted their SREP questionnaire with reference date December 31, 2010 and will be assessed by July 2011. All banks are expected to be assessed by end-2011. The assessors believe that the SREP, if properly implemented, has the potential to contribute to sound supervisory outcomes, but as the methodology is not yet in place and all assessments remain to be finalized, the SREP process cannot be taken into account in this Basel Core Principles assessment.

10. **The assessment team enjoyed excellent cooperation with its counterparts and, within the time available to perform its work, reviewed all the information provided.** The assessors only received translations of the inspection reports in the last two days of the mission. Hence, the verification of findings and the discussion with onsite examiners on specific supervisory issues of the examinations were limited in time. That said, a general impression with regard to the form and content of inspection reports is included in the assessment. The team extends its thanks to the management and staff of the KNF, in particular, for their openness and participation in the process. The authorities provided comments on a draft version of this assessment, which are reflected in the final assessment.

### **C. Institutional and Macro-prudential Setting, Market Structure Overview**

11. **The KNF, which was established on September 19, 2006, is still in its infancy.**<sup>2</sup> The agency is responsible for supervising most segments of the Polish financial market. During phase one of the integration, the new supervisory agency took over the tasks of the Insurance and Pension Funds Supervisory Commission and of the Securities and Exchange Commission. The integration process concluded on January 1, 2008, when the KNF took over the tasks performed by the Commission for Banking Supervision, which functioned under the auspices of the NBP. Among other activities, the KNF is responsible for ensuring the regular operation of the financial market; developing financial market and its competitiveness; participating in the drafting of legal acts related to financial market supervision; and creating the opportunities for amicable and conciliatory settlement of

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<sup>2</sup> The Act on Financial Market Supervision became effective on July 21, 2006.



disputes that may arise between financial market actors. The KNF is supervised by the President of the Council of Ministers or the prime minister.

12. **Besides the KNF, the MoF and the NBP are also indirectly involved in some aspects of banking supervision.** The MoF has taken an active role in the regulatory process in the area of prudential accounting for provisioning. Going forward, it is expected that the MoF will assume more prominent responsibility in the regulatory rule-making process. Similarly, through its General Inspectorate for Financial Institutions (GIFI), the MoF also shares responsibilities with the KNF in the field of AML/CFT. In practice, the MoF receives information from banks, performs onsite inspections, and imposes penalties relating to AML/CFT legislation violations identified by the controls, while the KNF performs onsite inspections and general AML/CFT oversight. The NBP collects the prudential returns (FINREP/COREP) from the banks and shares the information with the KNF on a real time basis.

13. **Poland has 49 commercial banks, of which 39 are foreign owned, 4 have majority public interest, and 6 are domestically owned.** In addition, there are 576 cooperative banks and 61 credit unions. Poland's banking sector is relatively concentrated, but less than other comparable countries in the region, with the largest 3 banks and the 10 largest banks controlling about one-third and two-thirds of total bank assets, respectively. The share in total bank assets of the five largest banks in Poland was 45 percent in 2008, compared to 62 percent and 72 percent for the Czech Republic and Hungary, respectively. Poland's banking concentration is lower than for the countries in the Euro area (57 percent) and the group of countries in Central and Eastern Europe (58.3 percent). Banking competition in Poland is intense, putting pressure on the smaller commercial banks, cooperative banks, and credit unions to consolidate. Nonetheless, the informational advantages and local knowledge and ties of the last two groups of institutions might delay the consolidation process.

### Republic of Poland: Ownership Structure of Banking Sector

December 31, 2010

Type of Institution	Assets (PLN mil.)	Percent of Total Assets in Banking Sector (percent)	Assets (percent of GDP)	Number of Institutions
<b>Banking sector</b>	<b>1,158,006.0</b>	<b>100.0</b>	<b>82.1</b>	<b>645</b>
<b>Commercial banks, of which:</b>	<b>1,032,817.8</b>	<b>89.2</b>	<b>73.2</b>	<b>49</b>
- with majority public sector interest	249,309.9	21.5	17.7	4
- with majority private domestic sector interest	71,982.0	6.2	5.1	6
- under foreign control	711,525.9	61.5	50.4	39
<b>Cooperative banks</b>	<b>70,454.1</b>	<b>6.1</b>	<b>5.0</b>	<b>576</b>
<b>Branches of credit institutions</b>	<b>54,734.0</b>	<b>4.7</b>	<b>3.9</b>	<b>20</b>

14. **The financial system remains stable.** Banks' profits have increased further in 2011, leading to a rise in capital adequacy ratios (CARs) to about 14 percent. While nonperforming loans have crept up—at 12.2 percent and 7.2 percent for loans to corporates and households, respectively, at end-September, 2010—their growth rate has slowed. Underpinned by improving domestic liquidity, credit growth is showing signs of revival, especially in mortgage lending. For consumer loans, banks are tightening standards following the introduction of KNF Recommendation T. Growth in corporate loans also remains subdued, due to weak demand, the overhang of NPLs, and still relatively tight lending standards.

15. **Poland's banking system has remained liquid, well capitalized, and profitable.** There are no apparent bank problems that could pose a threat of a systemic banking crisis. Direct exposure to banks in Europe's periphery is very limited, though Poland is highly exposed to banks in Europe's core, which could be a potential source of contagion risk. Finally, periodic top-down and bottom-up stress tests undertaken by the NBP and the KNF continue to show that overall the system remains resilient to adverse macroeconomic shocks.

#### **D. Preconditions for Effective Banking Supervision**

The assessment included the following findings in regard to preconditions:

##### ***Sound and sustainable macro-economic policies***

16. **Poland's sound economic policies in the decade prior to the global crisis led to healthy economic fundamentals, allowing it to weather the recent economic crisis better than all its EU peers.** At the outset of the global crisis, Poland had limited macroeconomic imbalances: credit and domestic demand growth had remained relatively moderate, inflation was contained, and current account and fiscal deficits had been restrained. As a result, public debt and external debt were at comfortable levels. Poland's commitment to the EU Stability and Growth Pact helped to lower the fiscal deficit and limit government debt. A determined anti-inflationary focus built confidence in monetary institutions and anchored inflation expectations.

17. **Notwithstanding Poland's favorable fundamentals, the economy was severely affected by the global crisis through both real and financial channels.** With Poland's key trading partners in recession, exports contracted by over 30 percent year-on-year in the first half of 2009. The freeze in global funding markets was transmitted to domestic financial markets, which experienced sharp price declines. The stock market index fell by half between June 2008 and March 2009; the exchange rate against the euro depreciated by about 30 percent from peak to trough; and interbank transactions came to a virtual standstill. The associated fall in confidence caused an abrupt decline in investment. As a result, GDP growth slowed sharply from 5.1 percent in 2008 to 0.9 percent y/y in the first half of 2009.

18. **The authorities' adequate policy response, including implementing counter-cyclical policies, to the global crisis helped to avoid an outright recession.** Poland was the only EU country with positive GDP growth (1¾ percent) in 2009. Fiscal policy provided appropriate stimulus through a combination of tax cuts and by allowing automatic stabilizers to work on the revenue side. Monetary policy was also accommodative, with aggressive cuts in the policy interest rate through the first half of 2009, complemented by facilities for exceptional liquidity support. Measures were also taken to safeguard financial stability, including the recommendation that banks retain 2008 profits, restoring capital-adequacy ratios to pre-crisis levels.

*A well-developed public infrastructure*

19. **Systemically important payment systems in Poland are efficient and secure.** The NBP business continuity plan protects the banking sector as a whole against negative effects resulting from operational failures and the related liquidity risk. In addition, the very low failure rate and the accessibility ratios to date of systems operated both by the NBP (SORBNET and SORBNET-EURO) and KIR SA (ELIXIR and Euro ELIXIR) in 2010 reflect the high level of technical reliability of individual payment systems functioning in Poland. A number of technical projects are under development to further enhance reliability, including use of safer SWIFTNet, and to improve participants' access to liquidity management tools.<sup>3</sup>

20. **The NBP provides liquidity to the banking system through its open market operations in the form of repos with NBP paper.** In emergencies, the NBP can provide collateralized short-term loans to illiquid banks for a period not exceeding three months, as a lender of last resort (LOLR), once the KNF gives a favorable solvency opinion of the borrower.

21. **The BGF can offer financial assistance in the form of loans, guarantees, and the acquisition of receivables to commercial and cooperative banks to prevent bank insolvencies within a KNF-approved restructuring plan.** Since its formation, the BGF has extended 101 loans to banks, out of which one is currently outstanding. The BGF does not, however, have bank resolution authority.

22. **Oversight of external auditors was strengthened in 2009 with the establishment of the Audit Supervision Committee, an independent public administration body financed from the public budget.** Its duties include approval of the National Chamber of Statutory Auditors resolutions and yearly control plans as well as controlling audit plans.

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<sup>3</sup> NBP, Financial Stability Report, December 2010, pages 71–72.

*Effective market discipline*

23. **Listed companies in Poland are required to use International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) in their consolidated accounts beginning in 2005.** All banks in Poland are also required to apply IFRS in their consolidated financial statements. Apart from the mandatory application of IFRS, Poland permits IFRSs in the annual accounts of listed companies as well as in the consolidated and annual accounts of all other companies that have either filed for admission to public trading or are a subsidiary of a parent which prepares its consolidated accounts in accordance with IFRS.

24. **Other (smaller) commercial banks and credit cooperatives use Polish Accounting Standards (PAS), which implement relevant EU Accounting Directives.** According to the KNF resolutions, all commercial banks and credit cooperatives are subject to Pillar 3 disclosure requirements.

*Mechanisms for providing an appropriate level of systemic protection (or public safety net)*

25. **The framework for domestic information sharing and contingency planning has been strengthened.** A Financial Stability Committee (FSC), chaired by the MoF and including the NBP governor and the KNF chairman, was recently established by the Act on the Financial Stability Committee of November 7, 2008. The FSC permanently monitors the condition of the Polish financial market, particularly considering risks to financial stability. Typically, the FSC meets every six months but met more frequently during the global financial crisis. The membership with the FSC could be enlarged in the future with the President of the Management Board of the Bank Guarantee Fund.

26. **The weak resolution framework is a major gap in Poland's legal system, as bank insolvencies are treated as any other corporate bankruptcies under the Commercial Code.** Chapter 12 of the Banking Act ("Bank Rehabilitation Proceedings and Bankruptcies") regulates bank rehabilitation proceedings, liquidations, and takeovers. The remedial and resolution process has four distinctive stages with progressive escalation, including: (1) early remedial and rehabilitation; (2) provisional administration; (3) resolution by take-over; and (4) liquidation (see CP 23).

27. **The disposal of a troubled bank's assets, its takeover or liquidation, cannot be commenced prior to the court hearing the plaintiff's petition, which could cause considerable delay for depositors and undermine public confidence in the Polish banking system.** As featured in Article 147 (3), notice provisions exist for the appointment of a trustee, administrator or liquidator of a domestic bank operating in an EU member state, and likewise, the KNF recognizes through Article 157 the liquidation measures taken against a foreign domiciled member state bank subsidiary or branch operating in Poland. However,

there are no such provisions in place for banks operating in Poland domiciled outside the European Union.

28. **Poland established an independent Bank Guarantee Fund (BGF) in 1995 as a key pillar of its financial safety net.** Two sets of safety-net-related services are provided by the BGF: (i) deposit insurance for commercial and cooperative banks; and (ii) open bank assistance to commercial banks and cooperative banks. All commercial and cooperative banks participate in the deposit insurance regime. Deposit insurance coverage of up to €100,000 equivalent is available for natural persons and legal entity depositors' accounts. The BGF is prepared to return deposits in case of a bank failure in a month's time. The NBP is authorized (Article 43 of the Act of the NBP) to grant loans to the BGF under stipulated conditions. Since its formation, the BGF has made payouts of insured depositors at 94 banks (5 commercial banks and 89 cooperative banks) to more than 300,000 depositors. The BGF collects annually two type of ex ante fees, reflecting banks' capital and ex post reflecting the deposit base insured. As of end-2010, the BGF had accumulated reserves of about ZL 7 billion, equivalent to 3 percent of insured deposits in the banking sector, making it one of the best funded deposit systems in the European Union. Cooperative banks have a separate small fund with accumulated resources of ZL 123 million. The BGF is a member of the European Forum of Deposit Insurers (EFDI) and the International Association of Deposit Insurers (IADI).

## E. Main Findings

### *Objectives, Independence, Powers, Transparency, and Cooperation (CP 1)*

29. **The operational and financial independence of the KNF is subject to significant constraints.** Indeed, there is no legal source for the independence of the KNF, as the Financial Market Supervision Act (FMSA) does not stipulate explicitly the independence of the agency. Moreover, there are limitations in the KNF powers to set its own budget, amend its statute (including divisions, departments, and so-called separate positions) or add key staff. The KNF annual operating budget, organizational structure, and key staffing decisions are all subject to the approval of the prime minister.

30. **There are important legal limitations regarding the regulatory powers of the KNF.** The Banking Act takes a prescriptive approach by authorizing the KNF to issue binding resolutions only in the specific areas defined in the law, rather than giving the supervisor ample and more flexible powers to discharge its responsibilities. In other areas, the KNF can only provide recommendations for best practices in the banks' activities, which are not strictly obligatory for the banks. Moreover, the MoF can issue binding ordinances regulating certain aspects of banks' activities. The assessors note that the nonmandatory nature of the KNF recommendations undermines the enforcement capacity of the supervisor, may offer means for banks to escape implementing sound prudential standards, and could result in an uneven playing field. Therefore, the law should be amended to fully empower the

KNF to issue binding resolutions more broadly, for example, with the purpose of ensuring the safety and the soundness of the banking sector. In the longer term, it is also recommended that a comprehensive review of the regulatory powers of the KNF be undertaken.

31. **There are gaps in the legal framework providing for supervisors' protection.** More legal clarity is recommended regarding the protection against potential administrative responsibilities and economic liabilities resulting from actions or omissions by the four non-executive commissioners, who are not KNF employees, when discharging their duties in good faith. Also, the Act should specifically state that the legal protection provided KNF's commissioners and employees is not limited in time (i.e., provides protection beyond the termination of appointment or employment). Legal protection should also be granted to the persons designated by the KNF to act as trustees or receivers in bank rehabilitation procedures, according to the provisions of Chapter 12 of the Banking Act. Also, at the minimum, it is necessary that protection against incurring the costs of defending the actions of supervisors is stated clearly (at least at the level of internal procedures), including the financing of any expenses since the start of the legal proceedings.

32. **The non-executive members of the Commission have full-time senior positions in their respective organizations, while they are simultaneously faced with a heavy workload as KNF commissioners.** It is questionable if the non-executive members can properly discharge their KNF duties, as industry participants point to long delays in approvals requiring the Commission to vote. Prior and sitting commissioners concur with the difficulty to discharge their obligations in a part-time capacity. Moreover, there is no fixed term for the appointment of the non-executive commissioners. The KNF Commission has been characterized by a high level of turnover among its members since its establishment. More precisely, more than 10 non-executive members have been dismissed from their post since; in one case, after only just four weeks. The dismissal and appointment of members of the Commission is also, in some instances, aligned with the political cycle. Such high turnovers combined with the heavy workload of the position have undoubtedly affected the effectiveness of the KNF. Moreover, the position of vice chairman has also been vacant for almost two years, as the prime minister has yet to approve a replacement proposed by KNF's chairman more than a year ago.

33. **Although, *strictu sensu* the non-executive members do not represent their ministries or other government bodies, it is difficult to conceive how this can be achieved in practice.** The external commissioners serve in their personal capacity representing the principal referred in the Act to occupy such position (ministers of finance and labor, NBP governor, and the President of the Republic). In addition, the external KNF commissioners cannot discuss or seek the counsel of colleagues within their respective offices due to strict confidentiality clauses in the Act. The latter may inhibit their ability to provide informed inputs to the KNF and prevents any delegation of work to third parties.

34. **Asymmetries in the access of information between external and internal commissioners of the KNF and ambiguities in their decision-making powers lead to diffused responsibilities.** On the one hand, external commissioners do not take part in decision making relating to KNF's internal organization, budget, and strategy. On the other hand, they remain accountable for the consequences of these decisions. For example, the document "Summary for the Management," which includes the individual supervisory risk assessments for banks is prepared only for the chairman of the KNF and is not distributed to the external commissioners. The latter document is, however, presented to the NBP. The "Quarterly Information on the Situations of Banks," a document which contains broad information on the whole banking sector, including information on individual banks, is presented to all the commissioners. Thus, it is unclear how external members are supposed to take responsibility for the supervisory activities if they do not receive regular access to all relevant information.

35. **The formal requirement for the prime minister's approval of changes in the organization hampers managerial flexibility.** The KNF's current operational and organizational structure is complex and fragmented, with many departments involved in banking supervision, resulting in diffused and/or overlapping responsibilities.

*Licensing and Structure (CPs 2–5)*

36. **Essential criteria for assessing bank licensing applications are generally in place, but improvements in the fit-and-proper assessments for banks' supervisory and management Board members are crucial.** The KNF does not assess the fitness and propriety of the members of supervisory Boards or the head of the banks' internal audit departments. Moreover, the KNF does not have the power to remove supervisory Board members. There is also asymmetry in the assessment and approval processes for the members of the management Board. The legal requirements should require banks to demonstrate, at least, collective expertise of the management Board for all risk areas and allow the KNF to apply proportionate individual requirements of competence and experience, depending on the specific management functions assigned. The regulatory requirements for risk management and corporate governance in banks should provide more detail and be better aligned with international best practice.

37. **The Banking Act clearly defines permissible activities of banks; however, there are no restrictions regarding the banks' participations in nonfinancial entities.** Furthermore, credit unions as retail deposit-taking institutions are not subject to KNF supervision.

38. **Major financial and nonfinancial acquisitions by domestic banks require only 30-day ex ante notification to the KNF, while establishment of banks' subsidiary branches in third countries requires explicit approval.** In principle, the KNF can oppose a bank's acquisition in a third country, but in view of the limited time and the lack of clear

criteria for approval, it is doubtful if, in practice, it has sufficient time to thoroughly assess the application and oppose it. Although the bank subsidiary acquisitions of domestic banks in third countries—mainly Ukraine—may at first sight appear immaterial in terms of assets, the reputational risks for the Polish banks cannot be ignored. A comprehensive and structured supervisory assessment methodology to consider the quality of supervision in a third country and its own ability to exercise supervision on a consolidated basis should be developed.

***Prudential Regulation and Requirements (CPs 6–18)***

39. **The prudential requirements for monitoring risks in the banking activity are generally compliant with the BCP requirements.** The prudential standards are comprehensive and often very detailed and, importantly, have kept pace with risks emerging in the banking sector. Nevertheless, the assessors note that it is essential that the KNF regularly verifies the compliance with such requirements more frequently through onsite inspections.

40. **The capital adequacy framework is compliant with the relevant CP, and Basel II has been implemented since 2008.** Banks generally display high CARs (with average CAR for the banking sector at around 14 percent), with Tier 1 capital representing more than 90 percent of the total capital. The KNF is to be commended for the early alignment of the risk weights for FX residential loans under the standardized approach to the Polish environment. While the KNF has requested banks to raise additional capital where needed, the assessors recommend that the KNF introduce an articulated methodology for determining the need, if any, for additional capital requirements under Pillar 2.

41. **Prudential regulations in the areas of credit risk are generally adequate, with relatively minor shortcomings noted in the areas of exposures to related parties.** The KNF has actively tightened recommendations regarding lending standards in particularly risky areas (mortgage lending and consumer credit) and the onsite verification of compliance is thorough, although relatively infrequent, given the long supervisory cycle. The legal provisions in respect of arm's-length credit decisions are comprehensive and detailed. Nevertheless, the definition of related parties should be expanded to include close relatives or affiliations of the persons identified in Articles 79, 79a, and 79b of the Banking Act. Also, a more general ban for Board members with conflicts of interest to not take part in credit decisions should be envisaged. Banks are also required to incorporate country and transfer risks in their risk-management framework, while provisions for such risks are set by individual institutions at levels subsequently judged by external auditors and the KNF.

42. **The supervisory framework for market risk is in line with the requirements of the relevant CP.** The KNF Resolution 76/2008 introduces a separation of the trading book from the banking book. Banks are required to perform stress tests to determine the banks' response to a sudden and unexpected change in interest rates by 200 basis points and the



KNF is able to demand an increase of capital in cases where the economic value of an institution declines by more than 20 percent of own funds as a result of applying this shock.

43. **The liquidity framework is comprehensive and provides a good mix of qualitative and quantitative requirements.** Poland is advanced in implementing a rigorous framework for monitoring short term and long term liquidity, which has been in place since 2007. The assessors note that there is a great degree of reliance on the commitments made by foreign parents of local banks to provide liquidity support when needed. In this regard, the KNF could ask banks to take into consideration more closely situations of parent banks' inability to fulfill their funding commitments as part of the liquidity contingency plans. Recent impact studies performed by the NBP and KNF determined that most banks will be compliant with the liquidity coverage ratio requirements under the proposed Basel III framework, while compliance with the net stable funding ratio will depend on the further calibration of the indicator.

44. **The assessors note shortcomings related to the operational risk framework.** First, banks can shift freely from the basic indicator approach (simple capital charge calculation and low-risk sensitivity) to the standardized approach (intermediate approach, more risk-sensitive and more intense in terms of organization of the risk-management framework), which can generate a capital relief effect of which the KNF learns post factum, after receiving the periodical prudential returns. The assessors recommend the introduction of a supervisory procedure for evaluating the capacity of banks to meet the criteria for the standardized approach implementation. Moreover, more specificity is needed in terms of the requirements for IT audit in banks, in particular by setting more clearly their scope, frequency, and minimum set of requirements. Finally, the compliance function should be more specifically addressed in the regulations.

45. **The internal control and audit requirements are generally adequate, but the assessors recommend that KNF include a legal or regulatory obligation that calls for the banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the fitness and propriety of a Board member or a member of senior management.** Moreover, it is recommended that the KNF regularly exchange views on the scope, quality, and independence of banks' internal audit function with the external auditors during tri-partite meetings.

46. **The assessors note that the risk-management framework should be strengthened in both the areas of regulatory requirements and the KNF's approach to evaluating risk management in banks.** First, the existing risk-management regulations should become more explicit and comprehensive for many risk categories (e.g., concentration risk, securitization risk, residual risk, and market risk, etc.) and should offer more clarity regarding the supervisory expectations for the oversight functions, risk management, and internal control, so as to ensure banks' governance is aligned with their complexity and riskiness. Moreover, the KNF's approach to evaluating risk management practices in banks should be enhanced

through a more balanced supervisory approach. Currently, the assessors note the supervisory approach relies rather heavily on the offsite monitoring. Finally, it is recommended that the KNF develops internal guidelines setting supervisory expectations for risk management practices in banks according to the bank's size and risk profile. This could assist in aligning consistency in supervisory judgment across the agency.

47. **The anti-money laundering framework covers most requirements in the relevant CP, but remains to be tested, given relatively new legal provisions and institutional setup.** AML/CFT oversight functions are shared between the GIFI at the MoF and the KNF. Customer identification, enhanced due-diligence procedures, and other relevant financial integrity requirements are in place. Nonetheless, the legislation should be improved to require banks to report to the KNF any suspicious activities and incidents of fraud when they are material to their safety, soundness, and reputation, and also with respect to correspondent banks and foreign operations of local banks. The assessors also recommend enhancing the KNF resources for AML/CFT surveillance.

***Methods of Ongoing Banking Supervision (CPs 19–21)***

48. **The assessors consider that the KNF has well-developed onsite and offsite supervisory techniques; however, they note important shortcomings regarding the length of the supervisory cycle and the mix between offsite and onsite supervision.** Assessors recommend that the offsite and onsite functions be viewed as complementary instead of independent sources, and that the KNF seek to fully exploit synergies to ensure closer monitoring and a timely intervention in banks.

49. **The KNF's supervisory cycle for commercial banks ranges from two to four years and the inspections are extended, sometimes lasting up to two months.** Although the KNF aims to allocate its resources and set supervisory priorities on a risk-based basis, in terms of setting the length of the supervisory cycle, it remains largely compliance-driven when setting the scope of the inspections. At minimum, the KNF should have the resources to inspect the 10 largest banks, as well as particularly risky areas in the remaining banks, on an annual basis. To achieve this objective, the onsite resources of the KNF need to be significantly strengthened.

50. **As a result of the long supervisory cycle, the KNF's approach to evaluating risk management in banks is heavily reliant on the offsite monitoring process, which may lead to delays in the identification of emerging weaknesses in banks.** The mission found that KNF's supervisory processes do not focus on obtaining a full understanding of the business model of the institution, including strategies, commercial objectives, significant activities, risk areas, and risk-management processes and capabilities. The supervisory approach also makes little use of targeted examinations of risk management to complement or verify information obtained through offsite reporting. The KNF approach to monitoring risk-management practices in banks could be enhanced through a better balanced mix of offsite

and onsite instruments (in particular, targeted onsite inspections) and a stronger involvement in the onsite monitoring of the implementation of recommendations, especially in cases where the risk-management processes of a bank need improvement.

**51. More frequent communication with supervisory Board members, external and internal auditors, as well as a more intense dialogue with home supervisors, would give the KNF additional insights into the changing risk profile of banks between inspections.**

Frequent interaction with the supervisory Board, as well as regular individual meetings with the internal and external auditors to discuss issues of common interest and to serve as validation of findings, are essential components of the supervisory process. Given the prominence of offsite supervision and the heavy reliance on foreign parent funding in the financial system, the KNF should also ensure regular dialogue with home supervisors. While taking part in supervisory colleges is important, it should be supplemented, where possible, by the participation in joint inspections and the integration of home supervisory findings and risk assessments in the supervisory plan.

**52. The assessors did not encounter strong evidence of rigorous, timely, and forward-looking onsite/offsite coordination processes.** It is not clear if the current ad hoc coordination processes could withstand the test in more stressful times. Supervisory judgments made by the offsite department should be accurate, timely, and robust enough to ensure early supervisory intervention aligned with the risk profile of the bank. Due to the long inspection cycle and the backward-looking nature of the prudential reports, it is possible that the KNF may not be able to identify and address weaknesses and problems before they become serious threats to the health of the institutions and, potentially, the financial system.

**53. While the new Supervisory Review and Evaluation Process (SREP) methodology is a step toward a more risk-based approach, it poses the risk of overreliance on a bank's, information, procedures, and policies.** Despite its sophistication and volume, the SREP remains a self-assessment with no external verification or management Board level sign-offs within the supervised institutions. Very close coordination between onsite and offsite resources, as well as the active involvement of the KNF's most experienced staff with strong risk-management expertise, will be required before it can become an effective supervisory tool. Cumulatively, the largely *ad hoc* coordination processes and physical separation between the Inspection Department and the Banking Supervision Department, as well as the limited resources, have the potential to seriously compromise successful implementation. The new SREP methodology also provides for a late intervention through onsite inspections (i.e., when the bank is considered “in crisis”); such a reactive approach is not in line with a proactive supervisory stance.

**54. There is a high percentage of supervisory resources allocated to areas deemed to be of lower systemic priority and additional pressure on supervisory resources is likely to arise in the near term.** In 2010, 40 percent of onsite resources were allocated to the supervision of cooperative banks, which represent about 6 percent of total bank assets. This

observation raises concerns regarding the effectiveness of the supervisory process in terms of an adequate risk-based allocation of resources. The KNF will also have to cope with additional pressure on supervisory resources as the scope of the oversight may be widened and the new regulations will multiply (credit unions, Basel III). Also, the intensity and sophistication of supervisory methods will be increased (i.e., the introduction of the SREP annual review for all banks). The assessors recommend that KNF conduct an assessment of supervisory needs versus resources and align the intensity of supervision to risk profiles. The KNF's plan to delegate some supervisory responsibilities to the banks heading the networks of credit cooperatives is welcome, but the agency should be satisfied that their oversight capacities are adequate.

**55. The assessors note that the reporting framework is comprehensive and meets the relevant CP's requirements.**

*Accounting and Disclosure (CP 22)*

**56. The assessors are of the opinion that the accounting and disclosure practices in Poland are generally compliant with the relevant BCP.** While, at present, all commercial banks are requested to prepare IFRS consolidated financial statements and the banks publicly listed and other banks prepare individual IFRS financial standards, the assessors recommend further harmonization by introducing IFRS standards for the individual financial statements of all commercial banks. The credit cooperatives could continue to use the PAS.

*Corrective and Remedial Powers of Supervisors (CP 23)*

**57. The bank resolution framework in Poland is underdeveloped and the number of enforcement actions is relatively low.** The liquidation of a bank is to be carried out in accordance with the enterprise Bankruptcy Law and the Commercial Code, which is not designed to account for the specific characteristics of deposit-taking institutions. Moreover, the number of KNF enforcement actions—only five—in the last year is rather low compared to the total number of banks. Similarly, only one cautioning action was linked to the implementation of risk-management practices and policies.

*Consolidated and Cross-Border Banking Supervision (CPs 24–25)*

**58. Arrangements are in place for effective consolidated supervision, including adequate powers to receive adequate information on group structures and to impose limitations on their activities.** However, the assessors note that the supervisory practices for performing consolidated supervision should be enhanced in a number of areas. The KNF should further align supervisory methodologies across sectors to enable more coordination and consistency in the supervisory actions across groups. Also, the KNF should develop a framework for assessing contagion risks stemming from nonfinancial entities which are part of some banking groups. The supervision of foreign activities of domestic banks should consider the full range of risks, including reputational, that such entities can pose on parent

banks. The KNF should develop guidelines for assessing the equivalence of supervisory standards in foreign countries.

59. **Finally, the cross-border cooperation and exchange of information with foreign supervisory authorities is adequate.** The KNF participates in supervisory colleges and appropriate Memoranda of Understanding are in place. Given the predominantly foreign ownership in the banking sector, the assessors recommend that the supervisor take a more proactive stance with respect to the supervisory activities of home supervisors, including through the latter's participation in onsite inspections. Such an approach would enable a better overall understanding of the group situation and would enrich the information necessary for performing supervision on a sub-consolidated basis.

Table 1 offers a principle-by-principle summary of the assessment results.

**Table 1. Republic of Poland: Summary of Compliance with the Basel Core Principles**

Core Principle	Grading	Comments
1. Objectives, Autonomy, Powers, and Resources	MNC	See below.
1.1 Responsibilities and Objectives	LC	The KNF responsibilities and objectives are clearly stated in the legal framework. The laws and regulations are updated as necessary; however, the Banking Act needs to be more closely aligned to relevant EU directives. The KNF should take stock of the existing recommendations and bring them in line with current market developments and supervisory expectations. Some efforts in this area are already ongoing.
1.2 Independence, Accountability, Transparency	MNC	<p>The operational and financial independence of the KNF is subject to significant constraint as the authority's annual operating budget, organizational structure, and key staffing decisions are all subject to approval of the prime minister, which hampers the managerial flexibility.</p> <p>The appointment and dismissal for some of the external commissioners is aligned with the political cycle, and the agency has been confronted with a high turnover since its inception. Moreover, the external commissioners have full-time senior positions in their respective organizations while they are faced with a heavy workload at the KNF. Lastly, asymmetries in the information of external and internal commissioners of the KNF and ambiguities in their decision-making powers lead to diffused responsibilities. Moving to a system with full-time, remunerated external commissioners, appointed for cascading fixed terms, would improve the KNF's governance.</p>

1.3 Legal Framework	MNC	<p>The KNF can issue binding resolutions only in the areas explicitly mentioned in the Banking Act. This legal shortcoming is resolved in practice through the issuance of MoF ordinances or by KNF recommendations, which state nonbinding best practices. The nonmandatory nature of the KNF recommendations weakens the enforcement capacity of the supervisor, may offer escape-ways for banks in implementing sound prudential standards, and thus result in an uneven application. Some banks have raised concerns regarding the uniform application of KNF recommendations across supervised institutions.</p> <p>The law should be amended to fully empower the KNF to issue binding resolutions more broadly, for example, with the purpose of ensuring the safety and soundness of the banking sector. Moreover, the KNF should move to a system of fully enforceable prudential standards in the form of binding resolutions. In the longer term, it is recommended that the ambiguities regarding the regulatory powers of the KNF (which is not a source of law according to the Polish Constitution) are more fundamentally analyzed and addressed.</p> <p>If the current arrangement for sharing regulatory responsibilities between the KNF and MoF is to be maintained for a transitional period, the KNF's influence in the design and calibration of MoF ordinances and the independence of the regulatory process from political and industry interference should be secured. Moreover, a clear division of tasks between MoF and KNF in identifying and promoting relevant regulations should be established.</p>
1.4 Legal Powers	LC	<p>The KNF lacks the power to suspend members of the banks' supervisory Boards.</p>
1.5 Legal Protection	LC	<p>The legal protection for the KNF staff has shortcomings in a number of areas. The law should specifically state that the legal protection to KNF's Board members and employees extends beyond their termination of their appointment or employment. More legal clarity is recommended regarding the legal protection of the four non-executive members of the Commission. Legal protection should also be extended to the persons designated by KNF to act as trustees or receivers in bank rehabilitation proceedings.</p> <p>Finally, at the minimum, it is necessary that the protection for the costs of defending the actions of supervisors is stated clearly (preferably in the law or at least at the level of internal procedures), including the financing of any expenses from the start of the legal proceedings.</p>
1.6 Cooperation	LC	<p>It is unclear how the "Poland's economic interest" provision is to be interpreted in practice as the KNF has not established criteria to assess if, and when, information sharing would impair the economic interests of Poland.</p>
2. Permissible Activities	LC	<p>The permissible activities for banks are clearly defined in the legislation. As a key risk mitigant, the legal framework should be amended to limit the acquisition of real estate property to the</p>

		<p>purpose of conducting banking activities or for carrying out other activities, which can contribute to the good performance of the banks' operations. In addition, the law should establish limits for banks' investments in nonfinancial entities (EC 5).</p> <p>The credit unions, which are retail deposit taking institutions and use the name "bank" (Polish translation "kasa") should be brought under the KNF supervision.</p>
3. Licensing Criteria	MNC	<p>The licensing requirements are broadly in place and the licensing process is thorough; however, some major shortcomings regarding the governance framework are noted:</p> <ul style="list-style-type: none"> <li>- No fit-and-proper criteria for members of the supervisory Board. The fit-and-proper assessment for the members of the supervisory Board should become an integral part of the ongoing assessment of the banks' risk management.</li> <li>- Clear fit-and-proper criteria for all the members of the management Board and the head of the internal audit should be established.</li> <li>- The legislation should state the obligation to present a receipt of an assurance of the absence of potential conflicts of interest from all members of the supervisory and management Boards.</li> </ul> <p>The legislation needs to require a systematic analysis of the direct and indirect shareholders, natural or legal persons that have qualifying holdings in the bank or of the close links existing between the bank and other natural and legal persons. Moreover, the definition of "close links" should be expanded.</p> <p>Finally, a more specific and coherent licensing framework (in a form of a KNF resolution or a licensing manual) is recommended to enhance understanding of supervisory requirements and a more uniform and structured approach.</p>
4. Transfer of Significant Ownership	C	<p>The law should be amended to require banks to notify KNF as soon as they become aware of any material information, which may negatively affect the suitability of a major shareholder.</p>
5. Major Acquisitions	LC	<p>Major acquisitions by domestic banks require only one month's prior notification to the KNF. In view of the limited time for assessment of the notification and of the lack of clear criteria for approval, it is unlikely the KNF would have sufficient time in practice to thoroughly assess the acquisition.</p> <p>The Banking Act does not restrict individual holdings in nonfinancial entities as a percentage of capital as long as they do not exceed the single counterparty exposure limits (see CP 10).</p> <p>The authorities should develop a rigorous supervisory methodology for the assessment of contagion risk and restrict individual holdings to 15 percent of capital and aggregate qualifying holdings in nonbanking activities to 60 percent of capital in accordance with the EU Directives. Moreover, the Banking Act</p>

		<p>or the regulations should specify the criteria for the authorization of cross-border activities of domestic banks by the KNF.</p> <p>Furthermore, the KNF should develop a comprehensive and structured supervisory assessment methodology to consider the quality of supervision in a third country and its own ability to exercise supervision on a consolidated basis.</p>
6. Capital Adequacy	C	<p>The KNF is to be commended for the early alignment of the risk weights for FX residential mortgage loans under the standardized approach to the Polish environment. The assessors note that more progress would be desirable in terms of developing a methodology to set risk-based capital requirements based on the individual risk profile of the bank, i.e., drawing from the SREP analysis.</p>
7. Risk Management Process	LC	<p>The framework for the risk-management process is generally adequate; however, the assessors note that the following areas should be strengthened:</p> <ul style="list-style-type: none"> <li>- Some difficult to measure risks, like strategic and business risks, need to be more explicitly addressed in the risk-management framework.</li> <li>- The existing regulations should ensure that banks' complexity and riskiness are appropriately aligned with internal governance arrangements.</li> <li>- A more balanced mix of offsite and onsite instruments (i.e., targeted onsite inspections) and a stronger involvement of the onsite monitoring of follow-up actions are required, as, at present, the KNF's approach to evaluating risk management in banks is heavily reliant on the offsite monitoring process.</li> <li>- It would be useful if KNF develop internal guidelines setting supervisory expectations for risk-management practices in banks according to the bank's size and risk profile. This could assist in aligning consistency in supervisory judgment across the agency.</li> <li>- The KNF should strengthen the dialogue with the members of the supervisory Board.</li> </ul>
8. Credit Risk	C	<p>The legal provisions in respect of arm's length credit decisions are comprehensive and detailed, but legal provisions regarding exposures to related parties need to be strengthened (see CP 11) and a more general ban for Board members with conflicts of interest to not take part in credit decisions should be considered.</p>
9. Problem Assets, Provisions and Reserves	C	<p>The SREP process will provide additional information to KNF for evaluating provisioning and reserving policies and processes. It remains crucial, however, that frequent onsite inspections are performed to ensure that the policies and procedures are properly implemented.</p>
10. Large Exposure Limits	C	<p>No comments.</p>



11. Exposures to Related Parties	LC	The legislation should be amended to include in the range of related parties close family members of the bank's major shareholders, members of the management and supervisory Board, persons occupying managerial positions in the bank, or corresponding persons in affiliated companies. The legal provisions regarding the prevention of conflicts of interest should also be enhanced.
12. Country and Transfer Risks	C	No comments.
13. Market Risks	C	Although the KNF has introduced separation between the trading and the banking book in Resolution 76/2008, it is recommended that separation be more apparent in the other regulations and recommendations of the KNF.
14. Liquidity Risk	C	The regulatory framework for liquidity management is generally adequate, providing a good mix of qualitative and quantitative requirements. Closer attention should be paid to situations of inability of parent banks to fulfill their funding commitments, which should be considered as part of the banks' liquidity contingency plans.
15. Operational Risk	LC	<p>While separate criteria for the use of the three methods for calculating capital requirements for operational risk are provided in the KNF Resolution, the discretion left to banks in freely using STA method may potentially lead to regulatory arbitrage (through a capital relief effect). The KNF should introduce a supervisory procedure for evaluating the capacity of banks to meet the enhanced risk-management criteria for the STA implementation and should be able to fully control transition between the two simpler approaches.</p> <p>The regulations should impose more specific requirements regarding the IT audit in banks, in particular regarding its scope, frequency, and minimum requirements. The compliance function should be more specifically addressed in the regulations (see CP 17).</p>
16. Interest Rate Risk in the Banking Book	C	No comments.
17. Internal Control and Audit	LC	<p>It is recommended to introduce a legal or regulatory obligation that calls for the banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the fitness and propriety of a Board member or a member of senior management.</p> <p>The minimum requirements for the compliance function fall short of the international best practice guidance (BCBS 2005 principles for Compliance and the compliance function in banks), particularly in the areas of staffing, independence, access to information, conflicts of interest and seniority of head of the compliance officer.</p> <p>The KNF should perform a fit-and-proper assessment of the head of internal audit and impose a notification requirement on</p>

		commercial banks for his/her dismissal. The KNF should also regularly exchange views on the quality and independence of internal audit with the external auditor during tri partite meetings.
18. Abuse of Financial Services	LC	<p>The legal framework for AML/CFT is generally adequate and the assessors note the good cooperation between GIFI and KNF in sharing their AML/CFT oversight functions. However, given the relatively new legislation, the effectiveness of the AML/CFT supervision and the integration of the AML/CFT risk management into the banks' general risk-management framework are yet to be tested.</p> <p>Improvements should be sought in a number of areas:</p> <ul style="list-style-type: none"> <li>- The law should require banks and external auditors to report to KNF any suspicious activities and incidents of fraud when they are material to their safety, soundness or reputation.</li> <li>- The law should require that KNF is notified in cases where an investigation has been initiated in a bank by competent judicial authorities.</li> <li>- The law should specifically require banks the immediate termination of a relationship with a correspondent bank if subsequently found that correspondent bank does not have adequate controls against criminal activities or is not effectively supervised for AML/CFT by the relevant authorities.</li> <li>- The law should specifically require the escalation of decisions in cases of high risk-accounts to senior management level.</li> <li>- The law should require banks to notify KNF when their foreign offices are unable to apply adequate AML/CFT standards.</li> </ul> <p>Finally, the assessors ascertain that the KNF could consider enhancing its resources for AML/CFT surveillance.</p>
19. Supervisory Approach	LC	<p>The KNF has a well developed offsite supervisory system, but the assessors note that further improvements are needed in the following areas:</p> <p>The quality of the quarterly Executive Summaries (ES) could be further improved and the work plan flowing from the ES would benefit from a more detailed description of the specific risks and areas for attention.</p> <p>The new SREP methodology is a step forward in a more risk-based direction for the KNF. Nevertheless the assessors express the following concerns:</p> <ul style="list-style-type: none"> <li>- Given the intensity of the SREP process, it is doubtful that the KNF can effectively and efficiently handle the information received with the present supervisory resources.</li> <li>- Despite its sophistication and volume, SREP remains a self assessment completed by the banks. A critical review of the SREP is a complex task that requires good risk-management</li> </ul>

		<p>skills as well as sound supervisory judgment. It should therefore be performed and overseen by the KNF's experienced supervisors. Moreover, close coordination and cooperation between the onsite and offsite division is a crucial factor crucial for the assessment of the SREP.</p> <ul style="list-style-type: none"> <li>- The KNF should require sign off by the management Board, the supervisory Board or an independent review of the bank's responses to SREP for quality assurance.</li> </ul> <p>The SREP methodology should not be seen as a substitute for onsite inspections or an instrument to further reduce onsite resources. Although there is clear evidence of coordination and consultation between onsite and offsite, it remains unclear to the assessors where the ultimate responsibility for the supervisory methodology and processes (onsite and offsite) sits and how the process of changing and updating the methodology are project managed.</p>
20. Supervisory Techniques	MNC	<p>Assessors consider that KNF has well developed onsite supervisory techniques; however, note important shortcomings regarding the length of the supervisory cycle and the mix between offsite and onsite supervision.</p> <p>The inspection cycle (two to four years) is much too long and not aligned to international best practices. At the minimum, KNF should be able to inspect the largest banks on an annual basis and to deploy adequate resources for a closer monitoring of riskier banks. A closer involvement of onsite supervisors in the follow up with post-examination recommendations and a larger number of targeted inspections would be necessary.</p> <p>The assessors note that under the new offsite BION (SREP) supervisory methodology, the onsite inspections are required only when the bank's condition is deemed to be "bad" or "in crisis." Such approach is very reactive and may not offer sufficient time for effective remedial action.</p> <p>Assessors recommend that the offsite and onsite functions are viewed as complementary and KNF fully exploits synergies between the two so as to ensure a closer monitoring and a timely intervention in banks.</p> <p>The assessors reviewed some examination reports and ascertain that the analysis is thorough and comprehensive. The assessors note that post-examination recommendations should be more clearly prioritized.</p> <p>Assessors recommend that KNF should engage more actively in a dialogue with the supervisory Board members, and with external and internal auditors. KNF could also consider implementing the good practice of other supervisors' "tri-partite" meetings.</p>

		Finally, the large amount of supervisory resources for the cooperative banks compared to the relative small importance of the sector coupled with inadequate intensity of supervisory oversight for commercial banks raises concerns regarding the effectiveness of the supervisory process.
21. Supervisory Reporting	C	Assessors note that the reporting framework for banks is adequate; however, the KNF could further strengthen it by developing a systematic program for periodic verification of supervisory returns.
22. Accounting and Disclosure	LC	<p>The framework for accounting and disclosure is generally adequate, but improvements should be sought in the following areas:</p> <ul style="list-style-type: none"> <li>- KNF be forceful in ensuring audit quality by actively challenging external auditors and the bank's management when understatement of provisions is identified;</li> <li>- KNF introduce trilateral meetings, at least once a year, with the internal auditor and external auditors to discuss issues of common interest and to serve as validation and consistent communication;</li> <li>- IFRS become mandatory for the solo accounts of all commercial banks; and</li> <li>- KNF introduce specific banking expertise and experience requirements for auditors of commercial banks.</li> </ul>
23. Corrective & Remedial Powers of Supervisors	LC	<p>The requirement to caution a bank should be removed from the legislation.</p> <p>The KNF cannot suspend a member of the supervisory Board (see CP3).</p> <p>The bank resolution framework is inadequate, as bank insolvencies are treated as any other corporate bankruptcies under the Commercial Code. The disposal of a trouble bank's assets, its takeover or liquidation cannot be commenced prior to the court hearing the plaintiff's petition, which could cause considerable delay for depositors and undermine public confidence in the Polish banking system.</p> <p>Finally, the assessors also recommend that KNF establishes an internal methodology establishing well defined "red flags," firmly assigned responsibilities, and a clear ladder for proportionate supervisory intervention.</p>
24. Consolidated Supervision	LC	<p>The legal framework for performing consolidated supervision is generally adequate; however, improvements are needed in the following areas:</p> <ul style="list-style-type: none"> <li>- empowering the KNF to oppose ex-ante to major acquisitions made by banks;</li> </ul>

		<ul style="list-style-type: none"> <li>- specifying limitations for holdings in nonfinancial entities; and</li> <li>- providing fit-and-proper criteria for senior management of bank's parent companies.</li> </ul> <p>Further improvements are also needed in the supervisory practices for performing consolidated supervision. The supervisory methodologies across sectors (i.e., banking, insurance) should be further aligned to enable a more coordination and consistency in the supervisory actions across groups. A framework for assessing contagion risks stemming from nonfinancial entities part of banking groups should be also developed. Finally, the agency should take a more intrusive stance in respect to the supervision of foreign activities of domestic banks and consider more closely a full range of risks (i.e., reputational) that such entities can pose on parent banks.</p> <p>The effectiveness of performing effective consolidated supervision over financial holding companies is yet to be tested and the assessors recommend that the KNF maintain a close understanding and oversight over all financial and nonfinancial entities of the groups.</p>
25. Home-Host Relationships	LC	<p>There is no legal requirement for the home supervisor of banks established in Poland to practice consolidated supervision.</p> <p>The KNF should take a more proactive approach when foreign home supervisors inspect their subsidiaries.</p> <p>The assessors believe that the authorities as a home supervisor place too much emphasis on the quantitative indicators of the materiality of the group (see CP 24).</p>

## II. DETAILED ASSESSMENT

60. **The assessment of compliance of each principle is made based on the following four-grade scale: compliant, largely compliant, materially noncompliant, and noncompliant.**

61. **To achieve a “compliant” assessment with a principle, all essential criteria generally must be met without any significant deficiencies.** A “largely compliant” assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority’s ability to achieve the objective of that principle. Under the BCP methodology a “materially noncompliant” assessment is given whenever there are severe shortcomings, despite the existence of formal rules, regulations and procedures, and there is evidence that supervision has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance. A “noncompliant” grade indicates that no substantive progress toward compliance has been achieved. No Principle, however, has been assessed as noncompliant in Poland. In interpreting the grading, it is also important to note

that for some Principles the assessment takes into account both compliance at banks and compliance of the supervisors.

Table 2 offers the detailed Principle-by-Principle assessment. It provides a “description” of the system with regard to a particular Principle, a grading or “assessment,” and “comments.”

**Table 2. Republic of Poland: Principle-by-Principle Assessment**

<b>Principle 1</b>	<b>Objectives, autonomy, powers, and resources.</b> An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance, and adequate resources and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
<b>Principle 1(1)</b>	<b>Responsibilities and objectives.</b> An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.
Description	<p><b>EC 1:</b> In Poland, the core legal framework pertaining to the banking activity and the supervision of banks is composed of:</p> <ul style="list-style-type: none"> <li>- <i>The Banking Act of 29 August 1997 (The Banking Act)</i>, which stipulates the principles for conducting the business of banking, establishing and organizing banks, including branches and representative offices of foreign banks, and branches of credit institutions, as well as the principles for exercising banking supervision, rehabilitation proceedings and bank liquidation and bankruptcy; and</li> <li>- <i>The Act of Financial Market Supervision of 21 July 2006</i>, defining the organization, scope and purpose of supervision of the financial market, including banking supervision.</li> </ul> <p><i>The Act on Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate of 15 April 2005</i>, providing the framework for consolidated supervision of financial institutions.</p> <ul style="list-style-type: none"> <li>- <i>The Act of the National Bank of Poland of 29 August 1997</i>, stating the governance, activities, powers, roles, and responsibilities of the central bank.</li> <li>- <i>The Act on the Operation of Cooperative Banks, their Associations and Associating Banks of 7 December 2000 (Act on the Operation of Cooperative Banks)</i>, regulating the activities and operations of cooperative banks.</li> </ul> <p>The Polish Financial Supervision Authority (KNF) is, according to the Act of Financial Market Supervision (FMSA), the competent authority for the supervision of financial market (Article 3.2.), being an integrated supervisor for banks, insurance companies, investment firms, other capital market institutions, and electronic money institutions.</p>

The scope of the banking supervision is regulated in the Banking Act (Article 131.1.), covering the activity of banks, branches and representative offices of foreign banks and of credit institutions registered in other EU member states. The KNF is also responsible for the supervision of cooperative banks, according to the Act on the Operation of Cooperative Banks and to the provisions of the Banking Act.

The Act of Financial Market Supervision stipulates in Article 4 the responsibilities of KNF, consisting of:

- 1) exercising supervision over the financial market;
- 2) taking actions fostering proper operation of the financial market;
- 3) taking actions promoting the development of the financial market and its competitiveness;
- 4) taking educational and informational actions related to the operation of the financial market;
- 5) participating in the preparation of drafts of legal acts related to financial market supervision;
- 6) creating opportunities for amicable and conciliatory resolution of disputes between the participants of the financial market, including disputes arising from contractual relationships between the entities subject to KNF's supervision and their customers; and
- 7) performing other statutorily assigned tasks.

The KNF discharges its responsibilities related to the development and competitiveness of the financial market by promoting good practices in the area of financial market conduct (a Code of Best Practices in the Financial Market was issued by the KNF in 2008), monitoring market practices and taking measures in those areas of the regulated entities' operations which are exposed to the risk of law infringement or abuse of rights by nonprofessional market participants. In addition, the KNF performs a broad range of educational activities targeting financial market participants and the public.

According to Article 133.1. of the Banking Act, the objectives of banking supervision are to ensure the safety of funds held in bank accounts and compliance by the banks with the provisions of the Banking Act, the Act on the National Bank of Poland, relevant provisions of the Act on Trading in Financial Instruments of 29 July 2005, the banks' articles of association and the provisions specified in their authorization. In performing its banking supervision tasks, the KNF can take a broad range of measures specified in Article 133.2. of the Banking Act.

The Act of the National Bank of Poland empowers the central bank (NBP) to regulate bank liquidity (Article 3.5.) and to establish the necessary conditions for the development of the banking system (Article 3.6.). NBP is also empowered to assess the operations of the banking system (Article 17.4.5.) and banks are required to provide, at the request of the NBP, all data necessary to assess their financial standing and the risks to the banking system (Article 23.3.), information which can be conveyed to the MoF and KNF to the extent necessary for the pursuit of goals and tasks of the Financial Stability Committee (Article 23.8). The NBP uses these powers to perform its financial stability and lender-of-last resort functions. NBP is the main

	<p>recipient of information (monetary, financial, and prudential) from banks and shares such information with the KNF (see CP 21).</p> <p>The MoF also performs some regulatory functions related to the banks' activities and executes tasks related to supervision of the Bank Guarantee Fund, Bank Gospodarstwa Krajowego (Poland's state owned development bank, dedicated to providing banking services for the public finance sector and to supporting government's economic programs and which is not a deposit taking institution), the Insurance Guarantee Fund and the Export Credit Insurance Corporation.</p> <p><b>EC 2:</b> The Polish framework for prudential standards is three-tiered, comprising:</p> <ul style="list-style-type: none"> <li>- laws (Banking Act and other relevant laws pertaining to the banking activity);</li> <li>- binding regulations: which take the form of resolutions issued by the KNF, regulations and ordinances issued by the MoF, and resolutions issued by the NBP; and</li> <li>- nonbinding recommendations issued by the KNF.</li> </ul> <p>The Banking Act outlines a set of minimum prudential rules for banks in the following areas:</p> <ul style="list-style-type: none"> <li>- activities permitted (Articles 5–6) and outsourcing of activities (Article 6.a-d);</li> <li>- liquidity (Article 8);</li> <li>- risk management and internal control (Articles 9–10);</li> <li>- licensing and organization (Articles 12–48);</li> <li>- loans and principles for large exposure concentration (Articles 69–79);</li> <li>- associations, mergers and divisions (Articles 121–124);</li> <li>- auditing (Articles 134–136);</li> <li>- own funds, regulatory capital, and capital adequacy (Articles 126–128);</li> <li>- financial management and use of net earnings (Article 129);</li> <li>- general risk provisions (Article 130); and</li> <li>- consolidated supervision (Article 141f-l).</li> </ul> <p>The Banking Act also contains requirements regarding bank accounts (Articles 49-62), monetary settlements performed via banks (Articles 63–68), bank guarantees, other guarantees and letters of credit (Articles 80–87), issue of bank securities (Article 89–92), particular obligations and rights of banks (Articles 92a–112), bank rehabilitation proceedings, liquidation and bankruptcy (Articles 142–159).</p> <p>The KNF's power to issue resolutions stating mandatory prudential standards for banks is circumscribed to the specific areas indicated by the Banking Act, as follows:</p> <ul style="list-style-type: none"> <li>- detailed capital requirements for banks, including estimation of internal capital and its review, and procedures and principles for calculating the solvency ratio (Articles 127–128);</li> <li>- the scope of information to be submitted with the notifications of the management Board changes, the list of information and documents to be submitted for the approval of two members of the management Board by the KNF (Article 137.1) and the list of documents for the bank's founders during the licensing process (Article 137.2);</li> <li>- mandatory standards for liquidity and other standards regulating permissible risks in the conduct of banking activities (Article 137.3.);</li> </ul>
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- detailed principles for managing risk related to outsourced activities (Article 137.5.) and related documents (Article 137.1.a.); and
- permissible risks in banks' activities (Article 128.8) (see CP 1.3 EC2).

The KNF has issued binding resolutions using the powers vested to it according to the Banking Act, inter alia, in the following areas:

- capital adequacy (Resolution no. 387/2008, Resolution no. 381/2008, Resolution no. 387/2008, Resolution no. 369/2010);
- disclosure of qualitative and quantitative information on bank capital adequacy (Resolution no. 385/2008, Resolution no. 386/2010);
- concentration risk and large exposures (Resolution no. 382/2008, Resolution no. 384/2008);
- outsourcing (Resolution no. 379/2008);
- risk management, internal control, and internal capital estimation, review and maintenance (Resolution no. 383/2008);
- liquidity standards (Resolution no. 386/2008); and
- documents to be submitted by managers and founders of banks (Regulation no. 389/2008).

The MoF also has legislative powers in the area of banking, and has issued regulations pertaining to provisioning (Regulation of the MoF of 16 December 2008 on the bank provisioning, etc.—see CP 9), accounting regulations (see CP 22) and, more recently, regulations regarding the documentation to be submitted in the process of acquisition (MoF Ordinance of August 20, 2010).

In addition, according to the provisions of the NBP Act, the central bank issued Resolution no. 23/2003 on the financial and prudential reporting by banks (amended in 2007 to introduce FINREP and COREP reporting).

Finally, according to Article 137.5 of the Banking Act, the KNF is empowered to issue recommendations related to good practices of sound and prudent bank management. Such recommendations are considered “soft law” and while not binding, assessors confirmed with the KNF and market participants that there is an implicit and strong expectation of compliance and that they are generally implemented by banks. Also, assessors ascertain that within the industry there is a great sense of the need to meet the requirements stipulated in the KNF recommendations.

A broad range of recommendations were issued by the KNF or, previously, by the Banking Commission for Banking Supervision hosted at NBP. Such recommendations either take the form of general guidelines for best practice (i.e., Recommendation H—on the banks' internal control and audit in banks -2000, Recommendation L—concerning the role of statutory auditors in the process of bank supervision—2001), or of more prescriptive limitations on the risks incurred by banks (i.e., Recommendation I—on the foreign currency risk management at banks and policy banks to make transactions involving foreign currency risk, Recommendation S—on good practices in the management of exposures to credit financing secured by real estate and mortgages, Recommendation T—on good practices in risk management of retail credit exposures).

Some of the older recommendations issued by the Commission for Banking Supervision are outdated and have not been updated or formally withdrawn; however, the assessors have been informed of pending KNF efforts to update some recommendations (e.g., Recommendation H on banks' internal control, Recommendation M on the operational risk management in banks, and Recommendation R on guidelines to identify impaired balance sheet credit exposures).

**EC 3:** The Banking Act and the KNF resolutions and recommendations have been amended regularly, not least to bring them in line with the EU acquis communautaire, changes in international standards in the area of banking, as well as with developments in the local market identified as a result of the supervisory process.

For example, the Banking Act and KNF resolutions are updated to reflect changes in the EU Capital Requirements Directives (CRD) and European Banking Authority (formerly Committee of European Banking Supervisors) guidelines; although in some areas further harmonization is still needed.

Finally, the KNF follows potential risky developments in the activity of banks and modifies the prudential framework as needed. For example, Recommendation T on good practices in risk management for retail credit exposures was adopted in February 2010 in response to lower underwriting standards revealed by results of inspections carried out in banks and by reports developed by NBP concerning the situation in the credit market.

The KNF prepares annually an internal Plan of Strategic Activities, which also includes intended regulatory changes. The plan is used at an operational level but it is not formally endorsed by the KNF Board of commissioners. KNF also discloses publicly its road regulatory policy objectives. For example, the regulatory policy in 2009 (as reflected in the 2009 Report on the Activities of KNF) aimed at:

- enhancing security and stability of the financial sector;
- continuing actions accounting for experiences related to the financial crisis, aiming at improving the risk-management quality in banks and, as a result, protecting cash deposited in bank accounts; and
- ensuring the protection of nonprofessional market participants.

**EC4:** The KNF publishes annually on its website a comprehensive Report on the Condition of Polish Banks, which includes aggregate analyses of the main developments, financial results, and operational efficiency, main risk areas (liquidity risk, credit risk, capital adequacy) in the banking sector. The statistical appendix includes data on peer groups (commercial banks, branches of credit institutions, cooperative banks), on the number of banks, employment, network size, market share, concentration, ownership structure, foreign investors by country, main balance sheet items, amounts due from and owed to the financial institutions, loans and deposits of the nonfinancial sector, securities, capital and subordinated liabilities, profit and loss account and performance, nonperforming loans, capital adequacy. In some cases, the KNF presents separate analyses of relevant groups—i.e., “banks with aggressive development strategies.”

The KNF also publishes quarterly reports on “Banking sector key data,” which present aggregated information on the banking sector structure, aggregate main

	<p>balance sheet and profit and loss account items, capital adequacy, and compiled according to FINREP and COREP standards. Additional monetary, financial, and banking statistics are published by NBP on its website.</p> <p>Banks are also required to publish their audited annual reports (Article 64 of the Accounting Act) and also to disclose relevant information under Pillar 3 (under KNF Resolution no. 385/2008).</p> <p>In addition, According to Article 4.1.of the FMSA, KNF is taking educational and informational actions to improve financial literacy related to the operation of the financial market.</p> <p><b>AC 1:</b> The KNF supervisory program is determined on the basis of a risk-based assessment performed according to an internal methodology. The supervisory cycle takes into consideration the size and risks posed by individual banks, which are determined on an ongoing basis through the offsite supervision (see CP 20).</p>
Assessment	Largely Compliant
Comments	<p>The KNF responsibilities and objectives in regards to banking supervision are clearly stated in the legal framework.</p> <p>The prudential framework for banks is extensive in scope, but fragmented, with the KNF, MoF and, to a lesser extent, NBP, sharing responsibilities for issuing relevant regulations. A more structured dialogue between the KNF and MoF in setting up the regulatory agenda would be beneficial (see CP 1.3.).</p> <p>The current lack of legal certainty in respect of the enforceability of some existing recommendations creates doubts about the existence of a level playing field within the banking sector. The KNF should take stock of the existing recommendations and bring them in line with current market developments and supervisory expectations. The assessors have been informed that the KNF currently makes efforts to update some of the existing recommendations and resolutions.</p> <p>The Banking Act needs to be further streamlined and more closely brought in line with the provisions of the EU directives.</p>
<b>Principle 1(2)</b>	<b>Independence, accountability, and transparency.</b> Each such authority should possess operational independence, transparent processes, sound governance, and adequate resources and be accountable for the discharge of its duties.
Description	<p><b>EC 1:</b> In accordance with Article 5 of the FMSA, the KNF (the “Commission”) is composed of three executive members (the Chairperson and two Vice Chairpersons) and four non-executive members. The staff of the KNF is part of the KNF “Office” (Article 10 of the FMSA).</p> <p>The KNF's chairperson needs to satisfy the conditions stated in Article 7 of the FMSA and is appointed by the President of the Polish Council of Ministers for a fixed five-year term. The latter can also dismiss the chairperson before the expiry of his term only for the specific reasons mentioned in Article 8 (such as conviction of intentional offence or fiscal offence, resignation, loss of citizenship, prolonged illness).</p> <p>Two vice chairpersons shall be appointed and dismissed by the President of the Polish Council of Ministers at the request of the KNF's chairperson. The vice chairpersons need to satisfy the same conditions for appointment noted in Article 7 of the FMSA as the chairperson.</p>

The four non-executive members of the KNF Commission are:

- the minister in charge of financial institutions or such minister's representative;  
the minister in charge of social security or such minister's representative;
- the governor of the NBP or deputy governor of the NBP delegated by the governor; and
- a representative of the President of the Republic of Poland (the current representative is the President of the Management Board of the Bank Guarantee Fund)

In principle, the non-executive members do not represent their respective government bodies or offices but they represent themselves in the Commission. In the same way, for example, the Deputy Minister of Finance or the Deputy NBP Governor does not represent the MoF or the NBP but the minister and the governor respectively. Hence, in accordance with Article 16 of the FMSA they are bound by the KNF's strict secrecy requirements as they have the obligation not to disclose to unauthorized persons any information that has confidential status. Consequently, they cannot consult confidential matters with third parties.

Article 12 paragraph 2 of the FMSA states the decisions that have to be taken by the KNF Commission and they cannot be delegated to the Office of the KNF. These decisions include inter alia, the licensing of a bank, fit-and-proper approvals, limitation of a bank's operations, and revocation of a license. The KNF adopts resolutions by simple majority of votes, in an open vote held in the presence of at least four of its members, including the chairperson or a vice chairperson; in the case of a tie the chairperson has the deciding vote (Article 11, paragraph 2).

Although there is no explicit legal provision, in practice the non-executive members are not taking part in decisions related to internal matters of the KNF so as to avoid potential conflicts of interest. For example, they are not deciding on matters related to the budget, the internal organization, and the strategy of the office. Thus, the information provided and the decision making authority is unevenly divided among the KNF commissioners.

**EC 2:** The objective of supervision of the financial market is published in Article 2 of FMSA. Article 4 of the FMA defines the KNF's responsibilities. The KNF is accountable to the President of the Polish Council of Ministers (the prime minister) and presents an annual report on its operations by July 31 of the following year (Article 14 of the Act of Financial Market Supervision). This report is not subject to the approval of the prime minister. The prime minister defines the Statute (by laws) of the KNF Office stipulating its internal organization (divisions, departments and so called separate positions). Any changes in the by-laws that constitute the organizational framework of the KNF Office must be adopted by the prime minister. The KNF chairman is only empowered to establish committees, councils and teams of an auxiliary nature (paragraph 5 of the KNF Statute). The annual report is made public on the website of the KNF.

**EC 3:** Market participants confirmed that the staff of the KNF is professional and integer. A few individuals though mentioned some instances where KNF staff had limited or superficial knowledge and understanding of banking practices. Concerns regarding overly formalistic and excessively compliance-oriented supervisory approaches and practices were also raised by market participants.

	<p><b>EC 4:</b> The KNF draws up a multiannual financial framework and an annual budget for the MoF to approve and it forms part of the overall budget discussed and approved by the Polish Parliament. The KNF is financed by levies from the banking industry, calculated as the product of total assets times a rate not exceeding 0.024 percent, in the amounts specified by order of the prime minister (Article 131a of the Banking Act). In the last year, excess levies were refunded to the banks. Recently, the KNF submitted a request for additional supervisory resources to the MoF, which was denied.</p> <p>The transfer of banking supervision from the NBP to the KNF in 2008 has led to a number of resignations and departures of experienced banking supervisors. Since then, the KNF has built up its human resources again. The assessors, however, noted strain on the KNF's supervisory resources, evidenced by lengthy supervisory cycles (as described in CP 20) and the frequent reallocation of staff from supervisory activities to other tasks (for example, the Basel II advanced model validation work). The KNF sets its own salary structure within guidelines provided by way of regulation on the prime minister (Article 20.2. of FMSA). Although salary scales are below banking industry levels and the NBP scales, they remain higher than public salary scales. The Banking Act does not allow the KNF to hire external experts, except hiring of auditors in case irregularities are noted as referred to in CP 22. The KNF has an appropriate budget for computers and other equipment to equip its staff with the tools needed to review the banking industry and to assess individual banks and banking groups. It also has a travel budget to allow onsite work as appropriate. Regular training is organized by specialized training and consulting companies—both Polish and foreign—and staff also participate on an individual basis in specialized training. More in depth training and secondments to other agencies may be beneficial.</p> <p><b>AC 1:</b> The chairperson of the KNF is appointed for a minimum term of five years in accordance with Article 7 paragraph 1 of the FMSA.</p>
Assessment	Materially noncompliant
Comments	<p>There is no legal source for the independence of the KNF. Indeed, a major shortcoming of the FMSA is that it does not stipulate the independence of the agency.</p> <p>The mandates of the non-executive members of the Commission are part time and not remunerated. Typically non-executives have full time positions in their respective organizations. The assessors observed the high workload related with their mandate in the KNF, particularly in view of the pre-meeting material, the length and the frequency of the meetings of the Commission. It is questionable if the non-executive members can discharge their respective duties adequately, even more so if they cannot seek any kind of support due to the confidentiality of the matters treated by the Commission. In this regard, industry participants mentioned long delays in the approval processes of the fitness and propriety of management Board members. Moreover, there is no fixed term on the appointment of non-executive members of the KNF Commission. The KNF Commission has been characterized by a high level of turnover among its members since its establishment in September 2006. More precisely, 11 non-executive members have been dismissed from their post since October 2006, in one case even after just four weeks. The dismissal and appointment of some members of the Commission is also aligned with the political cycle. Such high levels of turnover, combined with the heavy workload for the position, have undoubtedly affected the effectiveness of the KNF. One position of</p>

Vice Chairman of the Office has also been vacant for almost two years, as the President of the Council of Ministers has yet to approve a replacement proposed by the chairman more than a year ago.

Although, *strictu sensu*, the non-executive members do not represent their ministries or other government bodies, it is difficult to conceive how this can be achieved in practice.

The asymmetries in the information and decision making in the KNF Commission lead to serious ambiguities in the role of the non-executive members. On the one hand, they do not take part in the decisions relating to internal organization, budget, and strategy. On the other hand, they remain accountable for the indirect consequences of these decisions. For example, the document “Summary for the management,” which includes the individual supervisory risk assessments for banks is prepared only for the chairman of the KNF and is not distributed to the commissioners. However, the latter document is presented to the National Bank of Poland. The “Quarterly information on the situations of banks,” a document which contains broad information on the whole banking sector, including information on individual banks, is presented to all the commissioners. It is doubtful, in the assessors view, how external members are supposed to take responsibility for the supervisory activities if they are not made regularly aware of the riskiness of the banking system and of individual banks.

The assessors consider that moving to a system with full-time, remunerated external commissioners, appointed for cascading fixed terms would improve the KNF’s governance. The activity of the KNF is regularly audited both internally and externally.

The MoF has set up two working groups—one on transparency and one on the level of industry levies—to consider the current financial model of the KNF. Working group members include the Polish Banking Association, the Insurance Association, the Warsaw Stock Exchange, and the KNF. The assessors are of the opinion that funding of the KNF should not be decreased any further, particularly in view of the high volume of new regulations forthcoming around Basel III and the likely introduction of credit union supervision to the KNF. Possibly, the policy to return excess resources to the banking sector should also be stopped.

The KNF does not have a clear policy to benchmark its salaries to those of the banking industry. An independent methodology to periodically benchmark its salaries against banking industry practices should be developed and implemented.

The formal requirement for the approval by the President of the Council of Ministers of changes in the organization seriously hampers managerial flexibility. The assessors observed that the current operational and organizational structure of the KNF is complex and fragmented with many departments involved in banking supervision with diffused and overlapping responsibilities.

The KNF has developed a comprehensive training program for its supervisory staff. However, training programs should be more focused, possibly go more in depth on topics, better aligned with the on-the-job responsibilities of supervisors. In this respect, staff exchanges with other supervisory agencies in the region or the rest of Europe or at first rated international banks should be envisaged.

The Banking Act should also allow for the hiring of independent external experts in particular instances (for example; a forensic investigation following a major fraud or

	<p>loss in a bank) so that investigations of isolated, but material, incidents in the banking sector do not create further disruption on the already protracted inspection cycle of the KNF.</p> <p>Article 8 of the FSMA gives a list of reasons that entitle the prime minister to dismiss the Chairperson of the KNF. The authorities state that this type of information will be published in case the Chairperson was to be dismissed.</p>
<b>Principle 1(3)</b>	<p><b>Legal framework.</b> A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.</p>
Description	<p><b>EC1:</b> According to the Banking Act, banks may be established in Poland as state banks, cooperative banks or banks incorporated as public companies (Article 12). Pursuant to Article 30.a. of the Banking Act, the KNF is the licensing authority for banks incorporated as public companies and cooperative banks.</p> <p>The KNF authorizes the establishment of branches of foreign banks after consultation with the minister competent for financial institutions (Article 40.1.). EU member states credit institutions may “passport” in Poland via a branch or through their cross-border activities on the basis of the authorization issued by the home competent supervisory authorities (Article 4.17). The Banking Act allows for mergers exclusively between banks, which have to be approved by the KNF (Article 124). Also, acquisitions of banks or of shares in banks need the KNF’s authorization (Article 124.a).</p> <p>Finally, the KNF is also responsible for the licensing of state-owned banks (Article 32.5. of the Banking Act). The transformation of a state-owned bank into a public company (Articles 43–48 of the Banking Act) does not require an authorization from the KNF, which has only a consultative role in this process (decision taken by the Council of Ministers, at the request of the Minister for State Treasury and having sought the KNF’s prior opinion).</p> <p>The KNF is empowered to withdraw the license of a bank (Article 138.3.4. of the Banking Act), after first cautioning the bank in writing, when:</p> <ul style="list-style-type: none"> <li>- it is determined that a bank is failing to comply with the recommendations or with the KNF orders;</li> <li>- where the bank's activity is in contravention of the law or its articles of association; or</li> <li>- when the bank’s activity endangers the interests of depositors.</li> </ul> <p>The activities of a bank may be also restricted in scope or its authorization revoked in cases specifically mentioned in Article 138.3.6. of the Banking Act. The KNF considers that the legal provisions endow it with adequate powers to influence the bank’s activities even when, from the formal point of view, business is conducted legally (i.e., pursuant to binding laws), but in a way that endangers the interests of the funds entrusted to it.</p> <p><b>EC 2:</b> KNF can issue binding resolutions only in the areas explicitly mentioned in the Banking Act (see CP 1.1.). Article 128.8. of the Banking Act allows the KNF to issue binding resolutions establishing “prudential standards regulating permissible risks in banks’ activities,” however, such broad powers have never been used in practice. Additional ambiguity regarding the KNF’s regulatory powers results from the fact that the authority does not constitute a source of law according to the Polish Constitution.</p>

	<p>The legal shortcomings are resolved in practice by (1) engaging MoF in the process of setting mandatory prudential standards for banks (through ordinances); and (2) the issuance of KNF recommendations, which are nonbinding prudential standards.</p> <p>The assessors note that, strictly speaking, the KNF recommendations' nonmandatory nature weakens the enforcement capacity of the supervisor, may offer escape-ways for banks in implementing sound prudential standards, and may result in an uneven application of regulations. In this regard, banks raised concerns to the assessors regarding the consistent application of the recommendations across all banks.</p> <p>The KNF holds consultations with banking industry representatives, even at the technical drafting stage. The KNF has the ultimate decision-making power and it does not need the consent of the sector to issue resolutions or recommendations. Draft regulations are published on the KNF website for public consultation, although industry representatives noted this process could be further strengthened in terms of regularity and timeliness.</p> <p>The KNF's resolutions and recommendations are published on the KNF website. The KNF also issues interpretative notes to individual banks on specific regulatory provisions which, in some cases, are broadly disseminated with the industry.</p> <p><b>EC 3:</b> According to the Banking Act (Article 134.2.), banks are required to submit to the KNF audited accounts, on a solo and consolidated basis, as approved by the relevant body of the bank in question, together with the auditor's opinion and report, within 15 days of the accounts being approved.</p> <p>The KNF is also empowered to receive consolidated audited financial statements from domestic banks operating in holding companies, reports and financial statements of subsidiary undertakings and of undertakings that the bank has close links to that have not been included in the consolidated financial statements of the bank, and consolidated financial statements of the original parent undertaking of the holding company, or consolidated financial statements drawn up at the highest level of consolidation according to specified timelines (Article 141.g. of the Banking Act).</p> <p>While according to legal provisions (Article 23.3. of Act of the National Bank of Poland and Resolution no. 23/2003 of the NBP Management Board), NBP is the primary recipient of prudential information prepared by banks (including FINREP and COREP reports), the KNF has timely and unconstrained access to such information. Other prudential reports can be required by the KNF according to specific regulations (see CP 21).</p> <p>Pursuant to the provisions of the Banking Act (Article 139.2.), banks, branches and representative offices of foreign banks in Poland, are required to make available to the KNF their accounts, balance sheets, records, plans, reports and other documents, and to provide any explanations necessary for performing supervisory activities.</p>
Assessment	Materially noncompliant
Comments	The KNF does not have full powers to set mandatory prudential standards (resolutions) without changing the laws and the KNF recommendations are not legally binding.



	<p>Therefore, the law should be amended to fully empower the KNF to issue binding resolutions more broadly, for example, with the purpose of ensuring the safety and soundness of the banking sector. Alternatively, the KNF should explore the possibility of issuing binding resolutions based on the broader regulatory powers conferred by Article 128.8 of the Banking Act.</p> <p>Moreover, to ensure enforceability and uniformity in application of prudential standards, it is recommended that the KNF moves from the system of issuing recommendations regarding “good practices” regarding the activity of banks to one of issuing mandatory prudential standards in the form of binding resolutions. In the longer term, the ambiguities regarding the regulatory powers of the KNF should be more broadly analyzed and addressed.</p> <p>If the current arrangement for sharing regulatory responsibilities between the KNF and MoF is to be maintained, the assessors consider that a number of essential criteria must be met:</p> <ol style="list-style-type: none"> <li>1) KNF opinions regarding the design and calibration of further regulations to be issued by MoF should be adequately taken into consideration;</li> <li>2) a clear division of tasks and a process of regular cooperation between the MoF and KNF in identifying and promoting relevant regulations should be established; and</li> <li>3) the regulatory process is kept away from any political and industry interference.</li> </ol> <p>In addition, the assessors recommend that the KNF establish the good practice of disseminating the generally applicable interpretations in a more transparent and extensive manner.</p>
<b>Principle 1(4)</b>	<p><b>Legal powers.</b> A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.</p>
Description	<p><b>EC 1:</b> Article 131 of the Banking Act paragraph 1 then entrusts the supervision of banks to the KNF. The objective of banking supervision—to ensure safety of the funds held in bank accounts as well as compliance by the banks with the provisions of the various Acts and legal provisions is stated in Article 133 of the Banking Act. The measures taken in performing banking supervision permit the supervisor to use qualitative judgment, since Article 133 of the Banking Act, paragraph 2 contemplates the assessment of the quality of bank management systems, in particular the quality of risk management and internal control.</p> <p><b>EC 2:</b> Article 139 paragraph 2 of the Banking Act provides the KNF with full access to the bank’s books and records, plans, reports and other documents, as well as to the staff able to give explanations to these. The KNF has not encountered problems in obtaining all the information it deems necessary from the supervised institutions.</p> <p><b>EC3:</b> In accordance with Article 138 of the Banking Act, the KNF has a range of powers when a bank is not complying with laws or regulations, or it is likely to be engaged in unsafe or unsound practices. Paragraph 1 and 2 of the above-mentioned article, allows the KNF to issue a range of “recommendations” to individual banks. Despite the term “recommendation” used in the English version of Banking Act, the assessors were assured by the authorities and the banks that these are effectively binding requirements. In practice, these “recommendations” are typically issued after inspections. They include, <i>inter alia</i>, the recommendation to increase own funds, to</p>

	<p>limit banking activity risk, to cease dividend payments and to request increased provisions and reserves. When a bank fails to comply with these “recommendations” or when its activities are in contravention with the law or its articles of association or when they impair the interests of depositors, the KNF has first to caution the bank before it can take additional measures. The law does neither define the notion of caution nor a time span before additional measures can be taken. The additional measures include: suspension of a member of the management Board, revocation of the banking license, limitation of the scope of banking activities and imposition of financial penalties. A banking license can also be revoked without prior caution in specific instances, for example when false information was provided during the licensing process (Article 138, paragraph 6 of the Banking Act).</p>
Assessment	Largely Compliant
Comments	<p>As described in CP 7, the KNF lacks the power to suspend member(s) of the supervisory Board.</p> <p>The requirement to “caution” a bank before taking further action can, in theory, lead to undue delays when prompt action is urgent. For example, Article 138 paragraph 3 of the Banking Act allows the KNF to suspend a member of the management Board or to limit the scope of the bank’s activity or the activity of its organizational units—after cautioning the bank first. That said, there is no minimum term defined in the Banking Act, and hence the authorities state that the cautioning requirement would not be an impediment in practice.</p>
<b>Principle 1(5)</b>	<b>Legal protection.</b> A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	<p><b>EC 1:</b> According to the Banking Act (Article 133.4) the KNF as an institution and the persons responsible for carrying out banking supervision activities are protected against any liabilities resulting from actions or omissions when discharging their duties in compliance with statutory regulations. Thus, fulfillment in good faith of their duties cannot provide a ground for instituting proceedings against them.</p> <p>The law does not explicitly specify that the legal protection of the KNF’s commissioners and employees for actions and/or omissions made during their tenure extends beyond their termination of appointment or employment.</p> <p><b>EC 2:</b> There are no legal or contractual provisions stating how the costs of defending the actions and/or omissions made by KNF’s Board members and its staff while discharging of their duties in good faith are borne.</p> <p>Although there have been no lawsuits brought against the KNF, its commissioners and employees so far, the KNF considers that its legal department would be instrumental in preparing the defense and providing expertise on the financial-legal aspects of the case. In such cases, the supervisor’s individual officials and staff members would be represented in court by a legal counsel from the KNF.</p> <p>The KNF staff does not feel inhibited in the exercise of their functions by the shortcomings mentioned above.</p>
Assessment	Largely compliant
Comments	<p>The law should specifically state that the legal protection afforded to KNF’s commissioners and employees for actions and/or omissions made during their tenure extends beyond the termination of appointment or employment. While the legal provisions could be interpreted as covering the non-executive members of the Commission (who are not KNF employees), it would be beneficial to add more</p>

	<p>specificity in the law regarding their protection against liabilities resulting from actions or omissions when discharging their duties in good faith (Article 5.1. of the FMSA). Moreover, clarification regarding the burden of proof would appear advisable so that any non-compliance with statutory regulations must be demonstrated by those who are initiating a lawsuit.</p> <p>Legal protection should also be granted to the persons designated by the KNF to act as trustees or receivers in bank rehabilitation proceedings according to provisions of Chapter 12 of the Banking Act.</p> <p>Also, at minimum, it is necessary that protection for the costs of defending the actions of supervisors be stated clearly - preferably in the law or at least at the level of internal procedures - including the financing of any expenses from the start of the legal proceedings. Finally, consideration may be given to allow for the choice of an independent legal counsel in cases where this is deemed necessary to avoid conflicts of interests.</p>
<b>Principle 1(6)</b>	<b>Cooperation.</b> Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p><b>EC 1:</b> Article 17 of the Act on Financial Market Supervision allows the chairperson of the KNF and the governor of the NBP to exchange information, including classified information, to the extent necessary for the performance of their statutory defined responsibilities. The chairman of the KNF and the governor of the NBP may also conclude arrangements regarding cooperation and exchange of information between the agencies. This procedure applies also to the arrangements of the Polish Bank Guarantee Fund. A Financial Stability Committee (FSC), chaired by the MoF and including NBP's governor and KNF chairman was recently established by an Act on the Financial Stability Committee of November 7, 2008. The FSC permanently monitors the overall condition of the Polish financial market, particularly considering risks to financial stability. Typically, the FSC meets every six months, but it met more frequently during the global financial crisis. It is envisaged that the membership of the FSC will be enlarged with the President of the Management Board of the Bank Guarantee Fund. Feedback from participants confirmed that the FSC provides a good forum for the exchange of information on emerging global and systemic risks.</p> <p>More informal exchange of information among domestic authorities consists of informal meetings and the regular sharing of reports reflecting the rating profile and distribution of the Polish banking system.</p> <p><b>EC 2 and EC 3:</b> The Banking Act allows for the sharing of information between the KNF and supervisory authorities from other countries, as long as it does not prejudice Polish economic interests, the information will only be shared for the sole purposes of banking supervision and it is guaranteed that the information may only be transmitted to parties outside the banking supervision authority with the prior consent of the KNF (Article 131 paragraph 2 of the Banking Act).</p> <p>MOUs have been signed with the foreign supervisory authorities of Belgium, China, Cyprus, France, Germany, Italy, Lithuania, The Netherlands, Portugal, Ukraine, and the United States. As part of its membership of the EBA, the KNF has also concluded a number of multilateral written coordination and cooperation agreements for the supervision of cross-border banks through supervisory colleges. These agreements facilitate the effective working of supervisory colleges.</p>

	<p>Arrangements have been signed for Banco Commercial Portugues Group, BNP Paribas, Credit Agricole, Societe Generale, HSBS, RBS, Santander, Dankse Bank, DnB NOR group, Rabobank, ING, Unicredit, Commerzbank, KBC, AIB, HSBC, Deutsche Bank, Nordea, and DZ Bank.</p> <p>The KNF also participates in the Group of Banking Supervisors from Central and Eastern Europe (BSCEE). The purpose of the BSCEE is to promote and maintain close cooperation and communication among the Central and Eastern European banking supervisors, to provide the possibility for the exchange of information on supervisory techniques and experiences. It also provides a high level forum for technical discussions among central and eastern European banking supervisory agencies leading to a better performance of their supervisory functions.</p> <p><b>EC4:</b> Article 131 of the Banking Act enables KNF to deny demands for sharing of confidential information in its possession. Additionally, broad secrecy provisions for the KNF's employees, members, chairperson, and vice chairperson of KNF are included in Article 16 of the FMSA.</p>
Assessment	Largely Compliant
Comments	It is unclear how the "Poland's economic interest" provision is to be interpreted in practice as the KNF has not established criteria to assess if, and when, information sharing would impair the economic interests of Poland. The authorities stated that this provision has never been used to deny information requests of foreign supervisory authorities and it has not hindered effective cross-border supervision.
<b>Principle 2</b>	<b>Permissible activities.</b> The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.
Description	<p><b>EC 1:</b> The Banking Act (Article 2) defines "banks" as legal persons established according to their own articles of incorporation, operating on the basis of an authorization to perform banking operations that expose to risk funds that have been entrusted to them and which are repayable.</p> <p>According to Article 12 of the Banking Act, banks can be established as: state banks, cooperative banks or banks incorporated as public companies. The following procedures apply to the three categories of banks:</p> <ul style="list-style-type: none"> <li>- <i>state banks</i>: established by ordinance of the Council of Ministers at the request of the Minister for the State Treasury and after having first obtained the opinion of KNF (Article 14) and operating under articles of association stipulated by ordinance of the minister competent for State Treasury matters (Article 19);</li> <li>- <i>cooperative banks</i>: established based on articles of association in the form of an authenticated deed and governed by separate provisions of the Act on the Operations of Cooperative Banks, their affiliation, and affiliating banks of December 7, 2000 (Article 20); and</li> <li>- <i>banks incorporated as public companies</i>: governed by the provisions of the Commercial Code, unless the Banking Act stipulates otherwise (Article 21).</li> </ul> <p>Separate provisions apply to the establishment of branches of EU credit institutions (Chapter 2a of the Banking Act), branches of foreign banks (Article 40–41 of the Banking Act), and representative offices of banks (Article 42 of the Banking Act).</p>

**EC 2:** The Banking Act describes a tiered list of permissible activities for banks, as follows:

- Operations exclusively reserved to banks, defined in Article 5.1.: acceptance of deposits, extension of loans, operation of bank accounts, issue of bank guarantees and letters of credit, performance of monetary settlements, issue of bank securities, issue of electronic money, or performance of other operations reserved solely to banks under separate legislation;
- Operations that are not exclusively reserved to banks, but if performed by banks are deemed banking operations, defined in Article 5.2. and including, inter alia: extension of cash advances, operations involving cheques and bills of exchange, issuance of payment cards, purchase and disposal of claims, foreign exchange and financial forward transactions, safekeeping of valuables and securities, extension and confirmation of sureties, execution of actions commissioned by customers relating to the issue of securities, acting as an intermediary in the performance of money transfers and foreign exchange settlements; and
- Other operations provided in Article 6: take up or acquire shares and rights on such shares, shares in other legal persons and units in investment funds, assume liabilities relating to the issuance of securities, trade in securities, exchange claims for assets belonging to the debtor, acquire and dispose of real estate property, provide financial consulting and advisory services, provide certification services as defined in the regulations on electronic signatures, excluding the issue of qualified certificates employed by banks in operations to which they are a party, provide other financial services, perform other operations, where so authorized under the provisions of separate legislation.

While the disposal of assets obtained from the exchange of debtor claims should take place between three and five years of their acquisitions (Article 6.2.), no restrictions apply to the acquisition of real estate property, which is undertaken beyond the scope of conducting their banking activity. Such loose provisions, coupled with the lack of adequate limits related to investment in nonfinancial entities or on significant acquisitions can lead in practice to the accumulation of dangerous levels of risks in the real estate market.

**EC 3:** According to Article 3 of the Banking Act, the terms “bank” or its Polish equivalent—“kasa” may be used exclusively in the names of banks complying with the conditions stipulated in Article 2 of the Banking Act, or in circumstances where it is absolutely clear from the context that the terms do not refer to banking operations. The illegal use of the terms “bank” or “kasa” is subject to financial penalty and imprisonment (Article 171.2. of the Banking Act).

The name of banks have to specify, in addition to the term “bank,” whether the bank in question is a state bank, a public company or a cooperative bank (Article 31.3. of the Banking Act).

At present, in addition to banks complying with the conditions stipulated in the Banking Act, the term “kasa” can be used in the name of the credit unions, which take deposits from natural persons affiliated with the given entity and extend cash advances to them. Credit unions are not presently supervised by the KNF and follow a self-regulatory regime under separate legal provisions of the Credit Union Act of December 14, 1995.

	<p><b>EC 4:</b> According to Article 5.4. of the Banking Act, the taking of deposits payable on demand or at a specified maturity, may be solely performed by banks or by entities specifically authorized under the provisions of separate legislation (Article 5.5 of the Banking Act). Also, the FMSA empowers the KNF to exercise supervision of the banks (Article 3.2.).</p> <p>In addition to the three categories of banks specified in EC1 (state banks, cooperative banks and banks incorporated as public companies), a separate category of mortgage banks can be established under the provisions of the Act on Mortgage Banks and Mortgage Bonds of August 29, 1997. According to the provisions of the mentioned act (Article 10), the KNF is the supervisor of the mortgage banks.</p> <p>While credit unions can also take deposits from the public, as mentioned in EC 3, they are not yet subject to supervision by the KNF.</p> <p><b>EC 5:</b> The KNF maintains and updates periodically separate public lists of domestic banks, branches, and representative offices of foreign banks established in Poland. A list of credit cooperatives is also provided on the KNF website.</p> <p>The KNF publishes on its website “public warnings” listing any unauthorized use of names reserved for supervised institutions or entities that do not have a license for performing banking activities.</p> <p>In addition, the KNF is also involved in educational and informational actions related to the operation of the supervised financial market entities (in accordance with the mandate conferred by Article 4.1. of the FMSA).</p>
Assessment	Largely compliant
Comments	<p>As a key risk mitigant, the legal framework (Article 6.1.5. of the Banking Act) should be amended to limit the acquisition of real estate property to the purpose of conducting banking activities or for carrying out other activities that can contribute to the good performance of the banks’ operations (i.e., training facilities for staff etc.). In addition, the law should establish limits for investments in nonfinancial entities (see EC 5).</p> <p>In recognition of risks building in the credit union sector, a draft law was prepared in 2009, bringing the credit unions under the supervision of the KNF. The law is currently reviewed by the Constitutional Court, which is expected to make a decision regarding the compliance of the draft law with the Constitution. The assessors note that, while accounting for only a small percentage of the total assets of the banking sector, the sector has expanded considerably and serves a large number of small depositors (over 2 million). Bringing the credit unions under KNF’s supervision would mark an alignment to the current provisions of the Banking Act.</p>
Principle 3	<p><b>Licensing criteria.</b> The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home-country supervisor should be obtained.</p>

Description	<p><b>EC 1:</b> According to the Banking Act, the KNF is the licensing authority for banks incorporated as public companies and cooperative banks (Article 30a). Also, the KNF authorizes the establishment of a branch of a foreign bank in Poland upon consultation with the competent minister for financial institutions (Article 40). Credit institutions from EU countries may “passport” into Poland according to EU directives, after having first notified the KNF (Article 48.1.). Also, state banks can be established by ordinance of the Council of the Ministers, at the request of the Minister of Treasury and after having first obtained the opinion of the KNF (Article 14).</p> <p><b>EC 2:</b> The licensing criteria are stipulated in a broad manner in the Banking Act— Chapter D “Procedures governing the establishment of banks.” In addition, according to the Banking Act (Article 137.2.), the KNF has issued Resolution No. 389/2008 specifying the list of documents regarding the members of the bank’s management Board and the bank founders during the licensing process.</p> <p>The licensing procedure and documentation are not formalized in specific KNF regulations and the KNF considers that the existing legal provisions offer sufficient powers and flexibility in assessing the licensing applications. In practice, the KNF sets its expectations regarding the required documentation in the pre-licensing process, when extensive discussions are held with the founders of the prospective banks.</p> <p>The licensing process comprises two stages: the setting up approval (according to requirements stipulated in Articles 31–34 of the Banking Act) and the operational license (according to requirements stipulated in Article 36 of the Banking Act).</p> <p>The bank’s application for obtaining the setting up approval include, among others: the bank’s name and proposed registered office; scope of intended activity; information on founders, persons proposed for the management Board and initial capital; draft articles of association, business plan for at least three immediate years; documents on the founders and their financial situation.</p> <p>The decision regarding the setting up approval is decided by the KNF Commission and delivered to the applicants under the signature of the KNF Chairman. If the decision is positive, a bank may proceed with the formal establishment (registration of the entity with the Register Court, appointment of supervisory and management Board members, endorsement of articles of association, strategies, policies and procedures by relevant bodies and payment of capital, etc.).</p> <p>The application for the authorization to commence activities is assessed in accordance with Article 36 of the Banking Act. The KNF performs a thorough onsite examination to determine whether the bank is adequately prepared in terms of organization and management, has adequate premises and systems for conducting the banking activities and fulfils other conditions stipulated in the setting up decision. The minimum initial capital has to be fully paid up. A decision regarding the authorization to commence activities is issued by the KNF Director of Banking Supervision and communicated to the bank.</p> <p><b>EC 3:</b> The same criteria used to assess an application for a license must be met on an ongoing basis to institutions that have received the license. The KNF may restrict the scope of the bank’s activities or revoke the license if any of these criteria is no longer satisfied (Article 138.6.1. of the Banking Act).</p>
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**EC 4:** According to Article 37 of the Banking Act, the KNF will refuse authorization to establish a bank where the requirements in force for licensing are not fulfilled, or where the activity intended by the bank would contravene the provisions of law or prejudice the interests of its customers, or would not guarantee the safety of the funds held by the bank, or where the provisions of law in force in the place where the founder's registered office or residence is located, or their relations with other parties, could prevent the effective supervision of the bank.

An application will not be considered until all information needed to assess the application has been received. Over the past four years, the KNF issued four new licenses and rejected one application.

**EC 5, EC 6, and EC 8:** The Banking Act requires that the licensing application includes information on the founders and persons proposed for members of the bank's management Board (Article 31.1.3) and may request the founders to supplement their application where it is deemed that the information is insufficient (Article 33.1.1).

The KNF may refuse to grant the authorization if the provisions of the law in force in the place where the founders' registered office or residence is located, or their relations with other parties could prevent the effective supervision of the bank (Article 37).

The KNF performs a scrutiny of group entities and structures based on information received from the applicant, from foreign and domestic authorities, and from public sources. KNF would also require information on the ultimate beneficial owners (although the concept of "ultimate beneficial owners" is not defined in the law).

The suitability criteria for founders take into consideration: financial situation; reputation, including of members of the founder's Boards and of entities and persons associated with the founder; transparency, integrity and current and previous activities of founders and associated entities and persons; intentions, business strategy of founders for the prospective bank; the ability of the founders to supply additional financial support in the future.

Poland has a dual-management structure for banks, composed of a supervisory Board consisting of at least five natural persons appointed by the general meeting of shareholders (performing the oversight function) and a management Board consisting of at least three natural persons appointed by the supervisory Board (performing the management function).

The major shortcoming of the Polish legal framework is the lack of fit-and-proper criteria for the members of the supervisory Board (EC8). The KNF is informed about the composition of the supervisory Board at the licensing stage and notified of any subsequent changes (Article 22.3. of the Banking Act). However, the KNF does not have instruments to assess the initial suitability of Board members or the power to subsequently request their removal if deemed necessary (refer to CP 17 EC 4).

The KNF is informed by the supervisory Board on the composition of the management Board and of those members who will manage credit risk and the internal audit unit (Article 22a.2). The Banking Act (Article 30) requires that all the members of the management Board give adequate guarantee for the sound and prudent management of the bank. Explicit fit-and-proper requirements are stipulated only for two members of the management Board, including the president, who are subject to KNF approval (Article 22.b. of the Banking Act). Interviews with the two



members of the management Board subject to KNF approval are performed selectively.

The KNF confirms that it requires the same set of documents to be submitted for all members of the management Board (Resolution no. 389/2008, para. 5) in the licensing process or when subsequent changes in the composition of the management Board occur. The law falls short of requiring a check for potential conflicts of interest in respect to supervisory and management Board members.

According to Article 30.5. the bank's initial capital shall not come from a loan or cash advance, or be derived from undocumented sources.

Also, prior to issuing the license, the KNF has to determine whether the bank is properly prepared in organizational terms (Article 36.3.1).

**EC 7:** According to the Banking Act, the initial minimum capital of EUR 5 million is required for banks and branches of third country banks (Article 32.1. and Article 40.6.). Also, the initial capital of cooperative banks, the founders of which expressed the intention to conclude an affiliation agreement pursuant to relevant specific legislation shall not be less than EUR 1 million.

The initial capital of a bank incorporated as public company or a cooperative bank should be paid up in full prior to the bank entered in the appropriate register.

**EC 9:** The KNF reviews the operational program covering at least the following three years, which has to indicate that the activity of the bank will not endanger the funds entrusted (Article 30.1.4 and Article 31.2.2 of the Banking Act). Detailed guidelines for preparing the prospective bank's business plan are provided by KNF in the pre-licensing process. Also, the KNF analyzes the draft articles of association which have to specify, among others, the management bodies and their competences; the decision making principles; the basic organizational structure of the bank; the procedures for issuing internal regulations; the principles for setting internal control; details on the structure of own funds and financial management principles.

**EC 10:** The KNF reviews the financial plan covering at least the immediate three years and the documents on the founders' financial situation (Article 31.2. of the Banking Act). Although there is no formal legal requirement, the KNF would generally require that such statements are prepared in accordance with IFRS or Polish Financial Reporting Standards (when applicable). The evaluation of the business plan includes an assessment of whether the applicant will be able to satisfy prudential requirements regarding solvency, liquidity and internal control.

**EC 11:** According to Article 31.2.4. of the Banking Act, the application for the banking license will include the opinion of the competent supervisory authorities of the country where the applicant has its registered office, where the founder is a foreign bank. Such requirement is also applicable to the applications submitted by branches of foreign banks (Article 140 and 140.a.1. of the Banking Act).

If the application concerns a branch of a bank that is incorporated outside the EEA, similar criteria to those required for banks incorporated in Poland are applied (including an endowment capital) and the same information must be provided (Article 40 of the Banking Act). In addition, the KNF requires a commitment from the applicant foreign bank that it will satisfy all claims of the branch that may arise from its relations with other parties (Article 31.2.3. of the Banking Act).

	<p>There are no legal requirements that home supervisors must practice global consolidated supervision (see CP 25) or for the KNF to perform an assessment of equivalence of supervisory standards of home countries outside the EU area.</p> <p><b>EC 12:</b> According to Article 138.6.2. of the Banking Act, the KNF may withdraw authorization if it has been obtained on the basis of false information or unlawful means.</p> <p><b>EC 13:</b> The Banking Act requires that management Board members give adequate guarantee of the sound and prudent management of the bank (Article 30.1.2. of the Banking Act). The KNF expects that the management Board of a bank as a whole has a good understanding of the risks run by the institution and of the manner in which these risks can be controlled. Regular supervision assesses the quality of an institution's management on an ongoing basis. The Banking Act is silent on any requirements for the supervisory Board members and there are no clear supervisory expectations with regard to the supervisory Board members.</p> <p><b>AC 1:</b> The assessment of the licensing application includes the ability of shareholders to supply additional financial support, if needed, which is largely reflected in the assessment of their financial position. The KNF requires letters of comfort from the parent entities committing liquidity and capital support if needed.</p> <p><b>AC 2:</b> The progress of new entrants in meeting their business goals and fulfilling prudential requirements is monitored and assessed as part of the ongoing supervisory process through offsite analyses and full-scope onsite examinations. During the offsite supervision, the information collected through the regular reports is compared with projections presented by the founders in the business plan and divergences are clarified during the ongoing supervisory process. A full-scope onsite inspection in the bank is performed usually in the first three years of the activity of newly established bank.</p>
Assessment	Materially noncompliant
Comments	<p>The basic criteria for assessing the licensing applications are generally in place and the KNF performs a thorough assessment of the licensing applications received, as shown during the review of a recent licensing application.</p> <p>However, the legal framework needs to be improved to provide a formal foundation for sound and consistent requirements in a number of areas:</p> <ul style="list-style-type: none"> <li>- Fit-and-proper criteria for members of the supervisory Board: The supervisory Board plays a paramount role in the governance of banks, as it carries the overall responsibility for the bank and is responsible for the oversight of the management Board. Therefore, from a corporate governance perspective, it is essential that the supervisory Board members meet requirements of personal integrity, professionalism, reputation, and have adequate knowledge and experience which enable them to exercise sound judgment about the business of a bank. The fit-and-proper assessment for the supervisory Board is explicitly requested by the Basel Core Principles for Effective Banking Supervision (CP 3, EC 8, and EC 13) and should become an integral part of the ongoing assessment of the KNF risk management of the bank.</li> <li>- Clear fit-and-proper criteria for all the members of the management Board and the head of the internal audit. The legislation should require that the management Board possess, both as individual members and collectively, appropriate experience, competencies and personal qualities, including</li> </ul>

	<p>professionalism and personal integrity. In addition, the KNF should be able to require that competences and experience are proportionate to the person's responsibilities in the day-to-day management of the bank and to take into consideration other facts and or circumstances that may influence the suitability of a member of the management Board.</p> <ul style="list-style-type: none"> <li>- While the first best option would be that KNF approves all supervisory and management Board members, it would be at least necessary to enshrine more clearly that KNF approval covers at least the Board member responsible for risk management (i.e., chief risk officer).</li> <li>- The obligation to present a receipt of an assurance of the absence of potential conflicts of interest (i.e., through a declaration) from all members of the supervisory and management Boards.</li> <li>- A systematic analysis of the direct and indirect shareholders, natural or legal persons, who have qualifying holdings in the bank or of the close links existing between the bank and other natural and legal persons. The Banking Act definition of "close links" (Article 4(1)(15)) should be expanded to cover situations where two or more natural or legal persons are permanently linked to one and the same third person by a control relationship (thus seeking alignment to the provisions of Directive 48/2006/EC, Article 4(46)).</li> </ul> <p>In general, assessors recommend that a more specific and coherent licensing framework (for example, in a form of a KNF resolution or a licensing manual) is needed to enhance understanding of supervisory requirements and a more uniform and structured approach, including in respect to applying fit-and-proper criteria for the members of the management bodies of a bank. Such framework should seek at the minimum to ensure harmonization with conditions for acquisitions of banks' shareholdings.</p>
<b>Principle 4</b>	<b>Transfer of significant ownership.</b> The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Description	<p><b>EC1:</b> Article 4.8. of the Banking Act defines "parent undertaking" as an entity that a) owns, directly or indirectly—through other entities, the majority of votes in a company's decision-making bodies; b) is able to appoint or dismiss members of a company's supervisory or management Board; c) members of management Board, proxies or members of decision making bodies constitute more than half of a company's management Board members, and d) may exercise, in the opinion of KNF, in some other way "significant influence" (as defined in Article 4.1.14. of the Banking Act) over another undertaking.</p> <p>There is no specific definition of "significant" or "qualifying" ownership in a bank; however, the KNF has the power to review and reject intentions of acquiring ownership thresholds clearly benchmarked. Specifically, according to Article 25.1. of the Banking Act, the KNF has to be notified of any intention to:</p> <ul style="list-style-type: none"> <li>a) take up or acquire shares or rights attached to shares in a domestic bank, directly or indirectly, that would result in the acquirer being entitled to, or more than 10 percent, 20 percent, 33 percent, or 50 percent of the total votes at a general meeting or interest in share capital; or</li> <li>b) become a parent company, directly or indirectly, otherwise than by taking up or acquiring shares or rights attached to shares in a domestic banks.</li> </ul>

The Banking Act (Article 25.p.) also prescribes that every person or legal entity must also notify the KNF of its intention to dispose shareholdings in a domestic bank, directly or indirectly, where the remaining shares will entitle that entity to less than the thresholds mentioned above or when the holding in question entitles it to exercise over 10 percent of the voting rights.

**EC 2 (see also EC 1):** According to Article 25.b. of the Banking Act, the notification sent to the KNF has to be accompanied by information on: the domestic bank targeted by acquisition; the proposed acquirer; the group to which the potential acquirer belongs; intended changes in relationship with the domestic bank's future operations, including organization, management, and financial plans.

The relevant information and documents requested in the acquisition process are specified in MoF Ordinance of 20 August 2010 on the documents enclosed to notifications of the intention of taking up or acquiring shares in a domestic bank or the intention of becoming a parent undertaking of the domestic bank.

**EC 3:** According to Article 25.h.1. The KNF may decide to issue a no objection statement or, otherwise oppose to the proposed acquisition.

The KNF may reject the acquisition if the entity submitting the information failed to supplement additional information and documents requested to make the assessment within a certain timeframe or when such a decision is justified by the need of prudent and stable management of the bank.

Specific criteria for assessment of the proposed acquisition are stipulated in Article 22.h.2. of the Banking Act and include, among others:

- the capacity of the entity submitting the notification to provide a guarantee for the due performance of its rights and obligations securing the interests of the domestic bank's clients and safety of the funds entrusted;
- the financial capability of the acquirer before and after the proposed investment;
- the persons designated to manage the domestic bank subsequently to acquisition have relevant professional experience and can secure the prudent and stable management of the bank;
- the funds used to perform the acquisition do not come from illegal or undisclosed sources and are not related to financing of terrorism, or that the proposed acquisition could increased the risks thereof; and
- following the proposed investment, the domestic bank will meet prudential standards and the structure of the group the bank will become a member of will allow exercising effective supervision, efficient exchange of information and adequate allocation of responsibilities among relevant competent authorities.

**EC 4:** The KNF collects monthly information about shareholders of a bank through FINREP reports. Such reports would capture information on all shareholders holding more than 5 percent of the share capital of the bank. During onsite examinations, more detailed information is gathered, including information on entities or persons related to the banks and their business contacts.

**EC 5:** According to Article 25.i. of the Banking Act, if a change in the ownership occurs without the KNF being notified, despite KNF objection, or in breach of the deadlines specified by law: no voting rights may be exercised under such shares or, if the voting rights are exercised, the members of the management Board appointed

	<p>by the acquirer will not participate in the process of decision making and the decisions will be deemed invalid unless they meet the requirements of quorum and majority of votes without nullified votes. While the KNF has the right to initiate proceedings for nullifying the decision of the general meeting, the decision will be made by administrative courts according to provisions of the Code of Commercial Companies (Article 5.1.3). Also, the KNF has the right to order the disposal of shares in the domestic bank and may impose a financial penalty on the shareholder, impose a Board of receivers in the bank or withdraw the license.</p> <p><b>AC 1:</b> There are no specific provisions in the Polish law requiring banks to notify the KNF as soon as they become aware of any material information that may negatively affect the suitability of a major shareholder.</p>
Assessment	Compliant
Comments	The law should be amended to require banks to notify the KNF as soon as they become aware of any material information that may negatively affect the suitability of a major shareholder.
<b>Principle 5</b>	<b>Major acquisitions.</b> The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations and confirmation that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	<p><b>EC1:</b> The Banking Act distinguishes between the regulatory treatment of an acquisition of a major investment and the establishment of branches and subsidiaries abroad. Art 128c of the Banking Act requires a bank to notify the KNF of its intention to purchase a portfolio of shares exceeding 5 percent of the banks own funds. In principle, the KNF could oppose (prohibit) the acquisition using its powers under Article 138, paragraph 1, subparagraph 6. Notably, the law does not provide the KNF with any powers in respect to acquisitions of banks accounting for less than 5 percent of their own funds.</p> <p>In the case of establishment of cross-border operations, Article 48a to 48c of the Banking Act allow a domestic bank to establish a branch in an member state of the European Economic Areas upon simple notification to the KNF under the relevant EU Directive of April 2008. Article 39 of the Banking Act requires authorization of the KNF for the establishment of branches as well as subsidiaries in third countries. The application for establishment of a bank abroad should include the bank's name, registered office and organizational form as well as information on the bank's founders and initial capital.</p> <p>The application shall also append a draft of the articles of association and reasons for the establishment of a bank abroad; the bank's program of operations and financial plan for at least the immediate three years, and information on the legal regulations in force in the country of establishment with respect to authorizations to assume activities by a bank, tax regulations applicable to the banks activities, regulations on the transfer of foreign exchange and on banking supervision. An application for establishment of a branch of a bank abroad should also include reasons for the establishment of a branch of the bank abroad and the information specified in para. 3, subpara. 3 of Article 39 of the Banking Act as applicable to branches of banks.</p> <p><b>EC 2:</b> Laws and regulations do not explicitly detail the criteria for KNF's authorization. The KNF has also not published any interpretation or guidance on this matter.</p>

	<p><b>EC 3:</b> As a result of the absence of clear criteria for the KNF's authorization, the discretion of the supervisor in this matter is in practice not limited. Criteria such as exposure of the bank to undue risk, obstacles to effective supervision, secrecy laws and other regulations in the host country that could hinder the adequate consolidated supervision, would be taken into consideration. Following a discussion between the assessors and a number of banking supervisors, there is little evidence of a rigorous and documented assessment methodology that is used within the KNF. There is, however, a list of countries on the website where the KNF does not want the Polish banks to invest or to acquire subsidiaries. The KNF can refuse approval for the establishment of foreign subsidiaries and branches in third countries under Article 39 of the Banking Act. With regard to the acquisitions under Article 128, the KNF could oppose the acquisition using its powers under Article 138, paragraph 1, subparagraph 6.</p> <p><b>EC 4:</b> The KNF must be satisfied that the credit institution has adequate financial and organizational resources. This assessment is performed by offsite supervision. As indicated in EC 3, no formal framework or methodology for this assessment was provided.</p> <p><b>EC 5:</b> The Banking Act and regulations do not specify cases where notification after the acquisition or investment is sufficient.</p> <p><b>EC 6:</b> The KNF offsite supervision monitors the risks on a consolidated basis. Contagion risks are accounted for in the qualitative component of the offsite CAEL rating, using supervisory discretion.</p> <p><b>AC1:</b> The authorities state that the KNF's analysis includes a review of the legal, institutional, and supervisory system of the third country. The assessors requested insight in the supervisory work performed with regard to the Ukrainian subsidiaries acquired by two domestic banks, but little evidence of a structured assessment methodology and a documented assessment was provided. Compliance with the above legal requirements and regulations is verified during complex onsite inspections as well as during offsite monitoring of the prudential returns.</p>
Assessment	Largely compliant
Comments	<p>Major acquisitions by domestic banks require only notification to the KNF, while establishment of subsidiaries abroad and branches in third countries require explicit ex ante approval. No clear rationale for this difference in treatment was provided by the authorities. The Banking Act or regulations do not specify the criteria the KNF uses in its authorization of cross-border activities of its domestic banks.</p> <p>Although the KNF could in principle oppose the acquisition of a major investment using its powers under Article 138, paragraph 1, subparagraph 6, in view of the limited time for notification and the lack of clear criteria for approval, it is unlikely the KNF would have sufficient time in practice to thoroughly assess the acquisition and oppose it.</p> <p>The Banking Act permits but does not prohibit credit institutions to perform all types of nonbanking activities in their subsidiaries, and it does not restrict individual holdings as a percentage of capital as long as they do not exceed the single counterparty exposure limits detailed in CP 10. In addition to activities related to the financial sector, the Polish banks appear to have invested mainly in commercial real estate, which may prove a large source of new risk.</p>

	<p>It is recommended the authorities develop a rigorous supervisory methodology for the assessment of contagion risk and restrict individual holdings to 15 percent of capital and aggregate qualifying holdings in nonbanking activities to 60 percent of capital in accordance with the EU Directives.</p> <p>Although the bank subsidiary acquisitions of domestic banks in third countries may at first sight appear immaterial in terms of assets, the reputation risks for the Polish banks when investing in third countries cannot be ignored. It is therefore recommended that the authorities develop a comprehensive and structured supervisory assessment methodology to consider the quality of supervision in a third country and its own ability to exercise supervision on a consolidated basis. This initiative could include due diligence visits to the supervisory authorities of third countries when appropriate.</p>
<b>Principle 6</b>	<p><b>Capital adequacy.</b> Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.</p>
Description	<p>Poland has implemented the Basel II framework since 2008, through the transposition of the provisions of the EU Capital Requirements Directives (Directive 2006/48/EC and Directive 2006/49/EC) into the national legislation. The Banking Act and the KNF resolutions are regularly updated to reflect changes in the EU capital adequacy framework, with most recent amendments pending referring to the remuneration practices in banks and to the new capital requirements for the trading book and for securitization (CRD III). The current capital adequacy framework addresses comprehensively Pillar I (minimum capital requirements), Pillar II (supervisory review), and Pillar III (market discipline) requirements. Capital requirements are applied at both individual and consolidated levels. In 2010, the regulatory capital was composed of 87 percent capital allocated for credit risk, 11 percent capital allocated for operational risk, and 2 percent capital allocated for market risk. All banks implement the standardized approaches for credit and market risks, while for operational risk banks apply either the basic indicator approach or the standardized approach. At the time of the assessment, the KNF was in the process of reviewing one application received from a bank for applying the advanced IRB for credit risk and one application received from a bank for applying the advanced measuring approach for operational risk.</p> <p><b>EC 1:</b> The initial capital provided by the bank's founders shall be no less than the zloty equivalent of EUR 5,000,000 translated at the average rate published by the National Bank of Poland. In the case of cooperative banks the initial capital shall be no less than the zloty equivalent of EUR 1,000,000. The initial capital for both categories of banks should be fully paid up before they can be entered in the register of banks.</p> <p>Article 127 of the Banking Act defines the components of banks own funds. The capital of a bank is the sum of primary (Tier 1) and secondary (Tier 2) and tertiary (Tier 3) capital. Tier 1 capital must constitute at least 50 percent of the bank's capital. The deductions applied to Tier 1 and total capital are specified in Resolution 381/2008 and Article 127 paragraph 2, sub-paragraph 3. The quality of bank capital is very high as the vast majority of bank capital in Poland consists of Tier 1 (aggregated ZL 90 billion, or about 90 percent of the capital), followed by Tier 2 (ZL 9 billion) and finally Tier 3 (ZL 300 million).</p>

Hybrid capital instruments are relatively rare in commercial banks and new issuances were recently banned by the KNF by Resolution number 434/2010.

Article 128 of the Banking Act requires every bank to maintain its capital base at a level that represents no less than 8 percent of risk weighted assets and off balance sheet commitments. Banks commencing operations are obliged to maintain higher levels i.e., a risk-based ratio of at least 15 percent for the first 12 months of operations and, at least, 12 percent for the following 12 months. The average CAR ratio for commercial banks in the Polish banking sector at the end of December 2010 is close to 14 percent and no banks are below the minimum 8 percent at the date of the assessment.

**EC 2:** The components of capital as well as the deductions detailed in Article 127 of the Banking Act and Resolution 381/2008 are in line or even more conservative than the Basel requirements. For example, the KNF has introduced higher risk weights for credit risk arising for FX loan exposures. Indeed, when the credit exposure is expressed in a currency other than the one of the borrower's income and secured by residential real estate, it receives 75 percent risk weight rather than a 35 percent under the standardized approach. This results in a level of regulatory capital, which is higher than the Basel II minimum.

**EC 3:** Article 138 paragraph 1 of the Banking Act states that the KNF may issue recommendations to banks to increase their own funds. Paragraph 2 allows the KNF to impose additional capital requirements exceeding the value resulting from the capital requirement calculated in accordance with detailed principles specified by the KNF, in particular in case of negative findings made while supervising the operation of risk management and internal control systems or the identification, monitoring and review of exposure concentration, including large exposures. The KNF required increased capital requirements for a few banks as part of its ongoing supervision activity; in addition, a handful of cooperative banks under rehabilitation programs have to meet consistently higher capital requirements.

**EC 4:** Article 126 of the Banking Act requires that in order preserve their economic safety, banks shall be required to possess own funds adjusted to the scale of the operations and risks they assume. In this regard, in case the bank calculates a capital amount to cover all identified and significant types of risk involved in its banking activity and changes in the economic environment, including changes in the forecasted level of risk (internal capital) higher than the sum of the capital requirements in accordance with the Banking Act and regulations, the bank shall maintain the higher amount.

**EC 5:** The stricter regulatory requirements under Pillar 1 for FX mortgages capture a risk specific to the conditions under which the banking system operates. Moreover, KNF has often required banks to retain profits to build additional capital buffers. Finally, in accordance with paragraph 13 of Resolution 383/2008, banks are required to implement risk-management policies, processes and procedures to deal with risks arising from macro-economic conditions—for example rules for managing and mitigating risks resulting from changes in macro economic conditions and their impact on future capital requirements. One of the risks expected to be covered under the Pillar 2 Internal Capital Assessment Process (ICAAP) is procyclicality risk linked with macroeconomic conditions.

When analyzing the ICAAP, examiners take into account environmental factors and they consider, *inter alia*, the real prospects for the bank's development, the influence



of extreme market conditions on the level of capital, and the access to capital markets and other sources of capital, including the available assistance from bank owners.

Compliance with the requirements is assessed during onsite examinations. The scope of the capital assessment is detailed in the onsite supervision manual and includes compliance with the supervisory requirements, the structure and level of capital, the influence of the various risks resulting from the current and anticipated activity of the bank on its capital. There are cases in which following onsite examinations, banks have been requested to increase their capital.

In the course of onsite examinations, examiners also verify the correctness of the calculation of capital requirements which mirror the risk profile (in terms of Pillar 1 risks) of individual banks and include all relevant on balance sheet and off balance sheet items. Risks not included in Pillar 1 are subject to review in the course of the assessment of the ICAAP. The ICAAP review covers the policies of the bank's management concerning capital planning and assessment, the level of retained profits, plans for development of the bank's activity and plans of the Management Board to increase capital. Poland is a host supervisor to many European subsidiaries and ICAAP assessments are performed on a solo basis and complete documentation from the domestic bank is required.

**EC 6:** Article 128.7 of the Banking Act states that in case of noncompliance with the minimum capital ratio, the bank is required to notify the KNF immediately. The KNF may issue recommendations, in particular:

- taking the necessary measures to restore payment liquidity or to achieve and observe the standards;
- increasing own funds; and
- limitation of the risk in its activity.

The KNF may order a bank to cease dividends or to refrain from opening organizational units until the liquidity is restored or the bank achieves the minimum capital requirement. Such powers have been used in practice in the form of binding resolutions issued by the KNF (see also CP 23).

**EC 7:** The KNF is in the process of reviewing the application of one bank in accordance with Article 128.3 of the Banking Act to apply the Advanced Measurement Approach for operational risk. The applications for advanced IRB are currently under review but have not yet been approved. Banks using internal assessments of risk shall not revert to the use of the simplified approaches except for demonstrated good cause and subject to approval by the KNF. While all banks are presently using the standardized measuring method for calculating capital requirements, migration to the internal models would be subject to supervisory approval. The KNF has a dedicated unit currently consisting of 10 staff (including one person delegated to work in EBA) for the accreditation of banks using the Basel II sophisticated approaches. The validation activity of this unit is supported by the inspectors and employees in other units. The assessment of applications for accreditation to use internal risk inputs in the capital calculation are made by the onsite and offsite department. It includes the qualitative and quantitative standards of the model, the IT environment, as well as the quality and security of data. Banks using sophisticated methods for regulatory capital calculation are monitored to assess if they continue to comply with the supervisory requirements.

	<p><b>AC 1 and AC2:</b> The legal and regulatory requirements described above are in place for all registered banks in Poland.</p> <p><b>AC 3:</b> Chapter 4 of Resolution 383/2008 defines the principles for capital management. It states that the Management Board is responsible for the preparation and implementation of the internal capital assessment, capital planning and capital management. The processes in this area must be documented and approved by the Supervisory Board. The KNF's onsite inspection manual outlines the detailed assessment criteria for a forward looking approach to capital management.</p> <p>These include:</p> <ul style="list-style-type: none"> <li>• the assessment of the adequacy of capital and the need for future capital increase taking into account the bank's strategy, the current and anticipated growth, development prospects and capital investments; and</li> <li>• the appropriateness of the level of retained profits and paid dividends in the light of the current level of capital and development plans for the bank.</li> </ul> <p>The examiners verify that dividend payments are not excessive and do not limit the bank's growth strategy. They also assess the bank's sources of capital and financial assistance. Based on these requirements in the resolution, the KNF can mandate higher capital requirements in accordance with Article 138a paragraph 1 of the Banking Act for an individual bank.</p> <p>Strictly speaking, the KNF does not have the power to mandate higher capital levels that would be binding for the whole banking system as the rule making authority is with the MoF. In January 2009, though the KNF issued a recommendation urging all banks (and insurance companies) to maintain the 2008 earnings in the domestic banking system. Although the recommendation was not binding, nearly 90 percent of the profits earned by commercial banks in 2008 remained in the Polish banking system. Under Article 138.2 of the Banking Act, the KNF has the power to order a bank to cease payments from net earnings.</p> <p><b>AC4:</b> While there is no explicit requirement for adequate distribution of capital in groups, the matter is addressed indirectly by paragraph 21 of the Resolution 383/2008, which requires that the bank monitor risks associated with the activities of its subsidiaries. The bank shall assess the size and profile of risk underlying the activities of its subsidiaries. Examiners always require banks to meet the capital requirements on a standalone basis as barriers to effective transferability of funds in crisis situations are very likely.</p> <p><b>AC 5:</b> In accordance with Article 138 of the Banking Act, the KNF can require a higher capital adequacy ratio on a consolidated basis.</p>
Assessment	Compliant
Comments	<p>The quality and quantity of banks' capital are deemed to be high in the context of the overall stricter capital requirements. The KNF is to be commended for the early alignment of the risk weights for FX residential mortgage loans under the standardized approach to the Polish environment.</p> <p>With the implementation of Basel II, it is recommended that the KNF progress its risk-based supervision and develops a methodology to set risk-based capital requirements based, for example, on the internal ratings the KNF currently uses.</p>

	The SREP methodology and the findings of the onsite inspections would be major inputs in this process.
<b>Principle 7</b>	<b>Risk-management process.</b> Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk-management process (including Board and senior management oversight) to identify, evaluate, monitor, and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.
Description	<p><b>EC 1:</b> The Banking Act (Article 9) requires that banks have in place a management system, composed of a set of rules and mechanisms related to decision making and to evaluation of banking activities including at least:</p> <ol style="list-style-type: none"> <li>1) a risk-management system, aimed at identifying, measuring, monitoring and controlling their risks in banking activities; and</li> <li>2) an internal control system, aimed at supporting decision-making processes, composed of: a) risk control mechanisms; b) review of compliance with legislation and internal regulations; and c) internal audit.</li> </ol> <p>According to Article 9.b.2. of the Banking Act, in designing their risk-management system framework, banks will apply standard principles, procedures, and limits. Also, the principles for risk management are applied at individual and consolidated bases, according to Article 9.b.3 of the Banking Act.</p> <p>The provisions of the Banking Act are further detailed in KNF Resolution no. 383/2008 on detailed rules of risk and internal control management systems and detailed terms and conditions of internal capital assessment performed by banks, as well as reviews of internal capital assessment and retention process.</p> <p>The organizational structure, as well as the strategies, processes, procedures and analyses for risk management should be commensurate with the volume and level of complexity of the bank's operations (paragraph 6.2.) and necessary adjustments should be introduced to reflect the risk profile, business environment factors, and identified problems (paragraph 6.1.). The bank's management Board is responsible for the preparation, implementation and review of risk-management policies and procedures (paragraph 7.1.).</p> <p>The KNF evaluates the functioning of the risk management through a combination of offsite analysis of prudential and financial reports, regular (quarterly for the most important banks) meetings with the banks' management Boards and comprehensive onsite examinations, when an integrated risk-management analysis is performed.</p> <p>During onsite comprehensive examinations, the KNF performs separate assessments of risk management for each of the major risk areas (i.e., credit risk, operational risk, market risk, and liquidity risk, etc.) which are further integrated into an overall assessment of risk management by inspectors specialized in the assessment of the governance of the bank. Shortcomings identified are stated in the Report of Examination and the bank receives supervisory recommendations (which may also concern the subsidiaries) to eliminate poor or inadequate practices and to strengthen internal regulations, procedures and control mechanisms. Findings are also discussed with the members of the management Board at the end of the inspection. The follow up on implementation of such recommendations lies with the offsite monitoring team of the KNF, which receives quarterly progress reports from the banks. Given the long inspection cycle, the offsite monitoring takes an important</p>

role in assessing the risk management of banks. Moreover, the KNF makes little use of targeted examinations of risk management to complement or verify information obtained offsite, which substantially negates the potential value of such targeted examinations.

**EC2:** The Banking Act and Resolution no. 383/2008 stipulate the division of responsibilities between the management Board and the supervisory Board. The supervisory Board will approve the operational strategy and the rules of prudent and stable management of the bank (paragraph 3.1) and will supervise implementation of the management system and assess its adequacy and effectiveness (Banking Act, Article 9a.2.).

The management Board will prepare, implement and review written policies, strategies and procedures (paragraph 7.1), introduce appropriate adjustments to reflect changes in the risk level with respect to the bank's operations, commercial environment and occurrence of irregularities in the systems and processes (paragraph 6.1), and will be responsible for the efficiency of the risk management system, internal control system, internal capital assessment process, and review of the latter (paragraph 6.1).

During onsite examinations, the KNF performs a comprehensive assessment of the risk-management strategies, policies, and procedures and limits, and verifies the intensity of involvement and oversight by the management Board and supervisory Boards. The KNF analyzes internal documents (including minutes of the supervisory and management Boards, internal control reports, changes in policies, policies and limits following Board recommendations, etc.) and holds discussions with members of the management Board and key persons involved in the risk-management process (chief risk officer, internal auditors, etc.). The KNF assessment includes an evaluation of the ability of the risk manager to provide sufficient countervailing power to the business.

However, the KNF has little dialogue with the members of the supervisory Board, who are invited to participate in the discussion of the examination results, but KNF confirms that they rarely attend.

**EC 3 (also see EC1):** Resolution no. 383/2008 requires that internal limits established for risk management be determined based on written analyses (paragraph 17.1) and be aligned to the general bank's risk level approved by the supervisory Board (paragraph 17.4). The bank's management Board or appropriate committees approve internal limits (including their types and amounts) which should be commensurate to the scale and complexity of the various activities undertaken (paragraph 17.1). The internal procedures of banks will specify the rules for establishing and updating internal limits, the frequency of monitoring whether they are being observed, and for reporting of the results (paragraph 17.3).

The bank's internal procedures have to also specify the situations in which such internal limits can be exceeded as well as the conditions for acceptance of such exemptions, the procedure to be followed in cases of breach of limits, together with actions aimed at explaining the excess, eliminating the excess and preventing such situations in the future (paragraph 18).

The Banking Act (Article 9.b.4) requires that banks have an established system of management records that enable the risk level to be monitored.

During onsite complex examinations, the KNF examiners investigate if the risk-management strategies, policies, processes, and limits are documented, adequate to risk, updated, used in practice, and regularly reviewed. Examiners check the calibration and relevance of the level of exceptions and how such exemptions are managed.

**EC 4:** According to KNF Resolution 383/2008 the bank's management Board:

- provides the supervisory Board with periodic information presenting a reliable, clear, and synthetic view of the types and volume of risk related to the bank's operations (paragraph 9); and
- is responsible for the transparency of the bank's operations, including but not limited to the information policy within the scope of the bank's operations, allowing for the assessment of the effectiveness of the bank's supervisory Board and management Board activities regarding the management, monitoring the safety of the bank's operations and assessment of the bank's financial standing (paragraph 10).

The KNF assessment of the adequacy of risk management focuses on discharging the responsibilities by the management Board in respect to design, implementation and changes in strategies, policies, procedures and limits.

Under Article 138 of the Banking Act, the KNF may apply for the recall of a member of a bank's management Board if the bank's activity is in contravention of the law or its articles of association, or impairs the interests of the bank's account holders. Also, the KNF may suspend such a person from office or—as a last resort—recall such a person. The latter power relates only to cases where the person concerned has been convicted under a final and conclusive court verdict of a willful criminal offence against property or documents, or a fiscal offence.

**EC 5:** Resolution no. 383/2008 states that the internal capital assessment process should constitute an integral part of the bank's management process (paragraph 44.1) and that capital management policy and capital plans should be considered in the bank's management process (paragraph 44.2). Also, paragraph 40 of the Resolution states that bank's management Board is responsible for the preparation and implementation of the internal capital assessment; capital management; and capital planning.

The Resolution requires that bank's internal procedures relating to processes of internal capital assessment, capital management and capital planning be approved by the supervisory Board of the bank and properly documented.

The Banking Act (Article 128.2) and the Resolution above require that banks review at least once a year the process for estimating and maintaining the internal capital to ensure that it is appropriate for the type, scale and complexity of its banking operations. In addition, 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 (paragraph 43.2. of Resolution No. 383/2008). It is also required that the process of internal capital assessment and the review of this process be subject to independent evaluation carried out by the bank's internal audit unit (paragraph 43.3).

During onsite complex examinations, the KNF examiners investigate how a bank implemented ICAAP and if the capital planning process covers all significant risks also in relation to the size, complexity and business strategy of the bank. Also, the KNF evaluates how the bank's key staff and the management Board manage the risk being taken by a bank and how they influence the capital planning process.

**EC 6:** KNF Resolution 383/2008 (paragraph 15) states that a bank will use methods (models) for identifying and measuring risks associated with its activities, tailored to the profile, scale and complexity of risk. Models of risk measurement are applied to the current as well as planned activity (paragraph 15.3) and are subject to periodic internal evaluation that includes testing and historical back-testing (paragraph 15.4).

The KNF pays particular attention as to whether subsequent evaluation of the models is performed by persons who have been involved in the design of such models. The skills of the persons in the internal audit function dealing with the assessment of such models are also assessed and the KNF would require removal of persons insufficiently prepared to understand and challenge the banks' models. In addition, for those models that are developed at the group or parent company level, the KNF would verify whether assumptions are adjusted to the local market.

**EC7:** Resolution No 383/2008 states that the internal reporting system to the management has to provide information on the types and size of risk related to the bank's activities for risk-management purposes (paragraph 19.3). The system has to be reliable, accurate, current, and cover an appropriate range of areas (paragraph 19.2). The frequency of risk monitoring shall be such as to make it possible to provide information about changes in the bank's risk profile (paragraph 19.4).

During onsite complex examinations, the KNF assesses how a bank measures, assesses and regularly reports the risk exposures to the management Board and the supervisory Board. In particular, the KNF verifies if the flow of information and the management information system (MIS) are calibrated to the bank's profile.

**EC 8:** Under paragraph 20 of Resolution No 383/2008, prior to the introduction of a new financial product the bank has to carry out preparations, which includes in particular: the analysis of compliance with the bank's strategy, the 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 Board committees. During onsite complex examinations, the KNF verifies if risk assessment procedures for new products and projects are in place, and whether they have been approved by the management Board or a specific committee.

**EC 9:** According to paragraph 8.2. of Resolution 383/2008, the bank's management Board will distribute tasks related to bank's operations so as to ensure that the functions of risk assessment, monitoring and control are independent from the activities from which the risk taken by the bank derives. During onsite examinations, the KNF investigates whether banks established separate risk-management units, which are not involved in operations, and which reports on risk exposures to senior management and the management Board.

**EC 10:** Resolution no. 383/2008 (paragraph 13) states general principles of risk management to be applied by banks in the areas of credit risk and counterparty risk; residual risk; concentration risk; risk arising from securitization; risks from changes in macroeconomic conditions; market risk; interest risk in the banking book; operational risk and liquidity risk.

	<p>Detailed supervisory requirements for the risk-management processes relative to various types of risks are stated in specific KNF prudential recommendations (see CP 1.1).</p> <p><b>AC 1:</b> According to Resolution 383/2008 (paragraph 8.1), the bank's Management Board will design and implement the organizational structure of the bank reflecting the size and risk profile of the bank, approved by the Supervisory Board.</p> <p><b>AC 2:</b> On a yearly basis (within the SREP process), the KNF conducts a comprehensive stress test in cooperation with banks based on scenarios and a methodology provided by the supervisor. Also, larger banks are expected to conduct rigorous, forward looking stress tests as part of their own risk management. Separate stress tests are performed by banks in the areas of interest rate risk in the banking book and for setting limits on credit exposures secured by mortgages.</p> <p><b>AC 3:</b> Under paragraph 14 of KNF Resolution 383/2008 the bank shall introduce management procedures of other risks that were identified as important for the bank's business activity. The bank shall use methods (models) for identifying and measuring risks associated with its activities, tailored to the profile, scale and complexity of risk.</p>
Assessment	Largely compliant
Comments	<p>Assessors note that the following areas should be strengthened:</p> <p>The legal and regulatory frameworks assign explicit responsibility to the management Board for the effective management of the major types of risks, but some remaining and difficult to measure risks, like strategic and business risks, need to be addressed as well. Assessors note that the KNF is in the process of amending Resolution no. 383/2008, so that the risk-management requirements become more explicit and comprehensive in certain areas (i.e., concentration risk, securitization risk, residual risk, market risk etc.).</p> <p>In general, the existing regulations should be streamlined in order to offer more clarity with respect to supervisory expectations for the oversight function, risk management and internal control frameworks so as to ensure that banks' complexity and the riskiness are appropriately counterbalanced by internal governance arrangements. For example, taking into account the size and complexity of an institution, regulations should require the setting up of specialized committees, which could help support the management Board in specific areas and could facilitate the development and implementation of good governance practices and decisions. In big banks, specialized committees should include, besides the audit committee, a risk committee and a remuneration committee. The KNF notes that some improvements are planned through a revision of Recommendation H and through the implementation of CRD III in the national legislation.</p> <p>The KNF approach to evaluating risk management in banks is heavily reliant on the offsite monitoring process, which is not deemed sufficiently robust to capture efficiently all qualitative aspects of risk management. The KNF approach to evaluating risk-management practices in banks could be enhanced through a more balanced weight of offsite and onsite tools (in particular, targeted onsite inspections) and a stronger involvement of the onsite monitoring of follow-up actions especially in cases where the risk-management processes of a bank is deemed to be poor.</p> <p>While at present, the assessment of the risk management in banks is performed on a case-by-case basis, it would be useful if the KNF develops internal guidelines for</p>

	<p>benchmarking risk-management practices in banks according to the bank's size and risk profile. For example, assessors note that the KNF would need to benchmark more clearly the acceptable risk-management practices in relation to the separation of risk taking and risk-management functions, depending on the size and the risk profile of the institutions. The onsite inspection manual could be streamlined by providing a set of concrete examples for selected groups of banks, which would better ensure consistency in the supervisory judgment across the agency.</p> <p>It should be mentioned that the BION process implemented in 2010 introduces a more comprehensive and articulated offsite monitoring system of risk-management systems in banks. The system is yet to be tested as the results of the BION annual review will be only available later this year. Regardless of the introduction of BION, assessors consider that a more active and frequent deployment of onsite inspections is necessary for effectively monitoring the risk management in banks.</p> <p>In addition, the KNF should strengthen the dialogue with the members of the supervisory Board, not at least for ascertaining their capacity to provide effective oversight of the management Board.</p>
<b>Principle 8</b>	<p><b>Credit risk.</b> Supervisors must be satisfied that banks have a credit risk-management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor, and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.</p>
Description	<p><b>EC 1 and EC 2:</b> As described in CP 7 above, Resolution 383/2008 paragraph 3 lays out the responsibility of the supervisory and the management Board to ensure that effective risk management is in place and is adequate for the bank. The KNF has also issued a number of recommendations in the credit risk area, more specifically Recommendation T on best practices concerning retail credit exposures risk management (issued in February 2010), Recommendation S II on best practices in mortgage backed credit exposures (issued in 2008) and Recommendation B concerning the mitigation of the bank's financial investment risk (issued in 2002). Recommendation T is mainly designed to improve the standards for assessing the creditworthiness of retail clients; it details specific supervisory expectations in following areas: Board oversight, periodic assessment of policies, processes and procedures, continuous monitoring requirements, management information systems, limit structures, independent credit risk management, credit scoring systems, secured and collateralized credits, compliance reporting and internal control systems. The level of prescription of Recommendation T is extremely high.</p> <p>Supervisory expectations for credit risk are also detailed in the onsite examination manual, which was shared with banks. Based on this manual, the KNF generally expects that the banks policies and processes establish a well controlled credit risk environment. During onsite examinations, examiners specialized in credit risk management confirm that the bank complies with the KNF requirements and recommendations. That said, onsite examinations are infrequent and long (as described in CP 20). The offsite department also performs analytical reviews of the prudential return, assessing banks within their respective peer groups and identifying unusual trends or exposures. An annual survey to assess mortgage loans credit risk is also performed by the offsite analysts once a year. The data provided by the banks are split per quarter, per number of loans granted and broken by currency. Information on the quality of loans and LTV ratios is also collected.</p>



The findings are summarized in a report that provides macro level input into the supervisory process.

**EC 3:** Article 79 of the Banking Act states that a bank shall not apply terms to credit transactions that more favorable than those applied to third parties to its parent and subsidiaries and group members, shareholders or members, employees and members of the supervisory Board and the management Board, the parent's employees, members of the management Board and members of the supervisory Board as well as undertakings linked by capital or management to a shareholder and a member or a member of the management Board or the supervisory Board of a bank, or a person holding a management position in a bank.

Article 79 paragraph 2 requires banks to specify in the form of bylaws, the terms and conditions for extending loans, cash advances, bank guarantees and other securities and off balance sheet commitments to the parties described above and it shall keep separate record of the exposures.

Moreover, Article 79a and 79b of the Banking Act outline specific conditions for the extension of loans, advances, guarantees or other off balance sheet commitments to members of the management Board and supervisory Board. In summary, any exposure in excess of EUR 10,000 needs to be approved by the management and the supervisory Board of the bank. The resolutions of the respective Boards shall be adopted without the participation of the person concerned and require a two third majority. The provisions are also applicable to undertakings linked by capital or management to the members of the management Board or the supervisory Board or to a person occupying a management position—i.e., any employee reporting directly to the management Board.

Also, aggregate exposure of such transactions should be less than 10 percent of own funds for commercial banks. A reporting obligation to the KNF is also established in Article 79 b of the Banking Act for extensions of loans, advances or security exceeding 30,000 EUR to members of the management or supervisory Board, a person occupying a management position and a bank's shareholder. The reporting requirement does not apply to shareholders who own shares quoted on a regulated market that authorizes him to exercise not more than 5 percent of voting rights.

Supervisory verification is entrusted to onsite examiners who will check whether banks have policies and risk-management practices to make credit decisions free of conflicts of interests and on arm's length basis by reviewing credit approval policies and processes, credit committee minutes, loan file reviews, review of outstanding loans to employees, management and shareholders and other procedures detailed in the onsite supervision manual.

**EC 4:** In accordance with Article 139, paragraph 2, the KNF has full access to information in the credit and investment portfolio and to the bank officers involved in assuming, managing controlling and reporting credit risk.

**AC 1:** The KNF does not have a specific requirement that major credit risk exposures exceeding a quantitative threshold should be decided by the banks senior management. Likewise, there is no explicit requirement that credit exposures that are especially risky or otherwise not in line with mainstream bank activities need to be delegated to the Board. That said, there is a provision in the onsite inspection manual that banks should have written procedures for exceptional application

	<p>authorization to be indicated in the management information reports prepared for the management or supervisory Board.</p> <p><b>AC 2:</b> Paragraph 13 of Resolution 383/2008 requires that counterparty risk is included in the bank's risk-management processes. There is however, no explicit requirement for the inclusion of potential future exposure.</p> <p><b>AC 3:</b> Article 105 paragraph 4 of the Banking Act allows banks to act together with the bank economic chamber to establish an organization authorized to collect, process and share information constituting bank confidential information with the banks in so far this information is required in connection with the performance of banking activities. Following this provision the Polish Banking Association and the banking sector established the Credit Information Bureau (BIK). The vast majority of commercial banks in Poland use the BIK's services.</p>
Assessment	Compliant
Comments	<p>Supervisory verification of credit risk is infrequent, given the long credit cycles as described in CP 20.</p> <p>The legal provisions in respect of arm's length credit decisions are comprehensive and detailed. Nevertheless, the KNF could give further consideration to the inclusion of close relatives or affiliations of the persons identified in Article 79, 79a and 79b of the Banking Act. Also, a more general ban for Board members with conflicts of interest to not take part in credit decisions could be envisaged. Indeed, some members of the Board could not be beneficiary of the credit decision but may still be in a position of conflict of interest. This could occur, for example, when the bank approves a credit for the sole supplier of the business interest of a particular Board member.</p>
<b>Principle 9</b>	<b>Problem assets, provisions, and reserves.</b> Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.
Description	<p><b>EC1:</b> While the majority of commercial banks in Poland report under IFRS, some smaller banks still report under Polish accounting standards. Provisioning and reserving practices are governed by the KNF "Recommendation R on guidelines to identify impaired on balance sheet credit exposures, calculate impairment allowances for on balance sheet credit exposures and provision for off balance sheet credit exposures" issued in 2006, for banks using IFRS. The guidelines are also applied to branch offices outside of Poland as well as bank's subsidiaries. They do not apply to branch offices of banks operating in Poland; those entities are required to follow the principles and requirements of home supervisors.</p> <p>The purpose of Recommendation R is to stipulate principles of good practice in the identification of credit exposures that have become impaired and the determination of valuation allowances.</p> <p>Non-IFRS banks are also required to follow the more prescriptive Ordinance of the Minister of Finance of 16 December 2008 ("the Ordinance").</p> <p>All banks are required to implement paragraph 13.1. Of Resolution 383, which requires the establishment of a system for classifying credit exposures to risk categories and establishing provisions for risks related to banks' operations, or a system for identifying credit exposures, which lose their values, a system for credit exposures impairment write-offs, and establishment of provisions for off-balance credit exposures.</p>

Under the Ordinance, banks are required to establish provisions against the risk of their operations and they have to classify the exposures as satisfactory, special mention on impaired, including the substandard, doubtful and loss categories. Reserves should be created and updated at least every quarter in accordance with Paragraph 2.4 of the Ordinance.

**EC2:** During onsite examinations the supervisor assesses the adequacy of the classification and provisioning policies and processes of a bank and their implementation. The KNF allocates a significant amount of time during the inspections for provisioning and reserving and has 19 examiners specializing in asset quality. Additionally, sampling techniques to review a selection of credit exposures during onsite examinations are used. A specific methodology “Principles regarding the sampling of credit exposures” has been developed. The assessors reviewed the section on quality of assets of the onsite examination manual and concluded that it covers the most important areas comprehensively. The offsite supervision department also confirms the adequacy of the classification and provisioning policies and processes of a bank and their implementation. The offsite supervisors also use the B-300 and BS-300 forms (described under EC 5 of CP 10) to assess consistency of provisions for the same borrower across banks.

**EC 3:** Paragraph 1.2. of the Ordinance requires off balance sheet exposures of the borrower to be taken into account when establishing specific provisions and reserves. Under IAS 39 the off balance sheet commitments are also taken into account when establishing provisions.

Additionally, Recommendation R also explicitly requires the inclusion of off balance sheet exposures in the provisioning requirements.

**EC 4 and EC 5:** During onsite examinations, the supervisors assess if the policies and processes are appropriate to ensure that provisions and write offs reflect realistic repayment and recovery expectations. Onsite examiners evaluate if the bank's policies and processes are appropriate and if organizational resources enable the early identification of deteriorating assets and the ongoing monitoring of problem assets as well as the collection of past-due obligations. The assessors confirmed the scope and the depth and specific procedures used during the onsite examinations during a discussion with an examiner specializing in asset quality.

**EC 6:** The prudential reporting system (FINREP/COREP) collects information on bank's assets, liabilities and off balance sheet items, including information on the classification of credit exposures and established specific provisions. The KNF also collects and compares the B-300 and BS-300 forms as described in EC 5 of CP 10.

**EC 7 and EC 8:** In accordance with Article 138 paragraph 5 of the Banking Act, the KNF can make a recommendation to a bank to establish additional provisions or write offs. Additionally, the KNF can order a bank to cease payments from net earnings if it is not satisfied with the compliance of the bank with standards for sound and prudent bank management.

**EC 9:** For banks reporting under the Ordinance, paragraph 5 of the Ordinance specifies proportional factors of collateral value that may not be exceeded when reserves are created. For example, for mortgages maximum 50 percent of the value of an expert's valuation can be offset against the reserve. Banks are required to perform periodic analysis of the market price of mortgage security as part of its collateral reviews. Should the analysis reveal that since the last valuation the

	<p>market price has declined to such an extent that it may have a significant impact on the value of the security, the bank should commission a new valuation, or should justify in writing its decision to refrain from doing so (Paragraph 4.4 of the Ordinance).</p> <p>Recommendation R paragraph 1.3.5. also details specific requirements for IFRS banks with regard to collateral valuation. Valuation of collateral is based on the recoverable amount taking into account legal, economic and actual limitations that might affect the possibility of repayment (net realizable value).</p> <p>Onsite supervisors assess the types and valuation procedures for risk mitigants that are used by a bank.</p> <p><b>EC 10:</b> The principles for the classification of assets in the Ordinance are based on two simultaneous criteria: repayment performance and economic-financial condition of the debtor.</p> <p><b>EC 11:</b> In accordance with Resolution 383, banks should have their own internal procedures and policies to ensure the Boards receive timely and appropriate information of the bank's asset portfolio including classification of credits, the level of provisioning and major problem assets. During onsite inspections supervisors assess whether the reporting processes regarding credit quality and reserves are adequate.</p> <p><b>EC 12:</b> Banks have to create specific provisions on an individual basis. The valuation, classification and provisioning of large exposures is also verified using the B-300 and BS-300 forms as described in more detail in EC 5 of CP 10 below.</p> <p><b>AC 1:</b> The Ordinance requires loans to be classified when payments are contractually a minimum number of days in arrears. Restructured credit exposures may be upgraded to the next risk category no earlier than three months regular payments for exposures to natural persons. For other exposures they may only be upgraded on recovery by the obligor of the full creditworthiness, but not earlier than three months after payment of both principal and interest.</p>
Assessment	Compliant
Comments	The SREP process will provide additional information that will further assist KNF's supervisors to evaluate provisioning and reserving policies and processes. It remains, however, crucial that frequent onsite inspections are performed to ensure that the policies and procedures are properly implemented.
<b>Principle 10</b>	<b>Large exposure limits.</b> Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.
Description	<p><b>EC 1 and EC 2:</b> All banks, including branches of foreign banking organizations are subject to the limits on large exposures to a single counterparty or a group of connected counterparties.</p> <p>Article 71 paragraph 2 defines a large exposure as 10 percent of own funds. Article 71 paragraph 1 limits the total amount of a bank's claims on a consolidated and solo basis—including off balance sheet liabilities and shares or participations held by a bank directly or indirectly in another entity—in a single entity or to entities linked by organization and capital to a 25 percent of own funds concentration limit.</p> <p>Entities linked by organization and capital are generally understood to have minimum 20 percent capital participation.</p>

	<p>Also, the aggregate amount of bank's exposures equal or in excess of 10 percent of its own funds shall not exceed the large exposure limit of 800 percent of own funds. Exposures excluded from the large exposure limits are exposures on Public Sector Entities are detailed in Resolution 382/2008 in line with Art 71 paragraph 4 of the Banking Act. Annex 1.6 of this Resolution also details the treatment of collateral and guarantees for the large exposure calculation. The KNF has the power to deem particular counterparties connected in accordance with Article 4a, paragraph 1 of the Banking Act. This provision has not yet been used in practice.</p> <p><b>EC 3:</b> Onsite examiners verify large exposures calculations during examinations. They also verify that senior management monitors the limits of connected clients. Any breaches need to be reported to the KNF immediately in accordance with Article 71 paragraph 6 of the Banking Act.</p> <p><b>EC 4:</b> Recommendation C concerning the management of risk related to credit concentration details the specific risk-management requirements for banks. It includes the recommendation to set prudent internal limits as well as good practice principles like periodic review of credit concentrations and exposure concentrations related to derivative transactions. Supervisory verification takes place at onsite examinations.</p> <p><b>EC5:</b> A bank's management Board is required to inform the KNF immediately when the bank's exposure reaches or exceeds the level of 10 percent and 25 percent of the bank's own funds as well as when case the aggregate sum of large exposures exceeds 800 percent in accordance with Article 71, paragraph 6 of the Banking Act. Banks in Poland are also required to report all exposures in excess of PLN 500,000 (approximately 125,000 EUR) in case of commercial banks and PLN 100,000 (approximately 25,000 EUR) in case of cooperative banks to the KNF. Reports on a solo basis (B-300 forms) are submitted monthly and the consolidated forms (SB-300 forms) are submitted quarterly. Exposures include on and off balance sheet exposures. Identification of borrowers is facilitated through the use of the unique Polish identification numbering system for natural and legal persons. Foreign entities and their owners or stakeholders are registered separately, divided into countries. The reports are used by the KNF to monitor industry, territorial and monetary concentration risks in the banking sector and to identify (groups of) individual borrowers.</p> <p><b>AC 1:</b> Article 71 of the Banking Act is in alignment with the limits stated in this criterion.</p>
Assessment	Compliant
Comments	
<b>Principle 11</b>	<b>Exposures to related parties.</b> In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflicts of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.
Description	<b>EC 1, EC 2:</b> Although there is no comprehensive definition of "related parties," the Banking Act (Article 79) prohibits the application of a more favorable treatment to exposures (both on-balance sheet and off –balance sheet) to the following categories of entities and persons:

- 1) its parent undertakings or subsidiaries;
- 2) undertakings operating within the same group as the bank;
- 3) subsidiaries and associates of the bank;
- 4) its own shareholders or members;
- 5) the bank's employees, members of the management Board and members of the supervisory Board;
- 6) the parent undertaking's employees, members of the management Board and members of the supervisory Board of the parent undertaking; and
- 7) undertakings linked by capital or management to a shareholder, member of the management Board or the supervisory Board of the bank, or a person occupying a managerial position in the bank.

The enumeration is not fully aligned to the broad range of related parties referred to in the footnote to this EC, failing to include other categories of persons who may also raise a potential conflict of interest such as close family members of the bank's major shareholders, members of management and supervisory Board, and persons occupying managerial positions in the bank or corresponding persons in affiliated companies. However, some of the onsite monitoring tools used by the KNF (i.e., form B0700) capture exposures to relatives of the members of the bank's management and supervisory Boards.

**EC 3, EC 4:** The Banking Act (Article 79.a.1-3) requires that banks have internal rules adopted by the supervisory Board for extending loans, cash advances or other guarantees to management or supervisory Board members, to persons occupying managerial positions in the bank or to undertakings linked by capital or management to such persons.

Also, according to Article 79.a.2, exposures exceeding EUR 10,000 to the members of the management or Supervisory Boards, persons occupying a managerial position, or to undertakings linked by capital or management to such persons are approved by the Management Board and the Supervisory Board of the bank without the participation of the persons concerned (Article 79a).

The law does not specifically require to exclude other members of the Board with a potential conflict of interest from the decision making process. The implementation of internal policies and processes related to exposures to related parties is checked during onsite examinations (see EC 6).

**EC 5:** Exposures to members of the management Board, supervisory Board, or a person occupying a managerial position and to the undertakings linked by capital or management to such persons are limited to 10 percent of the total required capital of banks and 25 percent of the total required capital or cooperative banks (Article 79.a.4).

Limits to other related parties follow the large exposure regime applicable (maximum 25 percent of the bank's capital according to Article 71.1. of the Banking Act). The current limit of the bank's exposures to a parent and subsidiary undertakings is 20 percent of the bank's capital (Article 71.2. of the Banking Act).

KNF Resolution 381/2008 requires that the institution's own funds are deducted by qualified participations in financial holdings. Also, according to KNF Resolution

	<p>no. 382/2008, exposures to related parties that are subject to a consolidated supervision together with the bank may be exempted from the large exposure limits on a case by case basis.</p> <p><b>EC 6:</b> KNF Resolution no. 384/2008 of the KNF stipulates the risk-management principles for exposures to related parties as specified in Article 79.1 of the Banking Act. Under this framework, exposures to related parties are considered a concentration risk, which has to be managed by bank on individual and consolidated basis (paragraph 2).</p> <p>According to the Annex to KNF Resolution no. 384/2008, banks are required to meet minimum quality requirements concerning the identification, measurement, monitoring and control of risks stemming from exposures to such related parties, among others, including: the responsibility of the management Board for organizing the process of managing such risks and the periodic review by the internal audit unit of all the exposures to specified related parties.</p> <p>During onsite examinations, the KNF verifies the internal policies and procedures concerning related parties exposures on an individual and aggregated basis. The KNF pays particular attention to the identification of exposures to related parties, conditions related to such exposures (i.e., interest rate charged, period of loan, etc.), applicable limits, and whether exceptions to policies, processes and limits are reported to the appropriate senior management level and, if necessary, to the Board of Directors/supervisory Board.</p> <p>However, the KNF does not seem to perform more qualitative judgments on integrity and conflicts of interest on related party issues under the general risk-management framework implemented by banks.</p> <p><b>EC7:</b> The KNF performs a quarterly review of the scale of exposures and limits applicable to exposures to related parties by compiling information from forms B0300 and B0700. The B0300 reports provide information on exposures over PLN 500,000 for banks and over PLN 100,000 for credit cooperatives, indicating relations with the client, i.e., capital dependencies, participation in the management and supervisory Boards of the bank or whether relatives of such persons, employment relationship with the bank etc. Such information is compared with reports B0700 under which banks report about their capital and personal connections with beneficiaries of above-mentioned exposures or their relatives or shareholders.</p> <p>In addition, the KNF receives monthly information on the “Amounts payable and amounts receivable from, related parties” prepared under the FINREP framework.</p> <p>According to the Banking Act (Article 79b) a bank is required to notify the KNF regarding exposures exceeding EUR 30,000 to a member of the management Board or the supervisory Board, a person occupying a managerial position, bank’s shareholder, member of a cooperative bank and an undertaking linked to the bank by capital or management.</p>
Assessment	Largely compliant
Comments	The legislation should be amended to include in the range of related parties some other categories of persons who may raise a potential conflict of interest such as close family members of the bank’s major shareholders, members of the management and supervisory Board, persons occupying managerial positions in the bank, or corresponding persons in affiliated companies. There are no other legal provisions in the Polish legislation requiring banks explicitly to take all reasonable

	measures to prevent conflicts of interest within their more general risk-management framework and thus the powers of the KNF for conducting such assessments and imposing related measures are in practice limited, a fact that is recognized by KNF.
<b>Principle 12</b>	<b>Country and transfer risks.</b> Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring, and controlling country risk and transfer risk in their international lending and investment activities and for maintaining adequate provisions and reserves against such risks.
Description	<p><b>EC 1:</b> There are no specific regulations or prudential limits in place for country risk or transfer risk as these risks are expected to be captured in the overall credit risk-management framework, more in particular as a concentration risk. The scope of Resolution no. 384/2008 includes country or geographical concentration risk. It states banks are obliged to manage concentration risk on both a solo and a consolidated basis including risk connected with exposures to entities from the same geographical region, as well as from various countries. When setting country concentration limits, Annex 5 paragraph 5 to the Resolution 384/2008 demands a bank take into account relevant and reliable data and information about the economic and political situation in particular countries as well as other risks that may influence concentration risk (political risk). Moreover, Recommendation C on credit concentration states that limits should be approved by the management Board. Finally, the KNF has informally informed banks that it will not allow them to do business with counterparties in countries that are blacklisted by the Financial Action Task Force (FATF). The authorities state that such a list is available on the Polish section of its website.</p> <p>Country risk arising from the off shoring of activities by Polish banks needs prior supervisory approval in case the activity is outside of the EEA.</p> <p><b>EC 2:</b> It is general practice for banks in Poland to monitor country risk on an individual country basis. Additionally, country risks from EAA countries are often also monitored.</p> <p><b>EC 3:</b> There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. The bank itself decides on the provisioning for country risk according and the level will then be judged by the external auditor and by the supervisor.</p> <p><b>EC 4:</b> One of the major tools in monitoring country risk is the B-300 forms. As described under Core Principle 10 banks in Poland are required to report all exposures in excess of PLN 500,000 (approximately 125,000 EUR) in case of commercial banks and PLN 100,000 (approximately EUR 25,000) in case of cooperative banks to the KNF. Reports on a solo basis (B-300 forms) are submitted monthly and the consolidated forms (SB-300 forms) are submitted quarterly. Exposures include on and off balance sheet exposures and country risk identification is possible through the use of a country code for each exposure. The KNF then prepares summary reports for individual country exposures. The main country risk concentrations in the Polish banking system are the United Kingdom, France, and Germany although they are still very small (less than 0.70 percent). If country risk becomes material for a Polish bank, the KNF may demand that the institution establishes country exposure limits. From the analytical review of the B-300 and the SB-300 forms, the KNF has concluded that there is currently no need to establish formal country limits applicable to all banks. It has also not imposed country risk limits for any of its banks.</p>



Assessment	Compliant
Comments	
<b>Principle 13</b>	<b>Market risk.</b> Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor, and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
Description	<p>Most commercial banks in Poland have trading books and they are mainly exposed to interest rate and FX risk. Exposures to equity and commodity risk are relatively limited. Resolution 76/2008 separates the trading book from the banking book, despite the issuance of a number of overarching recommendations by risk category by the KNF.</p> <p>Banks use the internal model approach for capital calculation. The approval and periodic assessment is performed by specialists from the validation unit within the onsite supervision division and the qualitative and quantitative requirements for models approval are outlined in Resolution 76/2008.</p> <p><b>EC 1:</b> Paragraph 7.1. of Resolution 383/2008 allocates the responsibility for the development, implementation and updating of written policies, strategies and procedures relating to the risk management, internal control system, assessment of internal capital and review of processes of assessing and maintaining internal capital to the management Board. Specifically, with regard to market risk paragraph 13 of the above-mentioned resolution requires that as part of the strategies and risk-management procedures, banks shall introduce in particular procedures aimed at measuring and managing market risk elements that the bank considers important.</p> <p>The supervisory expectations in the area of risk management and internal controls are further detailed in the onsite supervision manual. During onsite inspections policies and procedures as well as the actual implementation in the area of strategy and policy, oversight by supervisory Board, management and specific risk committee, and internal and external audit are verified. Examiners also confirm that management understands the market risk embedded in the activities and products. They also obtain comfort that management reviews the market risk-management information they receive and that they understand the implications and limitations of this information. During onsite examinations the independent validation of the market risk models is also reviewed. Supervisors review the model documentation and interview personnel responsible for validation.</p> <p><b>EC 2:</b> Paragraph 17.1 of Resolution 383/2008 demands that, regarding all types of risks, 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. The paragraph specifies that the internal limits require Board or Board committee approval (paragraph 17.1.2); that rules for updating and establishing the limit system as well as the monitoring frequency and the periodic reporting need to be determined in the internal regulations (paragraph 17.1.3); that limits need to fit in the risk appetite set by the supervisory Board (paragraph 17.1.4); and that analyses on which the limit values are based need to be in writing (paragraph 17.1.5.).</p> <p>Onsite examiners ensure that banks have limits with regard to interest rate and FX risk, and other categories of market risk if applicable. They also verify how the limits are set, the frequency and structure of the monitoring process, the escalation procedures when limits are breached. Specific work programs and procedures in this respect are included in the onsite supervision manual. Approval of specific limits is</p>

	<p>generally the responsibility of the bank's management or of the Assets and Liabilities Committee (ALM Committee).</p> <p>The KNF issued Recommendation A concerning management of risk related to derivatives transactions executed by banks in 2010. The recommendation is not specific to the trading book or to market risk, but the authorities state that the vast majority of derivatives exposures of banks would be recorded in the trading book.</p> <p><b>EC 3:</b> Paragraph 7 of Annex 3 to the Resolution 76/2010 Part II requires that banks establish and maintain systems and controls to provide for prudent and reliable valuations of positions. Systems and controls should at least include documented policies and procedures for the process of valuation, which define responsibilities during the various stages and duties in the valuation process, sources of market information and review of their adequacy. Also included are requirements regarding the frequency of the independent valuation, the timing of closing prices, the procedures for adjusting valuations and month-end and ad-hoc verification procedures.</p> <p>Specific requirements to ensure the frequency, reliability and conservatism for mark-to-market valuation have also been developed.</p> <p>Paragraph 11 and 12 of the Annex 3 to the Resolution 76/2010 require that the bank develops procedures in the area of valuation adjustments and reserves.</p> <p>Detailed rules for less-liquid positions are detailed in paragraph 13.1. of the Annex mentioned above.</p> <p>Supervisory verification is performed during onsite inspections. The onsite supervision manual lists the procedures to be carried out in the area to verify proper valuation of market risk positions.</p> <p><b>EC 4:</b> Resolution 383/2008 paragraph 16.1 calls for the use of stress tests as part of risk-management processes and procedures for all risk categories. In the market risk area, this is reinforced by the stipulations in paragraph 1.5 "Market risk" of Recommendation A concerning management of risk related to derivatives transactions executed by banks. It requires that stress tests constitute an integral part and be embedded in the risk-management structure of the bank. Stress tests can include sensitivity analysis, scenario analysis, maximum loss approach and extreme value theory. Likewise, Recommendation A requires that the stress testing process is documented, including documentation of the contingency plan in cases of materialization of any individual scenario.</p> <p>In the area of testing and valuation of market risk, Resolution 383/2008 paragraph 15.4 demands that regarding all types of risk, the methods (models) or the risk measurement systems in use, in particular their assumptions, are subject to periodic internal evaluation that includes testing and historical back testing.</p> <p><b>AC 1:</b> Paragraph 10.5 of the Annex to Resolution 76/2010 requires that in addition to daily marking to market or marking to model, the bank performs independent verification of prices consisting of checking market prices or input data for the model in terms of accuracy and independence, at least once a month, or depending on the nature of the trading activity, more frequently. Verification of market prices and input data for the model is independent from the bank's front office that concludes the operations. When pricing sources are not available or are subjective, the banks use</p>
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	valuation mechanisms. Paragraph 10.4.4. of the above Resolution stipulates that models should be developed independently from the front office concluding the operations and shall be independently tested including the validation of the calculation formulas and assumptions. In case the model is developed by the bank, it should be based on assumptions that have been estimated and validated by qualified persons independent of the development process.
Assessment	Compliant
Comments	Although the KNF has introduced separation between the trading and the banking book in Resolution 76/2008, it is recommended that separation be more apparent in the other regulations and recommendations of the KNF. The current regulations by risk category do not refer to the separation requirements in 76/2008.
<b>Principle 14</b>	<b>Liquidity risk.</b> Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor, and control liquidity risk and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.
Description	<p><b>EC 1:</b> According to Article 8 of the Banking Act, banks are required to maintain adequate liquidity, corresponding to the scale and types of activities conducted, in a manner that ensures that all cash liabilities are fulfilled according to their maturity dates.</p> <p>Also, the KNF is empowered by the Banking Act (Article 137.3.) to establish mandatory liquidity standards and to take the necessary measures to restore payment liquidity (Article 138.1.1.).</p> <p>The banks' liquidity management framework consist of qualitative and quantitative standards set by the KNF in:</p> <ul style="list-style-type: none"> <li>- Recommendation P for banks concerning liquidity monitoring systems (published in 1996 and revised in 2002);</li> <li>- Resolution 383/2008 on detailed rules and risk and internal control management system, specifying basic requirements for banks' strategies and procedures for liquidity risk management;</li> <li>- Resolution 386/2008 on the establishment of liquidity standards binding for banks, which includes quantitative standards for short-term and long-term liquidity management.</li> </ul> <p>In addition, the KNF collects information on each bank's assets, liabilities and off-balance sheet items, including information on loans/deposits maturities though the FINREP reports.</p> <p>According to the qualitative requirements for liquidity risk management, banks and the branches of credit institutions must have written internal rules for maintaining their liquidity at a level commensurate with the scale and type of their operations, including an organization chart of liquidity management stipulating the division of powers and responsibilities, methods for reducing liquidity risk, including a set of internal limits, contingency action plans ensuring undisturbed conduct of business in the event of a crisis situation, and rules for determining the position in foreign currencies.</p> <p>The banks' internal liquidity rules have to take into account the time-dimension (immediate, current, short, medium-term and long-term liquidity), for long-term liquidity management, analyses of maturity mismatches and the capacity to access</p>

	<p>future funds and their costs forecasts of cash inflows and outflows, and an assessment of the impact of the bank's subsidiaries and other entities related to it by capital or by management, on the bank's level of liquidity.</p> <p>Banks are required to verify the principles of cash flow liquidity management at least yearly, in order to adjust them to the size and type of business and in the event of substantial changes of external factors (e.g., including factors related to strategic objectives e.g., economic sector or geographic region).</p> <p>Resolution No. 386/2008 also establishes quantitative standards for liquidity risk management, i.e., banks and branches of banks have to maintain short and long term liquidity measures, as follows:</p> <p>Short-term liquidity measures:</p> <ul style="list-style-type: none"> <li>- short-term liquidity ratio (ratio between the sum of primary and supplementary value of liquidity reserves and the value of external unstable funds) with a minimum value of one.</li> </ul> <p>Long-term liquidity measures:</p> <ul style="list-style-type: none"> <li>- non-liquid assets to own funds ratio (ratio of the bank's own funds less the aggregate value of capital requirements for market risk and delivery settlement risk and counterparty risk to nonliquid assets) with a minimum value of one; and       <ol style="list-style-type: none"> <li>1. non-liquid and limited liquidity assets to own funds and stable external funds ratio (the quotient of the total of own funds, less the total value of the capital requirements for market risk and delivery and settlements risk, and counterparty risk and stable external funds to the sum of nonliquid assets and limited liquidity assets) with a minimum value of one.</li> <li>2. The resolution provides clear guidelines for determining the categories of assets, liabilities and off-balance sheet items to be included in the calculation of the supervisory liquidity measures. Also, the calculation of liquidity measures takes into account all currencies (7.1). For significant inconvertible foreign currencies, a separate analysis of liquidity is conducted for each of these currencies (7.5).</li> </ol> </li> </ul> <p>Banks should comply with limits of short- and long-term liquidity on a daily basis and must report monthly their liquidity position. Banks with an average monthly value of assets below PLN 200 mil. follow more simplified procedures. Also, branches of credit institutions are exempted from the requirements to calculate and comply with long-term supervisory liquidity measures.</p> <p><b>EC 2 and EC 3:</b> Banks have to comply with the general rules for risk management stipulated in KNF Resolution no. 383/2008 and with specific requirements for liquidity management. Banks are required to have:</p> <ul style="list-style-type: none"> <li>- a liquidity management strategy, part of the general operation strategy, approved by the Supervisory Board; and</li> <li>- policies and procedures to identify, measure, monitor and control risks, developed in writing and approved by the bank's Management Board or appropriate committees appointed by the Board (see EC1).</li> </ul> <p>During onsite comprehensive examinations, the KNF assesses the adequacy of liquidity management strategy and of the internal policies and procedures concerning liquidity risk management. Examiners verify if policies and procedures</p>
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are approved by the Management Board of the bank, and whether they are subsequently implemented. Examiners analyze if policies and procedures are comprehensive and cover all relevant topics, including methods of liquidity measurement, management of deposit funding, introduction of new products, monitoring and control of liquidity, system of limits, relevant aspects of the management information system on liquidity, and contingency planning and organizational aspects regarding management and control of liquidity risk.

The adequacy of oversight carried out by the Supervisory Board, the Management Board and dedicated committees of the bank is also assessed through the analysis of the quality and frequency of information contained in relevant documents.

**EC 4:** In addition to the measurement of net funding requirements referred to in EC1, the KNF requires that banks' policies and processes for liquidity management include provisions on conduct under various scenarios and changes in market conditions. Banks have to analyze their funding sources in terms of diversification and concentration. Management practices should reflect the ability of the bank to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets while limiting losses.

On-site examiners analyze if the bank established appropriate measures and limits concerning concentrations. The KNF confirms that adequacy of implementation of such internal procedures and limits are also verified. Furthermore, the KNF evaluates whether funding practices limit a bank's reliance on funding sources that may not be available in times of financial crisis or adverse changes in market conditions. The banks are expected to include off-balance sheet commitments in the identification of liquidity risk concentrations.

Cross-risk dependencies including the impact of the credit, market, operational as well as other risks on liquidity are also considered when examining the bank procedures and processes.

During onsite examinations, the KNF assesses if the bank processes involve periodic reviews and assessment of liquidity risk measurement methods to conclude the adequacy and validity of risk measurement methods and assumptions on which they rest.

**EC5 and AC1:** Banks are required to have rules concerning the identification, measurement, control and limitation of their liquidity level in each currency, especially in significant currencies in which they conduct activities (Recommendation P, Chapter II).

Banks are required to ensure their access to different sources of liquidity in each foreign currency and perform a separate analysis of liquidity under normal and stressed conditions, including forecasts of cash flows taking into account the impact of potential fluctuation of the exchange rate on the level of liquidity. The KNF considers that it receives sufficient information to allow identification of those banks where foreign exchange liquidity is subject to substantial fluctuations.

This process is verified during onsite examinations, when the KNF analyzes if banks carrying out significant foreign currency liquidity transformation implemented appropriate arrangements to manage the liquidity in each significant individual currency. Examiners review if banks active in multiple currencies have access to diverse sources of liquidity in each currency (e.g., received commitments to provide

	<p>funding) and whether banks established targets related to funding in different currencies.</p> <p><b>EC 6:</b> According to KNF Recommendation P/2002, banks are required to have contingency plans to ensure the smooth conduct of business in the event of liquidity.</p> <p>Banks should submit the contingency plans to the KNF; however, no specific frequency for submission is stipulated in the regulations. For the systematically important banks, the KNF confirms that it collects updated liquidity contingency plans on an annual basis.</p> <p>Contingency plans are reviewed in more detail during onsite examinations. Examiners review if the bank has contingency plans in place, including plans for obtaining funds from alternative sources. The examiners verify if plans precisely define the reaction of the bank both to liquidity crisis resulting from the specific situation of this bank (for example, damage of bank's reputation), and to liquidity crisis of a systemic nature (for example, liquidity disturbances at the market) and the mix of these two scenarios.</p> <p><b>AC 2:</b> The KNF analyzes the level of engagement with bank's liability holders as part of the contingency planning assessment.</p>
Assessment	Compliant
Comments	<p>The regulatory framework for liquidity management is generally adequate, providing a good mix of qualitative and quantitative requirements.</p> <p>Assessors also ascertain that there is a great degree of reliance on the commitments made by foreign parents of local banks to provide liquidity support when needed. In this regard, the KNF could ask banks as part of the liquidity contingency plans to take into consideration more closely situations of inability of parent banks to fulfill their funding commitments.</p> <p>The KNF considers that the current approach for liquidity management (i.e., short term and long term liquidity measures) is broadly in line with the proposed Basel III standards. The KNF estimates that most banks will be compliant with the liquidity coverage ratio requirements, while compliance with the net stable funding ratio will depend on further calibration of the indicator (i.e., severity of scenarios to be applied).</p>
<b>Principle 15</b>	<p><b>Operational risk.</b> Supervisors must be satisfied that banks have in place risk-management policies and processes to identify, assess, monitor, and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.</p>
Description	<p><b>EC 1:</b> Resolution no. 383/2008 of the KNF provides the general risk-management principles for banks, which are also applicable to operational risk management (see CP 7). Resolution no. 383/2008, para. 13.8. also specifies the requirements for operational risk management, such as:</p> <ul style="list-style-type: none"> <li>a) operational risk-management procedures;</li> <li>b) plans for maintaining continuity of operations and contingency plans ;</li> <li>c) policy for selecting, supplementing and monitoring the personnel needs and human resources planning; and</li> <li>d) rules for managing outsourcing risks.</li> </ul>

	<p>Additional standards relevant to operational risk management are specified in Recommendation M/2004 concerning the operational risk management in banks, which is based on the Basel Committee's "<i>Sound Practices for the Management and Supervision of Operational Risk.</i>"</p> <p>Under the Basel II framework, implemented in Poland since 2007, the KNF requires banks to hold capital against operational risk. The capital allocated for operational risk accounted for about 11 percent of the total regulatory capital over the past two years.</p> <p>The approaches for calculating operational risk capital charges and the specific criteria are specified in KNF Resolution no. 76/2010. In 2010, about half of the commercial banks (23) and all credit cooperatives used the Basic Indicator Approach (BIA) (23) while the others (26) used the Standardized Approach (STA). One application for using the Advanced Measurement Approach (AMA) has been cleared by KNF and is currently waiting for formal endorsement from the home supervisor.</p> <p>KNF approval is required only for those banks intending to use AMA. Thus, since the Basel II implementation, banks have had discretion to choose between the BIA application (simple capital charge calculation, low risk sensitivity) or STA (intermediate approach, more risk-sensitive, and enhanced internal procedures, resources and oversight in use of the approach for the bank's major business lines). The supervisor's approval is not required for migrating from BIA to STA and, so far, five banks have switched to the intermediate approach. In practice, the KNF would only learn about such change in the capital charge calculation from the regular COREP reports submitted by banks.</p> <p>The KNF has applied enhanced scrutiny for approving AMA models and has rejected applications that did not have adequate internal oversight, including capacity of internal audit.</p> <p>The onsite assessment of the adequacy of operational risk management is guided by the specific section of the Onsite Examination Manual for Operational risk, IT risk and Electronic Banking, which is also made available to banks to enable a better understanding of supervisory expectations. The KNF investigates whether a bank has in place internal regulations and procedures to identify, assess, monitor and control/mitigate operational risk (including IT risk, legal risk and risk related to outsourced activities), which are aligned with the bank's operations and risk profile. Banks are expected to collect data on their major operational risk losses organized by business lines and event-types; key risk indicators to identify and monitor main areas of operational risk and scenario analysis and/or stress testing with respect to the identified key areas of operational risk.</p> <p><b>EC2 and EC3 (see also EC1):</b> During onsite examinations, the KNF assesses the quality of the oversight of the management Board over the operational risk-management. In particular, the KNF verifies whether the bank's strategies, policies, processes, and organizational structures for the management of operational risk are approved by the management Board (and/or other relevant decision making bodies), and whether they are regularly reviewed and updated to reflect the complexity of operations and risk profile of the bank. In performing such assessment, the KNF uses internal management documents (minutes of the Boards, internal control reports, etc.) and holds discussions with the bank's management, internal audit and other relevant staff. In particular, the KNF verifies</p>
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	<p>whether the supervisory and management Boards regularly receive and analyze results of controls carried out by internal audit and, in case of identification of deficiencies, take the appropriate actions to correct them.</p> <p><b>EC 4:</b> According to Recommendation M/2004, banks need to take measures for protecting themselves against the effects of unforeseeable events (i.e., external resources failure, acts of vandalism, war or catastrophes). According to para.3.2., banks should have plans for maintaining continuity of operations, contingency plans, designated alternative suppliers or services, duplication of processes, storing back-up copies of software, data replication capabilities, alternative processes and systems, insurance protection etc.</p> <p>The quality and comprehensiveness of a bank's business continuity plans and disaster recovery plans are reviewed during the onsite examinations. Although there are no specific legal requirements, the KNF expects banks to review business continuity maintenance plans periodically and conduct time-to-time business continuity plans test. At the minimum, emergency plans should include the critical or the most important elements and processes of the bank.</p> <p>The assessment of the operation of settlement and payment systems falls under the NBP responsibility (according to Article 17.4.3. of the Act on the National Bank of Poland).</p> <p><b>EC 5:</b> According to Recommendation M/2004 (para. 2.1.), a bank should establish and implement a system of management and control of information communication and technology (ICT), aimed at ensuring adequate organizational and reporting systems for technological processes (including oversight of senior management), cohesion of ICT developments with the general strategy of the bank, adequate procedures for acquisition, development and maintenance of ICT systems, and adequate support for ICT systems operations.</p> <p>Selected standards and supervisory requirements relevant to IT policies and related business resumption and contingency planning are contained in Recommendation D on the management of IT and telecommunications risk, issued in 1997 and further amended in 2002. However, a major shortcoming in the Polish legislation is the lack of requirements for the IT systems in banks to comply with internationally accepted standards for IT security. Security and integrity of IT systems is a key element of the operational risk management and becomes particularly relevant for banks using advanced models dealing with large amounts of data to be collected and processed.</p> <p>According to Recommendation D, independent IT audits have to be conducted regularly, and every time when significant changes in the IT systems are introduced. However, the legal requirements lack specificity in respect to the requirements applicable to IT audits. The KNF does not have inspectors with IT background and such specialized experience has been developed over the years.</p> <p><b>EC 6:</b> The main reporting mechanisms applicable to banks in the domain of operational risk refer to:</p> <ul style="list-style-type: none"> <li>- the submission of the COREP templates (involving the reporting of the capital charge for operational risk), which are analyzed by the offsite analysts; and</li> <li>- the notifications and requests for KNF approval for, <i>inter alia</i>: intention to conclude an agreement with an outsourcer (the bank's external service</li> </ul>
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	<p>provider), whose registered office is outside the European Economic Area, or when the activities are to be performed outside Poland (see EC 8); proposed mergers and changes in control; using statistical methods to calculate capital requirements.</p> <p>Starting from 2010, within the BION process, banks are required to report to the KNF on an annual basis comprehensive information collected for operational risk monitoring and to describe the tools for the management of operational risk including scenario analysis; risk and control self assessments; scorecards; key risk indicators; risk assessment processes for information security risk and business continuity, internal audit, and internal control assessments.</p> <p>Banks are not required to report to the KNF incidents of fraud when they are material to their safety, soundness or reputation (see CP 18).</p> <p><b>EC 7:</b> According to the definition of operational risk provided in para. 1 of Annex XIV to Resolution no. 76/2010 of the KNF, operational risk includes legal risk. Also, according to the KNF Resolution no. 383/2008 banks should implement their own definitions of the operational risk, which should include legal risk.</p> <p>Some general provisions regarding the compliance risk and the compliance function are comprised in Article 9.c. of the Banking Act and in Resolution 383/2008; however, the legal framework lacks specificity regarding, for example, requirements for the compliance function (independence, resources, and responsibilities), relationship with internal audit, etc.</p> <p><b>EC 8:</b> Outsourcing risk is an integral as part of the banks' operational risk management. According to Banking Act, the bank and the external service provider are required to have plans of activity ensuring continuous and uninterrupted operation within the scope covered by the agreement (Article 6.c.1.3).</p> <p>Restrictions on outsourcing by banks, the scope of the outsourced activities and the requirements for the service providers are stipulated in the Banking Act and in the KNF Resolution no. 379/2008. For example, outsourcing of bank's management and internal audit of the bank are strictly prohibited (Article 6.a.2 of the Banking Act). These regulations allow the KNF to exercise detailed and ongoing oversight of tasks outsourced by banks.</p> <p>Banks have to notify the KNF the intention to conclude, amend, or terminate an agreement with outsourcers (Article 6.c.1.). KNF approval is required before concluding an outsourcing agreement with an outsourcer whose registered office is outside the European Economic Area, or when the outsourced activities are to be performed outside Poland (Article 6.d. of the Banking Act). Approvals are handled by the offsite division of the KNF.</p> <p>According to Recommendation M/2004, a bank is responsible for controlling quality of outsourced activities (para.4.). In this purpose, agreements concerning outsourced activities should be detailed, with divided responsibilities.</p> <p><b>AC 1:</b> According to KNF Resolution no. 383/2008 (para. 21), banks are required to monitor risks associated with the activities of their subsidiaries. Also, 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 followed by the bank at</p>
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	<p>the solo level, with due consideration of the type of activities conducted by these entities. The bank shall assess the size and profile of risk underlying the activities of its subsidiaries (para. 21.3).</p> <p>Recommendation M/2004 also covers the aspect of operational risk management applied on group-wide basis (Chapter V.3).</p> <p>During onsite examinations, the KNF investigates if a bank has implemented consistent operational risk-management policies and processes across the group, and if a bank evaluates influence of other entities of the group on a bank risk profile and situation.</p> <p>The offsite monitoring focuses on the analyses the banks' consolidated financial statements and financial statements of subsidiary undertakings and the financial statements of undertakings, which the bank has close links to that have not been included in the consolidated financial statements drawn up by the bank. In addition, supervisory analysis of a group-wide operational risk and risk management also draws upon public disclosures of financial and managerial information.</p>
Assessment	Largely compliant
Comments	<p>While separate criteria for the use of the three methods for calculating capital requirements for operational risk are provided in KNF Resolution no. 76/2010, the discretion left to banks in using STA method for calculating the operational risk capital charge may potentially lead to regulatory arbitrage (through a capital relief effect). The KNF should introduce a supervisory procedure for evaluating the capacity of banks to meet the criteria for the standardized approach implementation and should be able to fully control transition between the two more simplified approaches. This would mark a closer alignment to the Basel II framework which explicitly states that supervisors should be satisfied that a bank meets enhanced requirements (qualifying criteria) before implementing a more advanced approach and may exercise the right to insist on a period of initial monitoring of a bank's STA before it is used for regulatory capital purposes.</p> <p>Assessors also recommend that the KNF requires banks to make a comparison between the capital requirements with the banks' actual inherent operational risk to confront their capital requirement (risk bearing capacity) with the expected and historical losses and worst case scenarios.</p> <p>The regulations should impose more specific requirements regarding the IT audit in banks, in particular regarding the scope, the frequency and the specification of a minimum set of requirements. Particularly, for banks moving to the advanced Basel II approaches, the IT requirements should be more strictly assessed.</p> <p>Finally, the compliance function should be more specifically addressed in the regulations through a closer alignment with the relevant BCBS 2005 principles for Compliance and the compliance function in banks.</p>
<b>Principle 16</b>	<p><b>Interest rate risk in the banking book.</b> Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor, and control interest rate risk in the banking book, including a well-defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.</p>
Description	<p>More detailed requirements for IRRBB are stipulated in Recommendation G concerning interest rate risk management in banks issued in 2002.</p>

	<p>According to Recommendation G, the bank's management Board is responsible, i.e., for:</p> <ul style="list-style-type: none"> <li>- organizing and supervising the interest rate risk-management system, in line with the strategy and general principles of the bank's policies, including the risk profile and the acceptable interest rate risk approved by the bank's supervisory Board (rec.1);</li> <li>- ensuring that the interest risk management is comprehensive, both in nature (taking into account all types of interest risk material for the bank) and in scope (by taking into consideration all the units of the bank, including foreign branches), (rec. 3); and</li> <li>- preparing and ensuring implementation of written policies and procedures for interest risk management, including internal limits for maintaining the overall bank's exposure to interest rate risk (rec. 6), which should take into account the results of the regular measurement of bank's vulnerability to incur losses caused by adverse economic conditions, including failure of the key assumptions (rec.7).</li> </ul> <p>The KNF monitors compliance with the IRRBB risk principles in the course of its onsite examinations, focusing on the following areas:</p> <ul style="list-style-type: none"> <li>- the adequacy of oversight carried out by the supervisory and management Boards and specialized committees of the bank;</li> <li>- whether periodic independent reviews and assessment of policies and procedures are conducted by the internal audit; and</li> <li>- the reasonability of the assumptions of the strategy and whether they are based on risk tolerance, ability of the bank to adopt its activities to changing market environment, quality of management information systems and professionalism of staff.</li> </ul> <p>There is no separate analysis of IRRBB during the BION process as management of this risk is an integral part of market risk.</p> <p>EC 2: KNF Resolution 383/2008 (paragraph 15) requires that the methods (models) for identifying and measuring risks associated with a bank's activities have to be tailored to the profile, scale and complexity of risk, should be applied in respect to both current and planned activities, and should be subject to periodic internal evaluation that includes testing and historical back-testing. Also, the frequency of risk measurement has to be adjusted to the size and nature of the different types of risk in the bank's activities (see also EC1).</p> <p>The KNF evaluates the adequacy of interest rate risk measurement methods during comprehensive onsite examinations, for example:</p> <ul style="list-style-type: none"> <li>- reviews if the measurement system covers all important aspects of IRRBB including re-pricing, basis, yield curve and optionality risk and covers all important elements of interest rate risk, which are related to assets, liabilities and off-balance sheet items of the bank;</li> <li>- verifies if the validation was conducted by the internal audit, including whether data, assumptions, calculation method, and back-testing results were considered; and</li> </ul>
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	<p>- assesses adequacy, monitoring and breaches of internal limits, including measures taken by management to address breaches of limits and to prevent any limit excesses in the future.</p> <p>The KNF verifies if banks have procedures for describing the mechanisms for handling the interest rate risk in the banking book or transferring it to the trading book, and whether they are effectively implemented. In banking book, there should be only residual risk resulting from inaccuracies in securities and strategic positions opened by the decision of the management or the Asset and Liability Management Committee (ALCO).</p> <p>EC 3: According to paragraph 13.7 of KNF Resolution no 383/2008, as part of the strategies and risk-management procedures, a bank has to introduce procedures for 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 that measure the bank's response to a sudden and unexpected change in interest rates by 200 basis points.</p> <p>Starting in 2010, the KNF monitors annually (offsite, using data from the BION questionnaire) the results of the standardized stress test scenario for IRRBB, i.e., changes in the economic value as well as the amount of internal capital set aside, when necessary. The KNF is able to demand an increase of capital in cases where the economic value of an institution declines by more than 20 percent of own funds as a result of applying a standard shock to its IRRBB (KNF Resolution 2/2008, paragraph 22.3).</p> <p>According to KNF requirements, positions in the banking book should be measured daily. Systems for identifying and measuring interest rate risk held by the bank should be able to identify and determine the size of the main sources of interest rate risk to which the bank is exposed. Sensitivity tests concerning the breakdown of key assumptions regarding the yield curves, prepayment, the behavior of nonmaturing instruments, are analyzed during onsite examinations. Also, the KNF assesses if shocks applied by a bank are appropriate given its risk profile and market environment.</p> <p>AC 1, AC 2 and AC 3: Starting in 2010, the KNF requests on an annual basis (through the BION reporting) the results of the application of the standardized interest rate shock on the banking book to the economic value.</p> <p>IRRBB is one of the risks banks are expected to consider under their ICAAP. The KNF reviews onsite if IRRBB is analyzed by bank in the process of assessment of materiality of respective risks. The examiners assess the criteria used to determine materiality of all aspects of the IRRBB, the adequacy of the method and the role of the stress test in the allocation of capital.</p> <p>Banks are expected to have reporting systems adequate to the complexity and scale of risk-taking operations. A specialized committee (i.e., ALCO) should receive reports concerning the size of the IRRBB at least once a month, and information on the risks associated with the trading book should be reported with a frequency allowing the ongoing monitoring of changes. Bank's management should also receive periodic information on the risk taken by subsidiaries, especially for those where the risk is considered significant.</p> <p>AC 4: According to paragraph 8.2 of KNF Resolution no. 383/2008, the bank's Management Board is required to introduce the division of tasks performed by the</p>
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	<p>bank so that the functions of risk measurement, monitoring and control are independent of the risk-taking operations.</p> <p>In particular, the KNF requires separation in terms of operation and oversight of the front-office, back-office and risk management. Middle-office functions, reporting and assessment of risk cannot be combined with front-office functions. Any shortcomings regarding the independence of abovementioned functions are subject to post-inspection recommendations sent to banks.</p>
Assessment	Compliant
Comments	
<b>Principle 17</b>	<p><b>Internal control and audit.</b> Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
Description	<p><b>EC 1 and EC2:</b> A management system is defined in the Banking Act as a set of rules and mechanisms to evaluation decision making processes and conducted banking activity (Article 9.2). Article 9.a. of the Banking Act requires that the management Board of a bank designs, implements and ensures the operation of the management system. The supervisory Board shall supervise implementation of the management system and assess its adequacy and effectiveness. Article 9 further states that the banks management system includes a risk-management system and an internal control system. Article 9.c. of the Banking Act defines the aim of the internal control system; namely to support decision making processes that contribute to ensuring efficient and effective operations of the bank, reliable financial reporting and compliance of the bank's activity with the provisions of law and internal regulations. According to paragraphs 27 to 31 of Resolution 383/2008 banks shall have an internal control system appropriate for its organizational structure, which shall include the banks organizational units and its subsidiaries.</p> <p>During onsite inspections, the examination team investigates, based on the onsite examination manual if a bank has in place all the necessary internal controls aligned to the nature and size of its business. Special attention is paid to the role of the management Board and the supervisory Board, the organizational structure, accounting policies and processes, checks and balances and investment security. The organizational structure is assessed by examiners who are responsible for the bank management process evaluation, and also by examiners who are responsible for the risk-management evaluation. The accounting policies and processes are analyzed by examiners in charge of the "earnings" of the bank. Checks and balances ("four eyes principle") are verified by the specific risk examiners (credit risk, liquidity risk, market risk, operational risk). The safeguarding of physical assets is assessed by the examiners in charge of operational risk.</p> <p>The assessors interviewed specialized examiners in the area of liquidity, credit risk, management and governance and were satisfied with the scope and the depth of the examinations.</p> <p><b>EC 3:</b> Paragraphs 1 to 11 and 30 to 34 of Resolution 383/2008 puts most responsibilities with respect to internal control on the respective Boards of banks.</p>

The respective paragraphs are exhaustive and comprehensive in describe the roles of the respective Boards. They require that the supervisory Board ensures the compliance of the bank's policy with respect to risk taking with the bank's strategy and financial plan. The Supervisory Board shall also ensure that persons elected to the management Board are suitably qualified to exercise the functions assigned to them and whether the actions of the management Board are in line with the supervisory Board's policy. The management Board is responsible, *inter alia*, for the effectiveness of the risk-management system, the internal control system and the internal audit system.

**EC 4:** If a bank is failing to comply with sound and prudent management or where the bank's activity is in contravention to the law or the bank's articles of association, or it is endangering the interest of account holders, the KNF may, after first cautioning the bank, apply two types of sanctions against the management or the individuals in the management Board. First, it may apply to the appropriate managing body of the bank for the recall of the president, vice president or other member directly responsible for the irregularities notes (article 138, paragraph 3.1 of the banking law). Second, the KNF may suspend from office the members of the management Board that have been charged with a criminal offence or with a fiscal offence of if the person has caused the bank major financial loss (article 138, paragraph 3.2 of the banking law). The KNF does not have power to suspend members of the supervisory Board.

**EC 5:** Paragraph 6 and 8 of Resolution 383/2008 introduces a division of tasks in the bank's organization so that the functions of risk measurement, monitoring and control are independent of the operations from which the risk taking by the bank derives. During onsite examinations the KNF examiners assess if there is an appropriate balance in skills and resources of the back office and control functions relative the business for every significant risk. The factors taken into account in this assessment were discussed with the examiners during the interview with the assessors and the assessment is largely based on the supervisory judgment of the examiners.

**EC6:** The bank's management Board shall ensure compliance of the bank's activities with the applicable legal obligations. Paragraph 25 of Resolution 383/2008 requires the establishment of a permanent and efficient compliance unit in the bank. Pursuant to paragraph 8.2. of Resolution No. 383/2008 the compliance function should be independent of the business activity.

**EC7:** The objective of the internal audit function is to carry out independent and objective examinations and to evaluate the adequacy and effectiveness of internal control as well as to issue an opinion on the bank's risk-management system. The onsite examination manual gives a detailed outline of the supervisory expectations regarding internal audit. Specialized examiners of the inspection department assess the quality and independence of internal audit during onsite examinations. The assessors interviewed a specialized examiner and were satisfied with the depth and scope of the work done in this area.

**EC8:** The KNF has issued Recommendation H in 2002 for internal control and internal audit in banks. That said, Recommendation H (which includes specific requirements regarding planning and carrying out the audit according to an audit plan and written specific procedures etc.) was not mentioned in the self assessment and staff of the KNF informed the assessors that it was not used during inspections

	<p>as it was under review. As indicated in CP 1.3., recommendations that are not enforced anymore and/or that are under review should be clearly identified and/or withdrawn to ensure transparency. Paragraph 35 of the Resolution 383/2008 outlines the criteria for persons performing the internal audit function. Banks are required to have mechanisms in place to ensure the independence of its internal audit function.</p> <p><b>AC 1:</b> Not applicable, Poland has a bi-cameral Board structure.</p> <p><b>AC 2:</b> The Act on Certified Auditors describes the task of the audit committee as monitoring the effectiveness of internal control systems, internal audit and risk management. The KNF's recommendation regarding the functioning of the audit committee states that the audit committee obtains detailed information from the managers, an independent auditor, internal audit department and the finance department</p> <p><b>AC 3:</b> Not applicable, Poland has a bi-cameral Board structure.</p> <p><b>AC 4:</b> There are no legal or regulatory requirements that call for the banks to notify the supervisor as soon as they become aware of any material information that may negatively affect the fitness and propriety of a Board member or a member of senior management.</p>
Assessment	Largely compliant
Comments	<p>It is recommended to introduce a legal or regulatory obligation that calls for the banks to notify the supervisor as soon as they become aware of any material information that may negatively affect the fitness and propriety of a Board member or a member of senior management.</p> <p>The responsibility for the control environment is placed on the Board and senior management of the bank. Having said that, the KNF is in a weak position with regard to enforcement of these provisions for the supervisory Board. It does not assess the fitness and propriety of the members of the supervisory Board and does not have the power to suspend them.</p> <p>The minimum requirements of the Banking Law and the Resolution for the compliance function fall short of the international best practice guidance issued, particularly in the areas of staffing, independence, access to information, conflicts of interest and seniority of the head of the compliance officer.</p> <p>It is recommended the KNF performs a fit-and-proper assessment of the Head of Internal Audit and impose a notification requirement on commercial banks for the dismissal of the Head of Internal Audit.</p> <p>It is recommended the KNF regularly exchange views on the quality and independence of internal audit with the external auditor during tri partite meetings.</p>
<b>Principle 18</b>	<b>Abuse of financial services.</b> Supervisors must be satisfied that banks have adequate policies and processes in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.
Description	<b>EC 1:</b> According to Article 106 of the Banking Act, banks are required to undertake measures to prevent using their activities for purposes associated with criminal offences referred to in Article 299 of the Penal Code of June 6, 1997 (money laundering and terrorist acts—a definition of terrorism financing being provided in 165a of the Penal Code).

The Act of 16 November 2000 on Counteracting Money Laundering and Counteracting Financing of Terrorism, further amended in 2009 (AML/CFT Act) provides the institutional and operational framework for counteracting money laundering and terrorist financing in Poland. The AML/CFT Act applies to domestic banks and branches of foreign banks, as well as to credit cooperatives and credit unions (Article 2.1. of the AML/CFT Act).

According to the AML/CFT Act (Article 21.2.), the control of compliance of banks and credit cooperatives with obligations within the scope of counteracting money laundering and terrorist financing is carried out by the General Inspectorate of Financial Information (GIFI), which is a dedicated separate organizational unit established in the MoF. GIFI carries out the functions of a financial intelligence unit (being member of the Egmont Group of Financial Intelligence Units) and is headed by a General Inspector appointed by the prime minister.

At the same time, the AML/CFT Law provides that the control can be exercised by other institutions, including KNF (Article 21.3.), within the supervision or control performed on terms and according to procedures specified in separate provisions (i.e., Banking Act).

In practice, the monitoring of AML/CFT compliance by banks is divided among KNF and GIFI, as follows:

- GIFI receives information from banks (transactions above EUR 15.000 and suspicious transactions), performs onsite inspections, and imposes penalties relating to AML/CFT legislation violations identified by the controls; and
- KNF performs onsite inspections and some form of offsite AML/CFT oversight.

Both GIFI and the KNF are empowered to request any documents and materials and to obtain any explanations necessary to carry out the AML/CFT control (GIFI under Art. 22.1. and 23 of the AML/CFT Act and KNF under relevant provisions from Article 139.1.2. of the Banking Act). In practice, GIFI and the KNF achieve a good degree of cooperation in performing their AML/CFT oversight functions.

The KNF submits to GIFI its control schedules within two weeks following their preparations (Article 21.3.b), giving GIFI enough time to prepare its own control schedules. The KNF implements a risk-based approach in planning its inspections, taking into consideration factors as types of activities, number of clients, location of offices, etc. GIFI drafts its control schedules based on the KNF program of inspections and other internal information available.

Following the inspection, the KNF submits to GIFI a written report on the results of the control within 14 days following its preparation (Article 22.4) and, if necessary, could be requested by GIFI to submit certified copies of the documentation collected during the control (Article 22.4.a).

The law also requires GIFI to share the results of the control in banks with KNF (Article 27.1.). Also, GIFI can provide the KNF with any necessary information within the scope of performing banking supervision, if a written and well-grounded request is made (Article 33.2.2).

GIFI and the KNF present a follow-up report on the results of the control to the management of the bank within 30 days from the date of the control completion (Article 24.1.). The report contains findings of facts, evaluation of the controlled



activity, including any irregularities found and the persons responsible for such irregularities, together with conclusions and recommendations (Article 24.2).

GIFI does not share with KNF suspicious transactions reports (STRs) received from banks. However, the KNF is able to request copies of STRs during onsite inspections.

The KNF has a dedicated AML/CFT unit for monitoring compliance with AML/CFT requirements. The specialized unit is organized under the Enforcement Division of the Law and Legislation Department and is currently composed of 6 experts. Such resources are limited compared to the scope of activity (onsite inspections, international cooperation and training of relevant entities) and the number of financial institutions supervised (over 700 financial institutions supervised for AML/CFT purposes). Moreover, GIFI has only eight experts monitoring compliance of all institutions (financial and nonfinancial) falling under the scope of AML/CFT legislation.

In 2010, the KNF performed 35 inspections in banks, including branches of foreign banks and credit cooperatives (over two thirds of total number of inspections in supervised entities), while the plan for 2011 is to decrease their number to 20 (less than half of total planned inspections in supervised entities), reflecting a recalibration of focus toward riskier areas of the financial sector.

Also, in 2010 GIFI performed 8 inspections in banks, branches of banks, and credit cooperatives, amounting for about 40 percent of total inspections in supervised entities. Inspections are also carried out by the National Credit Union in respect to associated credit unions, the results of which are sent to GIFI (22 inspections performed in credit unions in 2009).

**EC 2:** According to the AML/CFT Act (Article 10.a.) banks are required to have written internal procedures for counteracting money laundering and terrorist financing. Such internal procedures are not specifically comprised in the framework for risk management and internal control—KNF Resolution no. 383/2008, although the regulation states that banks can implement management procedures for types of risk other than those explicitly mentioned (item 14).

No specific know-your-customer regulations or other relevant regulations have been issued by the KNF in the area of AML/CFT. However, GIFI has issued an extensive Handbook for AML/CFT compliance that contains specific detailed requirements addressed to banks. The Handbook is periodically updated by GIFI to reflect new legal requirements (currently at its third edition) and has been also internally adopted by KNF in 2009 to guide its AML/CFT supervisory process. In addition, GIFI makes available to supervised entities typologies and case studies of money laundering and terrorist financing and issues interpretations of its Guidebook, which are often made public through its website. Both GIFI and the KNF provide training for financial institutions on AML/CFT matters.

The banks' AML/CFT policies and procedures together with their related internal oversight structures and management information systems are reviewed during onsite inspections. In practice, both the KNF and GIFI assess whether banks have dedicated members of the management Board in charge of overseeing AML/CFT policies and processes and conduct interviews with such persons to determine their understanding and discharge of related duties. Also, during onsite controls, a formal review of internal AML/CFT policies and procedures and of the internal audit

	<p>involvement is undertaken. The KNF and GIFI check the existence of a dedicated AML/CFT person for ensuring compliance, although in practice such person is not necessarily placed under the compliance unit of the bank (for example, could operate under the security division).</p> <p>During the onsite inspections, the KNF (and GIFI) check the accuracy of the registry of transactions and compliance with reporting requirements and use sampling procedures to test adequacy of customer due diligence measures.</p> <p>Integration with the more general framework for risk-management oversight by the prudential supervisory units of the agency is ensured by sharing the recommendations issued by the specialized AML/CFT inspectors, together with the assigned ratings, with the offsite supervisory units of the KNF.</p> <p>Also, starting in 2010, the KNF monitors under the annual SREP process whether assigned AML/CFT banks' members of the management Board are regularly informed on related issues and whether banks have relevant procedures in place.</p> <p>With the relatively new legislation and supervisory tools, the effectiveness of interaction between the AML/CFT unit of the KNF and the other units in charge of prudential oversight of banks is yet to be tested.</p> <p><b>EC 3:</b> The law does not require banks to report to the KNF suspicious activities and incidents of fraud when they are material to their safety, soundness or reputation.</p> <p>According to Article 106a (1) of the Banking Act, where there is a reasonable suspicion that the bank's activity is used in order to conceal criminal activities or for purposes related to fiscal offence or criminal activities other than the offences referred to in Article 165a and Article 299 of the Penal Code, the bank is required to notify the prosecutor, police or another competent body entitled to carry out pre-trial proceedings of that fact.</p> <p><b>EC 4, EC 8, and EC 9:</b> The Polish AML/CFT Act has in place the main elements for sound KYC policies and procedures in banks. The legislation requires banks to apply "financial security measures" (customer due diligence—CDD) for their clients, the scope of which depends on the "risk assessment" for money laundering and terrorist financing (Article 8.b.1.).</p> <p>According to Article 8.b.3. of the AML/CFT Act, the financial security measures consist of:</p> <ol style="list-style-type: none"> <li>1) client identification and verification of his identity on the basis of documents or information publicly available;</li> <li>2) due diligence to identify a beneficial owner;</li> <li>3) obtaining information regarding the purpose and the nature of economic relationships intended by a client; and</li> <li>4) ongoing monitoring of current economic relationships with a client.</li> </ol> <p>CDD measures are applied according to Article 8.b.4 of the Banking Act, in particular:</p> <ol style="list-style-type: none"> <li>1) when concluding a contract with a client;</li> <li>2) when carrying out transaction with a client with whom the bank has not previously concluded any agreements of the equivalent of more than 15.000</li> </ol>
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	<p>EURO, regardless of whether the transaction is carried out as a single operation or as several operations if the circumstances indicate they are linked;</p> <p>3) when there is a suspicion of money laundering or terrorist financing regardless of the value of such a transaction, its organizational form and the type of a client; and</p> <p>4) when there are doubts raised that the previously received data are authentic and complete.</p> <p>Occasional transactions under the form of wire transfers covered by FATF Interpretative Note SRVII are also covered through the direct implementation of Resolution 1781/2006 of the European Parliament and European Council.</p> <p>Clear customer identification (Article 9) and verification (Article 9.a) procedures are established separately for natural persons and their representatives, companies and organizational units without legal entity. It is not clear, however, how the banks' KYC management programs are applied on a group-wide basis. There are specific provisions prohibiting banks from keeping anonymous accounts (Article 19 of the Act of 25 June 2009 amending the AML/CFT Act).</p> <p>The AML/CFT Act also provides cases of simplified CDD procedures, which can apply in cases of customers, transactions and products that present a lower risk of money laundering and terrorist financing (Article 9.d.1) and of enhanced CDD (Article 9.e), in particular in cases where the client is absent, in cross-border relations with institutional correspondents from countries other than EU member states of equivalent countries, or with politically exposed persons.</p> <p>Article 10.a of the AML/CFT Act requires that banks have specific written internal procedures consisting of:</p> <ul style="list-style-type: none"> <li>- a description of the manner of implementing the financial security measures;</li> <li>- registering transactions;</li> <li>- performing analyses and assessing risk;</li> <li>- providing transaction information to GIFI;</li> <li>- suspending transactions, blocking account and freezing assets; and</li> <li>- the manner of accepting statements from PEPs and the manner of storing information.</li> </ul> <p>The risk-based analysis performed by banks will take into account, according to Article 10.a.3 of the AML/CFT Act economic, geographic, factual and behavioral criteria. There are no specific requirements for escalation of decisions to senior management level in cases of high risk-accounts.</p> <p>Banks are required to ensure the participation of their employees performing duties related to counteracting money laundering and terrorism financing in training programs related to such duties. KNF notes that is not always satisfied with the level of banks' staff knowledge of AML/CFT related issues. An AML/CFT compliance officer is required in all banks according to Article 10.b.1. of the AML/CFT Act.</p> <p>According to Article 8 of the AML/CFT Act, banks are also required to maintain (in paper or electronic format), for a period of five years, records for transactions exceeding the equivalent of EUR 15,000 and for suspicious transactions,</p>
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irrespective of their value and nature. The two types of transactions have also to be notified to GIFI (Article 11.1. of the AML/CFT Act).

According to Article 8.a.1 of the AML/CFT Act, the obliged institutions have to carry out ongoing analysis of the effected transactions and findings of those analyses should be documented in paper or electronic form and be kept for a period of five years. The KNF and GIFI verify during onsite inspections adequacy of record keeping and transactions reporting.

**EC 5:** Article 9.e.3. of the AML/CFT Act requires banks to perform enhanced CDD in relationship to cross-border relations with institutional correspondents from countries other than the EU-member states and equivalent countries and specifies related procedures. There is no specific requirement that such relationship should be terminated if subsequently found that correspondent bank does not have adequate controls against criminal activities or is not effectively supervised for AML/CFT by the relevant authorities.

Article 9.f of the AML/CFT Act also forbids banks from establishing and maintaining cooperation within correspondent banking with a shell bank or within correspondent banking with any obligated institution that is a provider of financial services concluding contracts on accounts with a shell bank.

Article 9.j. of the AML/CFT Act requires that banks operate branches and agencies according to the Polish AML/CFT standards or, if the host country legislation does not allow the application of home standards, undertake all actions in order to effectively counteract ML/TF. However, the AML/CFT Act does not require banks to notify the supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT standards (as requested by FATF 22). The KNF has broad powers to limit bank's operations (including in foreign establishments) under Article 138.6. of the Banking Act.

**EC 6—See EC1 and EC4.**

**EC 7 (also see EC1):** According to the AML/CFT Act, only GIFI is empowered to impose financial penalties in connection with the violations identified in the course of the control (Article 21.3.a). However, the KNF notes that it can make use of broad sanctioning powers conferred by the Banking Act (Article 138.3.) in cases of AML/CFT noncompliance. No evidence has been provided to the assessors on recent sanctions issued by the KNF for noncompliance of banks with AML/CFT requirements.

**EC 10:** According to Article 108 of the Banking Act, banks are not liable for any damages that may arise from their performance in good faith of their AML/CFT duties. Article 18, paragraph 4 of the AML/CFT Act offers protection to banks' employees against disciplinary, civil or criminal liability as well as any other kind of liability only in cases where transactions are being postponed or the account blocked by the obliged institution.

**EC 11:** According to Article 15.a.1., the KNF cooperates with GIFI within the scope of its statutory competence in preventing offences referred to in Article 165a and Article 299 of the Penal Code, by immediately informing GIFI about any suspicion of money laundering and financing of terrorism and providing relevant documents.

The KNF is also required, within the scope of its statutory competence (Article 15) to render available information necessary to GIFI for accomplishment of duties

	<p>within the scope of preventing offences referred to in Article 165a or Article 299 of the Penal Code.</p> <p>The KNF has a legal obligation to inform the prosecutor's office of a reasonable suspicion that a crime in any form has been committed, which derives from Article 304 paragraph 2 of the Penal Procedure Code. In 2010, there were six cases of such notifications filed to the prosecutor's office following onsite examinations by the KNF.</p> <p><b>EC 12:</b> The KNF is an integrated supervisor and the AML/CFT compliance is checked across sectors by the dedicated unit, which cooperates, as necessary with other units of the KNF involved in prudential supervision across the whole financial sector. Cooperation between the KNF and GIFI is discussed under EC1.</p> <p>Also, the AML/CFT unit of the KNF is responsible for international cooperation in the area. In the field of international cooperation the representatives of the KNF's AML/CFT Unit are present (for the time being) in MONEYVAL, EU 3L3 AML Task Force, and COP of the Warsaw Convention (CETS No 198).</p> <p>The general legal provisions on exchange of information between supervisors as well as MOUs to which the KNF is a party, do not prohibit the exchange of information on AML/CFT issues. In the past, the AML/CFT unit of the KNF met with foreign supervisory authorities to discuss AML/CFT issues regarding individual banks.</p> <p><b>AC 1: See EC1.</b></p>
Assessment	Largely compliant
Comments	<p>As noted by the Second 3<sup>rd</sup> Round Written Progress Report adopted by Moneyval in September 2010, Poland has taken important measures with a view to addressing the deficiencies identified in respect of the core FATF Recommendations by the 2006 Moneyval evaluation, including through the amendment of the Act of 16 November 2000 on Counteracting Money Laundering and Counteracting Financing of Terrorism (AML/CFT Law) incorporating the third EU Directive requirements, the creation of an autonomous offence of financing of terrorism, achievement of a number of money laundering convictions, implementation of further outreach and training to the private sector, prosecutors and judges on the elements of money laundering offences.</p> <p>Assessors note the good cooperation between GIFI and KNF in sharing their AML/CFT oversight functions in respect to banks, but note that given relatively new legislation, the effectiveness of the AML/CFT supervision and the integration of the AML/CFT risk management into the banks' general risk-management framework remain to be tested.</p> <p>Assessors note that the legal framework should be improved in a number of areas:</p> <ul style="list-style-type: none"> <li>- The law should require banks to report to KNF any suspicious activities and incidents of fraud when they are material to their safety, soundness or reputation. Such requirements should also apply to external auditors;</li> <li>- The law should require that KNF is notified in cases where an investigation has been initiated in a bank by competent judicial authorities;</li> <li>- The law should specifically require of banks the immediate termination of a relationship with a correspondent bank if subsequently found that correspondent bank does not have adequate controls against criminal</li> </ul>

	<p>activities or is not effectively supervised for AML/CFT by the relevant authorities;</p> <ul style="list-style-type: none"> <li>- The law should specifically require the escalation of decisions in cases of high risk-accounts to senior management level; and</li> <li>- The law should require banks to notify KNF when their foreign offices are unable to apply adequate AML/CFT standards.</li> <li>- Assessors also ascertain that the KNF could consider enhancing its resources for AML/CFT surveillance, given the large number of institutions subject to AML/CFT oversight and compared to the scope of activity (onsite inspections, international cooperation and training of relevant entities).</li> </ul>
<b>Principle 19</b>	<b>Supervisory approach.</b> An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups—and of the banking system as a whole—focusing on safety and soundness and the stability of the banking system.
Description	<p><b>EC 1:</b> The KNF conducts offsite analysis and onsite inspections to develop and maintain a thorough understanding of the risk profile of banks and banking groups. The offsite analysis of commercial banks is supported by the 60 employees of the Bank Supervision Department. As part of the offsite review process, quarterly solo and consolidated returns are analyzed and an Executive Summary (ES) is prepared. The data included in the ES report are generated from the prudential returns using the Uniform Bank Performance Report (UBPR) and then benchmarked against peer groups. The ES is an analytical management tool that concentrates on financial trends in the balance sheet, profit and loss accounts and off balance sheet sections. The ES specifically reviews trends in each CAEL components area: capital adequacy (C), asset quality (A), earnings performance (E) and liquidity (L). A CAEL rating on a scale of 1–5 with 1 being the highest is granted during this review. They also include a supervisory strategy and a work plan. A simplified ES is prepared for EU branches. In principle, ES reports are prepared and approved within 30 days after submission of the returns.</p> <p>The assessors reviewed a sample ES report and concluded that the work plan was very general and not specific so as to cover the risks raised in the summary. The KNF will revise the ES in the second quarter of 2011 to ensure the work plans are more detailed and better aligned with the risks identified.</p> <p>Relatively infrequent onsite examinations also assist the KNF in its understanding of the risk profile of individual banks and banking groups. The scope of onsite complex examinations includes asset quality, liquidity risk, market risk (including FX risk) interest rate risk in the banking book, operational risk, earnings, capital adequacy and management. Details regarding the planning and performance of onsite examinations are described in CP 20.</p> <p>In 2010 the KNF introduced a new offsite methodology called Supervisory Review and Evaluation Process (SREP or BION). Each bank is required to complete a comprehensive SREP questionnaire on a yearly basis. Branches of EU parents are excluded; they are assessed in accordance with supervisory task sharing outlined in EU Directives. The KNF prioritized the large and more risky banks for the implementation of the SREP. A first group, consisting of banking groups with assets over-15 bio PLN and CAEL ratings of 4 or 5 submitted their SREP with reference date 31 December 2010 and will be assessed by the KNF by July 2011. A second group, including banking groups with assets below 15 billion PLN and</p>

CAEL ratings of 4 or 5 will have a reference date of the end of March 2011 and will be assessed by September 2011. The final and remaining group will be assessed by the end of this year. The assessors believe that the SREP will contribute to supervisory outcomes of the KNF but as the methodology is not yet implemented and the assessments remain to be done, the SREP process cannot be taken into account in this Basel Core Principles assessment.

**EC2:** The KNF monitors the financial condition of the banking industry on a monthly and quarterly basis. Monthly assessments are submitted to the management of the Banking Supervision Department and the Financial Stability Committee participants. Quarterly assessments are available on the KNF website.

Systemic risks are identified in a timely manner and prudential requirements (KNF resolutions and recommendations) are updated to take into consideration emergence of risks to the banking sector (see CP 1.3.).

There are no formal mechanisms to take into account developments in the nonbank financial sector and the KNF is organized along sectoral lines. Having said that, staff confirmed that various forms of informal exchange of information occur within the agency at industry level. More formal exchanges at institutional level also exist.

**EC 3:** The methodology used for assessing on an ongoing basis the nature, the importance and scope of the risks to which individual banks or banking groups are exposed is currently the CAEL offsite rating. Going forward, the SREP methodology will be used in this respect, but as indicated in EC 1 above, this cannot yet be taken into account for this assessment. When reviewing the quarterly returns the analyst may recommend that a targeted examination be performed immediately to investigate any problem areas. The analyst may also recommend an upgrade or downgrade of the CAEL rating. Onsite examiners, in agreement with the offsite department, also give a rating after each inspection as outlined in CP 20. This outcome feeds into the offsite process and positions the bank on the supervisory cycle for the next inspection. CAEL ratings differ from onsite ratings as they do not assess the qualitative risk-management components (mainly the “management” component).

**EC 4:** The confirmation of banks' and banking groups' compliance with the prudential regulations and other legal requirements is performed during the onsite inspections and during ongoing offsite monitoring through prudential and financial reports. As outlined in CP 20, the inspections are relatively infrequent and extended. There is also a reporting obligation on external auditors in Article 136 of the Banking Act. The external auditor also has to report to the KNF any facts disclosed that indicate the commission of a criminal offence, a violation of banking regulations, a violation of sound banking practices or other circumstance endangering the interest of the bank's customers, or the possibility that a negative opinion will be expressed on the bank's accounts, or that the expression of an opinion will be disclaimed immediately. In practice however, no such reports have been received by the KNF. There is an additional—informal and non-enforceable—reporting obligation on the bank, as described in EC 5 below.

**EC 5:** Article 139 of the Banking Act requires banks to notify the KNF of the commencement or cessation of business activity. As outline in CP 5, banks shall also notify the KNF of their intention to purchase a portfolio of shares the value of which shall exceed 5 percent (Article 89 of the Banking Act). Similarly, Article 142

	<p>of the Banking Act requires banks to inform the KNF in case of the bank suffering a net loss, being threatened with such a loss or finding itself in danger of insolvency.</p> <p><b>EC 6:</b> The KNF mainly uses the FINREP/COREP reporting forms and UBPR.</p> <p><b>AC 1:</b> The KNF's supervisory activities encompass limited forward-looking elements. The assessors saw little evidence of a thorough discussion and understanding of the bank's business model including strategies, commercial objectives, significant activities, risk areas and risk-management tactics and capabilities.</p>
<p>Assessment</p>	<p>Largely compliant</p>
<p>Comments</p>	<p>The quality of the ES could be further improved by a more graphical and structured approach to illustrate trends. Also, the work plan flowing from the ES would benefit from a more detailed description of the specific risks and areas for attention.</p> <p>The new SREP methodology is a step in a more risk-based direction for the KNF. Nevertheless the assessors express the following concerns:</p> <ul style="list-style-type: none"> <li>• The banking supervision department will perform the SREP within the existing resource envelope. Banks informed the assessors that many of the SREP questionnaires and annexes amount to four hundred pages. It is doubtful that the 60 offsite staff of the KNF can process this amount of information effectively and efficiently.</li> <li>• Despite its sophistication and volume, SREP remains a self assessment completed by the banks. A critical review of the SREP is a complex task that requires good risk-management skills as well as sound supervisory judgment. It should therefore be performed and overseen by the KNF's experienced supervisors. While the assessors do not advocate a particular departmental organization, they are of the opinion that close coordination and cooperation between the onsite and offsite division is a crucial factor for the assessment of the SREP. It is doubtful if the resource constraints, particularly in the onsite department will permit this. The recently enforced physical separation between onsite and offsite makes this observation even more relevant.</li> <li>• The quality assurance surrounding of the SREP questionnaire is limited. The KNF should require sign off by the Management Board, the Supervisory Board or an independent review of the bank's responses.</li> <li>• The SREP methodology should not been seen as a substitute for onsite inspections or an instrument to further reduce onsite resources. The gaps between the way the business is portrayed by senior management and the way it actually runs can be huge and this assessment can only be done by the inspection department. There is a significant risk of overreliance on bank's procedures and policies without verification of their actual implementation.</li> </ul> <p>There is also no separate methodology unit in the offsite banking division. The assessors were informed that individual staff were assigned to the work arising from changes in supervisory methodology and processes. Although there is clear evidence of coordination and consultation between onsite and offsite, it remains unclear to the assessors where the ultimate responsibility for the supervisory methodology and processes (onsite and offsite) sits and how the process of changing and updating the methodology are project managed.</p>



<b>Principle 20</b>	<b>Supervisory techniques.</b> An effective banking supervisory system should consist of onsite and offsite supervision and regular contacts with bank management.
Description	<p><b>EC 1:</b> The KNF has an organizational separation of onsite and offsite functions. The onsite resources are located in the Risk Evaluation Department, which is organized into separate units for inspection planning, onsite inspections, onsite methodology and regulations and policies.</p> <p>The KNF team of inspectors is largely decentralized, with a large share of the onsite inspectors located in the territorial units (with only around 30 inspectors located in the Warsaw office of the KNF), which raises costs and organizational challenges.</p> <p>The offsite resources are located in the Banking Sector Supervision Department, where three units deal with the regular monitoring of banks (around 60 people) and one unit with the special supervision of banks. Separate units are assigned to monitor large exposures, offsite supervisory tools and macro-analysis.</p> <p>A separate department (Cooperative Banking Department) deals with the offsite supervision of cooperative banks, while the onsite resources in the territorial offices of the KNF are shared for inspections of banks and cooperative banks. The KNF confirms that at present about 40 percent of the onsite resources are deployed to supervise the activity of cooperative banks, which only accounts for about 6 percent of the banking sector assets.</p> <p>The KNF approach to the supervisory process is that the offsite supervision is the main instrument for monitoring the activities and risks in the banking sector, while the onsite analysis is used to verify or further investigate offsite findings. Over the past year, the KNF has further enhanced the operational segregation between the onsite and offsite functions to enable “independent input” from the two sources, by deliberately separating their respective offices in Warsaw. Assessors note that such separation has potentially a negative effect on efficient coordination.</p> <p>Within the offsite supervision units, an analyst is assigned to monitor overall developments in a number of banks, while the onsite inspectors are specialized and deployed as needed.</p> <p>The KNF performs a range of onsite inspections, from comprehensive (full scope) onsite inspections, to targeted examinations and explanatory proceedings.</p> <p>The onsite supervisory cycle for full scope inspections is based on a clear allocation methodology, which takes into account the level of risk posed by the bank to the whole banking sector (defined as the share of net assets of the bank in the total assets of the banking system) and the current level of risk in a given bank (benchmarked against the most recent quarterly composite offsite CAEL rating).</p> <p>At present, the standard duration of the examination cycle for commercial banks can range from: 24 months (comprising the 10 largest banks in terms of assets, plus banks with composite CAEL ratings of 4 and 5 and, in justified cases, banks with composite CAEL ratings of 3 under rehabilitation procedures); 36 months (banks with assets above PLN 3 billion with composite CAEL ratings of 1 to 3); or 48 months (banks with assets below PLN 3 billion with composite ratings of 1 to 3).</p> <p>Full-scope examinations entail a comprehensive assessment of all major risk areas of the banks, following a comprehensive Onsite Examination Manual.</p> <p>The KNF also undertakes targeted examinations to review significant risks identified in a bank during the offsite monitoring, or other topics that are of supervisory</p>

concern (e.g., mortgage lending, FX lending, contingency plans, and IT systems). Targeted examinations can also be used to verify the implementation of recommendations formulated as a result of the previous onsite inspections.

Finally, explanatory proceedings can be carried out as a more limited (and ad hoc) form of onsite examination. These activities aim at the review of a single issue occurring in the course of a bank's operation.

In 2010, KNF performed 8 full scope inspections and 16 targeted examinations, of which 5 were to validate internal models.

On the conclusion of a full-scope examination, each bank examined is assigned a composite rating, together with component ratings for credit, liquidity, interest rate, foreign exchange, operational risks, earnings, and capital and management. The ratings are assigned based on the Methodology for Onsite Ratings by a rating panel composed of onsite and offsite supervisors.

The results of the examination report, the rating, and the post-examination recommendations (including a plan for implementation, as needed) are sent to the bank. The assessors were informed by the banking sector representatives and external auditors that the post-examination recommendations are not clearly prioritized. Also, at the end of the onsite examination, a discussion is held with the bank's management Board members. While members of the supervisory Board and external auditors are invited, both the KNF and industry representatives confirmed that their attendance is rather infrequent.

Offsite supervisory process is intense, using the annual supervisory review process (BION) and various interim tools (quarterly CAEL ratings, financial and prudential reports, peer-group analyses, etc.—see CP 19). The offsite units are the single point of contact for the ongoing monitoring of individual banks.

**EC 2:** The inspection planning unit within the onsite department is responsible for preparing the annual onsite inspection plan (see EC1). The yearly inspection plan is agreed by the onsite and offsite departments and the latter is able to influence prioritization for banks deemed to be high risk. A buffer for targeted ad-hoc inspections is maintained annually. The inspection plan is formally endorsed by the Chairman of the KNF.

The participation of the offsite supervisors in the rating panel, including the preparation of post-examination recommendations, ensures consistency across the agency regarding the supervisory approach. Follow up with post examination recommendations remains mainly with the offsite supervisors and subsequent targeted examinations to verify implementation of post-examination recommendations are rarely performed (only one follow-up inspection was undertaken in 2010).

High-level coordination between onsite and offsite supervisory processes is ensured through weekly meetings between the heads of the respective departments. The KNF senior management is responsible for approving the supervisory strategy, and ensuring that it is based on the institution's risk profile and KNF's policies.

**EC 3:** Onsite inspections are conducted by the KNF's own supervisory staff, who are usually specialized in 2–3 risk areas. The inspection teams are decided based on the size and complexity of the bank and on the topics to be assessed. Inspectors evaluate the bank's asset quality, liquidity risk, market risk (including FX risk),

interest rate risk in the banking book, operational risk, earnings, capital and management taking into consideration compliance with legal provisions and prudential regulations (including accuracy of supervisory reports) and bank's internal policies and procedures. During onsite inspections, the adequacy of the ICCAP process is also verified.

Each risk area is assessed in terms of the level of risk and risk management. An overall assessment of the risk management is performed by integrating the assessment of the risk management in separate risk areas and the overall corporate governance framework. The corporate governance verification is procedural oriented (verification of responsibilities of management vis-à-vis internal policies, procedures, limits), with little emphasis on the qualitative aspects (i.e., capacity of Boards to ensure a holistic approach to risk management, an assessment of the risk culture or risk awareness in bank, etc.).

Also, in the course of the examination, examiners verify the reliability of quantitative and qualitative data. The verification of quantitative information includes assessment of reliability of reporting, reconciliation of significant and relevant for a given bank positions e.g., adequacy of capital, FX position, sample of transactions performed by front-office, selected positions from profit and loss account, large exposures and concentration data.

In exceptional cases, when a justified suspicion exists, bank examiners also verify the evidence of bank assets and liabilities, and the reliability of financial records. The KNF is empowered by the Banking Act to use external auditors for targeted verifications in specific areas; however, this power has never been used. During examinations, the KNF can obtain any information needed for its assessment, including information from bank's related entities and may require any necessary explanations (Banking Act, Article 139 and Article 141k).

**EC 4:** Offsite surveillance involves the regular analysis of a bank's financial condition (on the basis of its financial returns), the monitoring of compliance with prudential standards and with supervisory recommendations (including examination recommendations), and also the identification of potential threats to the soundness of the institution (offsite supervisory tools described in EC19). The offsite supervisors have the responsibility of identifying areas requiring further attention and determining the intensity of supervisory oversight. Assessors note that that under the new BION methodology, the intervention through onsite inspections is late, i.e., when the bank is considered "bad" or "in crisis" (rating F).

**EC 5:** The KNF organizes quarterly meetings with members of banks' management Boards of the largest banks. Systemic issues are also discussed with banks' CEOs with the frequency deemed necessary. Offsite supervisors are interacting during the ongoing monitoring of banks with middle management or banks' experts.

**EC 6:** The assessment of the quality of the members of the management Board is performed during the onsite examinations. The offsite supervisors also monitor performance of banks' senior management and can request further verifications during the onsite targeted examinations. The KNF confirms that interaction with members of the supervisory Boards is infrequent (see also CP 3).

**EC 7:** The scope of supervisory assessment in terms of the bank's internal audit function includes, among others, a review of the quality of auditors' reports and implementation of auditor's recommendations, of the range of activities carried out

	<p>by the internal audit unit and identification of weaknesses in its work, of the independence of internal audit, and of the qualifications of employees. However, the KNF notes that, generally, performance of the internal audit is not very often fully satisfactory and thus it cannot always rely on the internal auditor's work.</p> <p><b>EC 8:</b> The examination report (including the rating assigned), the post-examination recommendations, and—if needed—a justification to take corrective actions, are communicated to the bank's management Board and discussed during the exit meeting. Banks may provide comments on the report and the examiner in charge should address all reservations and document them. Also, banks are required to provide the KNF with a written response concerning how they propose to address required actions.</p> <p>The quarterly offsite CAEL ratings are communicated to the management Board.</p> <p><b>AC 1:</b> While contact with management Board members seems to be adequate, the interaction with supervisory Board members is very weak and should be strengthened.</p>
Assessment	Materially noncompliant
Comments	<p>Assessors consider that the KNF has well developed onsite and offsite supervisory techniques; however; note important shortcomings regarding the length of the supervisory cycle and the mix between offsite and onsite supervision:</p> <p>The inspection cycle is too long to be aligned with international best practices. At the minimum, KNF should be able to inspect the largest banks on an annual basis and to deploy adequate resources for a closer monitoring of riskier banks.</p> <p>Assessors note in this regard that the onsite resources of KNF should be further enhanced, especially given forthcoming new demands.</p> <p>A closer involvement of onsite supervisors in the follow up with post-examination recommendations (including through regular discussions on the progress in implementing recommendations) and a larger number of targeted inspections would be necessary as a more thorough understanding of the banks' activities, business models and risks is acquired during the onsite inspections. The assessors note that such coordination is more difficult given current territorial separation of premises for onsite and offsite supervisory units in Warsaw.</p> <p>The assessors also note that under the new offsite BION supervisory methodology, the onsite inspections are required only when the bank's condition is deemed to be "bad" or "in crisis." Such approach is very reactive and may not offer sufficient time for effective remedial action.</p> <p>Assessors recommend that the offsite and onsite functions are viewed as complementary and the KNF should seek to fully exploit synergies between the two so as to ensure a closer monitoring and a timely intervention in banks.</p> <p>The assessors reviewed some examination reports and ascertain that the analysis is thorough and comprehensive. The risk areas are discussed in detail and shortcomings are identified against legal requirements and regulatory standards (KNF resolutions and recommendations). The assessors note that post-examination recommendations should be more clearly prioritized to enhance the banks' understanding of supervisory expectations and the relative importance of deficiencies noted during inspections.</p>

	<p>Assessors consider that the KNF should be more active in influencing the quality of internal audit in banks and establish a regular dialogue with the bank's internal auditors. From the experience of other countries, the internal audit is an important source of information for leveraging supervisory findings. Fit-and-proper criteria should be established for the head of the internal audit (see BCBS Principles for Enhancing Corporate Governance, October 2010).</p> <p>Assessors recommend that the KNF should engage more actively in a dialogue with the supervisory Board members and with external auditors. The KNF could also consider implementing the good practice of other supervisors' "tri-partite" meetings with the external auditors and the management of the bank.</p> <p>The large amount of supervisory resources for the cooperative banks compared to the relative small importance of the sector coupled with inadequate intensity of supervisory oversight (i.e., long supervisory cycle and limited number of targeted inspections) for commercial banks raises concerns regarding the effectiveness of the supervisory process in terms of an adequate risk-based allocation of resources. Assessors recommend that the KNF conducts an assessment of supervisory needs versus resources allocated and align the intensity of supervision to the risk profile of supervised entities. Assessors welcome the KNF's plan to delegate some supervisory responsibilities to the banks heading the networks of credit cooperatives ("aggregating banks"), but note that KNF should be satisfied that their oversight capacities are adequate.</p>
<b>Principle 21</b>	<b>Supervisory reporting.</b> Supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis and a means of independent verification of these reports, through either onsite examinations or the use of external experts.
Description	<p><b>EC1:</b> According to Article 23.3. of the Act of the National Bank of Poland, banks are required to provide, at the request of NBP, data necessary to assess their financial standing and the risks to the banking sector. BNP may share such information with KNF to the extent necessary for the pursuit of goals and tasks of the Financial Stability Committee (Article 23.8).</p> <p>In practice, sharing the reports received from banks between NBP and KNF under the above-mentioned framework works well and is based on a service level agreement under which KNF has simultaneous access to the information received by NBR through a "mirror image."</p> <p>Under Resolution no. 23/2003 of the NBP Management Board further amended in 2007, banks are required to submit to NBP standardized FINREP and COREP reports based on the EU unified reporting standards designed by the European Banking Authority (formerly Committee of European Banking Supervisors—CEBS).</p> <p>Other prudential reports are also submitted by banks to NBP, which makes them available to KNF. For preparing such reports, separate guidelines are provided in specific KNF regulations.</p> <p>Currently, KNF receives the following prudential reports from banks:</p> <ul style="list-style-type: none"> <li>- FINREP (individual on monthly basis; and consolidated on quarterly and annual basis): comprising information regarding on and off-balance sheet assets and liabilities, profit and loss, asset quality, loan loss provisioning, related party transactions, liquidity, some information on foreign exchange risk and interest rate risk, etc.;</li> </ul>

- COREP (individual on monthly basis; and consolidated on quarterly and annual basis): comprising information on own funds, capital adequacy (separately by credit risk, market risk, operational risk), additional information on equity risk, commodity risk, foreign exchange risk, interest rate risk, etc.;
- Form B0300 (monthly on individual basis) and Form SB300 (quarterly on consolidated basis): comprising information on large exposures and asset concentrations (including by economic sector, geography and currency);
- Form B0700 (submitted monthly on individual basis): comprising information on capital or other relationships for each of the exposures reported in form B0300; and
- Supervisory liquidity measures (monthly on individual basis): short term liquidity measures and long term liquidity measures according to KNF Resolution no. 386/2008.

Besides prudential reports, accounting reports are submitted to the KNF on a regular basis on both solo and consolidated basis (see CP 22). Polish banks may choose between applying IAS-IFRS standards or local accounting standards (Polish Accounting Standards—PAS), based on the Accounting Act. At present, 20 banks and all the credit cooperatives use the PAS for preparing their financial statements.

The Banking Act (Article 134.2) also requires that banks submit to the KNF audited annual accounts, on a solo and consolidated basis, together with the auditor's opinion and report.

**EC 2:** Valuation and compilation techniques for FINREP and COREP financial and prudential reports (templates, instructions etc.) are provided by NBP in accordance with the IAS/IFRS standards adopted at the EU level, or with PAS, which draw from the relevant EU Directives on accounting. When preparing the reporting instructions, NBP cooperates closely with the KNF who, in practice, is able to require any necessary changes.

In addition, the KNF is able to impose rules with respect to the calculation of capital adequacy, thus influencing the COREP reporting. KNF also sets detailed rules for the calculation of the minimum capital requirements under the Basel II IRB internal approach and for the model validation.

The laws and regulations stating the recognition on the accounts of economic events, valuation rules and presentation are described in CP 22. Also, Regulation (EC) no. 2002/1606 of the European parliament and of the Council on the application of international accounting standards is applied to companies that are admitted to trading on a regulated market (publicly traded companies), which must report their consolidated accounts based on IFRS as endorsed by the European Union.

**EC 3:** Valuation requirements originate from generally accepted accounting principles-based on IFRS—or specific local regulations aligned to EU requirements (Banking Accounts Directive) and to a large extent to IFRS standards. These standards ensure consistency in reporting. For prudential purposes, the KNF requires banks to adjust accounting information to calculate regulatory capital in accordance with KNF resolutions transposing CRD. Hence, the valuation rules used are consistent, realistic and prudent, taking account of current values where relevant, and show profits net of appropriate provisions.

**EC 4:** The Polish relevant regulations impose uniform frequency of reporting for banks. The data regarding individual balance sheet, income statement, capital adequacy, supervisory liquidity positions are collected monthly, while most of other data are collected on a quarterly basis. Branches of credit institutions are not required to submit the COREP reports.

The supervisory forms are sent in electronic form to NBP, which shares them with the KNF. The data entry programs contain a number of automated validity checks. The data is stored in a database, available for retrieval and further processing. Offsite analysts perform further plausibility checks when the reports are processed.

The information is used by the KNF for the ongoing monitoring of banks (i.e., through quarterly supervisory reports including CAEL ratings) and for planning onsite examinations.

The KNF uses since 1997 the Uniform Bank Performance Report (UBPR) for analyzing a standard set of ratios and key data for each bank, in comparison with peer groups of banks. UBPR has been subsequently adapted and is currently drawing from information received under FINREP and COREP framework.

During the crisis, the KNF requested from banks additional or more frequent reports such as weekly reports regarding financing from parent companies and intra-group transfers, daily information of foreign exchange positions etc. This information was conveyed directly to the KNF.

**EC 5 (See also EC1):** Due to the harmonized supervisory framework developed by CEBS for FINREP and COREP, there is no additional national guidance or explanatory notes (EBA plans to extend existing guidelines and incorporate detailed reporting instructions and data definitions). The scope of individual data submitted is more detailed than that for consolidated information; however, the forms are similar to a large extent. The reference dates for presenting the information on both solo and consolidated level are the same, while banks have more time to prepare and submit consolidated forms. Also, the frequency of consolidated data is lower (quarterly and annually only).

The relevant rules require harmonized supervisory returns in respect of the scope of consolidation, the valuation of items, the currency and unit of account used, frequency, reporting reference date and remittance date.

**EC 6:** The Banking Act (Article 139.1) provides broad powers to the KNF to require from banks any information (including book of accounts, balance sheets, records, plans, reports and any other documents) and explanation necessary for performing supervisory activities. The KNF can and would use such powers for both offsite and onsite supervisory actions.

According to Article 141.h.1. of the Banking Act, KNF can verify information in the banks' undertakings operating in holding companies and in ancillary banking services undertakings that provide services for entities operating in such holding companies.

The evaluation of banks' parent entities is performed annually, based on the information received from the annual consolidated financial statements. For EU parent entities, the KNF consults with home supervisors. However, assessors ascertain that the KNF could be more intrusive in requiring additional information from other group undertakings and performing its own verifications. Information on

	<p>the group's entities can be obtained by the KNF based of broad powers stipulated in Article 141.h.2. of the Banking Act.</p> <p><b>EC 7:</b> As shown above, the legal framework provides the KNF with access to all bank documents that may be of assistance in the performance of measures related to the supervision of banks and to banks' management Boards and other bank staff. In performing its supervisory functions, the KNF uses management reports, minutes of the management and supervisory Board meetings, internal auditor reports etc.</p> <p><b>EC 8:</b> When submitting their prudential and accounting reports, banks must enclose a statement—signed by the chairman of the bank, certifying conformity with the regulatory requirements. In addition, external auditor's certification is requested in respect to accuracy of individual and consolidated annual financial statements.</p> <p>Since according to the legislation, prudential reports are sent to NBP, the KNF is not entitled to impose fines on banks for late reporting. During its offsite monitoring process, the KNF pays close attention to the timeliness of submission of banks' financial reports. The KNF's approach would be to first discuss the reasons for tardy reporting (such cases have been very limited in practice) and, if necessary, to send a team of inspectors to perform a thorough evaluation. The KNF considers that, proportional to circumstances, it can also use the broader corrective powers conferred by Article 138 of the Banking Act or impose financial penalties on members of the management Board (according to Article 141 of the Banking Act).</p> <p><b>EC 9:</b> Besides automated validity checks and plausibility verifications made by offsite analysts when processing the reports (see EC 4), the KNF checks the accuracy of the information submitted during onsite inspections or ad-hoc investigations in cases where there are obvious deviations from normal patterns.</p> <p>The KNF also receives the auditor's reports containing the external auditor's opinion on the bank's annual accounts. However, the auditors are not required to verify the accuracy of all prudential returns, and therefore, in between sometimes rare onsite inspections, the only source of information for KNF remains offsite analysis. There is no systematic program for periodic verification of supervisory returns.</p> <p><b>EC 10—See EC 6</b></p> <p><b>EC 11:</b> According to Article 136 of the Banking Act, the external auditor is required to notify KNF immediately of any facts disclosed that indicate the commission of a criminal offence, a violation of banking regulations, a violation of sound banking practice or other circumstance endangering the interests of the bank's customers, or the possibility that a negative opinion will be expressed on the bank's accounts, or that the expression of an opinion will be disclaimed.</p>
Assessment	Compliant
Comments	<p>Assessors note that the reporting framework for banks is adequate; however, the KNF could further strengthen it by developing a systematic program for periodic verification of supervisory returns.</p> <p>For ensuring full consistency across the banking sector in terms of reporting, it would be advisable to consider implementation of IFRS standards for all banks.</p>
Principle 22	<p><b>Accounting and Disclosure.</b> Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.</p>



Description	<p><b>EC 1:</b> Pursuant to article 22 of the Accounting Act of 29 September 1994, accounting documents should be reliable i.e., consistent with the actual course of the business transactions that they document, complete and free of arithmetical errors. The KNF has not issued specific additional prudential accounting requirements or recommendations related to accounting and its powers in the Banking Act are not directly linked to accounting weaknesses. The KNF states it could hold the bank indirectly accountable under paragraph 37.6 of Resolution 383/2008, which requires that “the bank’s management and supervisory Board receive information with regard to the quality (accuracy and reliability) of systems; accounting, reporting and operating.”</p> <p><b>EC 2:</b> Article 64 of the Accounting Act requires banks to publish their financial statements. Under the Accounting Act, the management Board is also responsible for the preparation of the annual financial statements within 3 months of the end of the accounting year. The Accounting Act of 29 September 1994 requires all banks to be audited. Pursuant to the provisions of the Article 134, paragraph 2 of the Banking Act all banks are required to submit to the KNF their audited accounts and the audit opinion and report on a solo and a consolidated basis as approved by the relevant body of the bank. The KNF does not have direct legal powers to hold bank’s management and the bank’s Boards accountable for ensuring the financial statements receive proper external verification.</p> <p><b>EC 3:</b> All banks (both listed and nonlisted) are required to prepare their consolidated financial statements in conformity with endorsed IFRS, and their legal entity financial statements in conformity either with accounting regulations set by the Minister of Finance (“Polish Accounting Principles”), which are based on the Banking Accounts Directive, or with endorsed IFRS. In practice, only 20 commercial banks (including 5 branches) still use the Polish Accounting Standards for their solo accounts. During onsite inspections, examiners verify the accounting policy established by the bank and check continuity of rules applied.</p> <p><b>EC 4:</b> Accounting principles and procedures for auditing financial statements are specified in the Accounting Act of 29 September 1994. The scope and standards to be followed for external audits are defined in the National Public Sector Accounting Standards.</p> <p><b>EC 5:</b> The audit standards set in the National Public Sector Accounting Standards are comprehensive, they cover the loan portfolio, loans loss reserves, nonperforming assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, and the adequacy of internal controls over financial reporting.</p> <p><b>EC 6:</b> No ex ante supervisory approval is required for the auditor of a bank and the KNF does not have to explicit power to reject or rescind an auditor’s appointment. Only certified auditors meeting the standards referred to in Article 16 on the Act of Certified Auditors and Public Supervision of 7 May 2009 may be appointed to audit financial statements of a bank and also of a branch of a foreign bank. It should be noted that there are no specific additional requirements in terms of technical expertise for certified auditors for a bank. Article 135 of the Banking Act allows the KNF, when irregularities are found in the audit to require the bank, to commission to a specific certified auditor the examination of the correctness and accuracy of the financial statements of the bank, the inspection of the books of account and the analysis of the loan portfolio and performance of other measures specified in</p>
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	<p>Article 133 paragraph 2. When this audit review confirms the existence of irregularities, the cost of the review shall be borne by the bank. The audit review may also be commissioned directly by the KNF. In this case, the cost of the audit shall be borne by the KNF, subject to the provision of Article 135 paragraph 3. The KNF stated that an unqualified opinion for a bank where serious shortcomings are suspected would qualify as an “irregularity” that could trigger the commissioning of another audit. This power has, however, not yet been used in practice. During discussions with the KNF, it was stated that although this scenario has not yet occurred it would inform the Audit Supervision Committee, an independent public administration body whose duties include controlling audit firms. The KNF has two members on the Board of this supervisory body with decision-making powers.</p> <p><b>EC 7:</b> Article 64 of the Accounting Act requires banks to be subject to annual audit of the financial statements. The vast majority of commercial banks apply prepares its consolidated and sole entity financial statements in accordance with IFRS, but about 20 commercial banks accounting for a small market share still use Polish accounting standards for their solo accounts. That said, the authorities stated that both sets of accounting principles are relatively convergent and the levels of provisions should not be materially divergent.</p> <p><b>EC 8:</b> Article 64 of the Accounting Act requires banks to publish audited annual accounts and the audit opinion as well as a copy of the resolution or decision of the body approving the accounts and the allocation of the net profit. The accounts are filed with the Court of Register and forwarded for publication. The auditors also confirm that the bank has published its accounts for the previous financial years.</p> <p><b>EC 9:</b> Qualitative and quantitative information on the bank’s financial performance, financial position, risk-management strategies and practices, transactions with related parties, accounting policies and basic business, management and governance is disclosed as part of the bank’s annual accounts under IFRS and as part of Pillar 3 disclosures (Resolution 385/2008 of 17 December 2008) .</p> <p><b>EC 10:</b> The offsite supervisors verify compliance with Pillar 3 requirements. Although the KNF has the power to EC 11: The KNF publishes two quarterly reports about the banking sector on its website. The first report details the key data of the banking sector like <i>inter alia</i> aggregate balance sheet, profit and loss accounts and capital adequacy and comparisons with previous periods. The second report is a description of the condition of Polish banks including macro economic factors, trends, bank sector results, risk areas and capital adequacy.</p> <p><b>AC 1:</b> It is not part of the KNF’s supervisory practice to regularly meet with external auditors and the banks to discuss issues of mutual interest. The external auditors are invited by the bank during the closing meeting with the management Board after the inspection.</p> <p><b>AC 2:</b> An external auditor performing the audit of a bank shall notify under Article 136 of the Banking Act to the KNF immediately any facts disclosed that indicate the commission of a criminal offence, a violation of banking regulations, a violation of sound banking practices or other circumstance endangering the interest of the bank’s customers, or the possibility that a negative opinion will be expressed on the bank’s accounts, or that the expression of an opinion will be disclaimed.</p> <p><b>AC 5:</b> The KNF does not have access to the external auditor’s working papers.</p>
Assessment	Largely compliant

Comments	<p>The KNF does not have direct legal powers to hold bank's management and the bank's Boards accountable for ensuring the financial statements receive proper external verification.</p> <p>The KNF cannot reject or rescind the appointment of an external auditor that is deemed to have inadequate expertise or independence, or not be subject to or not to follow established professional standards. However, the KNF has some room to act through its representation in the Audit Supervision Committee (KNA), an independent body of the public administration that exercises oversight of the professional activity of statutory auditors.</p> <p>It is recommended the KNF to be forceful in ensuring audit quality by actively challenging external auditors and the bank's management when understatement of provisions is identified. The participation of KNF members in the Board of the Audit Supervision Committee should support this effort; introduce trilateral meetings, at least once a year, with the internal auditor and external auditors to discuss issues of common interest and to serve as validation and consistent communication; the IFRS become mandatory for the solo accounts of all commercial banks; and introduce specific banking expertise and experience requirements for auditors of commercial banks; these should be at the level of the firm as well as at the individual.</p>
<b>Principle 23</b>	<p><b>Corrective and remedial powers of supervisors.</b> Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.</p>
Description	<p>There are two types of early remedial actions provided in the Banking Act: (1) common enforcement; and (2) rehabilitation proceedings. The first start when there is a lack of compliance with the KNF's recommendations (Art. 138). These are related to compliance with laws and regulation, including augmented Pillar 2 capital adequacy ratio, as well as deficiencies in risk management and control systems (per Art. 138b). Lack of compliance empowers the KNF to apply a range of measures, although the proportionality of the reaction<sup>1</sup> is not explicitly related to the gravity of the situation and the rehabilitation proceedings. Rehabilitation is triggered in the event of bank losses and danger of insolvency (Art.142).<sup>2</sup> Those events must be immediately reported by the bank's management Board to KNF jointly with a proposed, time-bound, rehabilitation program. Its inadequacy or deficient implementation triggers further discretionary actions by the KNF, including powers to summon an extraordinary general assembly to decide how to absorb the losses and increase capital (Art. 143). The KNF might decide to nominate a trustee (Art. 144) to participate in the management Board and oversee the implementation of the program. When BGF grants financial assistance, it nominates the trustee (Art. 20 §2 of its Act).</p> <p>In stage two (provisional administration) if management fails to submit a rehabilitation program or its performance is ineffective, the KNF can (Article 145) appoint a Board of receivers. This compulsory administration suspends management and supervisory Boards' powers, vesting them in the Board of receivers that must: (a) balance the bank's books; (b) cover existing losses; (c) draw up a rehabilitation program with the KNF; and (d) proceed to its implementation.</p> <p>Stage three (take-over) has three discretionary triggers,<sup>3</sup> giving KNF the right to decide: (1) a takeover by an acquiring bank; or (2) the withdrawal of the license and</p>

the liquidation of the bank (Art. 147). The latter triggers the fourth stage of the resolution process as discussed below. The former provides for a series of steps that can result in transferring the failing bank to a reputable party through: (i) takeover of management; (ii) due diligence audit; (iii) application of losses to pre-existing capital; (iv) satisfaction/ securing of creditors; and (v) payment or residual value to shareholders (Articles 147 to 152). The Act does not provide further tools for partial transfers, asset carve-outs, or the assumption of liabilities and contingencies, all of them directed to compensate the acquiring bank of any losses above the net value acquired. Presumably, the provision of assistance by the BGF could cover these up to the limit of the guaranteed funds. The Act on Support of the State Treasury to Finance Institutions of 12 February 2009 provided further financing support.

Stage four (insolvency) is generally defined for corporations in the Bankruptcy Act (Art. 11). For banks insolvency is specified as a condition where asset are not sufficient to cover liabilities (Art. 158 (1)), subject to KNF's decision to suspend the bank's operations and decide: (1) its takeover by another bank (stage 3 above); or (2) petition to the appropriate court to declare bankruptcy, prior approval by the Council of Ministers (Art. 147(3)). There is not a special rule that precludes implementation of bankruptcy proceedings during rehabilitation and the Bankruptcy Act does not provide special procedures to liquidate banks, including tools to preserve value. In addition, the revocation of the license (Art. 138.3.4) determines liquidation. In both cases (Art. 138.3.4. and Art. 158.1), the KNF must notify the BGF of its decision, which constitutes the event for pay-off of the insured deposits.

**EC 1:** The most common trigger for remedial action is losses reported by banks in their quarterly prudential reports as well as findings from onsite inspections. The early warning systems are fully based on supervisory discretion; the KNF does not have any specific quantitative or qualitative triggers in its supervisory rating systems or analytical reviews of the prudential returns that oblige analysts to take immediate action or escalate concerns to managers ("red flags"). Where the KNF requires the bank to take significant remedial actions, these are addressed in a written document to the Board of Management or/and the Supervisory Board. The bank is required to submit the written report describing the measures that will be taken to remove any irregularities detected by the KNF, and to comply with any decisions and recommendations issued by KNF. These actions are monitored systematically during on-going supervision conducted by both offsite and onsite supervision.

**EC 2:** The KNF has no resolution function. The bank resolution framework in Chapter 12 of the Banking Act is not well developed as the liquidation of a bank shall be carried out in accord with the Bankruptcy principles applicable to any commercial enterprise. However, if a bank suffers a loss exceeding half of its capital base and circumstances indicate that the bank is threatened with insolvency or that its capital base may decrease to such an extent that it would no longer meet the regulatory requirements for authorization, the KNF may order the bank to liquidate or to be taken over by another bank. The KNF may appoint a trustee, administrator or liquidator, the latter of whom assumes the powers of the subject bank's management and supervisory Boards. The legal powers and reporting requirements for each type of KNF appointment are described in the Banking Act. As well, the troubled bank can undergo voluntary liquidation, and appoint a Liquidator, subject to the KNF's approval.

**EC 3 and EC 4:** The KNF has a broad range of tools and powers that can be applied in function of the scope and the scale of the irregularities. In accordance with Article 138, the KNF has a variety of options to choose from when a bank is not complying with laws or regulations, or it is likely to be engaged in unsafe or unsound practices. Paragraph 1 and 2 of the above-mentioned article, allows the KNF to issue a (binding) “recommendation” to individual banks such as the requirement to increase own funds, to limit banking activity risk, to cease dividend payments and to request increased provisions and reserves. When a bank fails to comply with these (binding) recommendations or when its activities are in contravention with the law or its articles of association or when they impair the interests of deposit holders, the KNF has first to caution the bank before it can take additional measures. The law does neither define the notion of caution nor a term that needs to expire before the additional measures can be taken. The additional measures include suspension of a member of the management Board, revocation of the banking license, limitation of the scope of banking activity and imposition of financial penalties. In 2010, one bank has been sanctioned for failing to implement an onsite examination recommendation and four banks have received written cautions.

In case of escalating financial problems (for example, net loss, threatened with net loss, danger of insolvency), the management must submit a recovery program (Article 142, paragraph 1 of the Banking Act). When a bank fails to properly implement the said program or financial problems further intensify, the KNF may implement rehabilitation proceedings (Article 143 of the Banking Act). The KNF has currently 10 banks under rehabilitation plans in accordance with Article 142 paragraph 3 of the Banking Act. The KNF may also decide to appoint a trustee (statutory manager or conservator) to oversee the rehabilitation program. In case the bank's management Board fails to submit a rehabilitation program or where performance of that program is ineffective the KNF may order the bank to be placed under administration (Board of receivers) for the duration of the rehabilitation program (Article 145 of the Banking Act).

**EC 5:** Article 128 paragraph 7 of the Banking Act requires the bank to inform the KNF immediately if its capital ratio falls below the minimum thresholds set in paragraph 1. The full range of powers of the KNF can be applied in this case. In practice, however, the KNF will generally issue a (binding) “recommendation” to the bank in accordance with Article 138 paragraph 1 and/or order a bank to cease payments from net earnings. (Article 138 paragraph 2).

**EC 6:** When performing its supervisory responsibilities, the KNF may apply measures addressed to the bank's management Board. If a bank is failing to comply with sound and prudent management or where the bank's activity is in contravention to the law or the bank's articles of association, or it is endangering the interest of account holders, the KNF may, after first cautioning the bank, apply two types of sanctions against the management or the individuals in the management Board. First, it may apply to the appropriate managing body of the bank for the recall of the president, vice president or other member directly responsible for the irregularities notes (article 138, paragraph 3.1 of the banking Act). Second, the KNF may suspend from office the members of the management Board that have been charged with a criminal offence or with a fiscal offence of if the person has caused the bank major financial loss (article 138, paragraph 3.2 of the banking Act).

	<p>Pursuant to article 141, paragraph 1 of the Banking Act, in the event of a bank failing to comply with recommendations issued in response to its conduct of activity in contravention with legislation or the bank's articles of association, or a refusal to furnish the explanations and information referred to in Article 139, or in the event of a bank failing to fulfill the requirements in Chapter 11b, the KNF may also impose financial penalties on members of the management Board up to the equivalent of three months gross remuneration of the person, calculated in reference to that persons remuneration in the last three months prior to the imposition of the penalty.</p> <p>Moreover, the KNF can also recall from the office a member of the management Board in the event that the person's final and conclusive conviction of criminal offence or with fiscal offence excluding private prosecution (art 138, paragraph 5).</p> <p>In case charges in criminal or fiscal proceedings were brought against a member of the management Board or in case a member of the management Board has caused major financial losses for the bank, the KNF may suspend the relevant member from office (Article 138 paragraph 4).</p> <p><b>AC1:</b> There is only one instance where the laws and regulations ensure appropriate and prompt corrective actions of the KNF. If a bank (for reasons that are directly related to its financial circumstances) is unable to repay deposits, the KNF has five working days to issue a decision on suspension of the bank's operations as well as the establishment of a Board of receivers.</p> <p><b>AC2:</b> There are no specific stipulations in the law or regulations that allow the KNF to ring fence the bank from activities of the parent or other members of the group.</p> <p><b>AC3:</b> As an integrated financial supervisor responsible for banking supervision, capital markets supervision, insurance supervision, pension scheme supervision and supervision of electronic money institutions, the KNF is aware of all regulatory action against nonbank related financial entities.</p>
Assessment	Largely compliant
Comments	The assessors also recommend that the KNF establish an internal methodology establishing well defined "red flags," firmly assigned responsibilities, and a clear ladder for proportionate supervisory intervention.
<b>Principle 24</b>	<b>Consolidated supervision.</b> An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.
Description	<p>Polish banking groups are typically composed of banks (as parent organizations) and banks' subsidiaries operating in the financial (leasing companies, securities brokerage companies, pension and investment fund management companies, etc.) and nonfinancial sector (mostly property development companies). Two domestic banks are also parent entities for two foreign bank subsidiaries. More recently (end 2010), a financial conglomerate composed of a bank (leading institution) and insurance companies (subsidiaries of the bank) was identified and brought under the KNF supervision.</p> <p><b>EC 1:</b> The legal framework for performing consolidated supervision is in place, i.e., Chapter 11.b. "Supervision on consolidated supervision" of the Banking Act and The Act on Supplementary Supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate of 2005. The latter implements the EU Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial</p>

	<p>conglomerate. The above-mentioned legal provisions define the cases where the KNF acts as a consolidated supervisor (Article 141.f.6. of the Banking Act).</p> <p>Several measures ensure that KNF has access to the structures of the supervised banking groups and financial holding companies. First, information on the structure and activities of the group entities is included in the mandatory financial and prudential returns (consolidated financial statements, financial statements of subsidiary undertakings or of undertakings that the bank has close links to, which have not been included in the consolidated financial statements, regular FINREP returns detailing group structures and other prudential reports, regular reports on holdings' structures according to KNF Resolution no.390/2008). Secondly, the KNF has the power to and regularly assesses group structures during onsite inspections and discussions with institutions. Thirdly, KNF can request information from other foreign and domestic authorities. The KNF became the consolidated supervisor of a financial holding company meeting the conditions for supplementary supervision and set up an internal unit for maintaining ongoing dedicated oversight.</p> <p>However, a major shortcoming of the Polish legislation (see CP 5) is the absence of specific legal provisions empowering KNF to explicitly oppose to major acquisitions made by banks. In the past, KNF became the consolidated supervisor of domestic banking groups that acquired foreign banks under a simple notification procedure. The regulatory loophole undermines the powers of the KNF to assess and influence the group structures over which it has to perform consolidated supervision.</p> <p><b>EC2:</b> KNF has broad powers to obtain information from and about the activities of the entities of a banking group or financial holding company, both domestic and cross-border. Such powers are stated in the Banking Act—Article 141.i-l. The power extends over entities of the group that are not included in the consolidated financial statements and KNF is entitled to override the scope of consolidation for prudential supervision purposes (Article 141.j.2).</p> <p>The KNF is a unified supervisor for banking, insurance and capital market, which inherently embeds an enhanced degree of communication on supervisory actions across sectors. KNF sectoral departments have conducted simultaneous onsite inspections in entities of a group supervised on a consolidated basis and shared their findings. However, assessors consider that there is room to further aligning the supervisory methodologies across sectors (i.e., by amending the rating methodology to take into consideration influences from other entities of the group).</p> <p>Assessors note that the KNF does not make full use of its powers to supervise foreign activities of domestic banks, for example by performing onsite inspections. The offsite monitoring of such foreign entities is performed through the review of financial and prudential reports, and the KNF holds discussions with parent banks on the condition of foreign bank subsidiaries. As described in CP 25, materiality of the operations is a significant factor in this decision.</p> <p>The KNF can also obtain information from cross-border entities of the banking groups based on agreements (MOUs) concluded with competent supervisory authorities from other countries. In the EU, the cooperation and exchange of information takes place within the CEBS framework established for supervisory colleges (to which Poland has adhered).</p> <p><b>EC3 (see also EC2):</b> The KNF does not have adequate powers to limit or tools to evaluate the risks stemming from nonfinancial activities conducted by a bank or a</p>
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banking group. First, the legislation falls short of restricting the qualifying participations in nonfinancial undertakings, which according to EU Directive 2006/48/EC are set at maximum 15 percent of a bank's own funds for holdings in individual nonfinancial entities and at maximum 60 percent of a bank's own funds for all holdings in nonfinancial entities. Second, the KNF does not have a formal framework for analyzing contagion risks stemming from nonfinancial entities and thus judgment on the relative importance and risks building in nonfinancial activities is exercised on a case-by-case basis. This approach carries significant risks for the effectiveness of the overall supervision of groups as many banks have many nonfinancial subsidiaries (including companies for real estate development).

**EC 4:** The KNF has the power to impose prudential standards on a consolidated basis, according to Article 141.j. of the Banking Act. In practice, supervisory activities are performed on both a consolidated and solo basis, including quarterly returns provided by banks, capital adequacy calculation, large exposures and exposures to related parties, under the provisions of relevant regulations (i.e., KNF Resolutions no. 380/2008, no. 381/2008, no. 382/2008, no. 383/2008, no. 385/2008 etc.). Under the BION process, capital adequacy and future capital needs are evaluated in a comprehensive manner in light of the bank and group capital needs.

**EC 5:** (See EC 2) the KNF has concluded a number of bilateral and multilateral MOUs with foreign supervisors and participates in 16 supervisory colleges (see also CP 25).

**EC 6:** The Banking Act (Article 138.6) empowers the KNF to limit the activities of a bank or to withdraw its license in cases where it is found that the bank has become the subsidiary undertaking of persons who, due to the provisions of law in force at the place of their residence or registered office, or due to their links to other parties, prevent the KNF from performing effective supervision of the bank or when the bank does not meet the requirements enabling the supervision on consolidated basis. So far, the KNF did not consider it necessary to exercise this power. Also, according to Article 141 of the Banking Act, the KNF may impose financial penalties on members of the Management Board or take other corrective actions when banks fail to fulfill the requirements for consolidated supervision.

**EC 7, EC 8, and EC 10:** KNF Resolution no. 383/2008 requires that risk management and internal control systems in banks cover operations conducted directly by the bank, as well as bank's operations in holdings referred to in Article 141 f par.1 of the Banking Act. The resolution also indicates that the bank's Management Board is responsible for designing and implementing the banks' policies and processes that have to be commensurate with the complexity and scale of bank's operations.

During onsite inspections, the KNF monitors whether the institution's management Board is informed adequately about the state of affairs in foreign establishments, and whether decision-making and governance have been adequately implemented in the foreign entities. When the risk profile of the foreign operations is higher, the KNF pays additional attention to the bank's internal governance and would perform onsite inspections at the parent entity.

The KNF reviews the available information concerning bank's foreign entities' financial position, activities and risks, including some documents received from host country supervisors. The assessors note however, that in some instances communication with foreign supervisors has been poor and the KNF has shown



	<p>little proactiveness in promoting a regular dialogue on supervisory matters of common. For example, the assessors were informed that the KNF did not meet with the Italian supervisor when they inspected the Polish subsidiary and the inspection report was not obtained after the inspection.</p> <p><b>EC 9:</b> The KNF has the power to require the closing of foreign offices of Polish banks (see EC 6) or to impose limitations on their activities. However, the assessors did not find evidence that KNF is actively using its powers to influence group structures so as to enhance effective oversight.</p> <p><b>AC 1:</b> There are no legal provisions stating fit and proper standards for senior management of parent companies, while the activities of parent companies and affiliated companies can be reviewed under the current applicable framework.</p> <p><b>AC 2:</b> The KNF does not assess and does not have a formal framework for assessing the quality of supervision conducted in countries in which domestic banks have material operations.</p> <p><b>AC 3:</b> Assessors did not find evidence of an active involvement of the KNF in the supervision of foreign offices of domestic banks.</p>
Assessment	Largely compliant
Comments	<p>While the legal framework for performing consolidated supervision is generally adequate, improvements are needed in certain areas:</p> <ul style="list-style-type: none"> <li>- the legal provisions should be expanded to empower KNF to oppose ex-ante to major acquisitions made by banks, which would allow it to better influence the area of consolidated supervision;</li> <li>- the legal framework should be amended to specify limitations for holdings in nonfinancial entities; and</li> <li>- the legislation should be amended to provide fit-and-proper criteria for senior management of bank's parent companies.</li> </ul> <p>Assessors also note that supervisory practices for performing consolidated supervision should be enhanced as follows:</p> <ul style="list-style-type: none"> <li>- the KNF should further align supervisory methodologies across sectors (i.e., banking, insurance) to enable more coordination and consistency in the supervisory actions across groups;</li> <li>- the KNF should develop a framework for assessing contagion risks stemming from nonfinancial entities part of banking groups;</li> <li>- the KNF should take a more intrusive stance in respect to the supervision of foreign activities of domestic banks and consider more closely a full range of risks (i.e., reputational) that such entities can pose on parent banks;</li> </ul> <p>the KNF should be more proactive in respect to the supervisory activities of home supervisors, including through the participation in onsite inspections of the latter. Such an approach would enable a better overall understanding of the group situation and would enrich the information necessary for performing supervision on a sub-consolidated basis; and</p> <ul style="list-style-type: none"> <li>- in line with international best practices, the KNF should develop guidelines for assessing the equivalence of supervisory standards in foreign countries.</li> </ul>

	The effectiveness of performing effective consolidated supervision over financial holding companies is yet to be tested and assessors recommend that KNF maintains a close understanding and oversight over all financial and nonfinancial entities of the groups.
<b>Principle 25</b>	<b>Home-host relationships.</b> Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.
Description	<p><b>EC 1:</b> The KNF has mainly a role of host supervisor. The KNF has signed MOUs with several supervisory authorities and has regular meetings with these authorities, particularly in the setting of supervisory colleges. The KNF has signed MOUs with the supervisory authorities in Belarus, Belgium, China, Cyprus, France, Germany, Hungary, Italy, Jersey, Lithuania, Luxemburg, the Netherlands, Portugal, Ukraine, and the United States. The KNF is represented on core supervisory colleges of all the systemically important banks in Poland: Unicredit, ING, Rabobank, Commerzbank, KBC, Raiffeisen, Millennium BCP, BNP Paribas, Santander, Eurobank EFG, and Nordea. Information exchange during these colleges is governed by the relevant CEBS/EBA guidelines. The KNF also has a bilateral relation and exchanges information with the banking supervisor of Citigroup.</p> <p><b>EC 2:</b> The Polish banks have limited foreign operations, but two Polish banks have subsidiaries in Ukraine. An MOU with the Ukrainian supervisor, including the right to perform onsite inspections, has been signed, but, despite a relatively high level of nonperforming loans and poor performance, the KNF has not yet inspected the Ukrainian operations because of its low materiality to the total assets of the domestic group. Instead, a targeted examination focused on risk management and governance of subsidiaries at the domestic bank was performed in the last quarter of 2010. The Ukraine supervisory authorities on the other hand have asked assurances on the financial standing of the domestic banking group.</p> <p><b>EC 3:</b> The KNF's role as a home supervisor is very limited. The KNF has exchanged information with the Ukrainian supervisor on the overall framework of supervision and the domestic bank and banking group. The local operations in Ukraine are not material to the Ukrainian financial sector.</p> <p><b>EC 4:</b> The KNF shares information with home country banking supervisors on the basis of the MOU signed. The cooperation is mainly among EEA countries and the USA. The EEA cooperation is governed by the CEBS/EBA guidelines. This includes the escalation to the home supervisor regarding material or persistent noncompliance with supervisory requirements, adverse or potentially developments in the local operations, adverse assessments of qualitative aspects of the bank's operations and any impending supervisory action. The KNF regularly provides copies of the risk assessments and its onsite examination findings. Any other relevant ad hoc requests are also fulfilled. In the case of EEA branches the KNF is responsible for liquidity supervision and frequently exchanges information with the home supervisor in this regard.</p> <p><b>EC 5:</b> Banks and subsidiaries of foreign banks are subject to similar regulatory requirements to Polish banks. For branches of banks from outside the EEA, the KNF retains full supervisory responsibility and imposes the same requirements as</p>

	<p>those applicable to domestic banks. There are currently no third country branches in Poland. For the branches from EEA countries, the KNF supervises liquidity, in accordance with the EU Directive and the home supervisor remains responsible for the oversight of these institutions.</p> <p><b>EC 6:</b> The KNF does not have a specific condition in its licensing policies and procedures that the home supervisor must practice consolidated supervision. In most cases, however, this is not an impediment as the vast majority of the home supervisors are EEA countries who practice consolidated supervision.</p> <p><b>EC 7:</b> Home supervisors are given access to local offices and subsidiaries after prior notification of the KNF. The assessors requested an overview of the inspections carried out by home supervisors and were informed that regular inspections were carried it out. It appears, however, that it is not part of the supervisory practice of the KNF to meet with home supervisory delegations when they are in Poland and that the KNF does not request insight in their findings.</p> <p><b>EC 8</b> Shell banks or booking offices are not permitted in Poland.</p> <p><b>EC 9:</b> The KNF does not have clear internal procedures regarding home host communication and subsequent sanctions, but the staff of the agency confirms that if action were taken on the basis of information received from another supervisor, it would consult with that supervisor before action was taken. Most of the supervisory cooperation within the KNF is governed by the EU framework, which imposes strict rules concerning consultations and supervisory action.</p> <p><b>AC 1:</b> The KNF as a home supervisor has not agreed any particular communication strategy with host supervisors.</p>
Assessment	Largely compliant
Comments	<p>There is no legal requirement for the home supervisor of banks established in Poland to practice consolidated supervision in the Banking Act or regulations.</p> <p>The KNF should take a more proactive approach when foreign home supervisors inspect their subsidiaries. Findings of these inspections should be shared with the KNF and at least a meeting should be organized.</p> <p>Based on the discussions with the KNF, the assessors believe that the authorities as a home supervisor place too much emphasis on the quantitative indicators of the materiality of the group and are at risk of underestimation the reputational damage that may occur as a result of a further deterioration in the Ukrainian subsidiary.</p>

1/ Per Art. 138(3)., from dismissal and suspension of management, to imposing penalties, limiting activities and revoking the license.

2/ Per Article 142, a net loss, the threat of a net loss and a danger of insolvency.

3/ The triggers provide ample powers to KNF, but may not delimit well the risk of forbearance. The first trigger are losses exceeding half of the bank's capital after 6 months of the date of an extraordinary meeting of shareholders, the other two triggers are general: (i) circumstances that threaten the viability of the bank; and (ii) fall of own funds below minimum requirements.

**Table 3. Republic of Poland: Overview of Ratings**

Core Principle	C <sup>1/</sup>	LC <sup>2/</sup>	MNC <sup>3/</sup>	NC <sup>4/</sup>	NA <sup>5/</sup>
1. Objectives, Autonomy, Powers, and Resources			X		
1.1 Responsibilities and Objectives		X			
1.2 Independence, Accountability, Transparency			X		
1.3 Legal framework			X		
1.4 Legal powers		X			
1.5 Legal protection		X			
1.6 Cooperation		X			
2. Permissible Activities		X			
3. Licensing Criteria			X		
4. Transfer of Significant Ownership	X				
5. Major Acquisitions		X			
6. Capital Adequacy	X				
7. Risk Management Process		X			
8. Credit Risk	X				
9. Problem Assets, Provisions and Reserves	X				
10. Large Exposure Limits	X				
11. Exposures to Related Parties		X			
12. Country and Transfer Risks	X				
13. Market Risks	X				
14. Liquidity Risk	X				
15. Operational Risk		X			
16. Interest Rate Risk in the Banking Book	X				
17. Internal Control and Audit		X			
18. Abuse of Financial Services		X			
19. Supervisory Approach		X			
20. Supervisory Techniques			X		
21. Supervisory Reporting	X				
22. Accounting and Disclosure		X			
23. Corrective & Remedial Powers of Supervisors		X			
24. Consolidated Supervision		X			
25. Home-Host Relationships		X			

<sup>1/</sup> C: Compliant.

<sup>2/</sup> LC: Largely compliant.

<sup>3/</sup> MNC: Materially noncompliant.

<sup>4/</sup> NC: Noncompliant.

<sup>5/</sup> NA: Not applicable.

### III. RECOMMENDED ACTION PLAN AND AUTHORITIES' RESPONSE TO THE ASSESSMENT

#### Recommended Action Plan

Table 4 lists the suggested steps for improving compliance.

**Table 4. Republic of Poland: Recommended Action Plan to Improve Compliance with the Basel Core Principles**

Reference Principle	Recommended Action
Objectives, Independence, Powers, Transparency and Cooperation (CP1)	<p>CP 1.(1)</p> <ul style="list-style-type: none"> <li>• Take stock of the existing recommendations and bring them in line with current market developments and supervisory expectations.</li> </ul> <p>CP 1.(2)</p> <ul style="list-style-type: none"> <li>• Develop and implement an independent methodology to benchmark salaries against the banking industry.</li> <li>• Include the option to hire independent external experts at the expense of the bank in the Banking Act.</li> <li>• Include the requirement to publicly disclose the reasons for the dismissal of the Chairperson of the KNF in the Banking Act.</li> <li>• Move to a system with full-time, remunerated external commissioners appointed for cascading fixed terms to improve KNF's governance.</li> </ul> <p>CP 1.(3)</p> <ul style="list-style-type: none"> <li>• Amend Banking Act to fully empower the KNF to issue broader binding resolutions.</li> <li>• In the longer term, enhance legal clarity regarding the regulatory powers of the KNF.</li> </ul> <p>CP 1.(5)</p> <ul style="list-style-type: none"> <li>• Amend Banking Act to enhance legal protection for KNF's employees, commissioners, as well as for trustees and Board of receivers.</li> </ul>
Permissible Activities (CP2)	<ul style="list-style-type: none"> <li>• Amend Banking Act to limit the scope of real estate property acquisitions.</li> <li>• Establish adequate prudential supervision for credit unions.</li> </ul>

Reference Principle	Recommended Action
Licensing Criteria (CP3)	<ul style="list-style-type: none"> <li>• Amend law to introduce fit-and-proper standards for supervisory Board members.</li> <li>• Introduce fit-and-proper criteria for all members of the management Board and the head of the internal audit.</li> <li>• Require assurance of absence of potential conflicts of interest from all members of the supervisory and management Boards.</li> <li>• Amend law to require a systematic analysis of the direct and indirect shareholders, natural or legal persons, who have qualifying holdings in the bank or of the close links existing between the bank and other natural and legal persons.</li> <li>• Introduce a streamlined and more specific licensing framework and ensure harmonization with conditions for acquisitions of banks' shareholdings.</li> </ul>
Transfer of Significant Ownership (CP4)	
Major Acquisitions (CP 5)	<ul style="list-style-type: none"> <li>• Amend the Banking Act so as to require pre-approval for major acquisitions by domestic banks.</li> <li>• Develop a supervisory methodology to assess contagion risk for nonfinancial activities in banking groups.</li> <li>• Amend the Banking Act to restrict individual holdings in nonfinancial activities as a percentage of own funds.</li> </ul>
Capital Adequacy (CP6)	<ul style="list-style-type: none"> <li>• Consider setting truly risk-based capital requirements as part of risk-based supervision.</li> </ul>
Risk Management Process (CP 7)	<ul style="list-style-type: none"> <li>• Amend law to assign explicit responsibility of the management Board for the effective management of all types of risks significant in the bank's activity.</li> <li>• Streamline and modernize corporate governance regulations.</li> <li>• Develop internal guidelines for benchmarking risk-management practices in banks according to the bank's size and risk profile.</li> </ul>
Credit Risk (CP8)	<ul style="list-style-type: none"> <li>• Consider a more general ban for Board members with conflicts of interest to not take part in credit decisions.</li> <li>• Consider a wider definition for the requirement of arm's length credit decisions by including relatives and close affiliates.</li> </ul>
Problem Assets, Provisions and Reserves (CP 9)	
Large Exposures (CP10)	

Reference Principle	Recommended Action
Related Parties (CP 11)	<ul style="list-style-type: none"> <li>• Amend the Banking Act to expand the range of related parties to other categories of persons who may raise a potential conflict of interest.</li> <li>• Amend the Banking Act to require banks to take all reasonable measures to prevent conflicts of interest within their more general risk-management framework.</li> </ul>
Country Risks (CP 12)	
Market Risk (CP 13)	
Liquidity Risk (CP 14)	<ul style="list-style-type: none"> <li>• Require banks to take into consideration more closely situations of inability of parent banks to fulfill their funding commitments as part of the liquidity contingency plans.</li> </ul>
Operational Risk (CP 15)	<ul style="list-style-type: none"> <li>• Introduce a supervisory procedure to assess the banks' capacity to meet the risk-management criteria before they can progress to the standardized approach.</li> <li>• Introduce more specific and more detailed requirements regarding the IT audits banks.</li> <li>• Enhance regulations to more specifically address the compliance function.</li> </ul>
Interest Rate Risk in the Banking Book (CP 16)	
Internal Control/Audit (CP17)	<ul style="list-style-type: none"> <li>• Include a legal or regulatory obligation that calls for banks to notify the KNF as soon as they become aware of any material information that may negatively affect the fitness and propriety of a Board member, the Head of Internal audit, or a member of senior management.</li> <li>• Perform a fit-and-proper assessment of the Head of Internal Audit and impose a notification requirement on the Board for the dismissal of the Head of Internal Audit.</li> <li>• Regularly exchange views on the quality and independence of internal audit with the external auditor during tri-partite meetings.</li> </ul>
Abuse of Financial Services (CP18)	<ul style="list-style-type: none"> <li>• Amend legislation to require banks to report to the KNF any suspicious activities and incidents of fraud when they are material to their safety, soundness and reputation.</li> <li>• Improve AML/CFT Act in respect to correspondent banks and foreign operations of local banks.</li> <li>• Enhance the KNF resources for AML/CFT surveillance.</li> </ul>
Supervisory Approach (CP 19)	<ul style="list-style-type: none"> <li>• Make the work plan in the ES more specific and better aligned to the specific risk areas.</li> </ul>

Reference Principle	Recommended Action
Supervisory Techniques (CP 20)	<ul style="list-style-type: none"> <li>• Perform onsite inspections at the largest banks at least on an annual basis.</li> <li>• Increase the number of targeted examinations for riskier banks.</li> <li>• Improve involvement of onsite supervisors in the follow up with post-examination recommendations.</li> <li>• Enhance supervisory methodologies to enable a timely intervention in banks.</li> <li>• Introduce clearer prioritization of post-examination recommendations.</li> <li>• Take a more active stance in influencing the quality of internal audit in banks and establish a regular dialogue with the bank's internal auditors.</li> <li>• Engage more actively in a dialogue with supervisory Board members and with external auditors.</li> <li>• Enhance onsite resources and streamline allocation.</li> </ul>
Supervisory Reporting (CP 21)	
Accounting/Disclosure (CP 22)	<ul style="list-style-type: none"> <li>• Include direct powers in the Banking Act to allow the KNF to rescind or reject the appointment of an external auditor that is deemed to have inadequate expertise.</li> <li>• Be more forceful in challenging external auditors and the bank's management when accounting and reporting matters are identified during onsite inspections.</li> <li>• Introduce trilateral meetings, at least once a year, with internal and external auditors to discuss issues of common interest and to serve as validation and consistent communication.</li> <li>• Make IFRS mandatory for the solo accounts of all commercial banks.</li> <li>• Introduce specific banking expertise and experience requirements for auditors of commercial banks; these should be at the level of the firm as well as the individual.</li> </ul>
Supervisors' Corrective and Remedial Powers (CP 23)	<ul style="list-style-type: none"> <li>• Amend the Banking Act to eliminate the requirement to caution a bank before taking action.</li> <li>• Amend the Banking Act to allow the KNF to suspend members of the supervisory Board.</li> <li>• Establish a proper bank resolution regime.</li> </ul>



Reference Principle	Recommended Action
Consolidated Supervision (CP 24)	<ul style="list-style-type: none"> <li>• Further align supervisory methodologies across sectors (i.e., banking, insurance) to enable more coordination and consistency in the supervisory actions across groups.</li> <li>• Take a more intrusive stance with respect to the supervision of foreign activities of domestic banks and consider more closely a full range of risks (i.e., including reputational) that such entities can pose on parent banks.</li> <li>• Take a more proactive stance with respect to the supervisory activities of home supervisors.</li> <li>• Develop guidelines for assessing the equivalence of supervisory standards in foreign countries.</li> <li>• Perform enhanced oversight of financial holding companies.</li> </ul>
Home-Host Relationships (CP 25)	<ul style="list-style-type: none"> <li>• Amend the Banking Act to include a legal requirement for assessing whether the home supervisor of domestic branches or subsidiaries practices global consolidated supervision.</li> <li>• Be more proactive when foreign home supervisors inspect subsidiaries and ensure inspection findings are shared.</li> </ul>

## **A. Authorities' Response to the BCP Assessment**

### **Unequal Treatment**

Based on other ROSCs conducted in recent years we have some doubts concerning the equal treatment of the solutions adopted in the Polish supervisory system as compared to the legal and institutional frameworks of other countries assessed. Comparative analysis of such indicators as independence of supervisory authorities or the quality of legal systems indicates that there is no sufficient rationale for formulation of divergent assessments.

The issue of unequal treatment is especially adequate in the context of the assessment of the model of supervision and independence of the KNF. Further details are provided below.

### **Model of Supervision**

As regards the reservations concerning the model of supervision in Poland in terms of the internal structure of the KNF we would like to stress that there is no single global approach to the supervisory framework. It differs significantly across Europe. Shortly speaking, supervisory structures are designed according to their administrative framework, local financial market, legal order and other circumstances. In slightly less than a half of EU Member States more than one authority is responsible for supervision of financial market. Competences are divided either on sectoral or functional basis. In the first case, usually a central bank supervises banks, and independent or semi-independent agencies supervise insurance companies and capital market institutions. The second approach is so far limited to one country (and another one will soon follow), where one authority (the central bank) carries out prudential supervision and another - conduct of business supervision. The rest of the EU countries (more than a half) have allocated supervision to one authority, either a central bank or a central agency. Within those single authorities responsible for supervision, various approaches to the structure exist. Most of the countries align them with a strong sectoral focus. A small majority apply a quasi-twin-peaks model, having one authority internally split into prudential/conduct of business supervision.

There is also no general internal structure of the supervisory authority and it is designed according to the model of administration and the needs of financial market. Our approach to internal organization was based on international standards. The structure of the KNF is embedded in the by-laws and each department has individual rules which describe its duties and competences. Respective departments support and complement each other in order to implement tasks and ensure effective supervision.

In addition, there is no one sole internal model of structure of the inspections. The model of separated on-site and off-site inspections is used in many countries. Therefore in our opinion the reservations contained in the report concerning the separation of on- and off-site inspections are unjustified.

Finally, the amount of resources allocated to the supervision over cooperative banks is tailored to the issue of systemic risk which could be generated by such institutions.

## **Independence**

We do not agree with the general conclusion of the report indicating that operational independence of the KNF is seriously limited. The Polish legal solutions and practice of supervision do not form basis for such strong and negative valuations. It should be stressed that under the present legislation three out of seven Members of the KNF have got defined terms of office. We also believe that the report requires further clarifications as regards the powers of the President of the Polish Council of Ministers with regard to defining the by-laws of the KNF's Office, which stipulate its internal organization rules - we would like to stress that the statute is a two pages document consisting of six paragraphs whereas orders on the organization of the KNF's Office issued by the Chairman consist of several hundreds of pages.

## **B. Detailed Comments**

### **Principle 1(1): Responsibilities and Objectives**

As regards the description and comments of the assessors (relating also to Principles No.7 and 17) in the scope of the Polish regulations, we would like to point out that the KNF has already approved amended Recommendation H on internal control and Recommendation R on guidelines to identify impaired on-balance sheet credit exposures, calculate impairment allowances for on-balance sheet credit exposures and provision for off-balance sheet credit exposures.

### **Principle 1(2) Independence, Accountability, Transparency**

#### **a) Composition of the KNF**

In our opinion it understandable that the non-executive Members of the KNF have full time position in their respective organizations. It is worth to mention that the non-executive Members of the KNF represent two Ministers who are strongly connected with the financial markets, i.e. Minister of Finance (responsible for financial institutions) and Minister of Labor and Social Policy (responsible for social security), as well as the Governor of National Bank

of Poland and the President of Poland. Owing to such a composition, the KNF is able to achieve a high level of synergy. It also protects the KNF from the potential political influence of the government being currently in power, as only two out of seven Members of the KNF are representatives of the governmental ministers, i.e. they may be replaced upon the change of the government. It is worth to note, that the other two non-executive KNF Members (representatives of the President of Poland and the Governor of the National Bank of Poland) are fully independent of the government. As the office terms differ among those authorities, the balanced composition and the immunity to the political influence on the KNF is ensured.

Also the doubts concerning proper discharging of the duties by the non-executive KNF Members are not justified. The KNF Office and its staff assist all KNF Members, also the non-executive ones. Besides that, having full time positions in their respective authorities and dealing with the financial market problems, the non-executive KNF Members have sufficient knowledge and experience that enable them to exercise their duties properly.

Furthermore, according to the Act on the Financial Market Supervision (FMSA), the role of the non-executive KNF Members is equal to the role of the executive Members, and the KNF is free to decide on its operating procedures in the Rules of Procedure, which shall be issued by the KNF itself according to Article 11(4) of the FMSA.

## **b) Funding of KNF**

We would like also to further explain the establishment of the “Working Group on the financing model of the financial supervision in Poland” and its tasks. Its main goal is to achieve comprehensive outlook on the financing system of the supervision, trying to make it more transparent and to allocate the levies among the supervised institutions in more just and balanced manner, reflecting the real costs of performing supervisory duties. On this occasion we would like to assure that the aim of this initiative is in no case the attempt to decrease the funding of the KNF. The Working Group was created in response to the strong demand articulated mainly by the capital market which has pointed out that levies for the supervision are not well distributed among the participants of that market.

It shall be underlined that the MoF, while preparing the budget bill, always takes into account the current tasks of the KNF as well as any prospective enlargement of such tasks and duties. Minister of Finance, being responsible for the proper functioning of the financial institutions, is fully aware of the importance of effective and efficient supervision, and understands that the proper funding of the KNF is crucial. On the other hand, as the KNF Office is the public body, some degree of control over its spending has to be maintained. It is indeed financed by the supervised entities, however the payments shall be treated as a kind of public levy, and for that reason shall be subject to all necessary procedures.

### c) Benchmarking the Salaries of KNF's Employees

As the salaries of the employees of the KNF Office are concerned, it shall be underlined that they reflect the level of market salaries offered by supervised institutions. Article 20 (2) of the FMSA stipulates that “The President of the Polish Council of Ministers shall define, by way of a regulation, the manner of establishing the amount of funds to be appropriated for payment of remuneration and bonus awards to the KNF's Chairperson and Vice-Chairpersons, and determining the amount of such remuneration and bonus awards, as well as the manner of establishing the amount of funds to be appropriated for payment of remuneration and bonus awards to employees of the KNF Office, **taking into account** the organization of the KNF and the KNF Office, the necessity to ensure the proper discharging their duties within the scope of supervision exercised and **the level of salaries in the regulated institutions**”. On the basis of this empowerment, on December 4<sup>th</sup>, 2006, the Prime Minister issued the Regulation on remuneration and bonus awards for employees of the KNF Office, the KNF's Chairperson and Vice-Chairpersons (published in Official Journal of Laws of 2006, No. 183, item 1358 as amended).

Paragraph 7 (1) of this Regulation stipulates that the amount of funds assigned for remuneration and bonuses for the employees of the KNF Office shall take into account “the amount of the average gross salary offered by the supervised institutions in the year preceding by two years the budgetary year”.

Section 2 of the Paragraph 7 of the Regulation provides additionally that the amount of funds allocated in the budgetary year for remuneration and bonuses available for the employees of the KNF Office shall not be lower than the result of multiplying of the amount of remuneration and bonuses scheduled for the year preceding the budget year and the average annual index of growth of wages in the public sector for the budget year.

Those provisions warrant that the level of salaries in the KNF Office is more than satisfactory<sup>4</sup>, being able to attract highly qualified professionals from the industry who often join the KNF team.

### Principle 1(3) Legal Framework

The assessors have also evaluated the legal framework (sub-principle 1.3) for the banking supervision in Poland as „materially non-compliant” stating in their comments that the KNF

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<sup>4</sup> The average monthly salary in the KNF Office in 2010 amounted to PLN 8633 (excluding additional annual remuneration). Whereas the average monthly salary in the section *"Financial and insurance activities"* in 2009 (excluding annual bonuses) amounted to PLN 5325, 55 (Statistical Yearbook of the Polish Central Statistical Office 2010).

does not have full power to set mandatory prudential standards without changing the laws and recommending to fully empower the KNF to issue binding rules more broadly. In our opinion this subprinciple encompasses the broad and complex issue of legal framework not limited solely to the problem of the supervisor's ability to set prudential standards. The legal framework as a whole is complete, sound and robust, what was proved during the last crisis. Also the supervisor itself, as it is indicated in the description to this subprinciple, is of the opinion that the legal framework is sufficient to exercise the supervision in the effective way. For those reasons the assessment of the level of observance of this subprinciple as "materially non-compliant" is far too strict.

Moreover, it must be indicated that in the light of the Polish constitutional law, the postulate to grant the KNF more power to set prudential mandatory standards is not possible. The main source of law in Poland is the act of Parliament. The act may stipulate that its provisions might be supplemented by the act of lower rank. It must however indicate the scope of such regulation as well as the guidance for the content. It is rather not possible in the light of the Polish Constitution to give the KNF the right to set freely the prudential standards limiting this right only by the purpose, i.e. ensuring the safety and the soundness of the banking sector, as it is recommended in the BCP DAR.

On the other hand, the KNF has the power to issue the recommendations dealing also with prudential standards. Indeed, the recommendations are not legally binding; however it is a common and established practice that banks do follow them.

Furthermore, if in the opinion of the KNF the formally legally binding regulations are necessary, the MoF is always open to suggestions concerning the improvement of the legal framework and ready to initiate the legislative procedure.

The assessors have indicated that creating a legal framework with reference to the cooperation between the MoF and the KNF must meet the following conditions:

"1) KNF opinions regarding the design and calibration of further regulations to be issued by the MF should be adequately taken into consideration;

2) a clear division of tasks and a process of regular cooperation between the MoF and KNF in identifying and promoting relevant regulations should be established; and

3) the regulatory process shall be kept away from any political and industry interference".

We are pleased to state that these conditions have been already met and fulfilled. The opinions of the KNF are always considered in detail and duly taken into account. The division of tasks between those two authorities (KNF and MoF) is clearly set by the legal acts, which establish their responsibilities, including the role in creating the legal framework for the financial markets. The KNF position is particularly strong in the area of banking

legislation, where it is empowered by the Banking Act to issue resolutions in the areas specified by the Act.

The third condition is also fulfilled, as all the regulatory measures undertaken by the MF, as well as by KNF, are based on the merits.

In case of the MoF regulations, it is the Minister of Finance who takes the final decision. He/she is however obliged by law to consult a draft regulation with other relevant Ministers as well as interested stakeholders, e.g. market participants associations. These consultations enable to shape the legal acts in the most suitable way, profiting from the experience and practical knowledge of market participants who have to follow those laws. The consultations may not be however considered as an interference of the industry, as it is the Minister of Finance who takes a decision on the final content of the regulation.

In the case of the KNF resolutions, the final decision on the content of these acts is within the KNF itself.

Concluding, we are of the opinion that the Polish legal framework in the area of banking supervision is sufficiently good, reflecting the EU developments, as well as specificity of the Polish banking environment.

### **Principle 2: Permissible Activities**

As far as Principle 2 is concerned (implementation was described as "largely compliant") it is mentioned about possible introduction of the credit unions' supervision, necessary creation of the effective, prudential supervisory rules and, in consequence, increasing the number of employees of the Polish Financial Supervision Authority. The works have already got underway in order to prepare properly the KNF to the new tasks. The working team responsible for the development and implementation of the KNF's system of supervision over credit unions has been established recently. Nevertheless, because the Credit Union Act was brought to the Polish Constitutional Tribunal by the President of the Republic of Poland for adjudication on its conformity with the Constitution - as noticed by the *IMF/WB* mission experts - the entry into force of the said Act, and therefore the establishment of such a responsibility, is still uncertain.

### **Principle 3: Licensing Criteria**

We would like to inform the recipients of the BCP assessment report that on the 10<sup>th</sup> of June 2011, an important amendment of the Banking Act has been introduced. According to the amended Article 34 paragraph 1, the KNF - while issuing the authorization for establishment of a bank - also approves the composition of the first management Board. This means that the explicit approval of the management Board is currently an element of the said authorization.

### **Principle 6: Capital Adequacy**

We would like to kindly inform that between the entry into force of the principles of Basel 2 and the end of 2010, the KNF:

- performed assessments of applications received from seven banks applying for the IRB for credit risk, and performed two processes of verification of fulfillment of conditions arising from the decisions issued in this scope. As a result, in the considered period three negative and four conditional decisions were issued, and three cases were in progress;
- the performed assessments of applications received from two banks applying for the advanced measurement approach for operational risk (resulting in one negative and one conditional decision), and carried out a verification of fulfillment of the conditions arising from the conditional decision.

### **Principle 15: Operational Risk**

We would like to indicate that the EU Directive *2006/48/EC* (and, in consequence, the relevant Polish regulation) does not require a formal approval of the competent authority for the use of the standardized approach to operational risk. The KNF's approach complies with Directive *2006/48/EC* which sets particular requirements for a bank intending to apply the standardized approach. The compliance with those requirements is assessed during an on-site examination.

It should also be stated that the requirement of banks' notifications to competent authorities prior to using the standardized approach is stated only in CRD IV, which is not binding at the present. However, even the CRD IV does not mention the requirement to receive such an approval of the competent authority.

However, we recognize the fact that the BCP assessment is solely based on the Basel Core Principles and other standards and recommendations of Basel Committee for Banking Supervision and not specific legislation of European Union, implementing such standards.

### **Principle 20: Supervisory Techniques**

Please be also informed that the KNF applies a number of measures aimed at monitoring of the bank's follow-up activities. These measures assume balanced involvement of both off-site and on-site resources.

The on-site is engaged in the process of the verification of the post-examination recommendations implementation at several stages:



- during the assessment - whether the draft schedule of the recommendations' implementation prepared by the bank is appropriate;
- during the off-site analyses the quarterly reports from banks concerning the implementation of recommendations. Regular consultation on the progress in implementation of recommendations takes place between off-site and on-site;
- during targeted examinations focused on the review of the implementation of recommendations; and
- in the course of every next full-scope examination.

According to the on-site examination methodology "The principles regarding the format and content of after examination recommendations", the post-examination recommendations are grouped and described by areas examined. In each area recommendations are listed starting from the most important and most material findings. When in the judgment of examiners it is necessary, the word "immediately" or "promptly" is added to stress the urgency of a given recommendation.

What concerns the prioritization in terms of the date of implementation is that banks are required to propose and to put forward the draft of the detailed schedule of the implementation of all recommendations. The schedule provided by a bank referring to the implementation of the on-site examination recommendations is analyzed by the off-site in cooperation with the on-site. As a result the schedule is adjusted appropriately and determines clear priorities.

We would like to explain that the on-site activities in the area of management take into account the qualitative aspects of corporate governance. The elements examined include, inter alia:

- the risk awareness (the content, frequency and the quality of Management Information System, risk appetite approved by the Supervisory Board);
- the strategy formulated for the bank and the ability to implement it;
- the ability of the bank's management to plan and prevent excessive risk, which may occur at the moment of a change of market conditions or the introduction of a new product or transaction; and
- the Management Board composition, professional experience and skills.

The findings in that regard are described in the examination report and the note supplementing the report which is focused on management issues.

Furthermore, the amount of resources allocated to the supervision over cooperative banks is tailored to the issue of systemic risk which could be generated by such institutions.

Despite the fact that the World Bank and International Monetary Fund noticed that importance of particular cooperative banks for the whole banking system is low, it needs to be stressed that those institutions are meaningful for local communities, especially SMEs, as in many cases cooperative banks are the only source of access to banking services.