

**REPORT ON THE ACTIVITIES  
OF THE POLISH FINANCIAL  
SUPERVISION AUTHORITY  
IN 2011  
(SHORT VERSION)**

## CONTENTS

<b>THE MOST IMPORTANT EVENTS OF 2011 .....</b>	<b>7</b>
<b>1. THE POLISH FINANCIAL SUPERVISION AUTHORITY .....</b>	<b>8</b>
<b>2. THE FINANCIAL MARKET IN POLAND.....</b>	<b>9</b>
2.1. OVERVIEW .....	9
2.2. BANKING SECTOR .....	11
2.3. INSURANCE SECTOR .....	16
2.4. PENSIONS SECTOR.....	17
2.4.1. Open pension funds and general pension fund management companies .....	17
2.4.2. Occupational pension funds and occupational pension fund management companies .....	22
2.4.3. Occupational pension schemes and individual pension accounts .....	23
2.5. CAPITAL AND COMMODITY MARKETS .....	27
2.5.1. Investment firms and banks operating securities accounts (custodian banks) .....	27
2.5.2. Organised securities markets .....	29
2.5.3. The settlement and depository system.....	32
2.5.4. Public offerings of financial instruments other than investment certificates .....	32
2.5.5. Undertakings for collective investment.....	35
2.5.6. Commodities market.....	38
2.6. LICENSING AND AUTHORISING ACTIVITIES .....	40
<b>3. SUPERVISORY ACTIVITIES OF AN ANALYTICAL NATURE .....</b>	<b>41</b>
3.1. BANKING SUPERVISION.....	41
3.1.1. Monitoring of banks' financial condition.....	42
3.1.2. Monitoring of banks' compliance with regulations in force .....	42
3.2. SUPERVISION OF THE INSURANCE MARKET .....	43
3.2.1. Monitoring the financial standing and investment policy of undertakings and supervision of the implementation of recovery plans.....	44
3.2.2. Supervision of undertakings' compliance with legal regulations concerning reporting and disclosure obligations .....	46
3.3. SUPERVISION OF THE PENSION MARKET .....	48
3.3.1. Monitoring of the financial standing of pension fund companies and the investment activity of pension funds.....	48
3.3.2. Supervision of occupational pension schemes .....	50
3.4. SUPERVISION OF THE CAPITAL AND COMMODITY MARKETS .....	50
3.4.1. Supervision of entities operating on the securities market.....	50
3.4.2. Trading Supervision System .....	53
3.4.3. Supervision of securities issuers other than investment funds .....	53
3.4.4. Supervision of undertakings for collective investment .....	55
3.5. SUPERVISION BASED ON RISK ANALYSIS USING BION METHODOLOGY .....	57
3.5.1. BION scoring in the banking sector.....	58
3.5.2. BION scoring in the pension sector.....	59
3.5.3. BION scoring in the insurance sector.....	59
3.5.4. BION scoring of capital market entities .....	60
3.6. STRESS TESTING .....	62
3.6.1. Stress tests in the banking sector - EBA .....	62
3.6.2. Stress testing in the banking sector - KNF Office.....	63
3.6.3. Stress testing of the insurance industry - EIOPA .....	63
3.6.4. Stress testing in the insurance sector - KNF Office.....	64
<b>4. INSPECTION ACTIVITIES .....</b>	<b>65</b>
4.1. INSPECTIONS OF BANKS .....	65
4.2. INSPECTIONS OF INSURANCE UNDERTAKINGS .....	70
4.3. INSPECTIONS OF INSTITUTIONS OPERATING IN PILLARS II AND III OF THE PENSION SYSTEM .....	71
4.4. INSPECTIONS OF INVESTMENT FIRMS.....	71
4.5. INSPECTIONS OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT.....	72

4.6.	INSPECTIONS OF POWER COMPANIES .....	73
4.7.	INSPECTIONS REGARDING FULFILMENT OF OBLIGATIONS RELATED TO THE PREVENTION OF MONEY LAUNDERING AND FINANCING OF TERRORISM .....	73
<b>5.</b>	<b>REGULATORY AND PRUDENTIAL REGIME TASKS .....</b>	<b>75</b>
5.1.	RESOLUTIONS OF THE POLISH FINANCIAL SUPERVISION AUTHORITY .....	75
5.2.	RECOMMENDATIONS OF THE POLISH FINANCIAL SUPERVISION AUTHORITY .....	79
5.3.	CIRCULARS FOR REGULATED ENTITIES .....	81
5.4.	RISK WARNING CONCERNING INVESTMENTS IN CONTRACTS FOR DIFFERENCE... ..	82
<b>6.</b>	<b>MEASURES TAKEN TO COUNTERACT FINANCIAL MARKET ABUSE .....</b>	<b>83</b>
6.1.	EXPLANATORY AND ADMINISTRATIVE PROCEEDINGS RELATED TO SUPERVISION OVER THE FINANCIAL MARKET .....	83
6.2.	ADMINISTRATIVE PROCEEDINGS INVOLVING FINANCIAL INTERMEDIARIES .....	85
6.3.	NOTIFICATIONS OF SUSPECTED OFFENCE .....	86
6.4.	INDICTMENTS .....	88
6.5.	CONVICTIONS AND CONDITIONAL DISCONTINUATION OF PROCEEDINGS .....	88
<b>7.</b>	<b>PARTICIPATION IN LEGISLATIVE PROCESSES .....</b>	<b>90</b>
7.1.	SELECTED BILLS AND ACTS .....	90
7.1.1.	Bills .....	90
7.1.2.	Acts .....	93
<b>8.</b>	<b>INTERNATIONAL COOPERATION .....</b>	<b>97</b>
8.1.	MAIN AREAS OF ACTIVITY .....	97
8.1.1.	Amendment to the CRD Directive (CRD IV) .....	97
8.1.2.	Cross-border crisis management in the banking sector .....	98
8.1.3.	Amendment to the Deposit Guarantee Schemes Directive .....	98
8.1.4.	Solvency II Project .....	99
8.1.5.	Drafting new legal acts governing trading in financial instruments on capital markets 103	
8.1.6.	Developing cooperation among host-country supervisors .....	104
8.1.7.	Supervising rating agencies .....	105
8.2.	COOPERATION AS PART OF THE EUROPEAN FINANCIAL SUPERVISION SYSTEM .....	105
8.2.1.	European Banking Authority (EBA) .....	105
8.2.2.	European Insurance and Occupational Pensions Authority (EIOPA) .....	106
8.2.3.	European Securities and Markets Authority (ESMA) .....	107
8.2.4.	European Systemic Risk Board (ESRB) .....	107
8.3.	ACTIVITIES WITHIN EUROPEAN INSTITUTIONS .....	107
8.4.	COOPERATION IN SUPERVISORY COLLEGES .....	108
8.4.1.	Banking sector .....	108
8.4.2.	Insurance sector .....	108
8.4.3.	Rating agencies .....	109
8.5.	COOPERATION WITH FOREIGN REGULATORS .....	109
<b>9.</b>	<b>PROTECTION OF FINANCIAL MARKET PARTICIPANTS .....</b>	<b>109</b>
9.1.	EXPLANATORY PROCEEDINGS FOLLOWING COMPLAINTS .....	110
9.2.	ANALYTICAL ACTIVITIES AND INTERVENTIONS .....	110
9.3.	SUPERVISION OVER MARKET PRACTICES BY FINANCIAL MARKET PARTICIPANTS 112	
9.3.1.	Binding the consumer with an electronic contract form .....	113
9.3.2.	Uniform complaint handling procedure by financial institutions .....	113
9.3.3.	Analysis of bank practices in the organization of promotions and promotional sale of banking services .....	113
9.3.4.	Making the execution of financial service agreements conditional on the conclusion of an agreement concerning another financial service as part of a combined offer .....	113
9.3.5.	Review of practices employed by insurers with regard to the reimbursement of the leasing costs of replacement vehicles following KNF recommendations .....	114

9.3.6.	Making the payment of damages under compulsory fire and accident insurance of buildings forming part of an arable farm conditional on the submission of documents confirming that the claimant owns the buildings.....	114
9.3.7.	The effect of the death of clients having the status of consumers on their bank account agreements and loan liabilities .....	114
9.3.8.	Other activities related to the elimination of market practices infringing the interests of the clients of financial institutions .....	115
9.3.9.	Analysis of the reliability of advertising communication by regulated entities.....	115
9.3.10.	Enhanced protection of capital market participants .....	116
<b>10.</b>	<b>EDUCATIONAL AND INFORMATIONAL INITIATIVES .....</b>	<b>117</b>
10.1.	EDUCATIONAL INITIATIVES .....	117
10.1.1.	Training seminars and workshops delivered as part of CEDUR .....	117
10.1.2.	Other direct educational activities .....	117
10.1.3.	Indirect educational activities .....	118
10.2.	INFORMATIONAL ACTIVITIES .....	119
10.3.	COOPERATION WITH THIRD PARTIES.....	120
10.3.1.	Cooperation with financial market participants.....	120
10.3.2.	Cooperation with the National Bank of Poland.....	120
10.3.3.	Cooperation with the Bank Guarantee Fund .....	121
10.3.4.	Participation in the works of the Inter-Institutional Organizational Structure for Euro Changeover in Poland .....	121
10.3.5.	Cooperation with the Audit Supervision Committee and the auditing community.....	122
10.3.6.	Cooperation with other institutions .....	123
11.	KNF OFFICE .....	124
11.1.	BUDGET OF THE KNF OFFICE .....	127
11.2.	HUMAN RESOURCES MANAGEMENT.....	130
11.3.	CONSTITUTIONAL TRIBUNAL JUDGEMENT ON THE CONSTITUTIONALITY OF REGULATIONS LEAVING KNF EMPLOYEES OUTSIDE OF THE CIVIL SERVICE .....	131
11.4.	CODE OF ETHICAL CONDUCT FOR KNF EMPLOYEES.....	131
11.5.	INSPECTIONS BY EXTERNAL BODIES.....	132
<b>ANNEXES.....</b>		<b>133</b>
	PUBLICATIONS AND STUDIES PREPARED BY THE KNF OFFICE IN 2011 .....	133
<b>LIST OF TABLES.....</b>		<b>135</b>

## LETTER FROM THE CHAIRMAN OF THE POLISH FINANCIAL SUPERVISION AUTHORITY

Although 2011 was a year of prolonged debt crisis in the Eurozone, financial institutions operating in Poland recorded high profits and maintained their strong capital position.

According to preliminary data, the annual net profit of the banking sector amounted to PLN 15.7 billion, its highest ever and 37.5% more than in 2010. The capital adequacy ratio of banks at the end of 2011 amounted to 13.1% and the Tier 1 ratio to 11,6%. General pension fund management companies earned PLN 616 million net, 3% more than in the previous year, despite the reduction of contributions to open pension funds in May 2011, The net profit of insurance companies amounted to PLN 6.13 billion and was 9.1% lower than in 2010. Brokerage houses have initially reported a net profit of PLN 550.3 million (down by 28% in comparison with their reports on 2010) and investment fund management companies one of PLN 428.2 million (down by 3.2%).



The Polish financial system is growing steadily and the main risk factor remains the international situation. A continuing challenge for financial institutions is adaptation to changes in the macroeconomic environment and further strengthening of their capital position, particularly through the retention of dividends recommended by the supervisory authority.

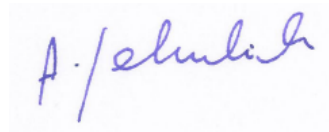
What should the KNF focus on in these challenging times? In my opinion it should focus on its core activity, the prudential supervision of financial institutions. Its strategic objectives are to ensure the safety of deposits collected by banks, to watch over the financial stability of insurance undertakings, to take care of the interests of members of pension funds and to increase the transparency of the capital market.

Towards the end of 2011 we returned to the practice of sending circulars to supervised entities. Letters addressed to individual sectors show the market how the supervisory authority regards the most important occurrences and indicate the direction in which we want to move together with them. We remind the market of the established "rules of the game" - we express the expectations of the supervisory authority and point to the consequences of ignoring them.

What awaits us in 2012? As a result of a judgement of the Constitutional Tribunal, savings and loans associations (SKOKs) are likely to come under the supervision of the KNF. 24 April 2012 will see the end of the six-month long transition period for providers of payment services who were operating on 24 October 2011, the date of entry into force of the Act on Payment Services. Before then payment institutions must apply for KNF authorisation and payment service offices must apply for registration.

In view of the international situation, the supervisory authority regards it as especially important to strive to shape EU regulations so that they take into account the interests of host markets. As regards solutions supporting the development of the financial sector, we are working on proposals to stimulate the market for long-term bank debt instruments and for new principles for the operation of the cooperative banking sector. In the field of recommendations for banks we have begun analytical work in the area of corporate governance and on operations on the interbank market. In insurance the key will be a new perspective on insurance undertakings' cooperation with banks and further gradual preparation of the market for Solvency II. It is important for the pension sector, in turn, to implement supervision of voluntary pension funds and to support any regulatory work on increasing the efficiency of open pension funds, and in particular on linking the minimum capital requirements for pension fund managers to the value of the assets of the open pension funds that they manage. In the money markets we wish to address to a greater extent than previously risks associated with the forex market.

When in October 2011 I began my mission in the KNF, I was well aware of the challenges that face Polish financial markets. I am convinced that by honestly performing our duties, we will together be equal to these challenges.

A handwritten signature in blue ink, appearing to read 'A. Jakubiak', is centered on the page. The signature is written in a cursive style with a prominent initial 'A'.

Andrzej Jakubiak  
Chairman of the Polish Financial Supervision Authority  
(KNF)

## THE MOST IMPORTANT EVENTS OF 2011

	Section	Page
Updating of Recommendation S for banks	5.2.	74
Increase of risk weighting for foreign currency loans	5.1.	69
Entry into force of the Act on Payment Services	2.6.1.	50
Start of work on preparing the insurance sector to use internal assessment models	8.1.4.	96
Packet of measures increasing protection of participants in the capital market	9.3.10.	112
Launch of the SNO turnover supervision system	3.4.2.	47
New principles of supervision of non-public closed-end investment funds	3.4.4.	52
Addition of representatives of host states to the boards of European supervisory agencies	8.1.6.	99
Ruling by the Constitutional Tribunal on the status of the KNF	11.3.	128

# 1. THE POLISH FINANCIAL SUPERVISION AUTHORITY

The Polish Financial Supervision Authority (referred to later as “the Authority”, “the KNF” or “the supervisory authority”) operates on the basis of the Act on Financial Market Supervision of 21 July 2006 (Journal of Laws 2006 No 157 item 1119, as amended), referred to later as the Act on Financial Market Supervision.

The KNF exercises banking supervision, capital market supervision, insurance supervision, pensions supervision and supplementary supervision of financial conglomerates.

The objective of financial market supervision is to ensure the proper functioning of the market, its stability, security and transparency, and confidence in the financial market and to ensure protection of the interests of participants in the market.

Supervision of the activities of the Authority is exercised by the Prime Minister.

The Authority is a collegial body. The Authority consists of its Chairman, two Vice-Chairmen and four members - the minister competent for financial institutions or that minister’s representative, the minister competent for social security or that minister’s representative, the President of the National Bank of Poland or a Vice President delegated by him, and a representative of the President of the Republic of Poland.

In 2011, the Polish Financial Supervision Authority was composed of:

## **Chairman of the Authority**

Stanislaw Kluza - to 11 October 2011

Andrzej Jakubiak - from 12 October 2011

## **Vice-Chairmen of the Authority**

Lesław Gajek

Wojciech Kwaśniak - from 21 October 2011

## **Members of the Authority**

### **Representative of the Minister of Finance**

Dariusz Daniluk - to 19 April 2011

Maciej Grabowski - from 20 April to 21 August 2011

Wiesław Szczuka - from 22 August to 1 September 2011

Maciej Grabowski - from 2 September 2011

### **Representative of the Minister of Labour and Social Policy**

Marek Bucior - to 19 January 2011

Czesław Ostrowska - from 20 January 2011

### **President of the National Bank of Poland or Vice President of the National Bank of Poland delegated by him**

Witold Koziński - Vice President of the NBP

### **Representative of the President of the Republic of Poland**

Jerzy Pruski



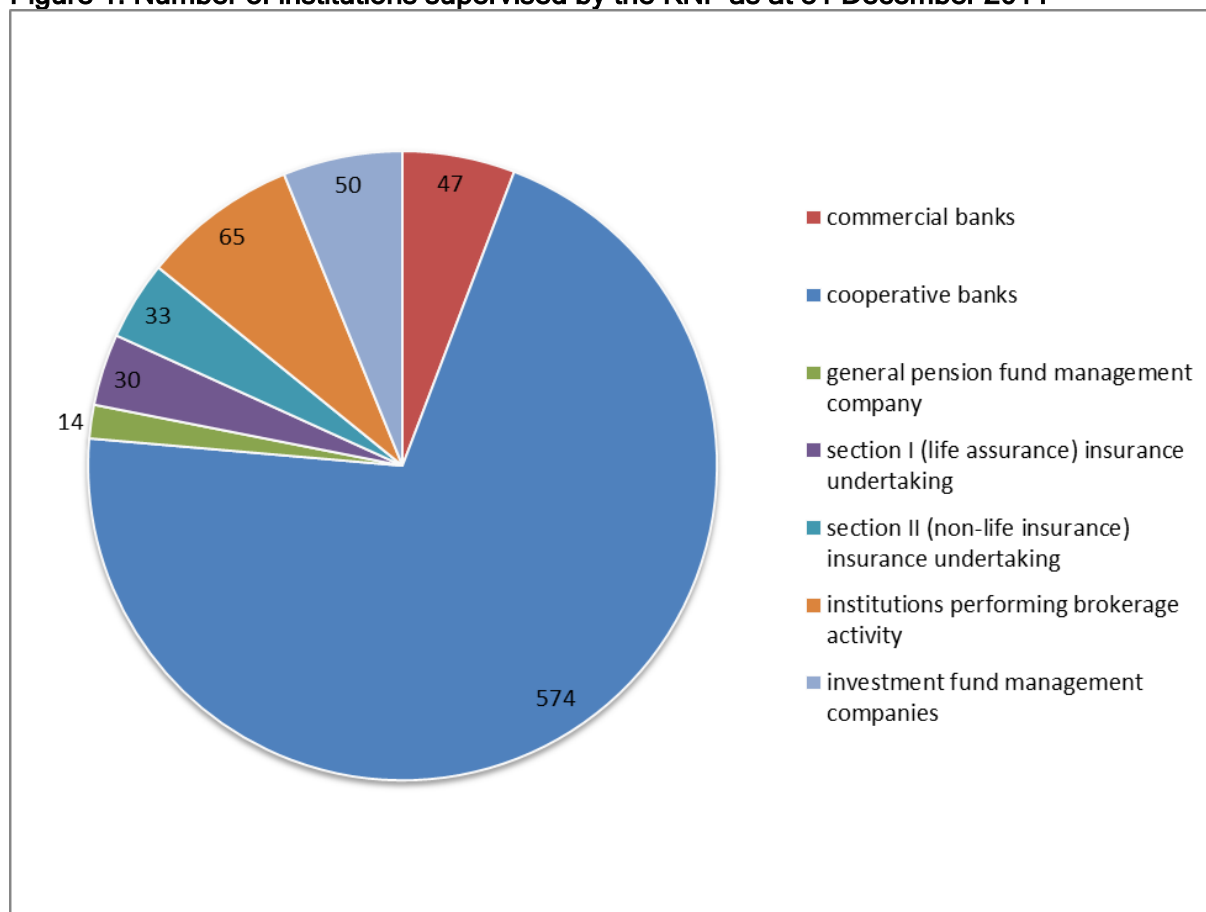
## 2. THE FINANCIAL MARKET IN POLAND

### 2.1. OVERVIEW

In 2011 the situation in the financial market was affected above all by the influence of the international economic crisis and the severe economic difficulties of some eurozone countries. Although at the same time economic recovery was seen in the world's largest countries, the crisis of public finances in many European Union countries made itself felt in the Polish market.

The slow resolution of the crisis in the eurozone resulted in a low level of external demand and so the trade balance for the whole of 2011 remained negative. The zloty's exchange rate against the euro fell during the year by 11.5% and November and December saw even greater depreciation of 14.8%.

Figure 1. Number of institutions supervised by the KNF as at 31 December 2011



Source: KNF Office's own work

The banking sector maintained its crucial importance for the national financial system - this is shown by the importance of its relationships with non-financial enterprises, domestic households and the public sector, which derive from the function of financial intermediation performed by the banks. The banking sector thus has a major, albeit indirect, impact on the real economy. The banking sector is also of crucial importance because of its balance-sheet links with other segments of the financial market. The increase of the aggregate balance-sheet totals of Polish banks in 2011 was connected, *inter alia*, with the increased exposure of domestic banks to the government securities market. In 2011, the value of debt securities

held by banks in their portfolios increased from PLN 234 billion to PLN 250 billion and the value of Treasury bonds held by banks amounted to PLN 123 billion at the end of the year.

In turn, for insurance undertakings deposits with local banks are the main instrument that they use to manage current liquidity and they also form a component of the portfolio of deposits related to certain types of insurance products (so-called "policy/deposits" and structured instruments offered by life assurance undertakings). In 2011 the concentration of investments by insurance undertakings in a single bank decreased in comparison with the previous year and so risk relating to high concentration of bank deposits was reduced.

The economic downturn in Europe was reflected in the condition of the Warsaw Stock Exchange. During 2011 the WIG index fell by 21.68%, almost matching the WIG20 index of the twenty largest companies, which recorded a decrease of 22.92%. For comparison those indices rose by 18.77% and 14.88% respectively during the previous year. Turnover of shares in 2011 amounted to PLN 252 billion and was higher than turnover in 2010 (PLN 234 billion).

The year 2011 was weaker than the previous two in terms of value of public offerings conducted. The value of public offerings totalled more than PLN 13 billion, down by almost half from the previous year and by more than 6% compared with 2009. The main reason for this was the growing fiscal crisis in the eurozone and the reduced activity in the capital market of the State Treasury, which carried out one large-scale privatisation deal (the sale of shares worth over PLN 5.37 billion in Jastrzębska Spółka Węglowa).

Pension funds play a major role in the domestic equity market and account for a substantial proportion of demand on the Warsaw Stock Exchange. The value of shares held in the portfolios of open pension funds, expressed as a percentage of the total capitalisation of the WSE, remained at 10%, close to its level at the end of 2010. Meanwhile, in 2011 the share of equity instruments in the portfolios of open pension funds ("OFE s") declined from 36% at the end of 2010 to 31% at the end of 2011. The value of investments by OFEs in shares quoted on the Warsaw Stock Exchange declined in that period from PLN 80 billion to PLN 70 billion.

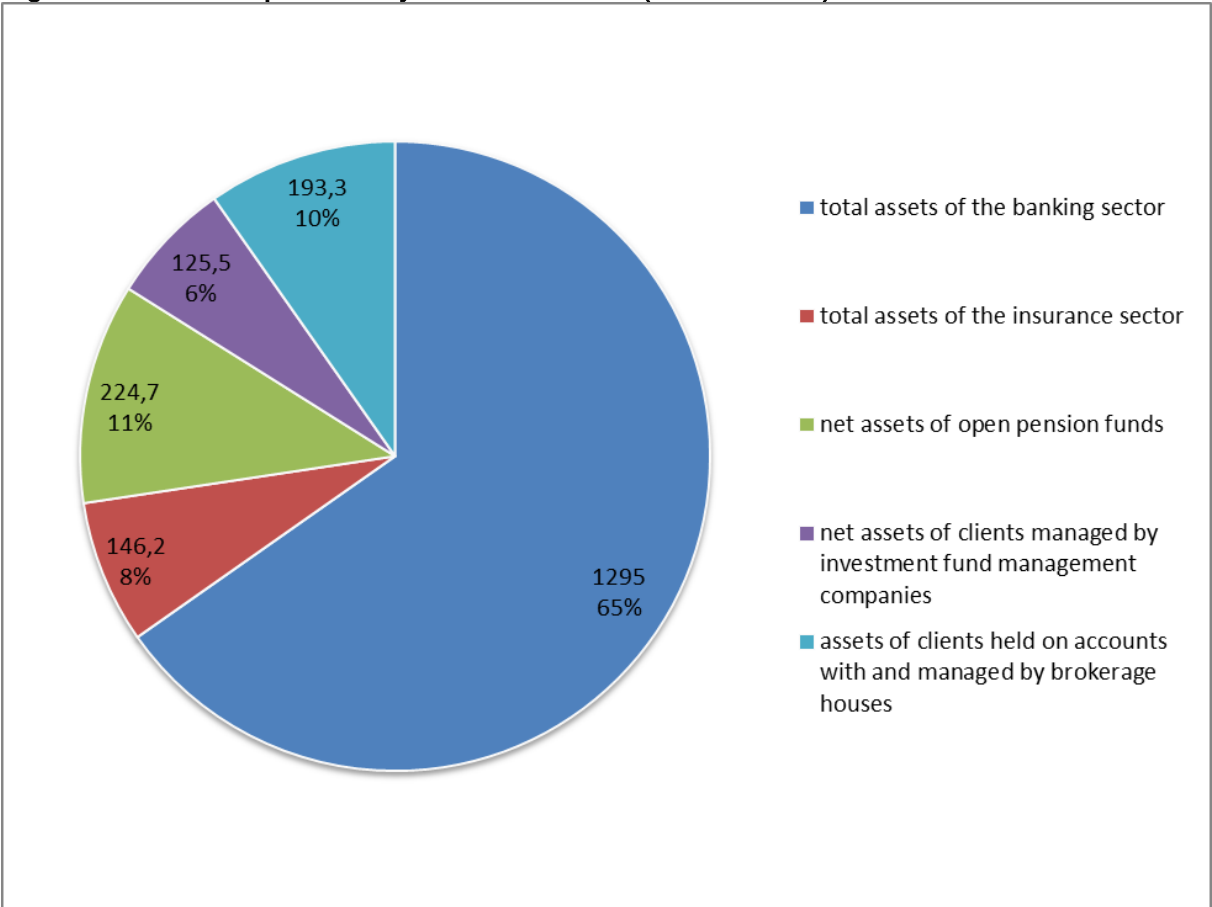
In the course of 2011 the value of the assets entrusted to the management of fund management companies fell by PLN 6 billion (-4.8%). This was the fourth year in the twenty-year long history of Polish fund managers in which the value of the assets managed by them declined. The net balance of subscriptions for and redemptions of units in domestic investment funds amounted to PLN 0.5 billion in 2011. It was the assets of equity (-33%) and mixed (-29%) funds that fell most during the year.

2011 saw an increase both in the value of insurance undertakings' equity portfolio (shares and units in investment funds together with investment certificates) and in its share in the total investment portfolio. The value of debt securities held by insurance undertakings did not change - at the end of 2011 was at the same level, PLN 58 billion, as a year earlier. One of the key risks for insurance undertakings is interest rate risk. This is related to the nature of these institutions' investment strategy, which is based on fixed-income instruments, and especially on Treasury bonds. Nonetheless, the changes in interest rates which took place in 2010 were small enough not to have a significant effect on the financial performance of these institutions and other risks, and particularly strictly insurance-related risks, turned out to be more important.

The value of OFEs' portfolio of debt securities grew in 2011 from PLN 132.5 billion to PLN 144 billion. This is consistent with OFEs' long-term investment horizon and the stability of their approach to the market for debt instruments. Therefore, from future pensioners' point of view, although rising interest rates reduce the value of the present portfolio of fixed-income debt securities, they also contribute to the improvement of OFEs' future performance. The OFE sector, similarly to investment funds, is closely linked with the capital market, where

debt instruments constitute a fundamental component of their investment portfolio. OFEs invest mainly in the Treasury securities market - as at the end of 2011, non-Treasury securities accounted for only about 16.9% of their total portfolio of debt securities.

**Figure 2. Sectors supervised by the KNF in 2011 (in PLN billion)**



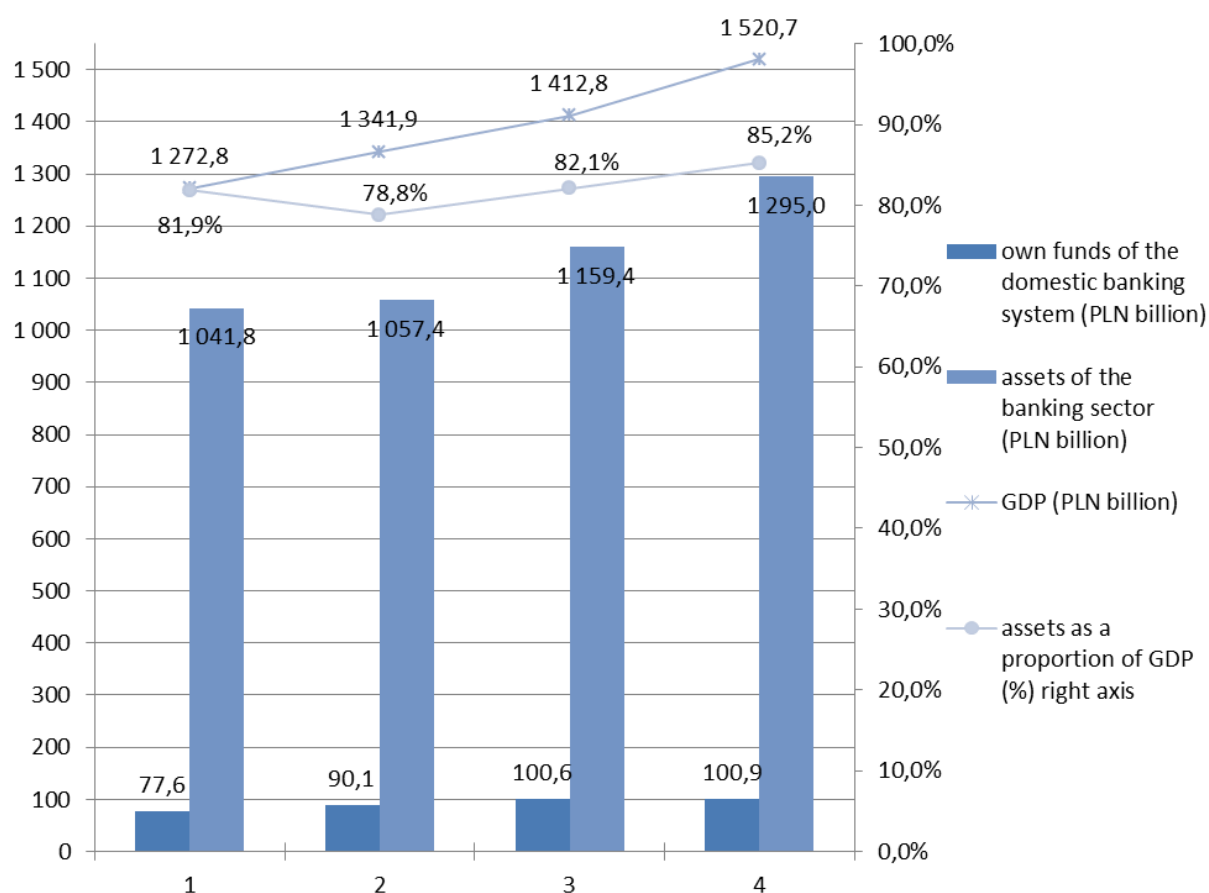
Source: KNF Office’s own work

Despite the increased uncertainty in global markets, there was no significant change in risk perception on the Polish interbank market. In the third quarter of 2011 the difference in interest rates between 3-month WIBOR interbank deposit and Overnight Indexed Swap rates remained relatively low at about 40 basis points. It was only when WIBOR increased in late October that this difference increased to rather more than 60 basis points, a level that lasted until the end of the year.

**2.2. BANKING SECTOR**

The Polish banking sector, regulated by the Polish Financial Supervision Authority, is the largest and the most developed segment of the Polish financial market. In 2011 its assets reached the amount of PLN 1.3 billion and were 11.7% higher than a year earlier. They amounted to 85.2% of GDP (as against 81.9% in 2010). Figure 3 presents selected data on the Polish banking sector in 2008-2011.

**Figure 3. Fundamental data on the Polish banking sector in 2008-2011**

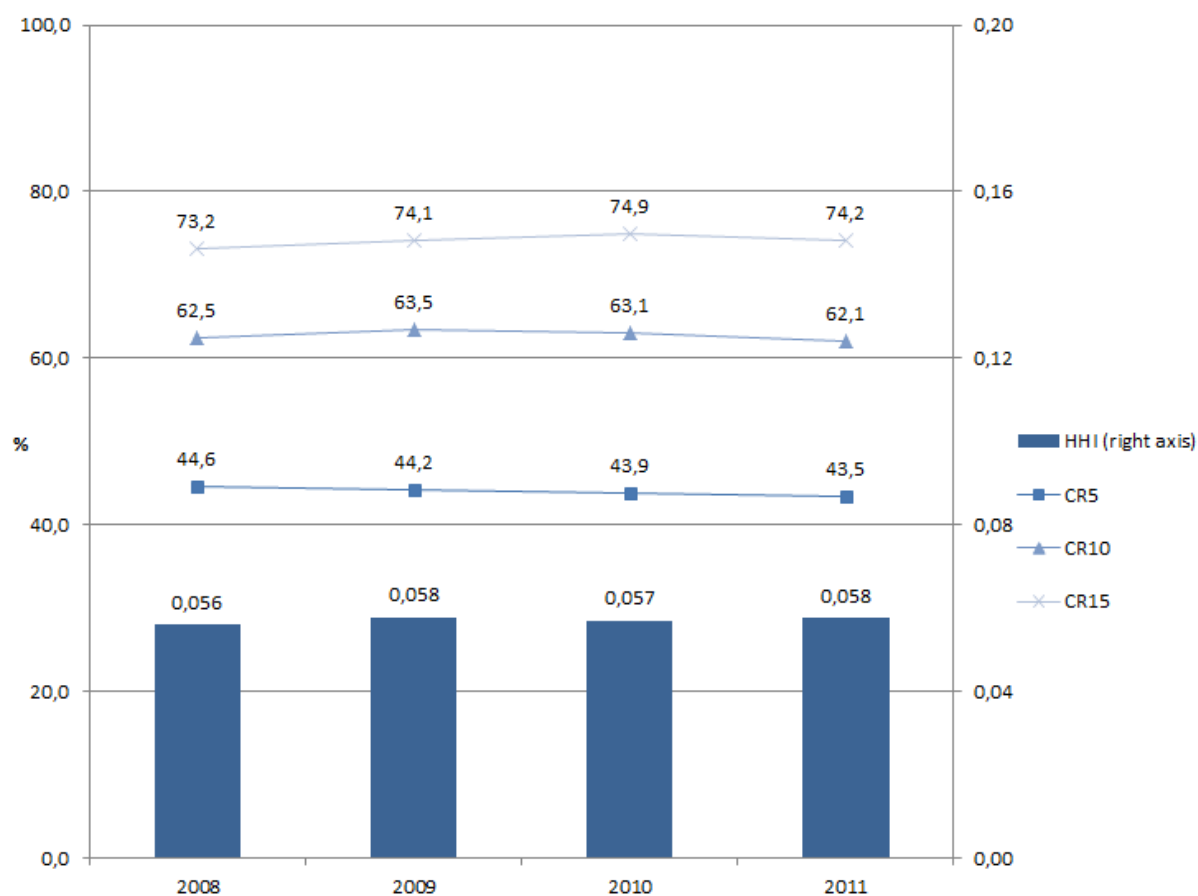


Source: KNF Office's own work

In 2011 the number of domestic commercial banks fell to 47. The number of branches of credit institutions fell from 21 to 19. At the end of 2011 the Authority supervised 574 cooperative banks.

In 2011 there were only minor changes in the ownership structure of the sector. The State Treasury continued to control four banks (two of them directly), representing 22.2% of the total assets of the banking sector. Foreign financial institutions owned 37 banks and 19 branches of credit institutions, which held 65.0% of the sector's total assets. The six private banks with majority Polish ownership accounted for 6.7% and the 574 cooperative banks for 6.1% of the sector's total assets. The position of the 10 largest banks has a crucial impact on the sector as a whole - at the end of 2011 their assets accounted for 62.1% of the total assets of the banking sector. The value of shareholders' equity is a key factor determining the banking system's resilience to the effects of different phases of the economic cycle and to internal and external shocks.

**Figure 4. Concentration of assets in 2008-2011**



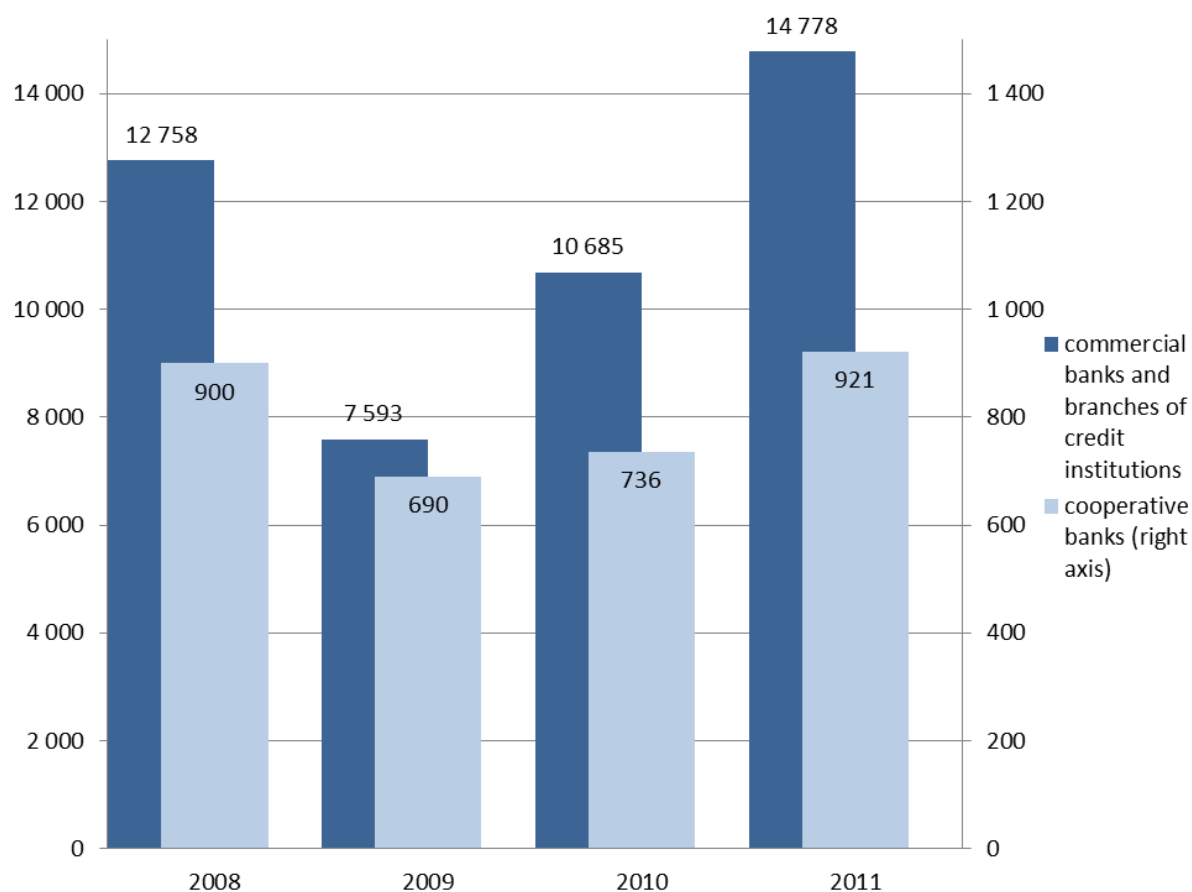
Source: KNF Office's own work

CR5, CR10, CR15 - indicators showing the shares of the five, ten and fifteen largest banks in the sector's total assets

HHI - the Herfindahl-Hirschman Index, a measure of market concentration which specifies the estimated level of concentration in a given industry and the level of competition in a given market, calculated as the sum of the squares of the market shares of individual companies (e.g. the sum of the squares of the shares of banks in the total assets of the banking sector).

In 2011 the own funds of domestic commercial banks increased by 10.1% (i.e. by about PLN 9.5 billion) and those of cooperative banks by 11.6% (i.e. by PLN 0.8 billion). One source of the growth in domestic banks' own funds during the reporting period was retention of profits for the year 2010, which 17 banks decided on (40 showed a profit at the end of 2010). The net profit of the banking sector in the period under review amounted to PLN 15.7 billion and was up by 37.5% from that recorded in 2010. Net profits rose by 38.3% in commercial banks and branches of credit institutions while the net profits of cooperative banks rose by 25.2% (Figure 5).

**Figure 5. Net profits of commercial banks and branches of credit institutions and net profits of cooperative banks in 2008-2011 (in PLN million)**



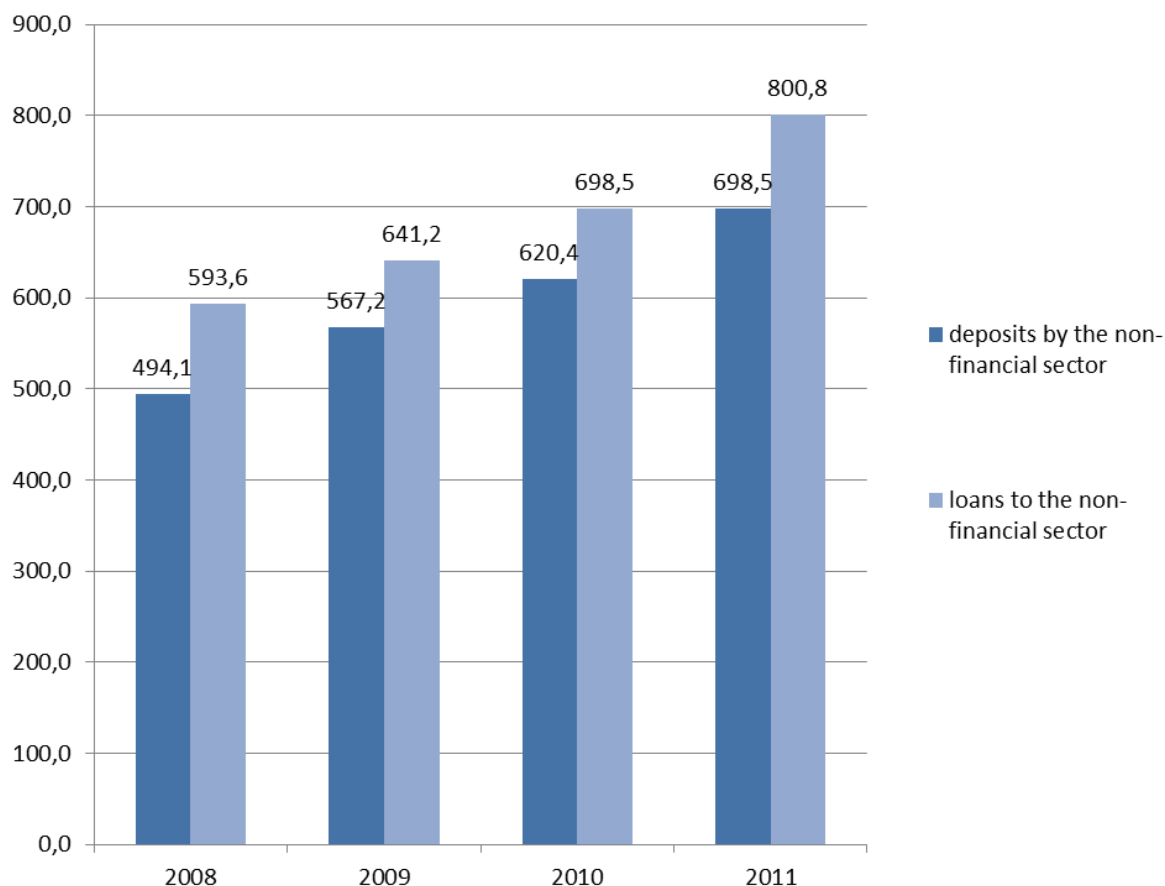
Source: KNF Office's own work

An appropriate dividend policy has had a positive influence on the stability of the banking sector. The increase in banks' own funds promoted growth of the domestic banking sector as a whole and at the same made it possible to maintain the pace of new lending. Some banks additionally secured financial backing from their foreign parents (as subordinated loans). The increase in own funds did not however equal the growth of the total capital requirement, which rose by 16.2%. In consequence there was a decrease in the average solvency ratio of the domestic banking sector from 13.8% at the end of 2010 to 13.1% at the end of 2011 (for commercial banks it fell from 13.9% to 13.1% while for cooperative banks it rose from 13.2% to 13.4%). It continued to be, however, well above the required minimum. In December 2010 the solvency ratios of all cooperative banks exceeded the required level of 8%.

Receivables from the financial sector increased by 3.7% (from PLN 94.1 billion at the end of 2010 to PLN 97.5 billion at the end of 2011) but liabilities to the financial sector increased by 15.5% (from PLN 294.6 billion at the end of 2010 to PLN 340.2 billion at the end of 2011). The increase in the negative balance of liabilities to and receivables from the financial sector that has been seen in recent years has been the result of the rapid development of small and medium-sized banks and of branches of credit institutions. Because of their poorly developed deposit base they have made use of funds from financial markets or the support of foreign parent companies. Also some large banks, despite their having a well-developed deposit base, have used funds from financial markets to expand the volume of their new lending business and to increase their market shares. A significant proportion of the funds of non-residents are sourced from their parent companies and are of a long-term nature.

In 2011 liabilities to the non-financial sector increased by 14.6% to PLN 800.8 billion, with those to domestic households increasing by 11.9% to PLN 532.0 billion and those to enterprises by 20.4% to PLN 264.5 billion. Deposits by the non-financial sector rose by PLN 53.2, or 12.6%. Overall, entities from the non-financial sector held over PLN 698.5 billion in deposits in bank accounts, of which PLN 60.0 billion was in accounts with cooperative banks.

**Figure 6. Loans and deposits of the non-financial sector in 2008-2011 (in PLN billion)**



Source: KNF Office's own work

Growth in the deposit base, especially in the fourth quarter of 2011 (by PLN 48 billion) must be viewed as positive, as must the change in the structure of housing loans in favour of loans denominated in zlotys. The banks also retained a part of their earnings, thanks to which their own funds increased. An improvement in the quality of the portfolio of receivables, and particularly in that of the portfolio of receivables from corporates, had a positive impact on the banks' condition. The quality of the portfolio of receivables from domestic households, after worsening considerably in 2010, stabilised at a level at which loans confirmed to be impaired accounted for slightly more than 7% of all loans. This was the result of several factors - the rapidly growing proportion of housing loans (which have by far the lowest share of "bad" loans) in the overall portfolio of loans to households, the increase year by year in the volume of sales to non-bank entities of portfolios of "bad" debts (for the most part consumer loans, which are by far of the worst quality) and reduction of the sales by banks of new consumer loans, among other things as a result of recommendations to the banking sector issued by the supervisory authority. On the other hand, the portfolio of housing loans is the largest loan portfolio and its quality continues to deteriorate.

## 2.3. INSURANCE SECTOR

At the end of 2011 authorisation to conduct insurance business in Poland were held by 63 domestic insurance undertakings (30 life insurers and 33 non-life insurers, including one reinsurance undertaking). One insurance undertaking (UNIVERSUM Towarzystwo Ubezpieczeń na Życie SA w likwidacji) was in liquidation. Compared to 2010 the number of insurers decreased by two. This change resulted from the liquidation of one domestic insurance undertaking and the merger of two insurance undertakings, Amplico Life Pierwsze Amerykańsko-Polskie Towarzystwo Ubezpieczeń na Życie i Reasekuracji SA and Metlife Towarzystwo Ubezpieczeń na Życie SA. The merged insurer operates under the name Amplico Life Pierwsze Amerykańsko-Polskie Towarzystwo Ubezpieczeń na Życie i Reasekuracji SA.

As at the end of 2010, 562 insurance undertakings from EU and EEA member states had submitted notifications of the provision of insurance services in Poland under the freedom to provide services, while 19 insurance undertakings and one reinsurer had submitted notifications of the provision of services in Poland through a branch. In 2011 the KNF received 45 notices from foreign insurance undertakings (43 from EU member states and two from Lichtenstein) of intent to engage in insurance business on the basis of cross-border activity and four notices of intent to engage in insurance business through a branch of an insurance undertaking the head office of which is in an EU member state. In 2011 the KNF also received ten notifications of cessation by an insurance undertaking registered in an EU member state of the conduct of insurance business on the territory of the Republic of Poland. Three notifications relating to the conduct of insurance business by domestic insurance undertakings on the territory of EU member states and one notification of the cessation of the conduct of insurance business by a domestic insurance undertaking on the territory of EU member states were also submitted.



**Table 1. Major indicators of the performance of insurance undertakings in 2008-2011 (financial data in PLN million)**

<b>Selected profit and loss account items</b>				
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Gross premiums written	59,366.93	51,405.85	54,159.42	57,149.65
Gross compensation and benefits paid	30,037.57	39,415.45	36,753.68	39,808.22
Costs of insurance operations	10,166.05	11,244.38	11,600.04	12,244.35
Client acquisition costs	7,324.76	8,089.08	8,400.80	9,367.32
Administrative expenses	3,479.40	3,648.12	3,685.31	3,567.77
Profit/(loss) on technical account	4,182.69	4,070.52	2,308.48	3,773.90
Net profit/(loss)	5,794.78	6,641.36	6,746.98	6,130.19
<b>Selected balance sheet items</b>				
Investments (item B under assets)	99,642.34	94,047.91	92,272.05	92,743.34
Shareholders' funds	35,710.00	29,184.34	30,883.73	30,969.68
Share capital	5,231.59	5,440.62	5,762.00	5,796.20
Gross technical provisions	97,994.14	100 211.62	109 800.81	109 293.16
Total assets	137 994.58	139 068.56	145 170.31	146 134.48
<b>Selected financial ratios (%)</b>				
Costs of insurance operations to premiums written, net of reinsurance	18.02	23.29	22.83	22.97
Profit/(loss) on technical account to gross premium written	7.05	7.92	4.26	6.60
Net profit/(loss) to shareholders' equity	16.23	22.76	21.85	19.79
Net profit/(loss) to assets	4.20	4.78	4.65	4.19

Source: KNF Office's own work

The data provided in table 1 for 2011 have been calculated on the basis of insurance undertakings' unaudited quarterly financial statements.

## 2.4. PENSIONS SECTOR

The KNF supervises the funded part of the pension system, which comprises the so-called Pillar II and Pillar III. Pillar II consists of open pension funds (referred to below as "OFEs") and general pension fund management companies ("PTEs"), which are components of the obligatory part of the Polish pension system. OFEs are a special type of legal person, each being the mass of assets managed by one of the PTEs, which were also established under the Act on the Organisation and Operation of Pension Funds. The compulsory part of the pension system is supplemented by Pillar III, which consists of occupational pension funds ("PFEs") managed by occupational pension fund management companies ("PrTEs"), occupational pension schemes ("PPEs") and individual retirement accounts ("IKEs"). Pillar III, participation in which is voluntary, is organised on an institutional basis, unlike other forms of individual accumulation of savings for pension purposes. The development of this market is supported by such incentives as tax exemptions and the possibility of concessions relating to social security contributions.

### 2.4.1. Open pension funds and general pension fund management companies

At the end of 2011 authorisations to operate were held by 14 open pension funds and the same number of general pension fund management companies which managed them.

2011 saw a reduction in the proportion of social security contributions transferred to OFEs by the Social Insurance Institution ("ZUS"). From 1 May 2011 2.3% of the base premium is transferred to an OFE, previously the rate had been 7.3%. This proportion will grow in future years to reach 3.5% in 2017.

**Table 2. Net asset value of open pension funds at year end, 2008-2011**

Open pension fund	Net asset value (PLN million)				Market share (%)
	2008	2009	2010	2011	2011
AEGON OFE	5,897.3	7,275.1	9,088.6	9,692.7	4,3
Allianz Polska OFE	3,644.8	5,052.9	6,511.4	6,725.7	3,0
Amplico OFE*	11,116.8	13,702.8	16,905.6	17,444.7	7,8
Aviva OFE Aviva BZ WBK**	36,116.9	45,188.5	52,889.1	51,272.0	22,8
AXA OFE	6,557.6	9,251.4	12,833.3	14,142.9	6,3
Generali OFE	5,476.0	7,724.9	10,426.0	11,270.0	5,0
ING OFE	33,058.4	43,245.3	53,202.0	53,301.7	23,7
Nordea OFE	5,122.8	6,905.6	9,337.6	10,083.9	4,5
Pekao OFE	2,218.3	2,841.1	3,411.4	3,387.7	1,5
PKO BP Bankowy OFE***	4,030.4	4,911.8	6,565.2	7,558.3	3,4
OFE Pocztylion	2,777.5	3,477.3	4,263.7	4,261.3	1,9
OFE Polsat	1,243.6	1,689.6	2,050.4	2,000.0	0,9
OFE PZU "Złota Jesień"	18,952.3	24,751.3	30,659.6	30,523.0	13,6
OFE Skarbiec-Emerytura****	N.A.	N.A.	N.A.	N.A.	N.A.
OFE WARTA	2,048.5	2,612.6	3,107.2	3,056.4	1,4
<b>Total</b>	<b>138 261.4</b>	<b>178 630.1</b>	<b>221 251.1</b>	<b>224 720.1</b>	<b>100,0</b>

\* until 8 October 2009 - AIG OFE

\*\* until 31 May 2009 - Commercial Union OFE BPH CU WBK

\*\*\* until 23 December 2009 - Bankowy OFE

\*\*\*\* on 7 November 2008 the liquidation of OFE Skarbiec-Emerytura was completed and its assets were transferred to AEGON OFE.

Source: KNF Office's own work on the basis of OFEs' daily reports

The assets of open pension funds reached the level of PLN 224.7 billion and increased during the year by 1.6% (about PLN 3.5 billion). In 2011 ZUS transferred to OFEs PLN 15.8 billion in contributions but the financial loss of -PLN 11.0 billion significantly reduced the increase in assets. The rates of return generated by OFEs in 2011 ranged from -7.2% to -3.3%, while the weighted average rate of return was -4.6%.

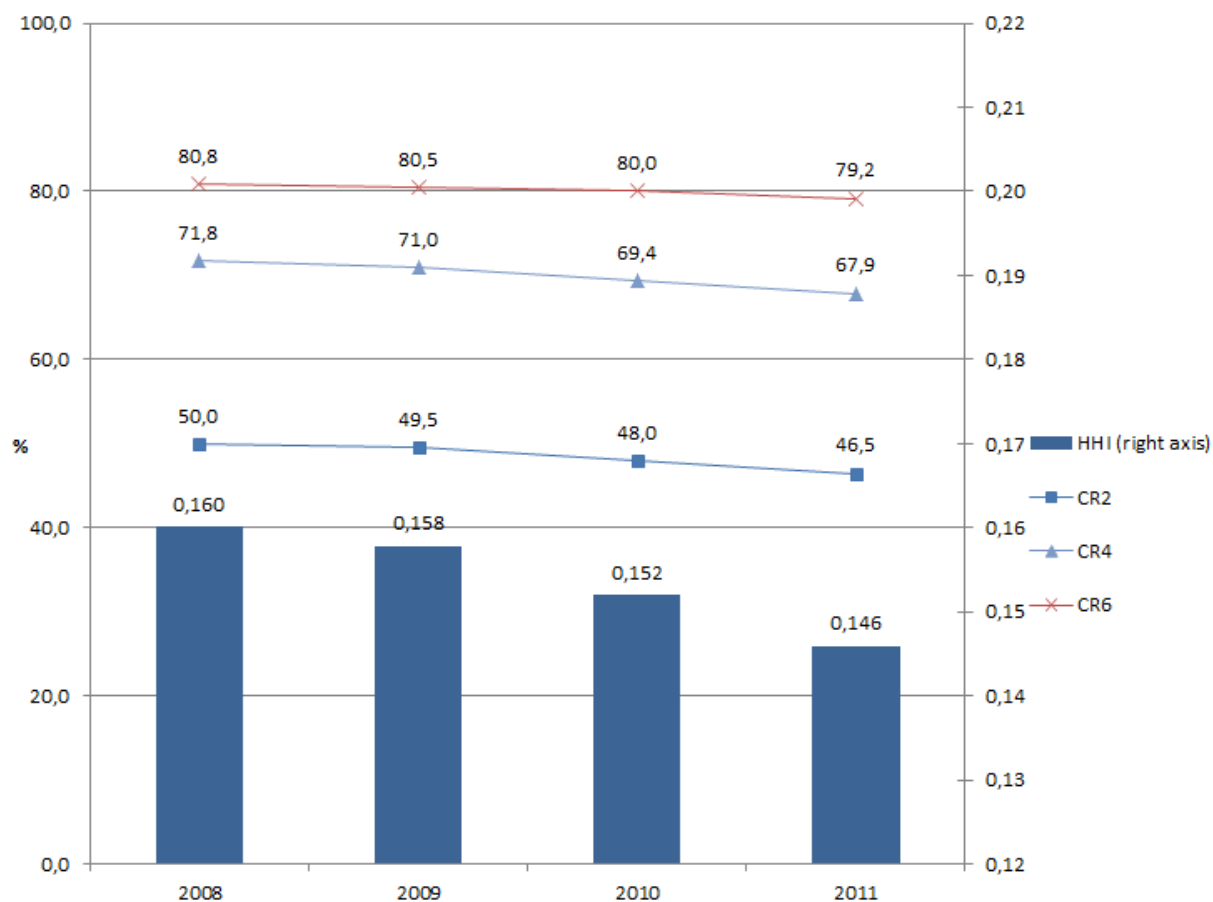
In response to falling share prices on the Warsaw Stock Exchange (referred to below as "the WSE"), the structure of OFEs' investment portfolio changed substantially in 2011. There was a substantial decrease, from 36.7% to 31.1% of their total portfolio, in the exposure of the funds to equities and a concomitant increase, from 63.3% to 68.7% in their exposure to debt instruments, primarily Treasury bonds and bills. The fall in the proportion of equities in the OFEs' portfolio amounted to 5.6 percentage points over the year. The falls in the prices of

shares in WSE-listed companies (the WIG index fell by 20.8%) contributed to the OFEs' relatively poor investment performance.

The equity portion of the OFEs' portfolio was dominated by the large-capitalisation companies which make up the WIG20 index, whose share of total portfolio at the end of 2011 was 18.9%. In the debt portion of the OFEs' portfolio the most important position was in instruments issued by the State Treasury (52.9% of the total portfolio), including above all fixed-coupon bonds (these composed 43.1% of the total portfolio). OFEs' foreign investments amounted to 0.48% of the portfolio's value at the end of 2011 and fell by 0.21 percentage points from a year earlier. The limit on foreign investments by OFEs is set at 5% of their assets.

The aggregate market share of the four largest pension funds (Aviva OFE Aviva BZ WBK, ING OFE, OFE PZU "Złota Jesień" and Amplico OFE), measured in terms of net asset value was 67.9% at the end of 2011 (as against 69.4% a year earlier). The structure of the OFE market was relatively stable in 2006-2011, although there were distinct changes in the market shares of some funds.

**Figure 7. Concentration of net assets of open pension funds in 2008-2011**



Source: KNF Office's own work on the basis of OFEs' daily reports

CR2, CR4, CR6 - indicators showing the shares of the two, four and six largest OFEs in total assets.

HHI - Herfindahl-Hirschman Index (see the legend to Figure 4)

As at the end of 2011 15.5 million people belonged to open pension funds. The market share of the four largest funds, in terms of numbers of members, fell during the year. At the end of the year their share was 58.4%, as against 60.6% a year earlier.

**Table 3. Number of open pension fund members at year end, 2008-2011**

Open pension fund	Number of members (‘000s)				Market share (%)
	At 31.12.2008	At 31.12.2009	At 31.12.2010	At 31.12.2011	2011
AEGON OFE	770.3	764.6	834.4	948.5	6.1
Allianz Polska OFE	354.7	398.2	448.5	508.1	3.3
Amplico OFE*	1,113.2	1,101.3	1,135.7	1,192.6	7.7
Aviva OFE Aviva BZ WBK**	2,859.6	2,893.7	2,786.2	2,687.5	17.3
AXA OFE	680.2	799.8	983.9	1,109.4	7.2
Generali OFE	605.9	681.3	788.0	890.1	5.7
ING OFE	2,787.7	2,903.8	2,929.8	2,954.1	19.1
Nordea OFE	776.4	828.0	868.5	898.8	5.8
Pekao OFE	333.9	348.5	349.5	344.5	2.2
PKO BP Bankowy OFE***	436.5	418.0	468.3	539.5	3.5
OFE Pocztylion	445.5	467.0	518.1	588.3	3.8
OFE Polsat	328.3	322.7	311.1	302.5	2.0
OFE PZU “Złota Jesień”	2,018.1	2,121.9	2,193.5	2,215.0	14.3
OFE Skarbiec- Emerytura****	N.A.	N.A.	N.A.	N.A.	N.A.
OFE WARTA	313.4	318.7	315.4	314.5	2.0
<b>Total</b>	<b>13,823.7</b>	<b>14,367.5</b>	<b>14,931.0</b>	<b>15,493.4</b>	<b>100.0</b>

\* until 8 October 2009 - AIG OFE

\*\* until 31 May 2009 - Commercial Union OFE BPH CU WBK

\*\*\* until 23 December 2009 - Bankowy OFE

\*\*\*\* on 7 November 2008 the liquidation of OFE Skarbiec-Emerytura was completed and its assets were transferred to AEGON OFE.

Source: the Social Insurance Institution (ZUS)

In 2011, as in previous years, the major items in the profit and loss accounts of pension fund companies were revenues related to the management of open pension funds, which included:

- revenues from charges on contributions (30.5% of total revenue),
- revenues from the charge for management of an OFE (54.2% of total revenue).

and:

- costs of client acquisition (36.5% of the total costs of general pension fund management companies),
- costs directly related to the management (operation) of PTEs (19.9% of total costs),
- costs of charges on contributions and charges on transfer payments made to the Social Insurance Institution (ZUS) and to the National Depository for Securities (referred to later as “the NDS”) (13.2% of total costs), and
- transfer agent costs (13.7% of total costs).

In 2011 the revenues of general pension fund management companies were lower than in previous years. This was caused by the introduction of a limit on charges deducted from contributions, which was set at 3.5% from 1 January 2010. The fall in revenues from these charges was not compensated for by a rise in other categories of revenues. Additionally, from May 2011 the proportion of contributions transferred to OFEs was reduced from 7.3% to

2.3% of total social security contributions. Consequently in 2011 the total revenues of general pension fund management companies from OFE management amounted to PLN 1.7 billion and were 8% lower than in the previous year. At the same time the costs of OFE management fell by 16.5% and amounted to PLN 1.0 billion. The profit on technical activities in 2011 amounted to just over PLN 653 million, which meant that it increased in comparison to the previous year by 9.6%.

Analysis of individual items in the profit and loss account shows that revenues, expenses and profit or loss are clearly related to the size of the OFE managed. The strongest market position is held by the PTEs that manage the largest pension funds; they earned the highest revenues, generated profits and achieved clear benefits in terms of their expenses from economies of scale.

2011 saw an increase in the total profits of general pension fund management companies. However, eight of them reported a deterioration in their financial performance. In 2011 two PTEs recorded losses. The total profits of all general pension fund management companies amounted to almost PLN 616 million, which meant an increase of 3.0% from the previous year.

#### 2.4.2. Occupational pension funds and occupational pension fund management companies

A special type of financial institution which is to be found only within Pillar III is occupational pension funds (PFEs) and the occupational pension fund management companies which manage them.

The shareholders of occupational pension fund management companies are employers who establish pension schemes under which contributions are paid into pension funds managed by those companies. Occupational pension fund management companies are non-profit organisations and those of their costs which are not covered by fees are financed by the shareholders/employers. The representatives of members of occupational pension funds who pay contributions to the funds managed by them constitute half the supervisory boards of the management companies. Regulations relating to the investments of occupational pension funds provide for the possibility of delegating asset management to third parties. At 31 December 2010, there were five occupational pension fund management companies and they managed five occupational pension funds. The first of these was established in 1999, while the remainder began operations late in 2004. This means that the entities operating in this market are at various stages of development.

The value of assets accumulated in occupational pension funds stood at PLN 1,558 million at the end of 2011. There was a small increase from 2010 of PLN 2.2 million, i.e. of 0.1%, in the net assets of PFEs. During the reporting period basic and additional contributions of PLN 160.6 million were paid into the accounts of PFE members.

**Table 4. Net assets of occupational pension funds in 2008-2011 (as at 31 December)**

Occupational pension fund	Net assets (PLN million)				Market share (%)
	2008	2009	2010	2011	2011
PFE TELEKOMUNIKACJI POLSKIEJ	672,9	831,1	934,6	909,4	58,4
PFE Nowy Świat	189,1	245,4	294,8	300,7	19,3
PFE Słoneczna Jesień	145,6	218,3	274,6	288,1	18,5
PFE UNILEVER POLSKA	16,3	20,3	27,2	31,7	2,0
PFE NESTLE POLSKA	11,9	17,8	24,2	27,7	1,8
<b>Total</b>	<b>1,035,8</b>	<b>1,332,8</b>	<b>1,555,4</b>	<b>1,557,6</b>	<b>100,0</b>

Source: occupational pension funds (data collected by the KNF Office in fulfilment of quarterly reporting obligations)

It is worth noting that no charges are levied on contributions to occupational pension funds and that in some cases the assets of the funds are also not subject to management fees, which from the perspective of participants in them increases the efficiency of this form of saving. The entire amount paid into these financial institutions is transferred to the accounts of PFE members.

The average rate of return achieved by occupational pension funds in 2011 was -4.34% (in 2010 the rate of return was 10.03%). The pronounced fall year-on-year in the value of an investment unit was due to the lower rates of return which could be earned on the equity market.

**Table 5. Investment performance of occupational pension funds in 2008-2011 (rate of return or percentage change in index )**

Indicator	2008	2009	2010	2011
PFE average rate of return	-11.03	14.82	10.03	-4.34
PFE lowest rate of return	-13.86	12.74	9.60	-5.20
PFE highest rate of return	-6.34	17.41	10.52	-3.10
Inflation	4.2	3.5	2.6	4.3
Change in WIG	-51.07	46.85	18.8	-20.8
Change in WIG20	-48.21	33.47	14.9	-21.9

Source: occupational pension funds (data collected by the KNF Office in fulfilment of quarterly reporting obligations)

### 2.4.3. Occupational pension schemes and individual pension accounts

Occupational pension schemes and individual pension accounts<sup>1</sup>, participation in which is voluntary, unlike other forms of voluntary individual accumulation of savings for pension purposes, are organised on an institutional basis and funds are accumulated in them in accordance with specific legal provisions. In comparison with the regulations governing the operation of Pillar II, the regulations governing the activities of institutions operating within

<sup>1</sup> From 1 January 2012 individual pension accounts (IKZE).

Pillar III provide for a narrower scope of administrative regulation in view of the voluntary nature of additional forms of pension saving.

The development of Pillar III of the pension system is supported by such incentives as tax exemptions and the possibility of making use of concessions regarding social security contributions. The regulations governing the activities of institutions and products that operate within Pillar III are designed to:

- protect the interests of members of occupational pension schemes,
- ensure that the assets accumulated are used to finance pensions, and
- ensure the long term and systematic accumulation of pension capital.

**Table 6. The development of occupational pension schemes in 2008-2011**

<b>Measure</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Number of PPEs	1,078	1,099	1,113	1,116
Number of members of PPE ('000s)	325	334	342	345
Value of accumulated assets (PLN million)	3,608	4,998	6,286	6,598

Source: KNF Office's own work, institutions managing the assets of occupational pension schemes

Savings are accumulated in occupational pension schemes in the form of:

- an occupational pension fund,
- an agreement for employee group life assurance in the form of group unit-linked life assurance,
- an agreement for payment of contributions to an investment fund, or
- foreign management.

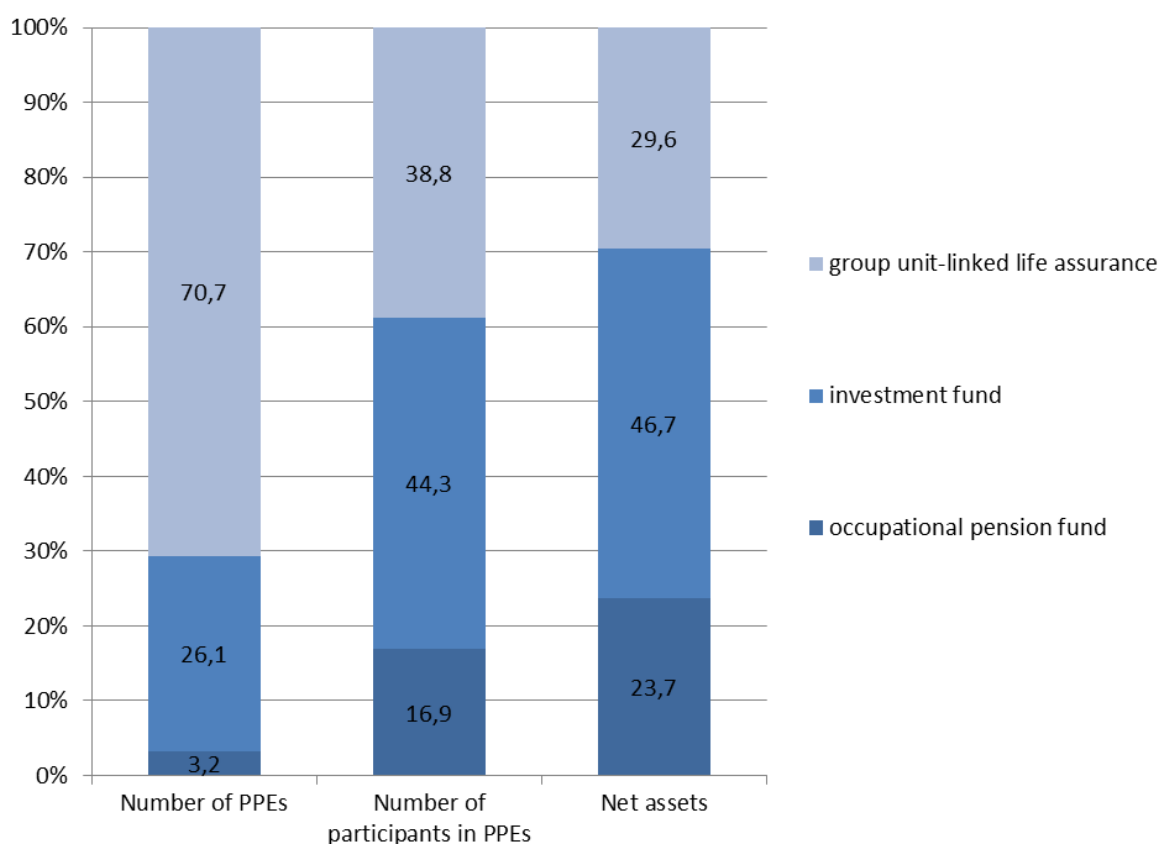
At 31 December 2011 there were 1,116 occupational pension schemes, these being

- 36 schemes operated as occupational pension funds,
- 789 schemes operated under agreements for employee unit-linked group life assurance, and
- 291 schemes operated under agreements for payment by employers of employee contributions to investment funds.

345,000 people participated in occupational pension schemes at the end of 2011 when the value of accumulated assets amounted to PLN 6,598 million, which meant an increase in the value of assets in the accounts of participants in PPEs of PLN 312 million (5%) from a year earlier.



**Figure 8. Structure of the PPE market in 2011 (%)**



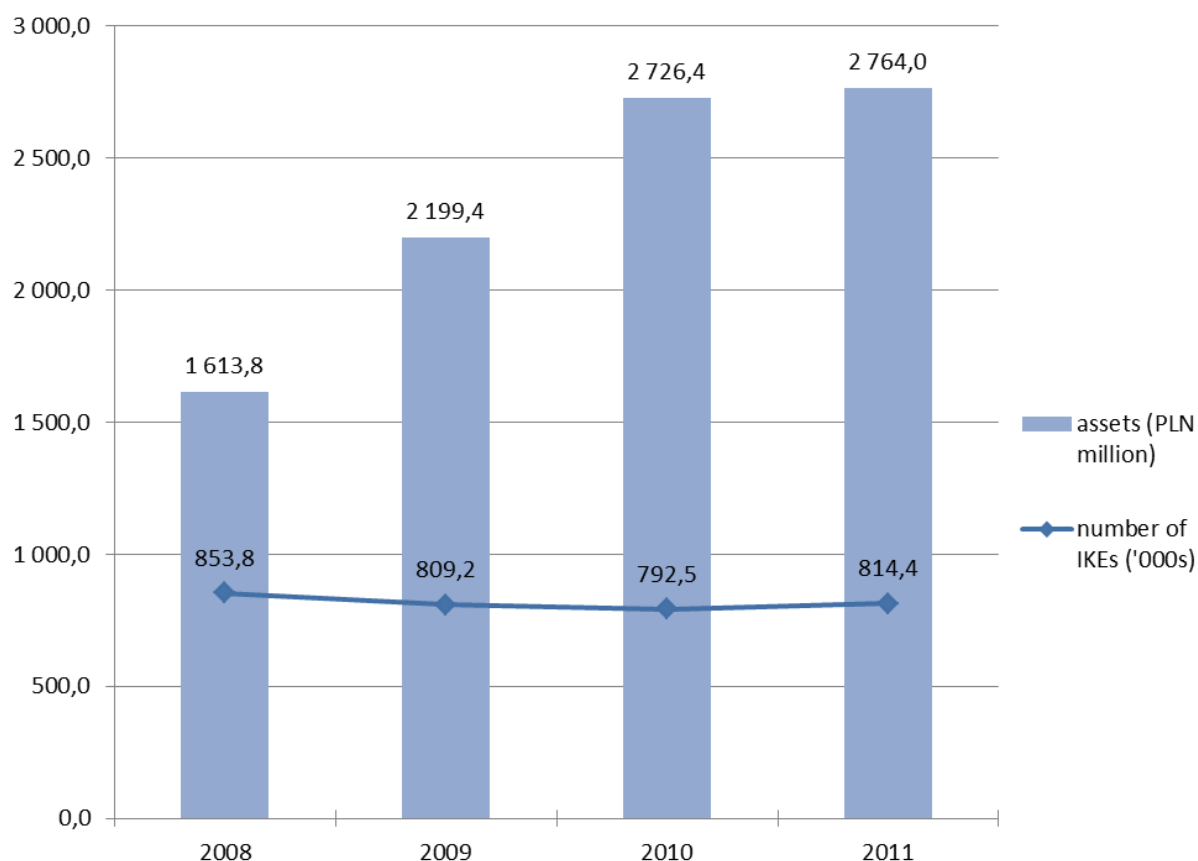
Source: KNF Office's own work

An individual pension account (IKE) is operated on the basis of a written agreement concluded by the saver with:

- an insurance undertaking (a unit-linked life assurance agreement),
- an investment fund,
- an entity conducting brokerage business, or
- a bank.

An incentive to invest in IKEs is the exemption from taxation of capital gains tax made by them. The tax exemption offered to persons saving in IKEs is limited to a fixed amount, which in 2011 was PLN 10,077.

**Figure 9. The development of individual pension accounts in 2008-2011**



Source: KNF Office's own work

The amount of the average payment into an IKE in 2010 was, at PLN 1,982, well below the applicable limit. The average value of an IKE account at the end of 2011 was PLN 3,394.

At 31 December 2010 institutions operating IKEs maintained 814,400 accounts, in which assets amounting to PLN 2,764.0 million had been accumulated. The number of IKEs in existence rose from the previous year for the first time since 2007. At the end of 2011 5,200 more IKEs were functioning than in 2010. The value of assets accumulated in IKEs increased in 2011 by 1.4% (about PLN 37.6 million).

In 2011 savers in IKEs paid into them a total of PLN 545.1 million, i.e. 9.8% more than in 2010. In addition, the positive balance of inflows to and outflows from IKEs amounted in 2011 to PLN 338.9 million (about 3.9% less than in 2010).

**Table 7. Value of assets accumulated in IKEs by type of institution in 2008-2011**

Institution operating IKE	Asset value (PLN '000s)				% of total (%)
	2008	2009	2010	2011	2011
Insurance undertaking	716,738	964,146	1,167,642	1,146,788	41.5
Investment fund	564,263	800,436	972,295	894,559	32.4
Institution conducting brokerage business	121,060	190,659	293,762	384,046	13.9
Bank	211,728	244,180	292,696	338,587	12.2
<b>Total</b>	<b>1,613,789</b>	<b>2,199,421</b>	<b>2,726,395</b>	<b>2,763,980</b>	<b>100.0</b>

Source: KNF Office's own work

## 2.5. CAPITAL AND COMMODITY MARKETS

The capital and commodity markets supervised by the Polish Financial Supervision Authority are formed of entities active in the market for securities and other financial instruments, undertakings for collective investment and entities that are active in commodity markets.

### 2.5.1. Investment firms and banks operating securities accounts (custodian banks)

Investment firms are an indispensable element of the infrastructure of the capital market since legal regulations provide that their intermediation is required for investment in the capital market. The catalogue of brokerage activities that investment firms are authorised to conduct includes a series of activities, which include accepting and transferring orders to purchase or sell financial instruments, purchasing and selling financial instruments for a firm's own account, management of portfolios consisting of one or more financial instrument, consultancy regarding investments and offering financial instruments.

Both domestic and foreign investment firms may operate in Poland. Domestic investment firms are brokerage houses and banks that conduct brokerage activities. These institutions must obtain KNF authorisation to conduct brokerage activities. Apart from them, brokerage activities in Poland may also be conducted by foreign investment firms under the *single licence* (or European passport) principle and by foreign legal persons domiciled in a member state of the Organisation for Economic Co-operation and Development ("the OECD") or the World Trade Organisation ("the WTO"). Under the single licence principle, an investment firm (or any other institution) domiciled in a member state of the European Union which has been authorised to provide services in its home country may also operate in other EU countries, both in the form of cross-border operations and through a branch.

The group of institutions specialised in the provision of intermediation services on the securities market that are licensed by the KNF also includes custodian banks. Such entities hold a KNF authorisation to keep registers of and hold securely financial instruments that are admitted to organised trading. In practice the role of custodian banks is to hold securely the assets of financial institutions.

**Table 1. Number of institutions conducting brokerage activities and operating securities accounts in 2008-2011**

Type of institution	2008	2009	2010	2011
Brokerage houses	45	46	50	51
Banks conducting brokerage activities	13	13	14	14
Custodian banks	13	13	14	15
<b>Total</b>	<b>71</b>	<b>72</b>	<b>78</b>	<b>80</b>

Source: KNF Office's own work

Tables 9 and 10 present basic data on clients of brokerage houses and of banks that conduct brokerage activities through brokerage offices.

**Table 2. Number of client accounts operated by brokerage houses and by banks that conduct brokerage activities in 2008-2011**

Type of institution	Number of client accounts				Share in total assets (%)
	2008	2009	2010	2011	2011
Brokerage houses	693,923	812,954	1,323,959*	1,210,088	64,2
Banks conducting brokerage activities	547,422	532,325	649,680*	675,327	35,8

Source: KNF Office's own work

\* change in manner of presentation, dissimilar population.

**Table 3. Value of assets in client accounts operated by brokerage houses and banks that conduct brokerage activities in 2008-2011**

Type of institution	Value of client assets held in accounts (PLN million)			
	2008	2009	2010	2011
Brokerage houses	63,447	98,828	139,157	122,516
Banks conducting brokerage activities	25,949	39,443	55,532	54,016
	Client assets under management (PLN million)			
Brokerage houses	73,589	79,738	84,412	70,747
Banks conducting brokerage activities	294	329	2,177	253

Source: KNF Office's own work

As at 31 December 2007, 31 December 2008, 31 December 2009, and 31 December 2010. Data sourced from monthly reports by Monitor Rachunkowości i Finansów

## 2.5.2. Organised securities markets

### Warsaw Stock Exchange

Rates of return of the key indices of the Warsaw Stock Exchange (“the WSE”) were lower in 2011 than a year earlier. The indirect cause of this may have been the repeated turbulence in global financial markets caused by the difficult macroeconomic situation of some eurozone countries (such as Greece and Italy) and the associated uncertainty for investors.

**Table 4. Rates of return of Warsaw Stock Exchange indices in 2008-2011 (%)**

WSE index	2008	2009	2010	2011
WIG	-51,07	46,85	18,77	-16,82
WIG20	-48,21	33,47	14,88	-16,62
mWIG40	-62,48	55,24	19,57	-22,58
sWIG80	-56,95	61,85	10,18	-28,58
WIG-PL	-50,62	44,93	18,70	-16,29

Source: [http://www.gpw.pl/analizy\\_i\\_statystyki](http://www.gpw.pl/analizy_i_statystyki)

**Table 5. Number of instruments traded on the Warsaw Stock Exchange in 2008-2011**

Instrument	2008	2009	2010	2011
Shares in companies	374	379	400	426
<i>of which foreign</i>	25	25	27	38
Number of new offerings	33	13	34	-
Number of delistings	10	8	13	11
Bonds	51	51	50	52
<i>of which foreign</i>	3	3	3	3
Futures	40	37	55	79
Options	138	110	106	142

Source: [http://www.gpw.pl/analizy\\_i\\_statystyki\\_pelna\\_wersja](http://www.gpw.pl/analizy_i_statystyki_pelna_wersja)

**Table 6. Warsaw Stock Exchange capitalisation at year end in 2008-2011 (PLN million)**

	2008	2009	2010	2011
Polish companies	267,359	421,178	542,646	466,046
Foreign companies	197,756	294,643	253,836	204,962
Polish bonds	362,704	411,018	486,505	518,407
Foreign bonds	586	586	586	586
<b>Total</b>	<b>828,405</b>	<b>1,127,425</b>	<b>1,283,573</b>	<b>1,190,001</b>

Source: [http://www.gpw.pl/analizy\\_i\\_statystyki\\_pelna\\_wersja](http://www.gpw.pl/analizy_i_statystyki_pelna_wersja)

The capitalisation of the WSE fell by 19% in 2011 from a year earlier.

**Table 7. Trading volumes on the Warsaw Stock Exchange in 2008-2011 (PLN million)**

Instrument	2008	2009	2010	2011
Equities	331,316	351,885	234 288	252,402
Bonds	4,999	2,951	2,855	741
Futures	613,495	517,366	681,296	337,467
Options	16,590	16,781	33,775	22,773

Source: [http://www.gpw.pl/analizy\\_i\\_statystyki\\_pelna\\_wersja](http://www.gpw.pl/analizy_i_statystyki_pelna_wersja)

Turnover in equities amounted to PLN 252,402 million, as against PLN 234,288 million the previous year.

As at 31 December 2011 short selling was permitted in 170 shares and 22 bonds.

### The alternative trading system (NewConnect)

In addition to the regulated market the Warsaw Stock Exchange operates an organised equity market in the form of an alternative trading system called NewConnect. In accordance with its organiser's intent, this market is dedicated to emerging and young companies the capitalisation of which is expected to remain relatively low (up to about PLN 20 million). Formalities related to entering the market are simplified - the process by which a company enters New Correct is faster and the costs of entering the market are lower than for the regulated market. The disclosure requirements imposed on issuers are also less stringent.

**Table 8. Data concerning the NewConnect alternative trading system in 2008-2011**

Measure	2008	2009	2010	2011
NCIndex at year end	38.19	49.70	63.44	41.62
Rate of return of NCIndex in current year (%)	-73.51	30.14	27.65	-34.39
Capitalisation of companies at year end (PLN m)	1,396.17	2,457.16	4,970.95	8,383.50
Number of companies at year end	84	107	185	351
Number of entries to NewConnect	61	26	86	172
Number of trading sessions	251	252	253	251
Trading volume (PLN million)	840.0	1,162.0	3,694.0	1,858,478
Number of trades per session	980	1,285	3,470	4,311
Average trading volume per session (PLN m)	3.3	4.6	14.6	1,717.43

Source: [http://newconnect.pl/index.php?page=statystyki\\_ryнку\\_roczne](http://newconnect.pl/index.php?page=statystyki_ryнку_roczne)

### BondSpot SA

The regulated off-exchange market (referred to below as the "RRP") operated in Poland by the company BondSpot SA is subject to KNF supervision. The main instruments traded on the BondSpot SA platform are Treasury bonds, corporate bonds, cooperative bonds and other debt securities; since 30 September 2009 these have been listed in the Catalyst system<sup>2</sup>. Trades on the RPP are executed through investment firms which are members of

<sup>2</sup> Catalyst provides a functional connection in the area of authorisation, admission and listing of debt on four markets for debt instruments (i.e. two regulated markets and two alternative trading systems). Among the four functionally interconnected markets are two organised by the Warsaw Stock Exchange and two organised by

Bondspot SA. Participants in trading may also be entities acting exclusively in their own name and for their own account which have been admitted to trading on the market. As at the end of 2011 the main shareholders in BondSpot were the WSE, banks and brokerage houses.

**Table 9. Data on the off-exchange market in 2008-2011**

Measure	2008	2009	2010	2011
ITO index at year end	30,154.3	32,342.9	- *	- *
Rate of return of ITO Index in current year (%)	-26.80	7.26	- *	- *
Capitalisation of companies at year end (PLN million)	380.6	314.0	214.6	-
Number of listed instruments	77	70	88	163
Number of trading sessions	251	252	253	250
Equities				
Trading volume (double-counted - counting both buy and sale trades) (PLN million)	6.0	1.7	0.6	0.084
Number of trades	2,298	715	388	65
Number of instruments	5	4	1	1**
Average trading volume per session (PLN '000s)	23.9	4.7	2.3	0.58
Covered bonds				
Trading volume (double-counted - counting both buy and sale trades) (PLN million)	74.5	36.5	99.8	23.3
Number of trades	87	59	19	17
Number of instruments	14	16	17	20
Bonds				
Trading volume (double-counted - counting both buy and sale trades) (PLN million)	202.6	4,995.8	261.5	1,165.55
Number of trades	452	140	156	216
Number of bonds listed	58	50	70	143

Source: KNF Office's own work

\* On 27 July 2010 BondSpot S.A. ceased calculation and publication of the ITO equity market index.

\*\* not listed at year's end

From 11 January 2010, apart from the regulated off-exchange market, BondSpot has also organised trade in debt instruments in an alternative trading system. This market is also one of the segments of the Catalyst system. Similarly to the case of the off-exchange market organised by BondSpot, dematerialised bonds, covered bonds and other debt financial instruments that incorporate property rights corresponding to the rights that arise from the incurrance of debt, are issued in accordance with the relevant provisions of Polish or foreign law and are admitted to trading on the market may be listed in the alternative trading system.

---

BondSpot (each company organises a regulated market and an alternative trading system). In accordance with the division made by the companies, the markets organised by the WSE constitute the so-called retail segment of the Catalyst "platform" while wholesale trading is carried out on the markets organised by BondSpot.

### 2.5.3. The settlement and depository system

The National Depository for Securities (Krajowy Depozyt Papierów Wartościowych S.A., referred to below as “the NDS”) is the central institution responsible for operating and supervising the settlement and depository system in support of the trading of financial instruments in Poland. The NDS is owned in equal parts by the WSE, the State Treasury and the National Bank of Poland. The main statutory tasks of the NDS are maintaining the securities depository, clearing and settlement of transactions concluded on the organised market, recording and holding securely dematerialised financial instruments, supervision of the correctness of the volume of issues of securities traded, fulfilment of the obligations of security issuers to security owners, maintaining the system that ensures the liquidity of transaction settlement, and management of the mandatory compensation scheme. On 1 July 2011 the NDS passed its tasks in the area of transaction settlement and the tasks associated with the operation of the system that ensures the liquidity of transaction settlement to KDPW\_CCP SA, a subsidiary of the National Depository in which the NDS holds 100% of the share capital. From 1 July 2011 the settlement of transactions in securities or in other financial instruments that are registered in the NDS system is performed by KDPW\_CCP SA while the clearing of such transactions (transfers between deposit accounts) is performed by the National Depository. In particular, KDPW\_CCP SA took over the settlement of transactions concluded on regulated spot and forward markets (the WSE and BondSpot) and also in alternative trading systems (NewConnect and ASO BondSpot SA). The activities of the NDS and KDPW\_CCP are subject to KNF supervision, which is exercised in particular through the right to approve or refuse approval of amendments to the Rules of the NDS and the Rules for Settlement Transaction (of KDPW\_CCP SA) and to perform inspections of these companies.

### 2.5.4. Public offerings of financial instruments other than investment certificates

A public proposal to purchase securities, defined as a proposal to acquire securities in any form and by any means that is addressed to at least 100 persons or to unspecified addressees, may be made only by means of a public offering. A public offering requires as a matter of principle the preparation of a prospectus, its confirmation by the Authority and its publication. Legal regulations provide, however, for a number of situations in which the conduct of public offerings does not entail an obligation to prepare a prospectus.

The year 2011 was weaker than 2010 in terms of the value of public offerings conducted. The value of public offerings totalled rather more than PLN 13 billion, which meant a decrease of almost half compared with the previous year. A big influence was exerted by the weaker second half, in which the growing fiscal problems of eurozone countries increased aversion to risk in, among others, the market for public offerings. This led to reduced activity in the capital market by the State Treasury, which carried only one major public offer, that of shares in Jastrzębska Spółka Węglowa (shares worth more than PLN 5.37 billion were sold in June). It should be noted, however, that the year 2010 was exceptional in terms of value of public offers by the State Treasury. During it four large public offers to sell shares worth a total of PLN 14.57 billion took place: ENEA (PLN 1.1 billion), GPW (PLN 1.2 billion), Tauron PE (PLN 4.2 billion) and PZU (PLN 8.07 billion).

Issuers conducted a total of 175 public offerings in 2011. Their structure is shown in Table 17.



**Table 10. Characteristics of public offerings conducted in 2011**

<b>175 public offerings, of which: 59 conducted by foreign issuers</b>			
<b>168 cash offerings</b>			<b>7 non-cash offerings</b>
<b>98 public offerings of shares</b>  of which:  <b>42 offerings exempted from the requirement to prepare and seek approval of the prospectus,</b>  <b>36 offerings conducted by foreign issuers</b>	<b>22 public offerings of structured products</b>          <b>all conducted by foreign issuers</b>	<b>48 public offerings of bonds</b>  of which:  <b>39 offerings exempted from the requirement to prepare and seek approval of the prospectus,</b>  <b>1 offering conducted by a foreign issuer</b>	
<b>26 public offers to sell</b>	<b>72 public subscriptions</b>		

Source: KNF Office's own work

The total value of public offers for cash conducted in 2011 amounted to PLN 13,045.9 million, of which sales of shares by subscription totalled PLN 3,749.9 million, public offers to sell shares PLN 6,649.6 million, bond offerings 2,026.1 million and public offerings of structured products 620.3 million.

**Table 11. Value and number of public offerings for cash in 2008-2011**

Year	2008		2009		2010		2011	
	Number of offerings	Value (PLN million)	Number of offerings	Value (PLN million)	Number of offerings*	Value (PLN million)	of offerings	Value (PLN million)
Public issues of shares	88	4,312.70	34	12,310.9	78	6,134.3	72	3,749.9
Public offerings of bonds	7	900	8	1,077.8	37	2,180.0	48	2,026.1
Public offers to sell shares	8	1,016.20	20	112.1	34	15,451.4	26	6,649.6
Public offerings of structured products	27	1,072.50	21	414.5	35	1,243.5	22	620.3
Total public offerings	130	7,301.40	83	13,915.3	184	25,009.2	168	13,045.9
of which: initial public offerings	43	4,419.90	22	7,539.2	60	15,899.5	64	8,472.4

Source: KNF Office's own work

\* In 2010 seven public offerings of shares were also conducted other than for cash

\*\* In 2011 seven public offerings of shares were also conducted other than for cash

If in comparison with 2010 there was a marked fall in the value of offerings, then in comparison with 2009 the fall in the value of offers was small and in comparison with 2008 there was a significant increase. In turn the fall in the number of public offerings conducted in 2011 compared to 2010 was small and their number was substantially higher than in 2009 and 2008. This can be seen even more clearly in the case of initial public offerings but in terms of their value 2010 was better.

Analysis of particular segments of the market for public offerings shows a marked weakness in the segment of raising capital through public offerings (by share issues). The number of subscriptions for shares conducted as public offerings fell only slightly in comparison with 2010 but the total value of subscriptions fell by more than 38%. In the second half of the year six issuers cancelled or suspended public offerings.

By dividing this segment of the market for public offerings into two main categories of companies:

- companies listed on the regulated market and
- companies entering the regulated market,

one can see that companies entering the market were as active in 2011 as they were in 2010. In 2011 companies entering the regulated market raised PLN 1.51 billion in 21 public offerings. These figures are similar to those for 2010, when PLN 1.53 billion was raised in 26 public offerings. The year 2011 was, however, weaker than 2008 and 2009 (when there were, respectively, 28 offerings worth PLN 2.91 billion and 10 offerings worth PLN 6.68 billion).

In 2011 there was, however, a substantial fall in the number and value of offerings in the case of companies already listed on the regulated market. The number of offerings declined from 19 to 12 and their value fell from PLN 4.37 billion to PLN 2.03 billion. It should be noted, however, that in 2010 large-scale offerings were conducted by such listed companies as Millennium Bank (PLN 1 billion) and BRE Bank (PLN 1.98 billion). In 2009 the same number of offerings (12) raised a total of PLN 5.54 billion, with PLN 5.12 billion being raised in the bank PKO BP's public issue of shares.

Greater activity by issuers could be observed in the market for public offerings of bonds, of which there were 48, after 37 in 2010. This did not carry over, however, to growth in the value of bonds offered, which fell by 7%. All the same, the growth of this segment of the market in recent years bears witness to the growing popularity of this form of debt financing.

Significantly lower activity was seen on the market for public offerings of structured products, where, after this market segment set a record in 2010, the value of offerings fell by half.

### 2.5.5. Undertakings for collective investment

An investment fund is a legal person the sole business of which is to invest cash collected through public, and in certain statutorily defined cases also non-public, offerings of units or investment certificates, in securities, money market instruments and other property rights defined in the Act on Investment Funds. An investment fund is managed by an investment fund company, which is its governing body.

When it is entered in the register maintained by the Regional Court in Warsaw a fund acquires legal personality and can then start independent operations. The register of investment funds is public, which means any person can inspect it without being obliged to demonstrate a legal or substantive interest in doing so.

An investment fund is a specific type of legal person, since it consists only of assets created from participants' contributions and assets acquired in exchange for those contributions. The assets of a fund (and thus of its participants) are not included in the bankruptcy estate of the investment fund company which manages the fund.

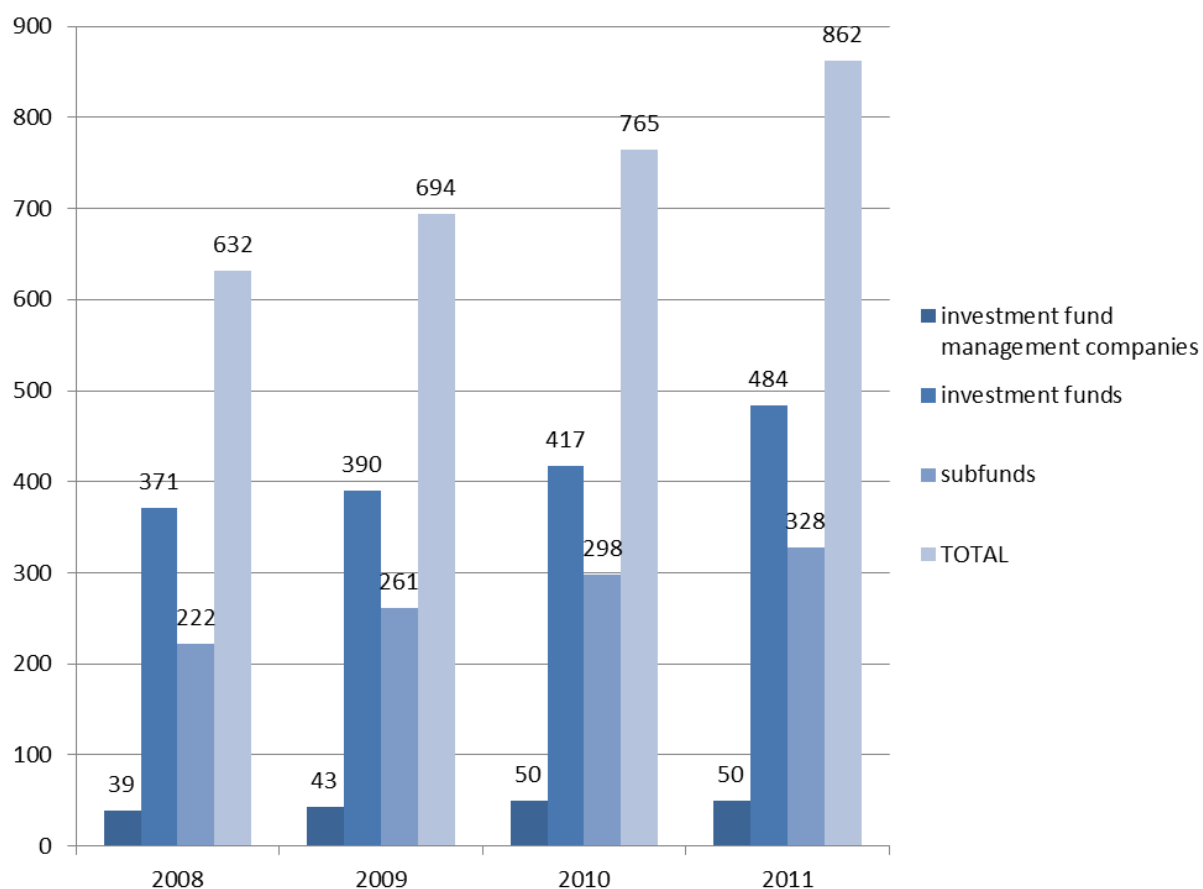
2011 saw an increase in the number of domestic institutions supervised<sup>3</sup>, as is shown by the cumulative totals in Figure 10.

As at 31 December 2011 50 investment fund management companies were active and they managed a total of 484 investment funds.

---

<sup>3</sup> Investment fund management companies, investment funds and subfunds.

**Figure 10. Total number of investment fund management companies, investment funds and sub-funds in 2008-2011 (cumulative, by type)**

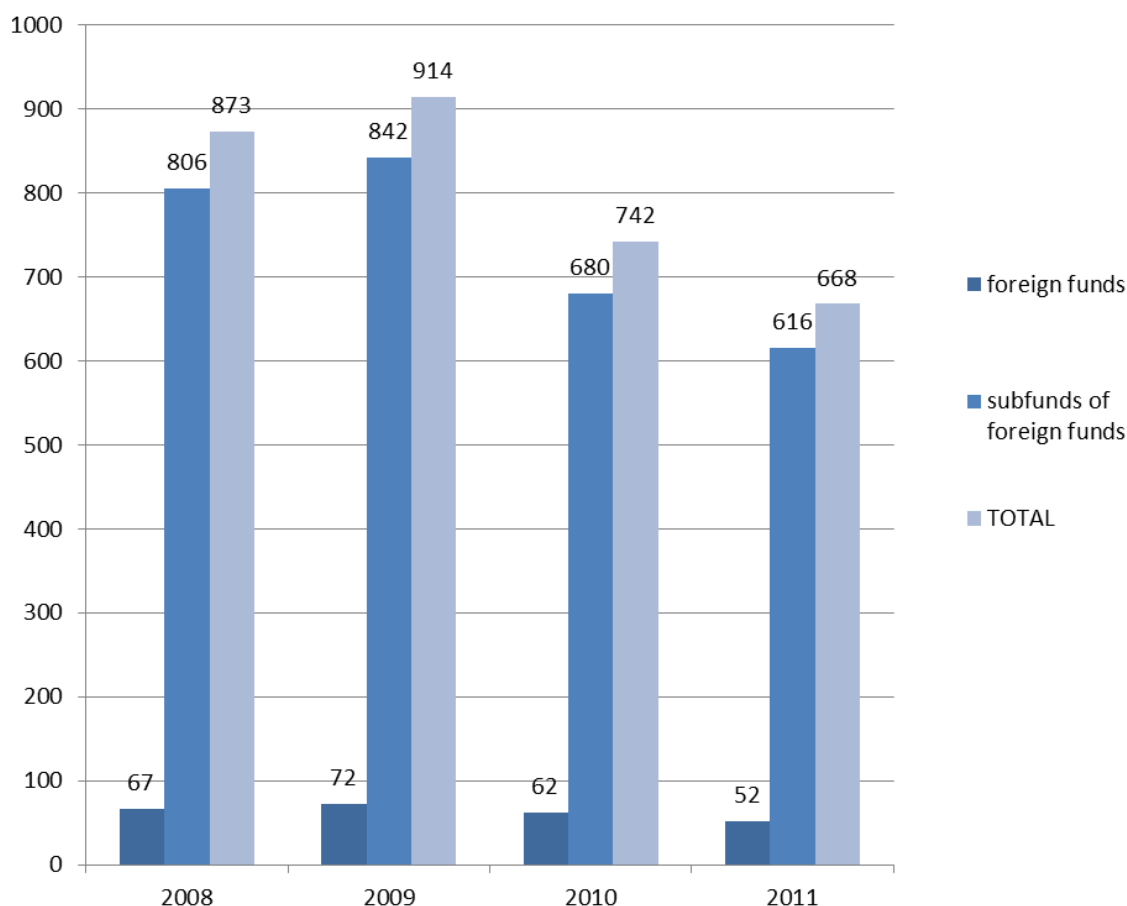


Source: KNF Office's own work

The Polish Financial Supervision Authority also supervises foreign investment funds and foreign investment funds' sub-funds which sell their participation units on the territory of the Republic of Poland.

After denotifications by some foreign funds in 2011, the number of such entities decreased as is shown by the cumulative totals in Figure 11.

**Figure 11. Total number of foreign investment funds and sub-funds of foreign investment funds in 2008-2011 (cumulative, by type),**



Source: KNF Office's own work

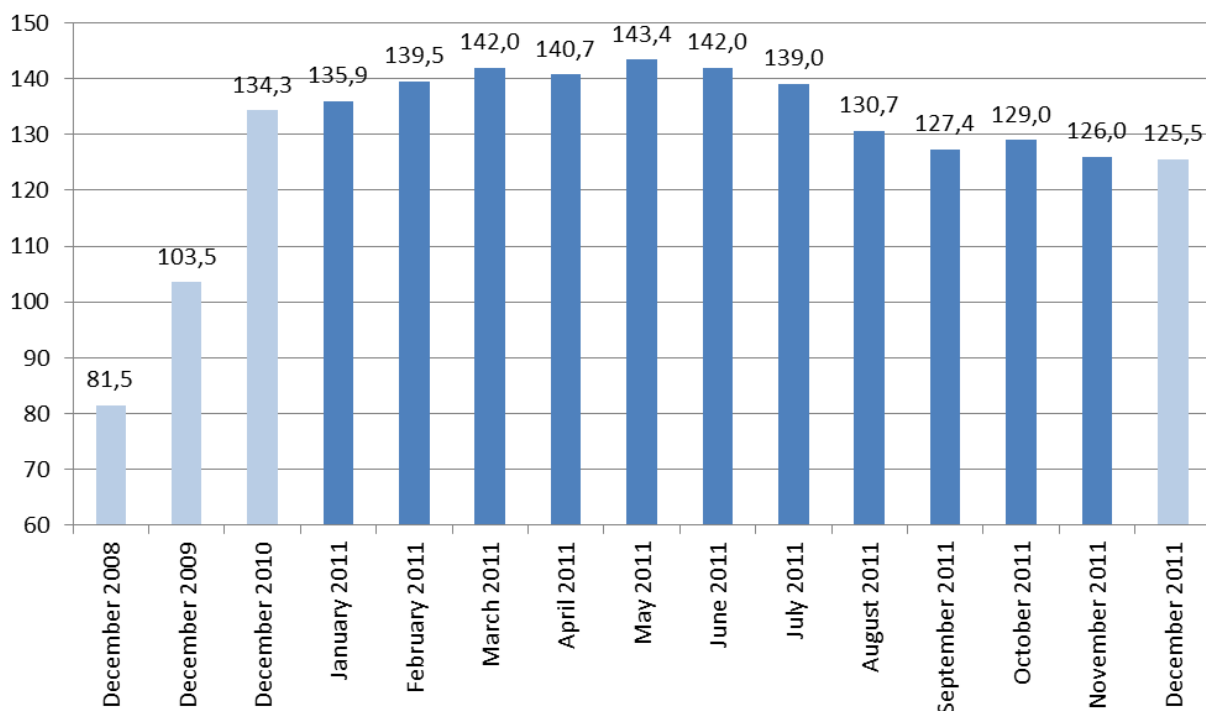
In the first half of 2011 there was further growth in the value of assets managed by investment fund companies, which rose to equal the level of the end of 2007. Because of worsening conditions in financial markets, however, the following months brought a reversal of the upward trend and at the end of 2011 total assets under management were lower than at the end of 2010.

Over the full year the value of assets managed by investment fund management companies fell by PLN 8.8 billion, to PLN 125.5 billion on 31 December 2011.

Figure 12 shows the value of assets managed by investment fund management companies at the end of the years 2008-2010, and in each month of 2011.<sup>4</sup>

<sup>4</sup> Based on monthly reports filed by investment fund management companies. Monthly reports are not audited or reviewed by qualified auditors, and so information in them may be subject to later revisions.

**Figure 12. Value of assets under management of investment fund companies at year ends in the period 2008-2010 and at month ends in 2011 (PLN billion)**



Source: KNF Office's own work

As shown by Figure 12, the level of assets was characterized by greater stability in 2011 than in the past few years. The highest growth could be observed in February and May. Meanwhile, in the second half of the year, with the exception of October, the level of assets managed by investment fund management companies gradually decreased, which was felt mainly in August. As in previous years, these changes reflected fluctuations in stock indices.

Despite the decline in assets under management, in 2011 investment fund management companies succeeded in earning slightly higher revenues than a year earlier. However, a simultaneous increase in costs meant that at the end of December 2011 the aggregate profits of fund managers amounted to PLN 429 million and were PLN 13 million lower than in 2010.

**Table 12. Aggregate costs of investment fund management companies in 2008-2011 (PLN million)\***

Costs	2008	2009	2010	2011	
Total costs, of which:	1,957	1,525	1,655	1,731	100.0%
- fixed costs	399	436	403	447	25.8%
- variable costs, of which:	1,558	1,089	1,252	1,284	74.2%
- <i>variable distribution costs*</i>	1,079	735	923	958	55.3%

\* costs related directly to acceptance and execution of orders to purchase, redeem or convert units in investment funds or to acceptance of subscriptions for investment certificates and allotment of them which constitute remuneration of distributors or are incurred in connection with the promotion or marketing of a fund.

### 2.5.6. Commodities market

In addition to the functioning capital market there also operates in Poland, though to a limited extent, a market for commodities, including the electricity market which is run by Towarowa

Giełda Energii SA SA (referred to later as "the TGE"). During the period covered by this report the TGE maintained five markets, the main commodities traded on which are electricity, property rights and CO<sub>2</sub> emission allowances. Apart from these markets, the TGE also organises auctions of electricity (in 2011 the TGE shortened the period for provision of information about an auction and now does so seven days prior to its taking place). Transactions on the exchange may only be executed by entities which have concluded membership agreements with the exchange and have been admitted to the exchange by the TGE's Management Board. The TGE has seventeen shareholders, the largest of which is the State Treasury, which holds 22.3% of its shares. Transactions carried out on the TGE are settled by Izba Rozliczeniowa Giełd Towarowych, which performs the role of exchange clearing house. The TGE is regulated by the KNF.

2011 saw an increase in turnover on the TGE from that recorded in 2010. Trading volume on the floor in 2011 amounted to 126,678,676 MWh (as against 81,725,273 MWh in 2010), which covered on average 81% of the needs of the National Power System.

19,740,974 MWh was traded on the Day-Ahead Market (referred to below as "the RDN"), the oldest of the TGE's markets, where electricity is traded for delivery the next day. Trading volume rose by 160.52% in comparison with the previous year. The weighted average price of electricity on the RDN in 2011 was PLN 199.57/MWh. The month with the lowest energy price was December (PLN 181.53/MWh) while that with the highest price was November (PLN 240.41/MWh). Over the year as a whole the average price of electricity was 4.18% higher in 2011 than in 2010.

On the Commodity Futures Market ("the RTT"), on which electricity is traded for future delivery, total turnover in 2011 amounted to 106,907,111 MWh. In comparison with 2010 turnover on the RTT increased by 44.18%. The average price of electricity in transactions concluded on the RTT amounted to PLN 207.54/MWh in 2011.

On the Property Rights Market ("the RPM"), on which members of the exchange can sell or buy property rights to guarantees of origin for electricity generated from renewable sources or by highly-efficient or methane-fired cogeneration systems, total turnover amounted to 50,606,981 MWh (up by 3.21%).

The most active player on all the TGE markets in 2011 was PGE Górnictwo i Energetyka Konwencjonalna SA. At the end of 2011 the list of members of the TGE included 49 entities, including three brokerage houses. Regularly increasing turnover in TGE energy markets in 2011 enabled the launch of a *market coupling* mechanism, i.e. connection of the Polish and Swedish energy markets. This fits well with a European Commission recommendation in accordance with which a common European energy market is to emerge by 2014. Transmission capacity for the transfer of power from Poland to Sweden amounted to 907,425 MWh in 2011 years, while capacity in the opposite direction was 3,263,969 MWh. Average flow capacity for one hour per from Poland to Sweden amounted to 104 MWh and that in the opposite direction to 373 MWh in 2011. It is worth noting that technical constraints make possible transmission in one direction of only 600 MWh in each hour of the day. Actual flows of power from Poland to Sweden in 2011 amounted to 287,155 MWh, which means 32% of capacity was used. The volume of power transfer from Sweden to Poland in 2011 was 1,452,082 MWh, which amounted to 44% utilisation of capacity in that direction. In 2011 the average flow of power from Poland to Sweden amounted to 33 MWh and that in the opposite direction to 166 MWh.

In August 2011 a year had passed since the introduction in the course of amendments to the Electricity Act of 10 April 1997 (referred to below as the "Electricity Act") of the so-called *trading obligation*. Its introduction has been judged successful because generators directed to public forms of sale much more power than was required by law. This is evidence of the maturity of the Polish electricity market and of its efforts to function in accordance with rules

of transparent competition. Ensuring liquidity in this type of trading is a step towards inclusion of Poland in the construction of a common, transparent energy market in Europe. It is a particularly important step in the light of the adoption by the European Parliament of the REMIT Regulation on integrity and transparency in the electricity market.

A total of 28 auctions of power were organised in 2011, 39% fewer than in 2010 year (when there were 46). In 2011 the TGE's Market for CO2 Emission Allowances conducted 90 sessions but no transactions were concluded during any of them.

Substantial amendments to the Electricity Act came into force on 1 January 2011. These amendments were largely concerned with the introduction of a system supporting the generation of electricity from biogas, with the Property Rights accompanying this that are listed on the TGE's RPM and with Certificates of Origin that are cancelled by the Energy Regulatory Office. Other changes came into force on 1 July 2011 as a result of the Act on the Preparation and Implementation of Investments in Nuclear Power Facilities and Associated Investments of 29 June 2011.

In 2011 electricity trading also took place on the POEE Energy Market maintained by the Warsaw Stock Exchange. The electricity market established by the WSE allows trading in electricity on three markets (daily-hourly, futures and property rights). In practice trading took place in the WSE's REK daily-hourly market (the equivalent of the TGE's RDN) and in the WSE's RTE futures market (the equivalent of the TGE futures market). In 2011 total volume in the two markets amounted to 4,078,521 MWh, which represents 3.22% of trading volume at the same time on the TGE.

At the end of 2011 30 entities, including two brokerage houses, were members of the WSE's POEE electricity market.

## 2.6. LICENSING AND AUTHORISING ACTIVITIES

The overall objective of financial supervision in the field of licensing is to ensure the stability of the financial sector. It does this primarily by:

- admitting to the financial sector as founding shareholders, members of corporate authorities, and particularly members of management boards, people who are fit and proper to provide prudent and stable management,
- checking that funds for the subscription for or acquisition of shares do not come from a credit, loan or undocumented sources,
- specification of the minimum initial shareholders' funds that a newly created institution should have in view of the nature and extent of its intended business,
- checking whether the provisions in force at the location of the founder's or shareholder's registered office or residence allow the Polish Financial Supervision Authority to exercise effective supervision, and
- checking whether the links of an institution's founders with other institutions may not prevent effective supervision of the institution.

The role of supervisory licensing and authorisation activities regarding supervised entities are in particular of a preventive and informational nature. Scrutiny of the legality of proposals regarding supervised entities and provision to such entities of answers to questions on matters relating to licensing, and in particular to the extent of application of the law, is aimed at preventing irregularities in supervised entities' activities at the earliest possible stage.



### 3. SUPERVISORY ACTIVITIES OF AN ANALYTICAL NATURE

Analytical supervision of the financial market involves continuous monitoring and assessment of overall conditions in the financial sector and in individual institutions, identification of existing or potential risks, and, where necessary, implementation of intervention measures.

Financial institutions' economic and financial standing and exposure to individual risks are systematically analysed and evaluated on the basis of reports submitted by them, surveys and other available information. Assessments cover in particular changes occurring at institutions and compliance with regulations in force, notably those concerning capital adequacy.

#### 3.1. BANKING SUPERVISION

The purpose of supervision by the Polish Financial Supervision Authority of the banking sector is to ensure the safety of funds held in bank accounts, ensure that banks comply with the law and with the decision on granting authorisation for the establishment of a bank and ensure that banks comply in their activities under Article 70 paragraph 2 of the Act on Trading in Financial Instruments of 29 July 2005 with the provisions of that Act, the Banking Law and their statutes.

In 2011 the KNF continued its activities in regard to supervised entities so as to allow continuous monitoring of their operations and, in particular, of their capitalisation and liquidity positions. As a result of these efforts risk of loss of liquidity did not arise at any bank. The supervisory authority reacted promptly to any signs of problems being experienced by groups of companies which could affect the condition of their subsidiaries operating in Poland, focusing on meetings with banks' management boards and contacts with their home country supervisory authorities. The KNF also monitored the possible impact on the operations of Polish subsidiaries of obligations imposed by the European Commission on banking groups in receipt of state aid. The Authority paid particular attention to transactions that could have the features of unjustified transfers of funds to parent companies. In its cyclical monitoring activities no such transactions were identified. At the same time banks were recommended not to pay a dividend for 2011 and to allocate profits earned to strengthening their capital bases.

Supervisory efforts were focused on a number of areas: additional advice and recommendations, monitoring activities, meetings with banks' management boards, contacts with home country supervisory authorities, and participation in the work of the Financial Stability Committee. These efforts included:

- continuing to monitor banks' involvement with foreign financial institutions (including their associates) and the sources of finance obtained from those entities,
- continued monitoring and analysis of transactions in foreign exchange derivatives entered into with non-financial entities,
- analysis of whether supervised banks possess assets from countries affected by fiscal problems, with the subject of concern being primarily securities from the GIIPS countries,
- actions taken to reduce risk in banks' operations (including financial result, liquidity and reputational risk) arising from banks' offering deposits with daily capitalisation of interest, particularly in light of proposed amendments to the provisions of the Tax Law,
- analysis of and giving opinions on the manner in which bank mergers are to be performed, and
- taking necessary individual actions in relation to particular banks in all these areas.

As part of monitoring activities banks were also requested, among other things, to provide information regarding:

- outsourcing, including entrusting the performance of certain activities to external institutions,
- contracts concluded by banks with affiliated entities, i.e. entities that belong to the same group of companies as a bank, that concern support by the bank in areas that are important to it, and
- due diligence processes conducted in banks.

### 3.1.1. Monitoring of banks' financial condition

Supervisory activities involved ongoing monitoring and quarterly analysis of banks' economic and financial standing. Each quarter on the basis of this analysis banks were awarded point scores in the CAEL system and areas of potential risks that should be subject to detailed investigation during inspections were identified. The conclusions were presented in executive summaries. In the first and second quarters of 2011 575 cooperative banks and 48 commercial banks were examined, while in the third quarter 574 cooperative banks (including the 249 largest) and 47 commercial banks were examined.

In 2011, apart from CAEL rating, banks were also covered by analysis as part of the BION research and supervisory assessment process. Detailed information on BION assessment in the banking sector is presented in subsection 3.5.1 of this Report.

In the area of consolidated supervision, the Authority analysed consolidated financial statements of banks and the economic and financial standing of banking groups and entities that control banks. As part of direct analytical supervision banks were selected for comprehensive and problem-oriented inspections and this information was then passed to the organisational units of the KNF Office that are responsible for the conduct of inspections. Data was prepared for inspections to be carried out at banks.

Summary and sectional reports were prepared, *inter alia* in relation to the financial difficulties suffered by some borrowers and groups of borrowers, compliance with concentration limits was monitored, and shareholding and personal links between banks and groups of borrowers were analysed. In 2011, as in previous years, comparative analyses were prepared to examine the manner in which debt owed by the same borrower is classified by different banks and also how the shareholder structures of some major clients of banks are presented; if any discrepancies were identified, relevant steps were taken with respect to the supervised institutions involved.

The KNF continued to implement the measures taken in previous years with regard to supervised entities to enable continuous monitoring of their operations and, in particular, of their liquidity positions. The supervisory authority reacted promptly to any signs of problems experienced by groups of companies which could affect the situation of their subsidiaries and branches operating in Poland, focusing on meetings with banks' management, contacts with their home country supervisory authorities, participation in meetings of colleges of supervisors, and regulatory activities.

### 3.1.2. Monitoring of banks' compliance with regulations in force

Banks' compliance with legal regulations in force (such as the Banking Law, regulations issued by the Minister of Finance and KNF resolutions) was subject to ongoing analysis, which also covered compliance with prudential standards. The correctness of reports prepared by banks was also analysed and, if errors or omissions were discovered, banks were required to make the necessary corrections. In the field of supervision of cooperative banks 185 letters concerning the classification of credit exposures to specific risk groups were prepared.

**Figure 13. Shareholders' equity and capital adequacy of the Polish banking sector in 2008-2011**



Source: KNF Office's own work

In the period under review, as in 2010, all commercial banks held the required amount of equity. The key capital requirement for the banking sector was the credit risk requirement, which amounted to PLN 59.7 billion and constituted 88.4% of the total capital requirement (of PLN 67.6 billion). The requirement related to operating risk was PLN 6.4 billion and accounted for 9.4% of the total requirement. The share of requirements relating to other types of risk was marginal. Also monitored was the discharge by banks of their obligation to file consolidated financial statements of banks and banking groups together with financial statements of subsidiaries and closely related undertakings, in accordance with Article 141g of the Banking Law.

At the end of the reporting period, seven cooperative banks did not have the required amount of own funds in (one decided to merge with another bank); at the end of 2010 all cooperative banks had the required amount of funds, of at least 1 million.

### 3.2. SUPERVISION OF THE INSURANCE MARKET

Supervision of the insurance market covers insurance and reinsurance activities. The purpose of supervision of the insurance market is to ensure the stability of the insurance market, to watch over insurance and reinsurance undertakings' (referred to below as "undertakings") conduct of business in accordance with legal norms, and to protect the

interests of parties purchasing insurance and insured parties together with the beneficiaries of insurance agreements and the holders of rights under them.

The basic activities related to the ongoing analytical supervision include:

- monitoring the solvency of undertakings, the safety, liquidity and profitability of investments and the matching of assets to technical provisions,
- monitoring the discharge by undertakings of their reporting and disclosure obligations in relation to the supervisory authority and undertakings' clients on the basis of their financial statements and other information required by applicable laws<sup>5</sup>,
- taking measures provided for by legal regulations and supervisory actions with respect to undertakings and issuing administrative instruments, including decisions and rulings, in these cases,
- issuing recommendations that arise from the conduct of ongoing supervision of undertakings, monitoring the implementation of such recommendations and imposing appropriate sanctions,
- considering undertakings' applications to be granted certain rights or to receive the supervisory authority's consent to specific activities that are subject to financial supervision, and
- issuing opinions in the fields of accounting, reporting and actuarial science.

### 3.2.1. Monitoring the financial standing and investment policy of undertakings and supervision of the implementation of recovery plans

The Polish Financial Supervision Authority's main task in the area of analytical supervision of undertakings' financial standing and investment policies is continuous monitoring of the situation and protection of market stability and, if threats to that stability appear, taking appropriate remedial measures. The overall objective of these activities is to ensure that insurance undertakings are able to pay the benefits due to entitled persons.

Assessment of the financial standing of undertakings, and in particular of their solvency, is performed primarily on the bases of undertakings' quarterly and annual financial statements and monthly reports on solvency ratios that are filed with the supervisory authority. During the reporting period work was carried out on the preparation of reports on the condition of the insurance sector after the first and second quarter of 2011. As a result of the analyses performed it was noted that the insurance market is stable.

As part of activities associated with supervising the solvency of particular undertakings the Polish Financial Supervision Authority monitored the implementation of recovery plans in two undertakings.

In 2011 the KNF Office continued to study the degree of concentration of investments in bank deposits and examined the degree to which undertakings are protected against the risk of excessive concentration of investments in the light of their surpluses of own funds over the solvency margin. These studies and examinations were conducted on the basis of data contained in quarterly financial statements and information submitted to the supervisory authority in accordance with the maintenance of the obligation first imposed on undertakings in 2008 to report data on key indicators relating to undertakings' solvency. The Authority continued to hold meetings with representatives of undertakings and to send letters to undertakings in which it put forward the KNF Office's position that undertakings should seek to reduce the excessive concentration of investments in a single institution or in a single

---

<sup>5</sup> Insurers and reinsurers are required to file with the KNF Office the following types of financial statements: quarterly and annual financial statements, consolidated financial statements, statements concerning coinsurance, statements concerning transactions carried out within an insurance group, actuary's reports, statements concerning unit-linked insurance plans and statements concerning IKE individual retirement accounts.

asset class. In reaction to the KNF Office's supervisory actions, undertakings took steps to reduce the level of concentration in credit institutions.

During the reporting period work was carried out on the preparation of reports on the condition of the insurance sector after the third and fourth quarters of 2010 and the first and second quarters of 2011. As a result of the analyses conducted it was noted that the insurance market is stable, cases of non-compliance with solvency requirements are temporary in nature and are eliminated principally through appropriate recapitalisation and the restructuring of activities by, *inter alia*, reducing operating expenses, changing the rates of insurance premiums, and linking the remuneration of insurance intermediaries to the loss ratio of a portfolio of insurance policies.

In March 2011 the report "Activities of Foreign Insurance Undertakings in Poland and Polish Undertakings Abroad in 2007 - 2009" was prepared. The report presents selected statistical information on the activities, conducted on the basis of freedom to provide services or of the freedom to establish an enterprise (through a branch), of foreign insurance undertakings in Poland in the years 2007 - 2009 and of Polish insurance undertakings outside Poland. The basis for this study is information provided by foreign supervisory authorities, the scope of which is specified in Article 44 of the Third Directive on non-life insurance 92/49/EEC and Article 49 of Directive 2002/83/EEC on life assurance. Additionally use was made of information on the cross-border activities of Polish insurance undertakings (on the basis of insurance undertakings' annual financial statements for 2009). Part of the report was published on the KNF's website [www.knf.gov.pl](http://www.knf.gov.pl).

In 2011 a study was conducted of non-life insurance undertakings' programmes for catastrophe reinsurance. The aim of this study was to check insurance undertakings' preparation for unexpected large random and catastrophic events, which could lead to a significant deterioration in insurance undertakings' financial standing, or even to their insolvency.

The major conclusions of the analyses conducted, which were included in the report "Reinsurance of National Insurance Undertakings in 2010", should be noted:

- non-life insurance undertakings use reinsurance to a much greater extent than do life assurance undertakings,
- in 2010 the level of reinsurance cession for insurance undertakings in Poland was about 10 - 12.5% and was markedly lower than in most OECD countries, and especially other European Union countries,
- in 2010 as a consequence of natural disasters the net balance of reinsurance operations for non-life insurance undertakings was positive for the first time in 10 years and amounted to PLN 655 million. This means that insurance undertakings spent on reinsurance less than they received from reinsurers as their share in meeting claims. Positive reinsurance balances were previously observed in 1997 and 1999 and were also the consequence of natural disasters, and
- the capacity of undertakings' catastrophe insurance policies may be judged sufficient even in the event of a flood of the same extent as 1997's.

As part of the cyclical continuation of analysis of reinsurance programme a letter was sent on 7 December 2011 to non-life insurance undertakings requesting them to submit their plans for catastrophe reinsurance for 2012 and if possible to forward a copy of catastrophe reinsurance contracts for 2012. The analysis of this study will be presented to the Authority in the first quarter of 2012.

In 2011 work was also continued on the analysis of the risk inherent in the current activities of insurance/reinsurance undertakings and assessment of the degree of advancement of works in each undertaking on the development of an effective risk management system, including rules for conducting its own risk and solvency assessment (ORSA). In the first quarter of

2011 a full report was prepared summarising the results of a survey of insurance and reinsurance undertakings in 2010 on the subject of their own risk and solvency assessment and their management of risk.

During the period covered by this report the KNF Office sent to insurance/reinsurance undertakings another survey on the subject of their own risk and solvency assessment and management of risk in the activities of an insurance/reinsurance undertaking. The report "Results of a Survey of Their Own Risk and Solvency Assessment and Management of Risk (ORSA) in the Activities of Insurance and Reinsurance Undertakings Conducted in 2011" was prepared on the basis of the responses received.

In relation to the results of the 2010 survey there was an increase in the number of insurance/reinsurance undertakings that had a risk management system, which indicates that undertakings have already implemented a series of tasks in the area of modification and expansion of this system. In addition, there was a decrease in the number of undertakings that did not have strategies, policies, rules, processes or procedures for managing capital or any of its components. As crucial kinds of risks in their activities insurance/reinsurance undertakings identified the following kinds of risks: risk of premiums and reserves, catastrophe risk, legal-political risk, systems risk, business risk, risk of revision of the levels of disability pensions, competition risk, interest rate risk, and equity price risk.

The results of the survey, especially in regard to possession of a risk management system, assessment of gross risk and key types of risks, will be used when conducting BION research and supervisory assessment of insurance/reinsurance undertakings.

### 3.2.2. Supervision of undertakings' compliance with legal regulations concerning reporting and disclosure obligations

Each of the financial statements filed by undertakings are subjected to separate analysis the results of which are then compiled into uniform reports that serve as the basis for the taking of individual supervisory decisions.

In 2011, in the course of analysis of financial statements submitted to it, the KNF Office in 249 cases asked insurance undertakings to submit corrections or to add missing information to financial statements. After analysing the undertakings' actuaries' reports on the state of insurance portfolios for 2010 the KNF Office made requests for additional information and explanations or correction of reports mainly to non-life undertakings.

**Table 13. Indicators of coverage of statutory requirements in 2008-2011 (%)**

Ratio	2008	2009	2010	2011
<b>Life assurance undertakings</b>				
Own funds to solvency margin	285.77	345.96	316.59	320.68
Own funds covering guarantee fund to guarantee fund	789.08	937.50	858.03	886.77
Assets covering provisions to technical provisions	108.6	108.88	109.06	107.91
<b>Non-life insurance companies</b>				
Own funds to solvency margin	642.71	363.16	390.48	385.18
Own funds covering guarantee fund to guarantee fund	1,712.29	974.19	1,053.78	1,056.20
Assets covering provisions to	154.8	116.73	124.52	124.09

technical provisions				
----------------------	--	--	--	--

Source: KNF Office's own work

The data shown in Table 20 for 2011 were prepared on the basis of the (unaudited) quarterly financial statements of insurance undertakings.

As a result of analyses conducted in 2011 recommendations were issued concerning the presentation of structured instruments in balance sheet assets and liabilities and the exclusion of the value of deferred income tax assets from undertakings' own funds. The question of setting and maintaining records of technical provisions was also the subject of recommendations.

In the course of its exercise of ongoing supervision over the insurance sector the KNF Office:

- in 74 cases analysis was performed of the internal rules in place at insurance undertakings (*inter alia* rules governing the creation of technical provisions and premium rate structures together with rules required in the draft Solvency II regime),
- in 14 cases examination was performed of the implementation of recommendations issued to insurance undertakings following inspections carried out by the supervisory authority (in seven cases recommendations were definitively judged to have been implemented), and
- in 24 cases examination was performed of the implementation of recommendations to adjust the activities of undertakings to meet legal regulations in the course of continuous supervision (in 15 cases recommendations were definitively judged to have been implemented).

Regulations governing insurance activity impose upon insurance undertakings a series of obligations to provide information both to the supervisory authority and to insured persons. The task of the supervisory authority in this regard is to check both whether the specified information has been published and the nature of that information. The timely and full discharge of disclosure obligations is one of the fundamental duties of undertakings and makes possible general access to operational data both for the supervisory authority and for consumers of insurance services.

In connection with undertakings' discharge of their statutory duties regarding information, the KNF Office in 2011 adopted and analysed:

- information about a choice or change of auditor - in 61 cases,
- information about the choice of an actuary - in nine cases,
- information about the selection of the person who will be responsible for maintaining the books of account - in two cases,
- information about the authorisation of another person to make declarations of will about claims - in six cases,
- information about changes in premium rates - in 69 cases,
- publication of annual reports of Insurance Capital Funds ("UFKs"), to which unit-linked policies are linked, as at 31 December 2010 (23 undertakings and 1,033 UFKs) and semi-annual reports of UFKs as at 30 June 2011 (23 insurance undertakings and 1,144 UFKs) on undertakings' websites, and
- information about Individual Retirement Accounts as at 31 December 2010 (30 life undertakings).

The results of analyses performed indicate that undertakings, other than in sporadic cases, are meeting the above disclosure requirements in accordance with legal regulations in forced. Cases of non-compliance are considered on an individual basis to determine whether the imposition of the financial penalties provided for by legal regulations is justified. As a result of proceedings conducted, the Polish Financial Supervisory Authority in 2011 imposed financial penalties on two insurance undertakings.

In 2011 analysis was also performed of the compliance by insurance undertakings with obligations to provide information about the Insurance Guarantee Fund. This analysis showed that not all supervised institutions are meeting the obligation in question. In relation to establishments failing to do so additional supervisory measures were taken (including commencement of proceedings on the imposition of financial penalties). As an effect of supervisory measures taken a financial penalty was imposed on one insurance undertaking.

### 3.3. SUPERVISION OF THE PENSION MARKET

Analytical supervision of the pension market covers the financial standing and the operating and investment activities of pension funds (the so-called Pillars II and III of the pension system) and also of occupational pension schemes and individual pension accounts (the so-called Pillar III of the pension system). The KNF Office also monitors the compliance of these institutions with legal regulations and with their statutes and also their fulfilment of disclosure obligations. The objective of supervision is to protect the interests of members of pension funds and of participants in occupational pension schemes.

#### 3.3.1. Monitoring of the financial standing of pension fund companies and the investment activity of pension funds

The following activities were undertaken as part of the monitoring of the financial standing of pension fund companies and the investment policies of pension funds:

- analysis of transactions concluded on the capital market in terms of the profitability and risk related to the acquisition of a given financial instrument, resulting from the structure of the instrument and the financial standing of its issuer,
- monitoring of investment activity by pension funds with respect to compliance with the overriding principle of profitability and the security of investments,
- verification of the valuation of financial instruments held in pension funds' investment portfolios,
- analysis of the structure of pension funds' investment portfolios, of how it changes over time and of the level of risk accepted,
- analysis of available financial instruments offered on the capital market in terms of their fitness for the investment activities of pension funds,
- assessment of the effectiveness of the investment activity of pension funds taking into account the conditions prevailing on capital markets and the macroeconomic environment, and
- analysis of internal procedures and declared rules of conduct of investment activities at supervised entities.

A particular task of the supervision authority is the obligation to review each detailed methodology submitted to it by pension funds for the valuation of financial instruments for which there is no market or for which it is impossible to perform valuation on a mark-to-market basis while observing the principle of conservative valuation. During the period covered by this report 236 valuations submitted by OFEs and PFEs were subject to approval by the supervision authority. The supervisory authority issued instructions to change valuation methodology 27 times in the case of OFEs and PFEs.

In view of the large proportion of their current financing provided by employers, a substantial part of supervisory activities regarding occupational pension fund management companies is performed indirectly and is particularly focused on monitoring the continuity of financing. This is a condition of financial security and of the continuing functioning of these entities. It was confirmed that shareholders in occupational pension fund management companies cover their operating costs on an ongoing basis and that balances of amounts due at the end of particular quarters arise directly from the settlement systems employed. Another



characteristic feature of occupational pension fund management companies is that they rely to a larger extent than general pension fund management companies on outsourcing and, as a result, a part of supervision activities cover entities other than the companies themselves. During the period covered by this report the Polish Financial Supervision Authority twice calculated and reported to the public the weighted average rate of return of all open pension funds for the periods from 31 March 2008 to 31 March 2011 and from 30 September 2008 to 30 September 2011. In both cases, all OFEs achieved a rate of return higher than the minimum required rate of return.

**Table 21. Statutory rates of return of open pension funds calculated and published by the KNF in 2011 (%)**

Open pension fund	Rates of return for the period		Open pension fund	Rates of return for the period	
	from 31 March 2008			from 30 September 2008	
	to 31 March 2010			to 30 September 2011	
Allianz Polska OFE	17.405%		PKO BP Bankowy OFE	16.138%	
PKO BP Bankowy OFE	16.427%		Allianz Polska OFE	15.980%	
AXA OFE	15.811%		ING OFE	15.901%	
OFE POLSAT	15.802%		AXA OFE	15.497%	
ING OFE	15.556%		Generali OFE	14.942%	
Nordea OFE	15.399%		OFE PZU "Złota Jesień"	14.880%	
Generali OFE	15.390%		Amplico OFE	14.766%	
AEGON OFE	15.312%		OFE WARTA	14.713%	
OFE Pocztylion	15.305%		Nordea OFE	14.709%	
OFE PZU "Złota Jesień"	15.167%		OFE POLSAT	14.431%	
Amplico OFE	14.826%		AEGON OFE	13.645%	
OFE WARTA	14.707%		Pekao OFE	13.199%	
Pekao OFE	14.396%		Aviva OFE Aviva BZ WBK	13.090%	
Aviva OFE Aviva BZ WBK	13.630%		OFE Pocztylion	12.873%	
<b>Weighted average rate of return</b>	15.177%		<b>Weighted average rate of return</b>	14.735%	
<b>Minimum rate of return</b>	7.589%		<b>Minimum rate of return</b>	7.368%	

Source: KNF Office's own work

In addition to measures taken by the KNF Office in regard to the financial standing of pension fund management companies and the investment activities of pension funds, it also issued opinions interpreting legal regulations in force. The following reports on the activities of participants in the pension market were submitted to KNF meetings:

- "The Financial Standing of General Pension Fund Management Companies in 2010",
- "Pension Funds' Investment Activities in the Period from 31 March 2008 to 31 March 2011",
- "General Pension Fund Management Companies' Financial Standing in the First Half of 2011",
- "Pension Funds' Investment Activities in the Period from 30 September 2008 to 30 September 2010",
- "The Open Pension Funds Market in the First Quarter of 2011",
- "The Open Pension Funds Market in the Second Quarter of 2011", and
- "The Open Pension Funds Market in the Third Quarter of 2011".

In addition to reports, the Supervisory Authority also receives annual information on the conduct of occupational pension schemes by their sponsoring employers. Monthly, quarterly and annual statistical and financial data on the OFE, PPE and IKE markets and information about transfers and allocation by lot of members of OFEs were regularly prepared and published on the basis of the information sent to the KNF Office in the year being reported on.

Apart from the activities of the KNF Office already referred to regarding supervision of the financial standing of pension fund management companies and the investment activities of pension funds and the presentation of opinions interpreting legal regulations in force, the KNF Office also presented its position on the required level of own funds of pension fund management companies and on how banks should perform depositary functions for open and occupational pension funds.

### 3.3.2. Supervision of occupational pension schemes

Under the rules in force an employer who sponsors an occupational pension scheme is required to submit annually to the supervisory authority information about the performance of the PPE maintained by him in a given calendar year no later than by 1 March of the following year. In this way the supervisory authority obtains the essential information about the functioning of particular occupational pension schemes and, after the aggregation of reports, information about the market and about important developments and trends.

At the end of 2011 1,116 PPEs operated, with some of them covering a number of undertakings in which more than one employer participates, which means that the obligation to report on PPEs maintained in 2011 falls on the 1,150 employers who, at 31 December 2011 sponsored occupational pension schemes.

In 2011 the supervisory authority conducted 22 proceedings in the course of indirect supervision of employers sponsoring occupational pension schemes.

## 3.4. SUPERVISION OF THE CAPITAL AND COMMODITY MARKETS

Ongoing supervision of the capital and commodity markets is performed chiefly through:

- monitoring of the current standing of supervised institutions on the basis of statements, reports and information submitted by them,
- checking compliance with capital requirements,
- preparation of opinions regarding materials for supervisory board meetings and general shareholder meetings of the companies that operate the regulated market, the securities depository and the commodity market, and also participation in those meetings, and
- checking supervised entities' compliance with disclosure requirements.

### 3.4.1. Supervision of entities operating on the securities market

#### **Investment firms and custodian banks**

The Authority monitors the financial standing of investment firms and custodian banks by analysing their financial statements submitted in accordance with legal regulations.

Basic activities related to supervision include:

- analysing financial statements submitted by supervised institutions in accordance with legal regulations, i.e. monthly, semi-annual and annual financial statements and half-

- yearly reports on the activities and functioning of internal supervision in institutions engaged in brokerage activity,
- conducting inspections of the activities of investment firms, custodian banks, foreign investment firms engaged in brokerage activities on the territory of the Republic of Poland through a branch, and
  - issuing recommendations and monitoring their implementation.

August 2011 saw the entry into force of provisions amending the Minister of Finance's Regulation on the scope and detailed rules for determination of the total capital requirement, including capital requirements, for brokerage houses, and specifying the maximum ratio of loans, credits and debt securities issued to capital of 18 November 2009 (Journal of Laws 2009 No. 204 item 1571, as amended), which regulates the capital adequacy of brokerage houses. Among the changes introduced the biggest impact on the level of brokerage houses' compliance with capital adequacy requirements was made by changes to the calculation of the level of supervised capital, and in particular the introduction of the obligation to obtain the Authority's approval for including category III capital in the level of supervised capital, and changes to the calculation of the capital requirement arising from exceeding the limit on concentration.

**Table 14. Average capital requirements (in PLN million) and capital requirement coverage ratios at brokerage houses in 2008-2011**

Measure	2008	2009	2010	2011
Average level of regulated capital	33.83	33.53	46.00	45.09
Average total capital requirement	4.78	5.41	19.63	35.35
Average level of internal capital	-	-	20.24	38.27
Average deviation of level of regulated capital from total capital requirement	28.98	28.07	26.35	9.74
Average deviation of level of supervised capital from internal capital	-	-	25.74	6.82
Average deviation of level of supervised capital from minimum amount of initial capital	31.44	30.47	43.53	42.26
Average coverage of total capital requirement by supervised capital *	7.07	6.20	2.34	1.28
Average coverage of internal capital by supervised capital *	-	-	2.27	1.18
Average coverage of minimum initial capital by supervisory capital *	15.67	15.25	27.01	24.57

Source: KNF Office's own work

Data are taken from monthly Monitor Rachunkowości i Finansów reports for 31 December 2008, 31 December 2009, 31 December 2010 and 31 December 2011 (including expected correction of net profit for 2011 to take account of impairment write-downs of investments).

\* Data expressed in dimensionless units, representing the average ratio of supervised capital to individual capital requirements.

In accordance with the provisions of the Minister of Finance's Regulation on supervisory review and assessment of supervised brokerage houses of 20 November 2009, in 2011 the KNF Office completed its first formal process of issuing supervisory assessments to brokerage houses.

### 3.4.2. Trading Supervision System

In April 2011 work was completed on implementation of the SNO Trading Supervision System (referred to below as "the SNO"). The aim of the project was to provide IT and analytical support to the KNF Office in the area of supervision of trading on the regulated market in Poland. The SNO was implemented as a safe and efficient environment supporting the performance of supervision processes by the Authority through the collection, processing and presentation of information about trading on the regulated market obtained from the WSE, the NDS and other sources. In the field of reporting, the system provides a flexible reporting environment for organising transaction data coming from different sources and the system also yields tools and reports that allow analysis of these data and provides necessary alert functionalities.

So as to ensure that the functioning of the SNO complies with European Union regulations and standards, the system's databases are also used to automatically provide MiFID transaction reports and to add to the IRD Instrument Reference Data database and to Market Calculations.

MiFID reports on transactions meet the Authority's obligation under Article 25 paragraph 3 of Directive 2004/39/EC of the European Parliament and the Council of 21 April 2004, in accordance with which investment firms are required to provide the competent supervisory authorities with reports on transactions concluded in financial instruments admitted to trading on regulated markets regardless of whether they are concluded for the investment firm's own account or for the account of customers. As part of the IRD project, a common database was created to collect new and regularly updated reports and to automatically exchange information on instruments for which particular supervisory authorities are competent. The Market Calculations database allows for identification of liquid shares, which the Authority is required to perform by Article 22 paragraph 6 of Commission Regulation (EC) 1287/2006 implementing Directive 2004/39/EC, under which each supervisory authority is to ensure the maintenance and publication of a list of all liquid shares for which it is the competent authority.

In the area of formal and legal adjustment of the system the KNF Office has already, in 2010, signed with the WSE and the NDS agreements ensuring the reliable receipt of data of appropriate quality.

### 3.4.3. Supervision of securities issuers other than investment funds

As part of the supervision of reporting by securities issuers other than investment funds, the KNF Office in 2011 among other things:

- examined the financial statements (including the consolidated statements) of 76 issuers for compliance with accounting standards in force, and in particular with the requirements of International Accounting Standards/International Financial Reporting Standards (referred to below as "IAS/IFRS"), selected on the basis of the selection rules spoken of in Standard No. 1 CESR (of the Committee of European Securities Regulators, now the European Securities and Markets Authority) concerning the supervision of financial information "Supervision of the Implementation of Standards for Financial Information in Europe". On the basis of the results of the analysis conducted a report is prepared and published on the KNF's website,

- prepared and delivered 124 statements of position and opinions, including 63 for outside bodies, relating to, among other things: the application of IAS/IFRS, historical financial information presented in issue prospectuses, the correctness of fulfilment by issuers of their disclosure obligations in the area of periodic reports, and in connection with proceedings conducted by the KNF Office with respect to reporting by securities issuers.

In the event of breach or justified suspicion of breach of legal regulations relating to the conduct of a public offering or to an application for admission to trading on a regulated securities market on the territory of the Republic of Poland, the Authority may make use of a series of powers set out in Articles 16, 17 and 18 of the Act on Public Offering, such as:

- ordering the suspension of the launch of a public offering or interruption of its course for a period not longer than 10 business days,
- prohibiting the launch or further conduct of a public offer,
- ordering suspension of application for admission or introduction of securities to trading on a regulated market for a period not longer than 10 business days,
- prohibition of application for admission or introduction of securities to trading on a regulated market, and
- publication, at the expense of the issuer or the party introducing a security to trading, of information about illegal activities related to a public offering or application for admission of securities to trading on a regulated market.

The tasks of the Financial Supervision Authority include supervision of the meeting by issuers whose securities are admitted to trading on the regulated market of the obligations placed upon them by the Act on Public Offering and the Act on Trading in Financial Instruments. In this field the KNF Office checks from a formal and legal viewpoint all current reports, interim reports and confidential information provided by such issuers, and in particular examines whether that information was provided in a timely manner and whether it contains all the elements required by those Acts.

In 2011 the supervisory authority checked compliance with legal regulations of about 30,000 current, periodic and confidential reports filed by public companies and about 2,600 notifications submitted by buyers and sellers of substantial holdings of shares in public companies, on the basis of Article 69 of the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading and Public Companies, as well as about 3,600 notifications submitted by entities obliged to do so on the basis of Article 160 of the Act on Trading in Financial Instruments (persons who are members of issuers' management and supervisory bodies or who are issuers' commercial proxies and other persons who hold management positions in the organisational structure of an issuer, have permanent access to confidential information related directly or indirectly to the issuer and are authorised to take decisions that affect the issuer's development and economic prospects).

Additionally, the KNF issues decisions concerning requests submitted on the basis of the Act on Public Offering:

- under Article 9 paragraph 2 (request for entry in the register of qualified investors),
- under Article 58 paragraph 1 (request for grant of the status of information agency),
- under Article 62 paragraph 1 (request for release from the obligation to disclose information that is not confidential information),
- under Article 62 paragraph 4 (request for consent for an issuer with its registered office in a non-member state, for whom the Republic of Poland is the home state, to file, instead of certain current and periodic reports that are spoken of in Article 56 of the Act on Public Offering, information that is required by the legal regulations of the state where the issuer has its registered office, provided that this information is equivalent to the information specified in Article 56 or will be deemed equivalent in accordance with regulations issued on the basis of Article 60 paragraph 2 or the rules spoken of in Article 61),
- under Article 60 paragraph 2 or the rules spoken of in Article 61,

- under Article 71 (request for release from the obligation to provide the notification referred to in Article 69 of the Act), and
- under Article 91 (request for an authorisation to convert shares into certificated form), and monitors the proper implementation of the decisions issued.

In 2011 the Authority issued one decision on granting the status of information agency, three decisions on cancelling the dematerialisation of shares, five decisions on adding entities to the register of qualified investors (there are 17 entries in the "small and medium enterprises" section and six entries in the "natural persons" section of the register of qualified investors) and one decision relating to the provisions of Article 62 paragraph 4 of the Act on Public Offering.

In 2011 the Authority intervened in about 420 cases where it discovered improper performance of the disclosure duties of public companies, with this resulting in the publication of current and periodic reports that comply with the regulations in force.

### **Tender offers to acquire or exchange shares in a public company**

The Polish Financial Supervision Authority's duties include supervision of the formal and legal correctness of the announcement and conduct of tender offers to acquire or exchange shares in public companies in connection with shareholders' exceeding particular thresholds in the total number of votes at general meetings. If an announced tender offer does not meet statutory requirements, the Polish Financial Supervision Authority may demand that the terms of the offer be changed or supplemented and may require the submission of explanations regarding the offer.

2011 saw the announcement of 18 tender offers to acquire or exchange shares in a public company. Of these, 11 tender offers were connected to exceeding the threshold of 33% of the total vote in public companies and another five were connected to exceeding the threshold of 66% of the total vote and covered all the remaining shares in the companies. Furthermore, one tender offer was made in connection with the intent to acquire shares representing 5% of the total number of votes in a company by a shareholder holding more than 33% of the total number of votes. In 2011 one invitation was also announced to subscribe to sell shares in connection with the restoration to them of certificated form (through the cancellation of the dematerialisation of shares), the subject of which was all the remaining shares in the company. The value of shares that were the subject of tender offers to buy announced in 2011 amounted to over PLN 17 billion. For comparison, the total value of shares covered by tender offers to buy was about PLN 3.2 billion in 2009 and about PLN 6 billion in 2010. In 2011 the Polish Financial Supervision Authority required necessary modifications to be made to its content in the case of one tender offer to buy.

#### **3.4.4. Supervision of undertakings for collective investment**

The supervisory duties of the Polish Financial Supervision Authority in relation to investment fund management companies and investment funds, after they receive the necessary authorisations, include monitoring of their current condition through analysis of current reports, current information, periodic statements and periodic reports.

In performing its supervisory tasks in relation to investment fund management companies and investment funds, the Polish Financial Supervision Authority also regularly analyses information sent by investment funds' depositaries on the basis of Article 231 of the Act on Investment Funds of 27 May 2004 (Journal of Laws 2004 No. 146, item 1546 as amended).

#### **Table 15. Number of current and periodic reports of investment fund management companies and investment funds and of reports from depositaries analysed in 2008-2011**

Type of report	Number of reports			
	2008	2009	2010	2011
Current and periodic reports of investment fund management companies	2,115	3,291	2,361	2,952
Current and periodic reports of investment funds	11,973	13,381	12,957	15,068
Information from depositaries	3,227	2,437	2,421	3,446
<b>Total</b>	<b>17,315</b>	<b>19,109</b>	<b>19,749</b>	<b>21,466</b>

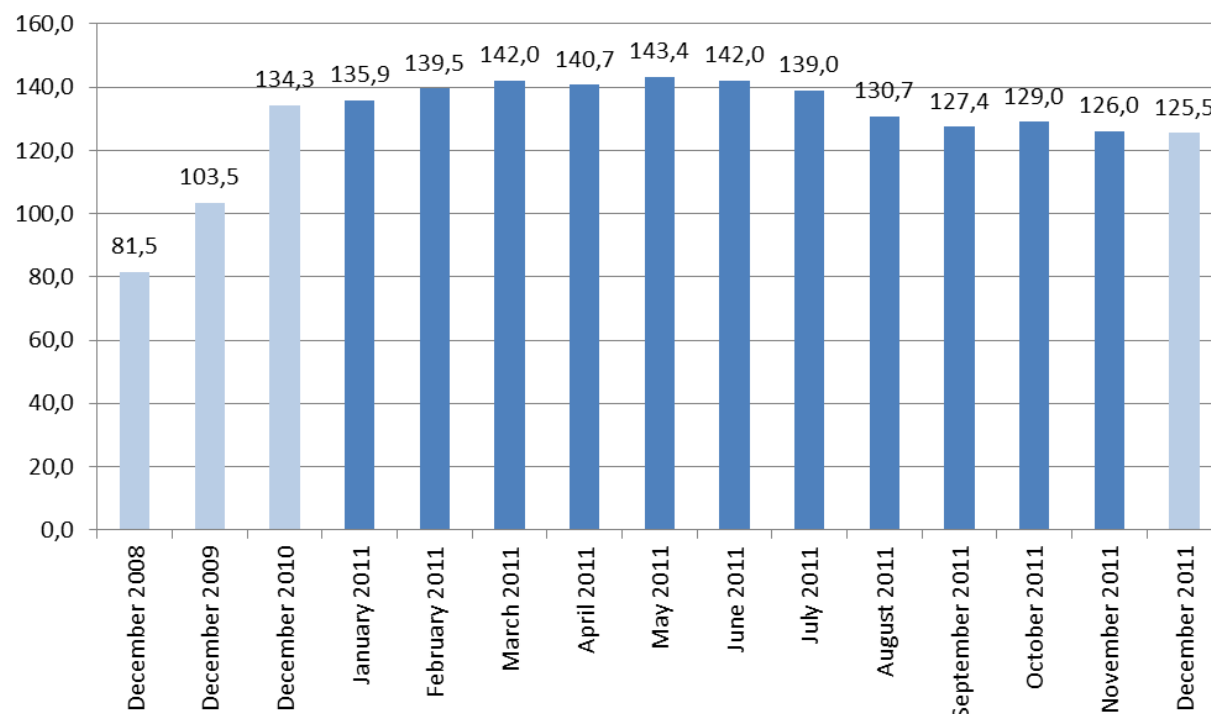
Source: KNF Office's own work

As part of its annual activities the KNF Office also prepares reports on such matters as the financial standing and capital position of investment fund management companies and the distribution activity conducted by foreign investment funds on the territory of the Republic of Poland. These reports are published on the authority's website.

In addition, the KNF Office exercises a supervisory function through participation in the European Securities and Markets Authority, in legislative work, in responding to queries from supervised entities, in the preparation of position papers and in supervisory interventions.

The Authority also oversees compliance by TFIs with capital requirements. Figure 14 presents the average ratio of capital coverage for the investment fund management company sector at the end of the years 2008 - 2010 and at the end of months in 2011.

**Figure 14. Average capital coverage ratios (equity to minimum capital requirement) of investment fund management companies at year end in 2008-2010 and month end in 2011**



Source: KNF Office's own work

The data presented in Figure 14 show that the capital position of investment fund management companies remained stable in 2011, as it had done in the previous year. Over the whole period under examination the average coverage ratio for the whole sector of



investment fund management companies remained in the range of 4.5 to 5, which means that the companies' own funds were on average almost five times higher than the mandatory minimum level of capital required by the Act on Investment Funds.

### **Supervision of closed-end investment funds issuing non-public investment certificates**

Following the publication in the Journal of Laws on 3 November 2011 of the Act amending the Act on Investment Funds and the Act on Corporate Income Tax of 16 September 2011, a change to the bases of KNF supervision of non-public closed-end investment funds (referred to as "FIZ", after their Polish initials) took effect on 4 December 2011.

The establishment of a FIZ that issues only investment certificates, which in accordance with the funds' statutes are not offered in public offerings, are not admitted to trading on the regulated market and are not admitted to an alternative trading system does not require authorisation by the KNF. The supervisory authority obtains information about the addition of such an institution to the register of investment funds together with the fund's statutes and information about contributions made to it.

Neither the statutes of a non-public FIZ nor amendments to them are confirmed by the Authority<sup>6</sup>, and so the investment fund management company (the "TFI") and participants in the fund have more freedom in determining its investment policies and fees or changes in its strategy. The Authority's consent is also not required for a change in a non-public FIZ's depository.

The burden of supervision of a FIZ and of previous supervision has been moved from the stage of licensing of funds to supervision of them during their operation.

The most important consequences of these changes have been:

- abandonment of inadequate requirements for products created for professional investors, who want flexibility rather than protection by the state supervisory authority,
- the shorter time and lower costs needed to establish a non-public FIZ, and
- rationalisation of the supervision of investment funds, so as to focus on supervision of bulk products (open investment funds, specialised investment funds and public closed-end investment funds).

## **3.5. SUPERVISION BASED ON RISK ANALYSIS USING BION METHODOLOGY**

The number of regulated entities and the scale of their operations creates the need to systematise the manner in which financial supervision is exercised so as to ensure that supervisory measures are sufficient in view of the level of risk. For this reason the KNF Office has launched a supervision system based on analysis of risk. Prudential supervision based on risk assessment, understood as an organisational concept whereby processes, organisational solutions and the allocation of resources are subordinated to the results of a risk assessment exercise and conducted on a continuous basis, is supported by the BION system (so-named after the Polish initials for Research and Supervisory Assessment).

The starting point for the BION methodology was the CAEL scoring model which was initially applied only to banks but was then significantly developed and extended to cover the other

---

<sup>6</sup> An exception would be an amendment to the statutes of a non-public FIZ that determines that the fund's investment certificates are to be offered in a public offering or admitted to trading on a regulated market or introduced to an alternative trading system. That would require KNF authorization.

markets supervised by the KNF, namely the insurance, pensions and capital markets. The results of the BION exercise determine the intensity of follow-up supervisory activities, and in particular of inspections. This ensures the more efficient allocation of the KNF Office's resources, which are assigned to areas and institutions that generate the highest risk.

The BION procedure makes use of all the information available to the Authority, obtained *inter alia* in the course of licensing procedures, contacts with owners, analyses of periodic reports, answers to the KNF Office's supplementary enquiries (questionnaires, supervisory requests, surveys, etc.) and also during inspections, visits and supervisory meetings. The BION process is supported by the KNF Office's IT systems designed to handle the exchange of supervisory information with financial institutions.

BION handbooks have been prepared, applying a harmonised approach to all segments of the financial industry while taking into account the specific nature of individual sectors.

The effect of BION is assessment by the supervisory authority of:

- the level of risk in a financial institution,
- the quality of the financial institution's process for the management of significant risks,
- the amount of capital held to cover the risks incurred by the financial institution, and
- the financial institution's compliance with applicable laws and internal regulations.

As the result of the analysis performed, the financial institution is assigned, and is confidentially advised of, a score which sums up the scores assigned to crucial risks and the quality of management of those risks. Particular risks are assessed on a scale of 1 to 4, where 1 is the best score and 4 the worst score, bearing witness to the entities' substantial exposure to a specific risk. The component scores are aggregated within thematic areas for a given sector using the weighted average method (where the weights reflect the impact of a specific risk on the area under review). One of the components of the final score is the assessment of risk management score, which rewards the institution for its implementation of risk identification and mitigation procedures.

The benefit arising from BION is the creation of a mechanism for applying supervisory measures to a particular institution that are appropriate given its score and are aimed at improving the institution's standing in areas that are generating excessive risk. The basic criterion for determining the priority and frequency of supervisory measures is the level of risk.

Maps of classes of risk and their definitions with respect to the sectors of the financial market that are covered by BION methodology are available on the Authority's website at [http://www.knf.gov.pl/o\\_nas/urzed\\_komisji/bion/index.html](http://www.knf.gov.pl/o_nas/urzed_komisji/bion/index.html).

### 3.5.1. BION scoring in the banking sector

BION is a holistic process that makes use of all available information held by the supervisory authority on a bank, including information obtained as a result of activities related to licensing, offsite analysis, supervisory visits and onsite inspections. The purpose of this process is performance by the supervisory authority of:

- assessment of the bank's risk,
- assessment of the quality of the bank's Internal Capital Adequacy Assessment Process (ICAAP), which protects against the risk of current and future activities and takes into account negative changes in factors present in the external environment,
- assessment of the bank's compliance in its activities with relevant laws and prudential regulations, and
- identification of irregularities in the business conducted by the bank.

BION scores are assigned in quarterly cycles (at least once a year for each supervised bank) and are based on a BION questionnaire, which differs in the case of cooperative banks from the questionnaire developed for commercial banks. In 2011, at the same time as work associated with awarding BION scores to individual banks, analysis continued regarding the definition of elements of BION methodology that require adjustments and possibly alterations so that the process evolves in the most advantageous direction while taking into account the principle of proportionality, which is of particular importance in the case of analyses of cooperative banks.

In the course of analytical supervision of banks the BION process was conducted in relation to a majority of banks operating in Poland. As a result of the process recommendations were directed to banks. These most often concerned issues related to the need to improve the quality of management and also, where appropriate, obliged banks to maintain a minimum capital adequacy ratio that is higher than the statutory requirement and the core capital ratio. No additional capital requirements were imposed, however. The process of advising banks of their scores and the comments of the KNF Office had not yet been completed at the end of 2011.

In 2011 the results of BION analyses had been delivered to a total of 20 commercial banks. When necessary, together with those results banks also received recommendations to eliminate irregularities identified in the course of analysis in the management of particular categories of risk.

In the course of work in 2011 on the implementation of the methodology in cooperative banks, 35 regulatory statements were directed to apex banks relating to BION and containing explanations or supervisory guidance of an intervening nature, or asking for the bank to explain its position. 142 BION scores were assigned in 2011. In relation to the first group of cooperative banks, the analysis was conducted of their standing as at 31 December 2010. The last group of cooperative banks in the first annual BION cycle will be assessed in terms of their standing at 31 December 2011.

It should be emphasised that in 2011 BION scores were assigned to banks in accordance with modified methodology. The assignment of scores necessitated the analysis of a wide range of materials submitted by banks. During the period covered by this report the severity of the crisis deepened, giving rise to the need to take rapid action, which could affect extension of the testing process.

### 3.5.2. BION scoring in the pension sector

The BION assessment performed in 2011 in the pension sector covered all general pension fund management companies. A "Survey on the Management of Risk by General Pension Fund Management Companies" was distributed to PTEs and supervisory assessment was performed on the basis of the questionnaires and of financial indicators calculated in accordance with the methodology described in the BION handbook. The results of BION assessment were presented at a meeting of the Authority and delivered to individual PTEs. Another supervisory assessment is to be performed during 2012.

### 3.5.3. BION scoring in the insurance sector

In January 2011 final BION methodology was prepared for the insurance sector and, on the basis of this, BION scoring was performed of insurance/reinsurance undertakings for 2009. This handbook is the result of analysis of all available information held by the supervisory authority about each insurance or reinsurance undertaking, numerous meetings with

insurance undertakings and two rounds of consultation with the market on the draft handbook.

BION methodology for the insurance industry consists of two manuals: an external handbook for the insurance/reinsurance undertaking and an internal handbook for employees performing BION assessments of the insurance sector. The handbook for insurance/reinsurance companies is available on the KNF's website and differs from the internal handbook in that it lacks detailed descriptions of particular indicators and qualitative criteria and of methods for their analysis and aggregation.

The methodology of BION assessment of insurance and reinsurance undertakings and the BION scores assigned to insurance undertakings and reinsurance undertakings for 2009 were presented to a meeting of the Authority. The methodology adopted by the Authority and the scores were provided to individual insurance/reinsurance undertakings. In the period April-May 2011 the BION results for 2009 were discussed with the insurance/reinsurance undertakings that received the worst scores or themselves expressed a desire to learn the details behind the score.

In 2011 there was also carried out work related to the conduct of BION evaluation of the insurance industry for 2010. The main tasks performed included:

- preparation of a new version of the BION questionnaire containing questions about the management system and delivery of it to insurance/reinsurance undertakings,
- preliminary expert (qualitative) BION assessment of insurance/reinsurance undertakings, making use of all available information held by the supervisory authority about each insurance/reinsurance undertaking and also of the responses of insurance/reinsurance undertakings to the BION questionnaire,
- design of a template for quantitative BION assessment of insurance/reinsurance undertakings in the SNU Insurance Supervision System electronic information system and performance of quantitative assessment of an insurance/reinsurance undertaking,
- conduct of supervisory panels confirming BION scores,
- establishment of supervisory actions for particular insurance/reinsurance undertakings related to the score assigned,
- delivery to insurance/reinsurance undertakings of the scores assigned.

A report summarising BION assessment of insurance and reinsurance undertakings for 2010 was adopted by the Polish Financial Supervision Authority.

The supervisory authority in December 2011 delivered to insurance undertakings information about the BION scores assigned.

#### 3.5.4. BION scoring of capital market entities

The first formal process of supervisory assessment of brokerage houses was begun in September 2010 and completed in the first half of 2011. The process covered institutions holding authorisations from the KNF to conduct brokerage activity and engaged in such activity, i.e. 50 institutions, of which 38 brokerage houses made presentations of their own risk management systems at the office of the KNF and the remaining 12 brokerage houses participated in "desktop" research. All of them were assigned BION scores based on documentation delivered to the KNF Office on the operation of their risk management systems. In connection with events taking place in some institutions after the assignment of scores, the initial BION score was reduced in the case of six brokerage houses.

Four BION studies were performed in 2011 in accordance with the guidelines for the BION process in relation to investment fund management companies - at the end of the fourth quarter of 2010, and at the end of the first, second and third quarters of 2011. During the first

quarter of 2012 scores will be assigned to the group of institutions assessed at the end of the fourth quarter of 2011.

**Table 16. Number of investment fund management companies undergoing BION assessment for 2011**

Quarter of 2011	Q1	Q2	Q3	Q4
Number of TFIs	13	13	12	12
Percentage share (%)	26	26	24	24

Source: KNF Office's own work

The overall shape of the assessment methodology did not change in 2011, i.e. assessment is still made of three areas:

- the risk exposure of investment fund management companies,
- the capital held by investment fund management companies, and
- the quality of management in investment fund management companies.

As regards risk four kinds of risk were taken into account: market risk, credit risk, operational risk and risk that is hard to measure. In the process of assessing the area of risk of TFIs account was taken of the fact that a given risk affects TFIs both through its level and through the methods used by TFIs to manage that risk. For the purposes of the BION process, it was accepted that risk taking into account the impact of risk management will be called "net risk".

In view of the specific nature of the operations conducted by TFIs, the risks with the highest impact on assessment of the area of risk were those associated with unreliability of technical (e.g. IT network failures) and organisational systems (e.g. dysfunctionality in the internal control system) and errors by people employed in TFIs, i.e. operational risk and hard to measure risk. These two types of risk accounted for 85% of the overall assessment of net risk.

Assessment of the area of capital backing concerned, above all else, examination of the compliance of TFIs' activities with the provisions of Article 50 of the Act on Investment Funds.

Assessment of the area of the quality of management was based on analysis of both quantitative and qualitative criteria. Quantitative criteria are typical indicators of the effectiveness of business operations (e.g. ROA and ROE). Qualitative assessment in turn is based on the following criteria:

- the organisation of a TFI, its human resources management and the competence of its management personnel, which included assessment of, among other things, the outsourcing of certain activities, the numbers of investment advisers and stockbrokers employed, changes in the occupancy of key positions, and procedures and rules operating in the company,
- systems of internal control, compliance, information management and information flow, which are assessed on the basis of mandatory reporting and, in particular, on the basis of the annual report on the functioning of internal control, an
- discharge by a company of obligations to provide information is assessed on the basis of the completeness and timeliness of reports submitted.

A description of the BION research and supervisory assessment process, together with the outline of the methodology for assessment of investment fund management companies, was presented at a meeting of managers of the KNF Office with representatives of TFI circles. BION methodology and scores assigned are not made available to investment fund management companies. It should be kept in mind, however, that, in connection with the pending introduction to the Polish legal system of Directive 2009/65/EC of the European

Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), Directive Commission Directive 2010/43/UE of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depository and a management company and Commission Directive 2010/42/UE of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure, it will be necessary to make appropriate modifications to the BION process after the revised rules enter into force. The design of the BION process in 2012 will be influenced by the entry into force of the Act amending the Act on Investment Funds and the Act on Corporate Income Tax in the area of alterations to the model for supervision of closed-end investment funds.

## 3.6. STRESS TESTING

### 3.6.1. Stress tests in the banking sector - EBA

The KNF Office has cooperated with the European Banking Authority in its work on stress tests. Powszechna Kasa Oszczędności Bank Polski SA (PKO Bank Polski) participated in tests through the intermediation of the KNF Office. Most other commercial banks controlled by foreign entities were surveyed indirectly, i.e. through their home country supervisory authorities. Overall tests involved 91 banks, which account for more than 65% of the assets of the banking sector in European Union countries. The aim of this exercise was to assess the resilience of European banks under negative market scenarios in hypothetical extreme conditions. For the purposes of the study 5% was taken as banks' minimum capital adequacy ratio for Tier 1 funds.

The tests were conducted on the basis of restrictive macroeconomic assumptions (covering GDP growth, unemployment, inflation, interest rates, exchange rates and changes in housing prices) prepared by the European Central Bank for each of the countries of the European Union. It was also assumed that banks' balance sheets were unchanged from the end of 2010. The baseline scenario was based on the European Commission's autumn 2010 economic forecasts and the adverse scenario assumed the occurrence of the following economic events in 2011-2012: a series of shocks within the European Union (connected, *inter alia*, with the ongoing government debt crisis of eurozone states), a global negative demand shock the source of which was the United States and depreciation of the US dollar against all other currencies.

According to the results of the tests this scenario's becoming real would cause an increase in the consolidated solvency ratio calculated for Tier 1 funds of the PKO Bank Polska Group to 12.2% at the end of 2012, as against 11.8% at the end of 2010 ( taking into account retained earnings for 2010).

The KNF Office also worked with the European Banking Authority on the *EU capital exercise* study of the capital position of European banks and the exposures arising from their holdings of debt securities issued by governments. The exercise covered a total of 71 banks and, through the KNF Office's intermediation, PKO Bank Polski was again subjected to analysis. In the course of this study the EBA decided that banks which at the end of September 2011 had a Tier 1 capital adequacy ratio of less than 9% and the exposures of which to governments required adjustment to valuations should be required to build additional buffers of capital before the end of June 2012. The EBA study did not identify a need for the PKO Bank Polski Group to raise additional capital - the consolidated Tier 1 capital adequacy ratio of the bank stood at 11.16% at the end of September 2011.

### 3.6.2. Stress testing in the banking sector - KNF Office

In 2011, as in the preceding year, the KNF Office performed stress tests of the banking sector. This exercise took into account recommendations formulated at the end of the 2010 tests, and among other things:

- the number of banks participating in the tests was increased to 25, with combined total assets constituting about 85% of the total assets of the entire banking sector in Poland, and
- the trading portfolio was also subjected to analysis.

The purpose of the test conducted was to determine the potential impact of a changing macroeconomic environment on the financial standing, liquidity and capital backing of institutions in the Polish banking sector and the resilience of the sector to the potential development of adverse macroeconomic scenarios. As in 2010, the form of the test assumed the active involvement of banking sector institutions and its primary purpose was to assess the sensitivity of banks' capital positions, to check the capital buffers held by banks and to estimate the potential capital needs of the banks surveyed under various scenarios.

For the purposes of the study a baseline scenario was assumed together with two shock scenarios, on the basis of which the KNF Office presented general outlines of developments in the economy and on financial markets in 2011-2012. The basis for choosing shock scenarios was to determine the effect on the situation of a bank of a simultaneous change in several factors. One of the shock scenarios took into account the macroeconomic assumptions that formed the basis of stress tests conducted on the largest, systemically important European banks by the European Banking Authority (EBA) - see subsection 3.6.1.

The calculations conducted by the institutions studied were based on the methodology developed by them. Apart from the impact of the external environment impact on credit risk, banks in their calculations were also required to include other types of risk. The results of the analyses conducted by the banks were reflected in projections prepared by them for balance sheets, in projected profit and loss accounts and in capital adequacy calculations.

Collection of data from banks was followed by the process of checking them, on the basis both of quantities previously reported (trend analysis) and of forecasts prepared on the basis of models developed in the KNF Office models that describe the formation of the quality of banks' loan portfolios. The next step was estimation of the potential capital needs of the banks examined. In order to determine the size of those needs corrections were applied by establishing the value of the minimum percentage of impaired receivables and the minimum rate of cover by write-offs of impaired receivables when a shock occurs. The methodology adopted in making adjustments entailed taking a differentiated approach to the major credit subportfolios.

Comparison of the adjusted carrying values of impairment losses and of reserves for incurred but not reported losses with the values given by banks became the basis for estimation of the potential additional burden of write-downs and reserves on banks' profit and loss accounts. The adjustment to net profits was then taken into account in the capital adequacy account through alteration of the value of the banks' own funds. The resulting data made it possible to determine a new capital adequacy ratio and to assess the potential capital needs of banks which might arise if that value fell below the regulatory minimum. As they were in the previous year, conclusions drawn from analysis of the results of stress testing will be taken into account in the BION analytical process and the inspection process so as to enable analysis in greater depth of certain areas.

### 3.6.3. Stress testing of the insurance industry - EIOPA

In the period from March to June 2011 EIOPA, the European Insurance and Occupational Pensions Authority, conducted the first all-Europe stress test for the insurance sector in its history as a new supervisory authority (and the second after that conducted by CEIOPS, the Committee of European Insurance and Occupational Pensions Supervisors, at the turn of 2009 and 2010). In 2011 a Stress Test Task Force was responsible for methodology and also for coordinating the conduct and analysis of results at European level. The KNF Office participated in all the work of this group.

The tests involved the largest European insurance groups and individual insurance undertakings holding in total at least 50% of the market in a given member state. The tests were conducted on the basis of Solvency II methodology (with QIS5 technical specification of the research) so as to ensure the comparability of results and to facilitate their analysis at the European level. Since the Solvency II system is not yet in force, and its regulations have still not received their final shape, the EIOPA decided not to publish a list of participants in the tests or individual results.

Information about the aggregated results was published on 4 July 2011. The tests showed that in general the European insurance market is well prepared for the potential shocks that were tested in this exercise. Only about 10% of participants in the tests did not demonstrate full coverage of the minimum capital requirement ("MCR") in the negative and inflationary scenarios and their total shortage of own funds amounted, respectively, to EUR 4.4 billion and EUR 2.5 billion. Shocks associated with exposure to bonds issued by EU member states ("sovereign bonds exposure") were separately tested. In this test an MCR shortage was shown by about 5% of participants and their total shortage of own funds amounted to EUR 33 billion.

In October 2011, the Stress Test Task Force started work on guidelines for further tests, which are to be conducted in 2012.

#### 3.6.4. Stress testing in the insurance sector - KNF Office

In 2011 work continued on the use of stress tests in the process of exercising supervision over insurance undertakings and reinsurance undertakings. In January the methodology for stress testing was updated and on 23 February 2011 a letter was sent to insurance/reinsurance undertakings obliging them to perform stress tests on data for 2010 in accordance with the valuation and accounting rules now in force. Insurance/reinsurance undertakings submitted the results of stress tests to the supervisory authority before the end of July 2011. In the course of receipt of the results of test stressed conducted by insurance/reinsurance undertakings, the KNF Office conducted internal stress tests on the basis of information held by the KNF Office. After checking and analysing the results received, a letter was sent to selected insurance undertakings that had not achieved positive results in stress tests requesting the repeating of stress tests on data for 30 June 2011 in the area of threatened kinds of risk. The report "Results of Stress Tests in Insurance Undertakings and Reinsurance Undertakings for 2010" was prepared on the basis of the results provided by undertakings of stress tests on 31 December 2010 and 30 June 2011 and also of the results of internal stress tests.

The purpose of stress testing is to improve the quality of risk management at insurance/reinsurance undertakings and to prepare them for the implementation of solutions arising from the Solvency II initiative. The results of stress tests are also used by the KNF Office in the course of its BION research and supervisory assessment of insurance/reinsurance undertakings.



## 4. INSPECTION ACTIVITIES

### 4.1. INSPECTIONS OF BANKS

Activities undertaken in the course of comprehensive inspections included examination of the management of the most important kinds of banking risk, such as credit risk, liquidity risk, market risk and operational risk and also of banks' capital adequacy and the management of banks and took into account compliance with the provisions of laws that regulate banking activities, their statutes and the conditions set out in each authorisation to establish a bank.

**Table 17. Inspection activities conducted by the KNF Office in banks in 2011**

Inspection activities	Number
Comprehensive inspections, of which:	64
– inspections of commercial banks	14
– inspections of cooperative banks,	50
Problem-oriented inspections, of which:	20
– inspections of commercial banks *	10
– inspections of cooperative banks,	10
Explanatory proceedings, of which:	2
– in a commercial bank,	1
– in a cooperative bank	1
Inspection in connection with the submission of an application for the issue of authorisation of the establishment of a national bank by a credit institution	1
Problem-oriented Inspection of a branch of a credit institution	1

\* including three inspections in the area of applications by commercial banks for approval of the use of statistical methods for the calculation of capital requirements,

Source: KNF Office's own work

As part of cooperation between the KNF Office and the National Bank of Poland, checks were made of the correctness of calculation of the amount and the formation of mandatory reserves in commercial banks and in unassociated cooperative banks. This was done in the course of 15 comprehensive inspections.

In the course of inspections conducted in 2011 at commercial banks particular attention was devoted to the following issues:

- the quality of the loan portfolio and the process of management of credit exposure risk,
- the management by the banks of the risks associated with loans secured by mortgages<sup>7</sup>,
- the management by banks of the risks associated with the portfolio of retail credit exposures<sup>8</sup>,
- compliance by banks with the provisions of Polish Financial Supervision Authority Resolution No. 383/2008<sup>9</sup> in the area of the management of banking risk and of the system of internal control,
- the use of statistical models in the process of risk management,

<sup>7</sup> In particular, assessment was performed of the extent to which banks take into account in their activities the provisions of the KNF's Recommendation S (II) on good practices in the area of credit exposures secured by mortgages.

<sup>8</sup> In particular, assessment was performed of the extent to which banks take into account in their activities the provisions of the KNF's Recommendation T on good practices in the area of management of retail credit exposures.

<sup>9</sup> Replaced by KNF Resolution 258/2011, which entered into force on 31 December 2011.n

- the scope and assumptions adopted in stress tests performed by banks and the use of their results in risk management,
- the quality of liquidity risk management, especially as regards the accuracy of calculation of and compliance with supervisory measures of liquidity, and
- assessment of the implementation of recommendations made during previous inspections.

The findings of inspections were set out in inspection reports and information on irregularities found at a bank with foreign capital was also sent to the bank's owner's home country supervisory authority. The purpose of inspections is to examine the compliance of a given bank's activities with the legal provisions that regulate banking activities and to detect careless practices of banks which could give rise to threats to the safety of funds deposited in accounts and to banks themselves. Studies conducted in 2011 in commercial banks showed that their activities did not constitute a threat to the safety of funds deposited in accounts. It was established, however, that risk management processes in most of the banks examined needs to be strengthened, in particular in the light of the continuing crisis in the European market.

In 2011 inspections conducted gave rise to the recommendations to banks set out in Tables 26-31.

**Table 18. Post-inspection recommendations to banks in 2011 in the area of credit risk**

<b>Credit risk</b>	
1.	performance of reliable assessment of creditworthiness and introduction of changes so as to comply with Article 70 of the Banking Law of 29 August 1997
2.	improvement in the area of control and monitoring of the value of real property that constitutes security for credit exposures, definition of internal limits and bringing up to date the system now in place of internal limits for the portfolio of exposures secured by mortgages
3.	establishment of an acceptable level of risk associated with the portfolio of retail exposures and verification of the level of expenditure made on assessment of creditworthiness
4.	adaptation of methods for valuation of credit exposures to meet the requirements of Commission Regulation 1126/2008/EC of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council
5.	adding to and checking internal procedures now in place, including review and classification of credit exposures and provisioning in accordance with the Minister of Finance's Regulation on the creation of provisions for risks associated with the activities of banks (for banks using Polish accounting principles) of 16 December 2008
6.	determination of internal limits on concentration of liabilities according to criteria that take into account the specific nature of banks' activities - in accordance with the requirements of Polish Financial Supervision Authority Resolution 384/2008 on requirements regarding identification, monitoring and control of concentration of exposures, including large exposures of 17 December 2008

Source: KNF Office's own work

**Table 19. Post-inspection recommendations to banks in 2011 in the area of liquidity risk**

<b>Liquidity risk</b>	
1.	adding to and improving internal procedures for the management of liquidity risk, and also the application of internal regulations to meet the provisions of KNF Resolution 386/2008 and performance of periodic review and verification of procedures
2.	calculation of supervisory measures of liquidity in accordance with the provisions of KNF Resolution No. 386/2008
3.	improvement of the process of measuring, monitoring and controlling liquidity risk, including: <ul style="list-style-type: none"> <li>– conducting more thorough analyses of long-term liquidity,</li> <li>– defining methods for the measurement of foreign currency liquidity,</li> <li>– defining or supplementing the assumptions made in stress test scenarios,</li> <li>– inclusion of all major off-balance sheet items in the measurement of liquidity,</li> <li>– checking methods for estimating the stability of the deposit base,</li> <li>– checking the principles for establishing the liquidity gap, including updating of the maturities of assets and liabilities,</li> <li>– checking and adding to the system of internal limits that mitigate liquidity risk, including <i>inter alia</i> long-term liquidity risk and liquidity in foreign currencies, and also performing analyses that are the basis for determining the size of limits and identifying situations in which it is permissible to exceed limits</li> </ul>
4.	specification of the sources of financing for long-term loans or increasing the diversification of funding sources
5.	development of a long-term plan to raise stable external funds
6.	checking and adding to the contingency plan for loss of liquidity, and in particular adaptation of the plan so that it meets the requirements of KNF Resolution 386/2008, including the identification of symptoms that indicate that the plan should be implemented, adding to scenarios, determining reserve sources of liquidity and ensuring the effectiveness of the plan

Source: KNF Office's own work

**Table 20. Post-inspection recommendations to banks in 2011 in the area of market risk**

<b>Market risk</b>	
1.	improvement of the quality of the process of market risk management by adding to internal policies and procedures detailed assumptions about the methods employed for measurement, identification and monitoring of market risk, including the performance of stress tests
2.	improvement of the quality of internal procedures governing the process of market risk management and, in particular, adding to the internal rules on principles for establishing and updating limits relating to market risk
3.	adjustment of the process of measuring and monitoring risk so as to meet the requirements of KNF Resolution 383/2008 on detailed principles of functioning of the risk management system and internal control system, and specific terms of assessing internal capital, reviewing the assessment process and maintaining internal capital by banks of 17 December 2008, including, in particular, checking and applying <i>post hoc</i> the methods of measurement used, and to the provisions of KNF Resolution 76/2010 on the scope and detailed procedures for determining capital requirements for particular risks of 10 March 2010
4.	improvement of the system of internal limits that limit the bank's exposure to interest rate risk and currency risk through, <i>inter alia</i> , confirmation of limits, conducting the written analyses needed to determine the levels of limits, setting limits at a level that limits risk to an adequate degree and verifying limits
5.	introduction of mechanisms to ensure independent monitoring of transactions concluded by the treasury unit
6.	broadening the extent of management information
7.	eliminating errors in FINREP and COREP reporting

Source: KNF Office's own work

**Table 21. Post-inspection recommendations to banks in 2011 in the area of operational risk**

<b>Operational risk</b>	
1.	verification of internal procedures governing the process of operational risk management
2.	adaptation of procedures for the security of information systems to suit the current organisational structure and the legal regulations in force
3.	development and implementation of internal procedures that define the rules governing access to and use of the Internet by employees
4.	inclusion among critical applications of calculation systems in entities that are covered by the mandatory guarantee system and coverage of their business continuity plans
5.	strengthening control mechanisms in the area of processes for management of access to IT systems and the storage and archiving of credit documents
6.	adaptation of documents that are part of information security policy to meet legal requirements relating to the frequency with which passwords giving access to IT systems are changed
7.	introduction of systemic safeguards so as to reduce the outflow of sensitive information
8.	conduct of comprehensive tests of business continuity plans
9.	introduction of control mechanisms, independent of operating activities and the functioning of the IT area, in the field of the system for management of information security
10.	introduction of control mechanisms aimed at improving the process of managing risk associated with the outsourcing of activities on the basis of Article 6a of the Banking Law

Source: KNF Office's own work

**Table 22. Post-inspection recommendations for banks in 2011 in the area of capital adequacy**

<b>Capital adequacy</b>	
1.	ensuring the compliance of rules for calculating the capital requirement with KNF Resolution 76/2010, including specification of the manner in which exposures are valued, recognition of off-balance sheet transactions, proper segmentation of exposures and assigning appropriate risk weights to them
2.	ensuring compliance of the process for calculating own funds with the provisions of KNF Resolution 381/2008
3.	adjustment of internal regulations to meet the provisions of KNF Resolution 76/2010,
4.	definition of principles for separating out the trading portfolio in accordance with the requirements of KNF Resolution 76/2010
5.	improving the quality of the internal capital assessment process, including coverage by the process of all the risks potentially occurring in a bank's business, definition of criteria for the recognition of a risk as significant, taking into account all material risks in the process of quantification, adjustment of the assumptions of methods for estimating the amount of capital to meet the characteristics of the bank's business, establishment of rules for regular reviews of the process, and compliance with internal procedures in this regard
6.	improvement of the process for managing capital, including development or improvement of internal procedures that govern the process of capital adequacy management, adding to capital policy and capital planning, including an emergency capital plan
7.	inclusion of the results of stress tests in the assessment of capital adequacy

Source: KNF Office's own work

**Table 23. Post-inspection recommendations for banks in 2011 in relation to the process of management**

<b>Management process</b>	
1.	Formalisation of the strategic planning process, taking into account the way in which business strategy is developed, timing of its implementation, and principles for its monitoring and updating
2.	improvement of the effectiveness of the internal control system ( <i>inter alia</i> through ensuring the independence of and strengthening the personnel of the internal audit unit, introduction of effective control mechanisms, including with respect to accepted limits, covering in analysis processes and areas of importance for the business of the bank in question and implementation of post-inspection recommendations)
3.	in relation to the management information system: improvement of the quality of reports prepared, <i>inter alia</i> , for the Management and Supervisory Boards, increasing the frequency or scope of the information prepared (e.g. by adding to management reports information about assessment of the risk of models used by the bank)
4.	introduction of a policy of managing the risk of models and determination of requirements regarding their validation and the quality of data used
5.	ensuring effective management of compliance risk, in accordance with the provisions of KNF Resolution 383 of 17 December 2008
6.	elimination of breaches of laws and internal regulations and of errors in reporting submitted to the NBP on the need for supervision by the KNF

Source: KNF Office's own work

Fulfilment of the KNF's recommendations is monitored on the basis of banks' current reports as part of desktop analyses and during the next inspection of the bank, and also of meetings of the supervisory authority with the bank's management and with representatives of the home country supervisory authority. If a bank fails to implement properly recommendations of the KNF or to provide reliable information on their implementation, this may be grounds for the issue of a warning to the bank. In connection with inspection activities conducted in 2011 in commercial banks the Chairman of the Polish Financial Supervision Authority issued warnings to three commercial banks, among other things for failure to take effective actions to implement the Polish Financial Supervision Authority's post-inspection recommendations, particularly in regard to reoccurring improprieties in a bank's activities and also for conducting banking activity in breach of legal regulations.

At the end of 2011 the Authority supervised 574 cooperative banks. During the period covered by this report data was prepared on the inspection of 50 cooperative banks and there were also prepared:

- 54 opinions concerning post-examination recommendations,
- four quarterly CAEL analyses of all cooperative banks,
- four quarterly sets of data on cooperative banks' CAEL scores, which were sent to apex banks,
- one quarterly set of data on cooperative banks' CAEL scores, which was sent to the Bank Guarantee Fund,
- two sets of a quarterly Economic and Financial Indicators Report on cooperative banks, which were sent to apex banks (one covering four quarters of 2010 and two quarters of 2011 and the second concerning the third quarter of 2011),
- four sets of a quarterly schedule of subordinated loans extended to cooperative banks included in the supplementary funds transferred to the Bank Guarantee Fund,
- 236 supervisory observations to banks,
- 142 letters to banks together with BION analysis,
- 185 letters concerning the classification of credit exposures to specific risk groups,
- 28 certificates/confirmations concerning the performance of banking activities,

- 111 letters, including letters relating to outsourcing, recovery programs, and the implementation of post-examination recommendations,
- 35 supervisory observations to apex banks (concerning BION, containing explanations or supervisory guidelines for associated banks, of an interventionary nature and with requests to be informed of a bank's position on an issue),
- 146 observations delivered to other entities or institutions,
- 18 studies for the KNF concerning the cooperative banking sector or a group of cooperative banks, and
- 32 opinions on approval by the KNF of the appointment of a president of the bank.

### **Validation of applications for the use of advanced methods of calculating capital requirements**

In 2011 the KNF cooperated currently and continuously with nine banks and five consolidating supervisory authorities in the assessment of requests for approval by the competent supervisory authorities of the application of statistical methods to calculation of capital requirements for credit risk and operational risk and of calculation by banks of the delta coefficient on the basis of their own option pricing models. The Authority considered six applications for the use of the Internal Ratings Based Approach (“IRB”), two applications for the use of the Advanced Measurement Approach (“AMA”) and four applications regarding the use of proprietary option pricing models.

In particular, in 2011 the KNF issued one decision on the application of the AMA method to the calculation of the capital requirement for operational risk and two decisions on banks’ calculation of delta using their own option pricing models, and - as the host supervisory authority - issued for the consolidated supervisor two opinions on the use of statistical methods for the calculation of capital requirements for credit risk (IRB). Work was also finalised on two joint decisions in the area of IRB and AMA issued by consolidated supervisory institutions and the KNF on the basis of earlier opinions of the KNF.

## **4.2. INSPECTIONS OF INSURANCE UNDERTAKINGS**

Inspection activities in insurance undertakings in 2011 were carried out on the basis of legal regulations and of the uniform standards and procedures for investigation contained in the Inspection Handbook.

In 2011 inspections were conducted of the activities and the financial status of 16 insurance companies, these being six inspections of life assurance undertakings and 10 of non-life assurance undertakings.

The inspections were devoted to the following material aspects of insurance undertakings’ operations:

- the valuation of technical provisions,
- the management of the insurance undertaking,
- accounting policies and the preparation of financial statements,
- investment policies,
- the claims handling process,
- the costs of insurance operations,
- the determination of premiums due under insurance policies, and
- the investment funds behind unit-linked insurance policies.

One of the inspections referred to was comprehensive and covered the major areas of the activities of the insurance undertaking in question. The other inspections were problem-oriented and in most cases covered two or more issues.

In 2011 15 insurance undertakings where inspections had been carried out were sent a total of 72 post-inspection recommendations. These concerned adjustment of the undertakings' operations to comply with legal regulations and ceasing to act against the interests of policyholders, insured parties, the beneficiaries of policies and persons with entitlements under insurance policies.

### 4.3. INSPECTIONS OF INSTITUTIONS OPERATING IN PILLARS II AND III OF THE PENSION SYSTEM

In 2011 a total of 18 inspections were conducted in the registered offices of institutions operating in the second and third pillars of the pension system. Of these 12 inspections were conducted of general pension fund management companies and open pension funds, three of banks performing acting as custodians for open pension funds and three of occupational pension fund management companies.

Comprehensive inspections at pension fund management companies and pension funds cover:

- the organisation and management of a general pension fund management company (including the actions of their governing bodies),
- internal control in a company,
- inspections of external entities (including shareholders),
- the conduct of investment policies,
- agreements with shareholders, members of governing bodies and other group companies,
- outsourcing of activities of pension funds and of pension fund management companies,
- client acquisition activity,
- accounting policies, books of account and preparation of financial statements,
- the process of transfer of members as part of transfer payments,
- the maintenance of fund members' individual accounts, and
- the handling of fund members' complaints.

Among these inspections of the activities of general pension fund management companies and open pension funds, six were comprehensive and covered the full range of the inspected institutions' operations. The other inspections were problem-oriented.

In inspections conducted in banks acting as custodians for open pension funds, the KNF thoroughly examined the operations of these institutions that related to the safe-keeping of the assets of open pension funds.

In 2011 the Polish Financial Supervision Authority conducted 19 post-inspection proceedings with respect to supervised entities, identifying in post-inspection notifications irregularities found during inspections.

### 4.4. INSPECTIONS OF INVESTMENT FIRMS

11 Inspections of investment firms were conducted during the period covered by this report . These inspections were problem-oriented and covered selected problems in the field of licenced activity and the conduct of brokerage activities performed by investment firms.

The inspections were devoted to the following material aspects of investment firms' operations:

- organisational structures, functioning, and the technical conditions of the activities conducted,
- conduct during contact with clients,
- the functioning of the internal control system, of supervision of compliance of activities with the law, and of internal audit,
- the provision of brokerage services in respect of:
  - the acceptance and transfer of orders to buy or sell financial instruments,
  - the execution of orders to buy or sell financial instruments for the account of the party placing the order,
  - the sale or purchase of financial instruments for the firm's own account,
  - the offering of financial instruments,
  - the holding or registration of financial instruments, including the maintenance of securities accounts and the maintenance of cash accounts,
  - the management of portfolios comprising one or more financial instruments, and
- the financial standing of the firm.

The range of individual inspections depended on the range and extent of operations.

As a result of inspections performed, post-inspection recommendations were issued to all 11 investment firms.

## 4.5. INSPECTIONS OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT

Inspection activities in joint investment institutions in 2011 were performed on the basis of legal regulations and of uniform standards of analysis.

Eight inspections were carried out during the reporting period at undertakings for collective investment,

- five of these being of investment fund companies and
- three of depository institutions.

The inspections were devoted to the following material aspects of the operations of investment fund management companies (TFIs):

- the functioning of the decision-making bodies of TFIs,
- the organisation and functioning of the internal supervision system,
- procedures and mechanisms designed to prevent conflicts of interest,
- discharge of reporting obligations,
- compliance with capital requirements,
- long-term plans for the operations of TFIs,
- the timeliness of execution of client orders,
- documentation of sources that have been the basis of investment decisions,
- management of the finances of TFIs and issues related to the liabilities of TFIs,
- the organisation and operation of risk management systems,
- the organisation of, compliance with and process for monitoring of investment limits,
- analysis of the correctness of the process for valuation of selected investments by funds and study of the flow of information related to valuations,
- the performance by TFIs of activity in the field of the management of portfolios that consist of one or more financial instruments, and
- the compliance of the operations of selected investment funds managed by TFIs with legal regulations or with their statutes.

The scope of particular inspections was dependant on the range and extent of activities conducted.



Inspection of depository institutions was concerned with checking whether their activities in performance of their duties as depository was in accordance with legal regulations, the provisions of the statutes of selected mutual funds and contracts currently in force for the maintenance of a register of assets for selected investment funds.

As a result of inspections carried out in 2011 at undertakings for collective investment, post-inspection recommendations were issued with respect to six such undertakings.

#### 4.6. INSPECTIONS OF POWER COMPANIES

Four inspections of power companies were conducted in 2011. The inspections were intended to check whether their activities were conducted in accordance with legal regulations, rules, terms and conditions specified in permits, principles of fair trading or the interests of clients, and in particular the Act on Commodity Exchanges of 26 October 2000 (Journal of Laws 2010 48 item 284, as amended).

Inspections of power companies covered:

- the organisational structure and activities of corporate bodies,
- the conclusion of transactions on a commodity exchange,
- the maintenance of accounting records and registers of commodity exchanges, and
- the protection of professional confidences.

As a result of inspection activities performed in power companies in 2011 post-inspection recommendations were issued to all the companies inspected.

#### 4.7. INSPECTIONS REGARDING FULFILMENT OF OBLIGATIONS RELATED TO THE PREVENTION OF MONEY LAUNDERING AND FINANCING OF TERRORISM

Chapter 6 of the Act on Counteracting Money Laundering and Financing of Terrorism of 16 November 2000 (Journal of Laws 2010 No. 46 item 276, as amended), referred to later in this subsection as "the Act", establishes the KNF's right to carry out inspections of institutions that are bound by the Act. Article 21 paragraph 3 point 2 of the Act designates the KNF as the body responsible for monitoring the discharge of obligations arising under the anti-money laundering and terrorism financing regulations by institutions that are bound by the Act, as part of the supervision it performs or of inspections performed in the manner and on the bases specified in separate regulations. Institutions bound by the Act which are subject to inspection in this area include banking, insurance (life assurance) and capital market institutions.

48 inspections were performed in 2011 of the area specified in the Act.

- Inspections in banks and branches of credit institutions:
  - 24 problem-oriented inspections were conducted, of which: seven were performed in commercial banks, 14 in cooperative banks and three in branches of credit institutions,
  - post-inspection recommendations were sent to the seven commercial banks and to 13 cooperative banks, and
  - three notifications were made to the public prosecutor - one relating to a cooperative bank, one to a brokerage house and one to a life assurance undertaking.
- Inspections in capital market institutions:
  - problem-oriented inspections were carried out in 12 capital market institutions, and
  - post-inspection recommendations were sent to 11 capital market institutions.

- Inspections in the insurance sector (in the area of life assurance):
  - problem-oriented inspections were carried out in 12 insurance undertakings.

Where irregularities were found to have occurred the KNF Office directed post-inspection recommendations to institutions bound by the Act. Information about how they were implemented was delivered to the KNF Office by the institutions inspected.

In the course of analytical works, assessment was performed of the internal procedures of 17 supervised entities. Also subjected to analysis were quarterly reports from banks concerning information about suspicious transactions they had transferred to the General Inspector of Financial Information.

## 5. REGULATORY AND PRUDENTIAL REGIME TASKS

The key regulatory and prudential regime tasks which were completed in 2011 included the preparation of KNF resolutions and prudential recommendations.

### 5.1. RESOLUTIONS OF THE POLISH FINANCIAL SUPERVISION AUTHORITY

The objective behind the adoption of the KNF resolutions was to:

- adjust the Polish legal framework to the amended directives of the European Parliament and of the Council, i.e. Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (CRD), adopted by virtue of Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009, Commission Directive 2009/27/EC of 7 April 2009 and Commission Directive 2009/83/EC of 27 July 2009 (CRD II),
- adjust the Polish legal framework to the amended directives of the European Parliament and of the Council, i.e. Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (CRD), adopted by virtue of Directive 2010/76/EC of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (CRD III),
- reflect amendment proposals submitted within the KNF Office and by the banking sector.

In 2011, the Polish Financial Supervision Authority adopted the following resolutions:

#### **Resolution No. 153/2011 of the Polish Financial Supervision Authority of 7 June 2011, amending Resolution No. 76/2010 of the Polish Financial Supervision Authority on the scope and detailed procedures for determining capital requirements for particular risks**

The resolution introduced an amendment that raised to 100 percent the risk weight of the retail exposures for which the principal payment or interest payment depend on the exchange rate of currency or currencies other than the currency of the debtor's income for:

- retail exposures,
- exposures secured by residential real property as an actual or potential place of residence of the owner or his/her rental property.

By increasing the capital requirement, the amendment is aimed to take into account a higher (than in the case of national currency or other currency of the debtor's income) level of risk associated with the above exposures.

Furthermore, in order to enable banks to accommodate the amendment, a transitional period was introduced - the resolution will enter into force on 30 June 2012.

#### **Resolution No. 206/2011 of the Polish Financial Supervision Authority of 22 August 2011, amending Resolution No. 76/2010 of the Polish Financial Supervision Authority on the scope and detailed procedures for determining capital requirements for particular risks**

The resolution introduced changes associated with the need to transpose CRD II and CRD III. CRD II is implemented through a change of reference to the Banking Law of 29 August 1998, with respect to exposure concentration limits and a large exposure limit, resulting from the amendment (also implementing the provisions of CRD II), implemented by the Act of 28

April 2011 amending the Banking Law, the Act on Trading in Financial Instruments and the Act on Financial Market Supervision (which entered into force on 12 July 2011).

CRD III is implemented, in particular, through the following implementing regulations:

- rules for the calculation of the credit risk capital requirement using the Internal Ratings Based (IRB) Approach:
  - until 31 December 2012, the LGD for all retail exposures secured by residential properties and not benefiting from guarantees from central governments shall not be lower than 10%,
  - change of the value of LGD (from 12.5% to 11.25%) for covered bonds,
- additional requirement for the use for the purpose of determining the risk weight for a securitisation position, credit assessment by an eligible external credit assessment institution.

**Resolution No. 207/2011 of the Polish Financial Supervision Authority of 22 August 2011, amending Resolution No. 384/2008 of the Polish Financial Supervision Authority, on the requirements concerning identification, monitoring and control of concentration of exposures, including large exposures**

The resolution introduced changes related to the implementation of CRD II, which amended the provisions on stress-testing concentration risk.

The resolution:

- specified that the tests should cover the risks connected with possible changes in economic circumstances of the bank, including market conditions, which could have a negative impact on the adequacy of the bank's own funds,
- specified the rules and procedures that banks should include in their strategies to address concentration risk,
- took into account the transposition of the definition of a "large exposure" from the Banking Law to the resolution superseding Resolution No. 382/2008 of the Polish Financial Supervision Authority on detailed rules and conditions for considering exposure when determining the observance of the exposure concentration limit and the large exposure limit.

**Resolution No. 208/2011 of the Polish Financial Supervision Authority of 22 August 2011 on detailed rules and conditions for considering exposure when determining the observance of the exposure concentration limit and the large exposure limit**

The amendment of CRD II also warranted amendment of the Banking Law. The amendments to the Banking Law were published on 27 June 2011 (Journal of Laws of 2011, No. 131, item 763) and became effective on 12 July 2011. The amendment of the Banking Law involved introducing a single exposure concentration limit of 25 percent of the bank's own funds. The delegation contained in the Banking Law required the KNF to:

- determine the rules and conditions for considering exposure when observing the exposure concentration limit, taking into account credit risk mitigation techniques,
- specify the detailed conditions to be met by exposures excluded from the concentration limit so that they do not jeopardise secure conduct of business and proper risk management at the bank.

Some of the most important changes introduced by the resolution include:

- excluding from the concentration limit short-term exposures related to cash transfer,
- modifying reporting obligations,
- excluding from the concentration limit exposures reserved by CRD II for the assessment of national regulators:

- exposures which constitute receivables and other exposures to other banks operating on an uncompetitive basis, granting loans in the framework of state socio-economic programmes and local programmes for regional development,
- exposures which constitute guarantees required by law, applied when mortgage-backed credit is paid, financed through the issue of mortgage bonds, prior to legally binding entry of the mortgage in the land and mortgage register.

**Resolution No. 258/2011 of the Polish Financial Supervision Authority of 4 October 2011 on detailed principles of the operation of the risk management system and the internal control system and detailed conditions for estimation of internal capital by banks and for reviews of the internal capital retention and estimation process and the principles of determining the policy of variable components of the remunerations of persons in managerial positions at banks**

The resolution introduced changes associated with the need to transpose CRD II and CRD III. CRD II is implemented through a regulation that requires banks to include reputational risk (applicable to complex structures and products) in their securitisation risk management procedures and also requires investing banks (in addition to sponsoring and originating banks) to develop such procedures.

CRD III is transposed by regulations concerning the principles of determining the policy of variable components of the remunerations of persons in managerial positions at banks.

**Resolution No. 259/2011 of the Polish Financial Supervision Authority of 4 October 2011 amending Resolution No. 385/2008 of the Polish Financial Supervision Authority on detailed principles and manner of disclosure by banks of qualitative and quantitative information pertaining to capital adequacy and the scope of information subject to disclosure**

The resolution introduced changes associated with the need to transpose CRD III. The amendments to the resolution are associated with the regulations, introduced in Resolution No. 258/2011 of the Polish Financial Supervision Authority, transposing CRD III and concerning the principles of determining the policy of variable components of the remunerations of persons in managerial positions at banks.

The new regulations introduced the requirement to publicly disclose:

- information concerning the process of determining the policy of variable remuneration components,
- most important information concerning changes in remunerations, in particular with respect to performance-based remunerations,
- information about performance assessment criteria, which serve as the basis for entitlement to remuneration components,
- primary parameters and principles of determining remunerations of persons in managerial positions, including the relationship between the amount of remuneration and the performance in the case of performance-based remunerations,
- collective quantitative information concerning the amount of remuneration, categorised by business lines used in bank management,
- collective quantitative information about the remunerations of persons in managerial positions, categorised by:
  - management board members, direct reports of management board members regardless of employment relationship, department directors and vice-directors and chief accountant,
  - other persons in managerial positions.

Furthermore, the resolution introduced the requirement that in disclosing quantitative information concerning the policy on variable remuneration components, information concerning the bank's management board members be disclosed separately.

The resolution stipulated that banks shall comply with the above requirements, taking into account their legal form, size of their business, risk inherent in their activity, internal organisation and the nature, scope and level of complexity of their operations.

**Resolution No. 324/2011 of the Polish Financial Supervision Authority of 20 December 2011, amending Resolution No. 76/2010 of the Polish Financial Supervision Authority on the scope and detailed procedures for determining capital requirements for particular risks and Resolution No. 386/2008 of the Polish Financial Supervision Authority on determining liquidity standards binding on banks**

The resolution introduced changes associated with the need to transpose CRD III. In particular, the following changes were introduced:

- amendment to Appendix 3 to the resolution, containing regulations with respect to defining a trading book,
- Amendment to par. 31.2 of Appendix 4 to the resolution, which currently states that in the case of exposures to regional and local authorities in member states, denominated and financed in the local currency of these regional and local authorities, the bank may assign a credit risk weight of 20%.
- amendment to par. 2 of Appendix 11 to the resolution, under which the requirement regarding settlement risk and delivery risk will also apply to items in the banking record,
- amendments to Appendix 19 to the resolution concerning the application of the value at risk method (internal models) for the calculation of the market risk capital requirement;
- amendments to Appendices 9 and 18 to the resolution on securitisation and resecuritisation.

The resolution also introduced changes not stemming from the above Directive, in particular:

- in par. 6.1.4, § 11.2.3c, par. 14.3.4, Appendix 1, par. 3, par. 6 pt 1 sentence one and par. 8 of Appendix 12, changes resulting from amendments to the Banking Law with respect to removing the large concentration limit,
- in par. 14.1 and 14.2, an amendment that includes maintaining the provisions concerning the comparative requirement - thus, also in 2012, banks using the internal ratings method in calculating credit risk capital requirements and the advanced measurement method for calculating operating risk capital requirement will need to maintain own funds at the higher of: total capital requirement or 80 percent of the comparative total capital requirement. Furthermore, the current regulations regarding the calculation of the comparative total capital requirement were maintained,
- in Appendix 12 par. 4 and par. 9 - changes were introduced to adjust it to the CRD, under which the requirement for exceeding the concentration limit is calculated solely with respect to the trading book.

As regards Resolution No. 386/2008 of the KNF, only the reference to Resolution No. 76/2010 was amended.

**Resolution No. 325/2011 of the Polish Financial Supervision Authority of 20 December 2011 on other deductions from the capital base, their amount, their scope and conditions of their deduction from a bank's capital base, other balance sheet items included in the supplementary capital, their amount, their scope and the conditions of their inclusion in the supplementary capital, deductions from the supplementary capital, their amount, their scope and conditions of their deduction from the supplementary capital and the scope and manner of treating the activity of banks that are members of conglomerates in calculating own funds**

The Resolution is a consolidated text prepared in connection with implementing CRD III. It superseded Resolution No. 367/2010 of the KNF of 12 October 2010, which amended Resolution No. 381/2008 of the KNF of 17 December 2008 and in order to eliminate any formal concerns, both resolutions were repealed.

Some of the most important changes introduced by the resolution are deductions from own funds that account for:

- negative amounts with respect to asset valuation adjustments,
- the amount of exposures arising from securitisation positions in the trading book, which would be assigned a risk weight of 1,250%, if these exposures were in the banking book of the same credit institution;
- capital exposures at reinsurance companies.

### **Resolution No. 326/2011 of the Polish Financial Supervision Authority of 20 December 2011 amending Resolution No. 385/2008 of the Polish Financial Supervision Authority on detailed principles and the manner of disclosure by banks of qualitative and quantitative information pertaining to capital adequacy and the scope of information subject to disclosure**

The resolution introduced changes associated with the need to transpose CRD III.

The newly-added provisions of Resolution No. 385/2008 introduce the requirement to publicly disclose:

- with respect to market risk, in par. 8a of Appendix 1:
  - information about the amount required for each type of that risk, to the extent that banks calculate those requirements, and the banks are required to disclose them separately for each type of risk for which the bank calculated the capital requirement,
  - the amount of capital requirement on specific interest rate risk associated with securitisation positions,
- more detailed information concerning the use of the value at risk method in calculating capital requirement,
- more detailed information on calculating capital requirement on the amount of risk-weighted securitisation exposures, in relevant cases separately for the trading book and the banking portfolio.

Furthermore, in par. 4 of the resolution, section 3 was added under which banks must have methods in place to assess whether the information published is sufficient in view of the bank's risk profile. Furthermore, it was noted that if the assessment is negative, the bank also publishes the necessary additional information.

## **5.2. RECOMMENDATIONS OF THE POLISH FINANCIAL SUPERVISION AUTHORITY**

In 2011, the Polish Financial Supervision Authority adopted the following amended recommendations:

### **Recommendation H concerning internal control at banks**

The need to amend Recommendation H resulted from:

- implementing provisions concerning internal control at banks in the Banking Law of 29 August 1997 and Resolution No. 383/2008 of the Polish Financial Supervision Authority of 17 December 2008 on detailed principles of the operation of risk management and internal control systems and detailed conditions of estimating internal capital by banks and reviewing the process of estimating and maintaining such capital,

- introduction of an obligation to create audit committees at domestic banks (excluding co-operative banks) in the Act on Qualified Auditors, Their Self-Government, Entities Qualified to Audit Financial Statements and on Public Supervision of 7 May 2009,
- KNF Office proposals to introduce regulations which would limit the number of cases where personal links exist between members of a bank's governing bodies.

The draft recommendation also took account of the relevant international guidelines.

### **Recommendation S on good practices in the management of credit exposures financing real estate and secured by a mortgage**

The reasons listed for amending the recommendation included:

- the risk associated with a growing share of the portfolio of mortgage-backed credit exposures and credit exposures financing real estate in dues from the non-financial sector,
- harmonisation of Recommendation S (II) and T concerning best practices in managing credit exposures financing real estate and mortgage-backed credit exposures,
- insufficient effectiveness of Recommendation S (II),
- the need to protect the Polish banking sector against disruptions such as those suffered by a number of other economies in the CEE region, which were caused by unrestricted foreign-currency lending to households.

In view of the foregoing, the following key areas requiring change were identified:

- duration of the lending period,
- borrowers' income taken into account in assessing creditworthiness,
- the LtV index,
- effectiveness of managing the risk of a mortgage-backed credit portfolio.

The amendments will help enhance the effectiveness of the credit risk management process.

### **Recommendation R concerning the rules for identification of impaired balance-sheet credit exposures, calculation of impairment losses on balance-sheet credit exposures and provisions for off-balance-sheet credit exposures**

The amendment of Recommendation R did not result directly from amendments to the applicable laws, but from the need to adjust the Recommendation to current market practice and the fact that its then-current version was implemented at a time when the provisions of international regulations were only starting to be effective in Poland and banks did not yet have the requisite knowledge and experience in that regard. Some of the most important changes include:

- verification of the adequacy of the parameters used in calculating impairment losses,
- developing a methodology for applying balance sheet credit exposures to restructured balance sheet credit exposures, which, among other things, contained a definition of a restructured balance sheet credit exposure and the conditions for impairment of these items,
- indication of the conditions for re-classification of exposure as exposure without impairment,
- frequency of conducting reviews associated with banks' historical data.

Recommendation R is addressed to banks operating in Poland that prepare consolidated or separate financial statements in accordance with the IAS/IFRS. The guidelines contained in Recommendation R also apply to branches of a domestic bank and the bank's subsidiaries located outside of Poland, taking into account the legal environment of local markets and the feasibility of ensuring compliance with the good practices set forth in the recommendation.



The changes will help improve the effectiveness of the process of identification of impaired balance-sheet credit exposures and calculation of impairment losses on balance-sheet credit exposures and provisions for off-balance-sheet credit exposures.

### 5.3. CIRCULARS FOR REGULATED ENTITIES

In implementing the concept of strengthening prudential supervision, in 2011, the practice of sending circulars to regulated entities was revisited. Letters addressed to individual sectors present to the market the supervisory authorities' view of major developments and indicate the direction of change. The supervisory authorities express their expectations and outline the consequences of disregarding those expectations. The Chairman of the KNF presented guidelines to:

- banks' management boards with respect to:
  - banks' decisions not to pay dividends and allocate their profits towards strengthening their capital base,
  - the requirement to notify the Polish Financial Supervision Authority of an intention to sell a block of a bank's shares that entitles the holder to exercise voting rights at the general meeting at the level set forth in Article 25p of the Banking Law,
  - detailed principles of the operation of the risk management system and the internal control system and detailed conditions for estimation of internal capital by banks and for reviews of the internal capital retention and estimation process and the principles of determining the policy of variable components of the remunerations of persons in managerial positions at banks,
  - banks offering customers investments with daily interest capitalisation, structured in a way that allows them to avoid paying income tax on interest income (anti-tax investments),
- management boards of investment fund companies with respect to:
  - permitting investment funds to invest in different asset types,
  - internal supervision and monitoring of risk by investment fund companies,
  - observing investment restrictions and diversification of investment fund investments,
  - risk associated with the absence of a reliable valuation of a major component of investment fund investments,
  - supervision over closed-end investment funds,
- management boards of universal pension fund companies with respect to operations conducted by universal pension fund companies in a manner that ensures a level of own funds that corresponds to the risk involved,
- management boards of insurance/reinsurance companies with respect to:
  - insurance/reinsurance companies preventing instances of unlawful conduct of business, in particular with respect to solvency ratios, which should be reflected in undertaking appropriate measures well in advance to:
    - identify reasons for the deterioration of the technical and financial performance,
    - maintain the capital buffer,
    - be actively involved in laying the groundwork for the new Solvency II regime,
  - the requirement to inform the supervisory body about every intention to dispose, whether directly or indirectly, of shares or rights from shares in a domestic insurance company,
  - irregularities related to performing obligations under civil liability insurance contracts for possessors of motor vehicles (third party liability coverage).

## 5.4. RISK WARNING CONCERNING INVESTMENTS IN CONTRACTS FOR DIFFERENCE

Due to the popularity on the Polish market of contracts for difference (referred to as CFDs) offered by some regulated entities, the KNF gave consideration to the risk for customers that is associated with these contracts.

Contracts for difference are non-standardised OTC derivatives, used primarily for speculation in currencies, stock market indices, commodities, raw materials, stock, bonds and other assets. Due to the low entry threshold for CFDs, with the minimum amount required to open an account not exceeding several thousand zlotys, more and more retail customers join CFD-related activities primarily through online trading platforms.

It was noted that, in selecting this product, retail customers should be mindful, in particular, of their investment goals and horizons, their knowledge and experience and maximum acceptable loss. CFDs are complex financial instruments and retail customers should at all times be asked by CFD providers to take a special test that determines whether the customer is aware of the risk involved in an instrument and has the requisite knowledge and practical skills. The customer should pay particular attention to the justifiability of their involvement in CFD trading if they have been warned by the CFD provider that the instrument is not suitable for them.

Providing professional intermediation services to investors requires an authorisation from the KNF or notification from foreign supervisory bodies for foreign EU member state investment operating in Poland.

## 6. MEASURES TAKEN TO COUNTERACT FINANCIAL MARKET ABUSE

### 6.1. EXPLANATORY AND ADMINISTRATIVE PROCEEDINGS RELATED TO SUPERVISION OVER THE FINANCIAL MARKET

In 2011, the KNF conducted twelve explanatory proceedings in order to determine whether there were grounds for filing a notification of a suspected offence concerning offences specified in the acts regulating the financial market in Poland, or for instigating administrative proceedings concerning violation of the law, to the extent falling within the scope of the KNF's supervision. The proceedings pertained to:

- manipulation involving a financial instrument - 3 cases,
- failure to discharge or improper discharge of disclosure obligations - 2 cases,
- misuse of inside information - 1 case,
- execution of transactions during a restricted period - 1 case,
- failure to disclose the holdings of a public company - 5 cases.

In 2011, the KNF conducted administrative proceedings in 105 cases concerned with the following acts of law:

- Act on Trading in Financial Instruments - 12 cases,
- Act on the Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies - 63 cases,
- Act on Investment Funds - 7 cases,
- Act on Insurance Activity - 5 cases,
- Act on Compulsory Insurance, the Insurance Guarantee Fund and the Polish Motor Insurers' Bureau - 9 cases,
- Act on the Organisation and Functioning of Pension Funds - 5 cases,
- other acts - 4 cases.

The administrative proceedings concerned:

- manipulation involving a financial instrument (Article 39 of the Act on Trading in Financial Instruments) - 4 cases,
- execution of transactions involving an issuer's shares during a restricted period (Article 159 of the Act on Trading in Financial Instruments) - 1 case,
- failure to discharge or improper discharge of disclosure obligations by an issuer (Article 56 of the Act on the Public Offering) - 29 cases,
- improper preparation of recommendations (Article 42 of the Act on Trading in Financial Instruments) - 3 cases,
- failure to discharge or improper discharge of obligations concerning major holdings (Article 69 of the Act on the Public Offering and Article 69 read together with Article 87 of the Act on the Public Offering) - 15 cases,
- failure to discharge or improper discharge of obligations concerning major holdings and purchase of the issuer's shares without a tender offer required by law (Article 69 and Article 72 of the Act on the Public Offering) - 2 cases,
- failure to discharge or improper discharge of obligations concerning major holdings and purchase of the issuer's shares without a tender offer required by law (Article 69 and Article 73 of the Act on the Public Offering) - 2 cases,
- failure to discharge obligations concerning major holdings in observance of statutory deadlines (Article 70 of the Act on the Public Offering) - 2 cases,
- imposing penalties on members of an issuer's management board due to the issuer's flagrant breach of Article 56 of the Act on the Offering (Article 96.6 of the Act on the Public Offering) - 11 cases,

- failure to discharge or improper discharge of disclosure obligations due to delayed disclosure of information (Article 57.3 of the Act on the Offering) - 2 cases,
- irregularities associated with the conduct of brokerage activity by investment firms, which breached the applicable laws, the principles of fair trading and the client's interests (Article 167 of the Act on Trading in Financial Instruments) - 4 cases,
- irregularities associated with a breach of the applicable laws in connection with the activities of investment companies and funds (Article 228 of the Act on Investment Funds) - 5 cases,
- irregularities associated with a breach of the applicable laws or the obligations under an agreement for keeping a register of investment fund assets in connection with the activities of a depository (Article 232 of the Act on Investment Funds) - 1 case,
- breach of the applicable laws in connection with a proposed purchase of shares in a company (Article 54 of the Act on Investment Funds) - 1 case,
- breach of the applicable laws, statute or insurance agreements concluded (Article 212.1.2 of the Act on Insurance Activity) - 5 case,
- failure to meet a claims adjustment deadline (Article 14.3a of the Act on Compulsory Insurance) - 5 cases,
- breach of disclosure obligations towards the Insurance Guarantee Fund (Article 102 and 105 of the Act on Compulsory Insurance) - 4 cases,
- breach of the applicable laws by a pension fund company (Article 204 of the Act on the Organisation and Functioning of Pension Funds) - 5 cases,
- other matters (forgiveness of administrative penalty or spreading out the payments - Article 67a of the Tax Ordinance) - 4 cases.

**Table 24. Number and type of proceedings conducted by the KNF in 2008-2011**

Type	2008		2009		2010		2011	
	No. of proceedings launched	No. of proceedings closed	No. of proceedings launched	No. of proceedings closed	No. of proceedings launched	No. of proceedings closed	No. of proceedings launched	No. of proceedings closed
Explanatory proceedings	13	8	7	9	6	5	9	7
Administrative proceedings	71	68	62	64	69	64	48	44
<b>Total</b>	<b>84</b>	<b>76</b>	<b>69</b>	<b>73</b>	<b>75</b>	<b>69</b>	<b>57</b>	<b>51</b>

Source: KNF's own materials

In 2011, 70 administrative decisions were issued, including:

- 52 in the first instance (of which 48 imposed a fine, 2 declined to spread out the payments, 2 cancelled the administrative penalty),
- 18 decisions in cases remitted for reconsideration upon a party's request (of which 12 upheld a first-instance ruling, 2 varied a first-instance ruling and lowered the amount of imposed fine, 1 varied a first-instance ruling and imposed a fine in the same amount, 2 varied a first-instance ruling and discontinued proceedings, 1 discontinued appeal proceedings).

In 2011, the KNF imposed fines in the total amount of PLN 7,560 thousand, including fines imposed on:

- issuers - PLN 3,650 thousand,

- investment fund companies - PLN 50 thousand,
- insurance companies - PLN 830 thousand,
- pension fund companies - PLN 350 thousand,
- depositaries - PLN 350 thousand,
- natural persons - PLN 2,330 thousand.

## 6.2. ADMINISTRATIVE PROCEEDINGS INVOLVING FINANCIAL INTERMEDIARIES

The KNF's regulatory tasks in the area of supervision over financial intermediaries include the conduct of administrative proceedings in cases involving:

- insurance agents, in particular a ban prohibiting the use of their services by insurance companies,
- insurance and reinsurance brokers,
- persons authorised to perform customer acquisition activities for pension funds,
- investment firm agents;
- persons authorised to perform customer acquisition activities for pension funds,
- securities brokers, investment advisers and commodity brokers.

In 2011, 56 remedial proceedings involving financial intermediaries were being conducted by the KNF under the following acts of law:

- Insurance Brokerage Act - 6 cases,
- Act on Trading in Financial Instruments - 13 cases,
- Act on Investment Funds - 1 case,
- Act on the Organisation and Functioning of Pension Funds - 36 cases.

The proceedings concerned:

- missing the deadline for filing with the regulator of a request to modify an entry in the register of insurance brokers following changes in the existing data (Article 46 of the Insurance Brokerage Act of 22 May 2003) - 4 cases,
- absence, prior to concluding an insurance agreement, of written advice, on the basis of thorough analysis of offers in a number that is sufficient to recommend the most suitable insurance agreement and written explanation of the grounds of the recommendation referred to in Article 26.1.2 of the Insurance Brokerage Act of 22 May 2003) - 2 cases,
- disclosure of professional secret (Article 159.1.2 of the Act on Public Trading in Financial Instruments, Article 148.1 of the Act on Trading in Financial Instruments, internal regulations of an investment firm) - 5 cases,
- disclosure of inside information (Art. 156.2.1 of the Act on Trading in Financial Instruments) - 1 case,
- use of inside information (Art. 156.1.1d of the Act on Trading in Financial Instruments) - 3 cases,
- improper supervision over brokerage activities (Art. 98a.1 of the Act on Trading in Financial Instruments, subordinate regulations under the Act on Trading in Financial Instruments, internal regulations of an investment firm) - 1 case,
- improper supervision over managing customer portfolios, in connection with management irregularities, internal regulations of an investment firm (Article 126 of the Act on Trading in Financial Instruments) - 1 case,
- performing transactions in a relative's account in breach of internal regulations of an investment firm (Article 126 of the Act on Trading in Financial Instruments) - 1 case,
- non-compliance with disclosure requirements by an agent of an investment firm (Art. 81.8 of the Act on Trading in Financial Instruments) - 1 case,
- non-compliance with disclosure requirements by a distributor of investment fund units (Art. 32.9 of the Act on Investment Funds) - 1 case,
- non-fulfilment of the registration criteria (conviction under a final court decision) - Art. 94.4.1 of the Act on Organisation and Functioning of Pension Funds of 28 August 1997

(Journal of Laws of 1997, No. 139, item 934, as amended) or pursuit of acquisition activities in violation of the law - Article 94.4.2 of the Act on Organisation and Functioning of Pension Funds - 36 cases (including 24 decisions to remove, 1 decision to discontinue proceedings regarding removal and 11 proceedings pending).

In 2011, 39 administrative decisions were issued in said cases, including:

- 6 first-instance decisions (including 6 to impose fines),
- 1 first-instance decision and 5 second-instance decisions in cases involving securities brokers and investment advisers (including 1 decision to suspend a licence for a period of three months, 1 decision to uphold a first-instance decision and 4 decisions to repeal a first-instance decision and discontinue administrative proceedings),
- 1 first-instance decision to discontinue proceedings against an investment firm agent,
- 1 first-instance decision to revoke an authorisation to intermediate in the sale and repurchase of investment fund units,
- 25 decisions in cases seeking removal from the register of persons entitled to perform client acquisition activities for open-end pension funds (including 1 decision to discontinue proceedings concerning removal).

In 2011, the KNF imposed fines on insurance brokers in the total amount of PLN 9,000 thousand.

### 6.3. NOTIFICATIONS OF SUSPECTED OFFENCE

In 2011, the KNF Office filed 71 notifications of suspected offences with the Regional Public Prosecutor's Office in Warsaw, relating to violation of the following acts:

- Act on Trading in Financial Instruments (consolidated text: Journal of Laws of 2010, No. 211, item 1384) - 25 notifications,
- Act on the Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies (consolidated text: Journal of Laws of 2009, No. 185, item 1439, as amended) - 12 notifications,
- Banking Law (Journal of Laws of 2002, No. 72, item 665, as amended) - 13 notifications,
- Act on the Organisation and Functioning of Pension Funds (consolidated text: Journal of Laws of 2010, No. 34, item 189, as amended) - 8 notifications,
- Act on Insurance Activity (consolidated text: Journal of Laws of 2010, No. 11, item 66, as amended) - 2 notifications,
- Act on Investment Funds (Journal of Laws of 2004, No. 146, item 1546, as amended) - 2 notifications,
- Act on Counteracting Money Laundering and the Financing of Terrorism (Journal of Laws of 2010, No. 46, item 276, as amended) - 3 notifications,
- Accountancy Act (Journal of Laws of 2009, No. 152, item 1223, as amended) - 2 notifications,
- Criminal Code - 4 notifications.

**Table 25. Notifications filed in 2008-2011 by type of offence**

Type of violated regulation	Number of notifications			
	2008	2009	2010	2011
Article 183 of the Act on Trading in Financial Instruments (financial market manipulation)	11	10	6	9
Article 180 and 181 of the Act on Trading in Financial Instruments (disclosure and misuse of inside information)	13	16	6	12
Article 295 (unauthorized conduct of activities referred to in Article 32.2, Article 45.1 or 45.2 or Article 209) and Article 296 of the Act on Investment Funds (unauthorised use of the name referred to in Article 14.4 of the Act)	2	2	-	-
Article 100 of the Act on the Public Offering (misrepresentation and concealment of facts in a prospectus or a report)	7	3	14	6
Article 178 of the Act on Trading in Financial Instruments (unauthorized trading in broker-traded financial instruments)	1	4	3	2
Article 171.1 of the Banking Law (unauthorised banking activity)	-	3	4	7
Other*	8	4	20	35
<b>Total</b>	<b>42</b>	<b>42</b>	<b>53</b>	<b>71</b>

Source: KNF's own materials

\* Violated regulations:

- Article 99 of the Act on the Public Offering (unauthorised offering of securities to the public),
- Article 103 of the Act on the Public Offering (failure to provide an annex to the prospectus or information memorandum),
- Article 179 of the Act on Trading in Financial Instruments (disclosure or misuse of a professional secret),
- Article 171.5 of the Banking Law (disclosure of banking secret),
- Article 77 of the Accountancy Act (failure to maintain accounting records in accordance with the Act or to prepare financial statements in accordance with the Act),
- Article 35.1 of the Act on Counteracting Money Laundering and the Financing of Terrorism (failure to register transactions subject to registration),
- Article 280 of the Act on Investment Funds (breach of professional secret),
- Article 287 of the Act on Investment Funds (unauthorised activities that involve investing funds of natural persons, legal persons or organisational units without legal personality - collected by way of a proposal to conclude an agreement for participation in such a project - in securities, money market instruments or other property rights),
- Article 289 of the Act on Investment Funds (disclosure or misuse of a professional secret),
- Article 57 of the Act on Commodity Exchanges (unauthorised conduct of a commodity exchange),
- Article 47.1 and Article 48.1 and 48.2 of the Insurance Brokerage Act (conducting unauthorised activity, using terms that indicate unauthorised conduct of insurance brokerage activity),
- Article 54 of the Personal Data Protection Act (data controller's failure to notify the data subject of their rights or provide them with information that enables them to exercise their rights under the Act),
- Article 225 of the Act on Insurance Activity (unauthorised conduct of insurance or reinsurance activity),
- Article 230 of the Act on Insurance Activity (using terms, be it in the name, to define the activity or in advertising, that indicate conduct of insurance or reinsurance activity by an unauthorised entity),
- Article 232 of the Act on Insurance Activity (disclosure of secret pertaining to insurance agreements),
- Article 219.2 of the Act on the Organisation and Functioning of Pension Funds (offering additional material benefits for joining or remaining a member of a particular open-end fund),
- Article 267a of the Cooperative Law (acting to the detriment of a cooperative),
- Article 585 of the Commercial Companies Code (acting to the detriment of a company),
- Article 191 of the Criminal Code (unlawful threat),
- Article 226 of the Criminal Code (insulting a police officer),
- Article 270 of the Criminal Code (forgery),
- Article 276 of the Criminal Code (destruction and removal of documents),
- Article 286.1 of the Criminal Code (fraud),
- Article 296.3 of the Criminal Code (causing significant material damage by abusing one's rights or failing to fulfil one's duties),

- Article 297.1 of the Criminal Code (loan scam),
- Article 47 of the Electronic Signature Act (unauthorised use of an electronic key).

Out of the notifications filed in 2011 with the Public Prosecutor's Office, as at 31 December 2011, 49 preliminary investigation proceedings were commenced (of which 10 were discontinued) and investigation was denied in 13 cases.

## 6.4. INDICTMENTS

In 2011, the KNF Office was notified that 14 indictments were filed by the Public Prosecutor's Office with common courts of law based on the notifications of suspected offence received from the KNF Office.

**Table 26. Indictments filed with courts in 2008-2011, by type of offence**

Type of violated regulation	Indictments			
	2008	2009	2010	2011
Article 183 of the Act on Trading in Financial Instruments (financial market manipulation)	4	9	3	9
Article 180 and 181 of the Act on Trading in Financial Instruments (disclosure and misuse of inside information)	1	1	1	1
Other*	4	3	3	4
<b>Total</b>	<b>9</b>	<b>13</b>	<b>7</b>	<b>14</b>

Source: KNF's own materials

\* Violated regulations:

- Article 100 of the Act on the Public Offering (misrepresentation or concealment of facts in a prospectus),
- Article 178 of the Act on Trading in Financial Instruments (unauthorised trading in broker-traded financial instruments)
- Article 179 of the Act on Trading in Financial Instruments (disclosure or misuse of a professional secret),
- Article 296 of the Act on Investment Funds (unauthorised use of the name referred to in Article 14.4 of the Act),
- Article 270 of the Criminal Code (document forgery),
- Article 296.1 and 296.2 of the Criminal Code (abuse of rights, failure to fulfil duties),
- Article 297.1 of the Criminal Code (loan scam),
- Article 47.1 read together with Article 48 of the Insurance Brokerage Act (unauthorised agency activity and unauthorised use of the name),
- Article 585 of the Commercial Companies Code (acting to the detriment of a company) read together with Article 296.1 and 296.2 of the Criminal Code (abuse of rights, failure to fulfil duties).

## 6.5. CONVICTIONS AND CONDITIONAL DISCONTINUATION OF PROCEEDINGS

In 2011, common courts handed down seven convictions as a result of the notifications of suspected offence received from the KNF Office with respect to the following acts:

- the Act on Trading in Financial Instruments - 6 convictions,
- Act on the Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies - 1 conviction.

The conviction handed down by the Regional Court in Zielona Góra on 1 March 2011, upholding the conviction handed down by the District Court in Zielona Góra in the case under Article 183 of the Act on Trading in Financial Instruments. The District Court sentenced the defendant to eight months of imprisonment with execution suspended for three years and a fine of PLN 5,000 (the sentence is final). The notification was submitted on 16 May 2006.



Conviction passed by the District Court for Gdańsk-Północ on 6 April 2011 in the case under Article 100 of the Act on the Public Offering and Article 176 of the Act on Public Trading in Securities. The District Court sentenced one of the defendants to one year of imprisonment with execution suspended for four years and the other defendant - to ten months of imprisonment with execution suspended for three years (the sentence is final). The notification was submitted on 1 April 2004.

Conviction passed by the District Court of Wrocław-Śródmieście in the case under Art. 183.1 of the Act on Trading in Financial Instruments on 4 July 2011. The Court sentenced the defendant to a fine of PLN 8,000 (the sentence is final). The notification was submitted on 13 September 2005.

Conviction passed by the District Court of Wrocław-Fabryczna on 8 August 2011 in the case under Article 183.1 of the Act on Trading in Financial Instruments. The Court sentenced the first defendant to a fine of PLN 25,000 and the second defendant to a fine of PLN 5,000 (the sentence is final). The notification was submitted on 2 June 2010.

Conviction passed by the District Court in Sierpc on 24 October 2011 in the case under Article 183.1 of the Act on Trading in Financial Instruments. The Court sentenced the defendant to a fine of PLN 10,000 and declared loss of the material benefit of PLN 24,802.89 (the sentence is final). The notification was submitted on 8 October 2010.

Conviction passed by the District Court in Żyrardów on 25 October 2011 in the case under Article 178 of the Act on Trading in Financial Instruments. The District Court sentenced the defendant to six months of imprisonment with execution suspended for five years and a fine of PLN 3,000 (the sentence is final). The notification was submitted on 3 November 2010.

Conviction passed by the District Court of Wrocław-Śródmieście in the case under Article 183.1 of the Act on Trading in Financial Instruments on 16 December 2011. The Court sentenced the defendant to a fine of PLN 5,000 (the sentence is not final). The notification was submitted on 23 July 2009.

**Table 27. Convictions and conditional discontinuations in 2008-2011, by type of offence**

Legal grounds for conviction	Number of convictions			
	2008	2009	2010	2011
Article 177 of the Polish Securities Act / Article 183 of the Act on Trading in Financial Instruments (financial market manipulation).	7	5	5	5
Article 176.1 and 176.2 of the Polish Securities Act / Article 180 and 181 of the Act on Trading in Financial Instruments (disclosure and misuse of inside information)	1	-	2	-
Other*	3	1	-	2
<b>Total</b>	<b>11</b>	<b>6</b>	<b>7</b>	<b>7</b>

Source: KNF's own materials

\*Legal grounds for conviction:

- Article 174 of the Act on Public Trading in Securities (misrepresentation of data in an issue prospectus or in other documents associated with introducing securities into trading),
- Article 178 of the Act on Trading in Financial Instruments (unauthorised trading in financial instruments)
- Article 100 of the Act on the Public Offering (misrepresentation or concealment of facts in a prospectus),
- Article 295 of the Act on Investment Funds (unauthorised conduct of the activity referred to in Article 32.2 of the Act),
- Article 296 of the Act on Investment Funds (unauthorised use of the name referred to in Article 14.4 of the Act),
- Article 47 read together with Article 48 of the Insurance Brokerage Act (conducting activity without required registration and unauthorised use of the name).

## 7. PARTICIPATION IN LEGISLATIVE PROCESSES

The statutory tasks of the Polish Financial Supervision Authority include participation in drafting laws regulating supervision over the financial market. In this process, the KNF acts as an advisor and gives opinions to authorities and agencies which, under separate legal regulations, initiate and conduct legislative work. The KNF's activity includes in particular cooperation with the Minister of Finance as the minister competent for the matters of financial institutions, and the Minister of Labour and Social Policy as the minister competent for social security matters. In 2011, the Polish Financial Supervision Authority's experts were involved in drafting and advising on several dozen draft bills, bill assumptions and regulations. This chapter discusses the most important legislative processes in which representatives of the KNF were involved.

### 7.1. SELECTED BILLS AND ACTS

#### 7.1.1. Bills

##### **Bill amending the Act on Trading in Financial Instruments and certain other acts**

The bill was submitted in 2011 by the Ministry of Finance. The proposed amendment is aimed to implement into the Polish law the provisions of Directive 2010/78/EU of the European Parliament and of the Council of **24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC** in respect of the powers of the European Supervisory Authority (European Banking Authority), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority), published in OJ L No. 331 of 15 December 2010, p. 120. The Directive is to be implemented on 1 January 2012. The proposed legislative changes primarily concern the exchange of information and cooperation between the Polish Financial Supervision Authority (as the Polish body supervising the financial market) and the European Supervisory Authorities. **Inter-ministry consultations regarding the bill were held until the end of 2011. It should be noted that, at the request of the Ministry of Finance, the original draft of the bill was prepared by the KNF.**

##### **Bill amending the Act on Trading in Financial Instruments and certain other acts**

The bill is aimed to initiate a legislative process to implement a new method of settling transactions, which would allow a clearing house to step in and replace any party to a transaction (settlement novation). The bill was prepared in connection with the Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (EMIR) and will allow KDPW\_CCP SA and Polish clearing houses to meet the requirements set forth in the proposal for this regulation for entities authorised to settle derivative transactions concluded outside organised trading. Due to the fact that the EMIR draft stipulates the obligation to settle certain OTC derivative transactions (standardised transactions that may be cleared) for clearing houses that meet elevated settlement security guarantee requirements, the proposed changes are necessary to enable Polish entities to offer these types of services. The draft agreed with concerned capital market institutions will probably be submitted for parliamentary review as an MP proposal. The KNF worked with KDPW SA to streamline the provisions, in particular with respect to the civil law structuring of the settlement novation mechanism.

## **Draft assumptions to the bill on insurance and reinsurance activity**

The bill submitted by the Ministry of Finance is aimed to implement Directive 2009/139/EC, which introduces new provisions concerning solvency of insurance companies, based not only on quantitative but also qualitative criteria. Furthermore, the Directive stipulates the introduction of a supervision regime based on risk assessment, while considerably modernising supervision of insurance groups. Upon conducting inter-ministry consultations, the Ministry of Finance, in view of the points raised by the participants of the legislative process, decided to prepare a new version of the bill.

## **Bill on the central register of vehicles and central register of motorists**

The bill prepared by the Ministry of the Interior and Administration included, among other things, introduction of regulations that provide for ongoing registration of civil liability insurance agreements for possessors of motor vehicles in the central register of vehicles and continued access to that data for authorities responsible for ensuring the fulfilment of the obligation to take out insurance. The regulation was designed to help avoid sanctions for vehicle owners who had concluded the relevant insurance agreements but drove without proper insurance documentation. At the Council of Ministers Committee stage, the KNF raised a number of comments regarding the draft to streamline its wording. The bill was not pursued any further in the legislative process.

## **Bill amending the Act on Compulsory Insurance, Insurance Guarantee Fund and Polish Motor Insurers' Bureau, as well as certain other acts**

In 2011, the KNF participated in the parliamentary process regarding the above bill. The bill involved introduction of a number of changes streamlining the functioning of the mandatory insurance market, which included granting principals rights to avoid instances of double insurance coverage and, thus, double premium payments, and resolving numerous concerns arising from the act (such as the legal consequences of misrepresented risk statements). The act was enacted by the Sejm on 19 August 2011. The Act enters into force on 11 February 2012, save for: Article 1.65 and Article 10 (concerning the earnings of the Insurance Guarantee Fund and the Fund's balance surplus), which entered into force 14 days after announcement, Article 1.50 and Article 8 (concerning charges for failure to conclude a mandatory insurance agreement), which entered into force on 1 January 2012.

## **Bill amending the Criminal Procedure Code**

The bill submitted by the Minister of Justice stipulated introduction of the "novation security" for the claims of a party injured in a car accident in cases where criminal proceedings are pending concerning offences against road safety. If the party at fault is likely to be found liable, the court (or the prosecutor in preliminary investigation proceedings), at the request of the injured party, would adjudicate an "advance" on future damages. To the KNF's knowledge, the bill has not yet been referred for further legislative review.

## **Cooperative Bill**

The bill sets out the issue of establishment, organisation and activities of cooperatives. The bill is to set forth the rights and obligations of cooperative members and the principles of operation of the governing bodies, management, vetting of organisational transformations and discontinuation of a cooperative. The bill sets forth the principles of appointing and organising cooperative unions and the Polish Cooperative Council, as well as the principles of supervising cooperatives and cooperative unions. The bill was reviewed by Sejm committees until the end of 2011.

## **Bill amending the Act on the Bank Guarantee Fund<sup>10</sup>**

The amended Act on the Bank Guarantee Fund of 14 December 1994 (consolidated text: Journal of Laws of 2009 No. 84, item 711, as amended) stipulates the establishment of a special stabilisation fund within the Bank Guarantee Fund. The stabilisation fund would be the Bank Guarantee Fund's own dedicated fund. The role of the stabilisation fund will be to support efforts to maintain the financial stability of the banking sector. Its resources would primarily be allocated towards indirect financing of certain initiatives of the State Treasury that involve supporting banks, undertaken pursuant to the Act on the State Treasury's Support to Financial Institutions of 12 February 2009 (Journal of Laws of 2009, No. 39, item 308, as amended) and the Act on Recapitalisation of Certain Financial Institutions of 12 February 2010 (Journal of Laws of 2010, No. 40, item 226, as amended). The source of financing for the stabilisation fund would be provided by the prudential fee imposed on banks. The draft was submitted for inter-ministry consultations on 9 December 2011.

## **Bill amending the Act on Investment Funds**

The draft amendment to the Act is designed to implement Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS IV Directive) and its implementing provisions: Commission Directive 2010/44/EU implementing Directive 2009/65/EC of the European Parliament and of the Council as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure and Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company. The Ministry of Finance is working on the bill.

## **Bill assumptions for the Reverse Mortgage Act**

Reverse mortgage is a brand new product on the market. The essence of reverse mortgage is that, in exchange for the right to the borrower's property after his death, a credit institution (bank, branch of a credit institution or branch of a foreign bank) pays him a certain amount of money. The amount of the loan may be paid in instalments over a period specified in the agreement or as a lump-sum payment. Funds thus obtained may be allocated towards any purpose. The basis for calculating the amount of the loan is the market value of the property, as estimated by a property valuation expert. The borrower may terminate the agreement at any time upon three-month's notice. He is also authorised to withdraw from the agreement without a cause, within 30 days from its conclusion, and if the borrower fails to observe the provisions of the agreement, the credit institution may call upon him to remedy the breach within 30 days. On 17 October 2011, the bill assumptions were adopted by the Committee of the Council of Ministers. The work on the draft is still under way.

## **Bill amending the Act on Settlement Finality in Payment and Securities Settlement Systems and the Principles of Supervising These Systems, the Act on Certain Types of Financial Collateral and the Bankruptcy and Corporate Recovery Law**

The bill is aimed to implement into the Polish legal regime Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims (OJ L 146 of 10 June 2010). As regards the Act on Settlement Finality, the amendments primarily concern including formal arrangements regarding settlements in the definition of a payment system

---

<sup>10</sup> Version of 8 December 2011.

and a securities settlement system, introducing the definition of an “interoperable system”, amending the definition of institutions that may participate in payment systems or securities settlement systems by including investment firms, amending the definition of foreign bankruptcy proceedings and expanding the powers of the President of the National Bank of Poland in the event of reasonable suspicion that an entity is operating a system without proper authorisation. The fundamental change in the Act on Certain Types of Financial Collateral is the introduction of credit claims as a category of assets securing a claim (financial claim). As a result of the above changes, the subject matter of some of the provisions of the Bankruptcy and Corporate Recovery Law was expanded.

### 7.1.2. Acts

#### **The Act Amending Certain Acts Related to the Operation of the Social Security System of 25 March 2011 (Journal of Laws of 2011, No. 75, item 398)**

The main objective of the amendments was to slow down the growth of public debt by reducing the cost of implementing pillar 2 by shifting a portion of the pension contribution from pillar 2 to the Social Security Office, changing the open-end pension fund investment limits and offering tax incentives for additional pension savings.

The Act amended legal acts affecting the scope of powers of the Polish Financial Supervision Authority, such as:

- the Act on the Organisation and Operation of Pension Funds of 28 August 1997 with respect to: broadening the subject matter of the activity of a universal pension fund company (UPFC) by enabling the establishment and management of open-end and voluntary pension funds, defining the terms of operation of voluntary pension funds offering individual pension security accounts and individual pension savings accounts, amending the terms of concluding pension fund participation agreements, prohibiting client acquisition activity with respect to open-end pension funds, amending the terms of conducting client acquisition activity and performing disclosure obligations of pension funds,
- **the Act on Individual Pension Savings Accounts of 20 April 2004 - by introducing the option for customers to open individual pension security savings accounts (IPSSA), defining the tax implications related to IPSSAs by stating that contributions to IPSSAs would be deducted from the PIT base up to the amount set forth in the Act.** Furthermore, it introduced the option to accumulate funds in IPSAs or IPSSAs by concluding agreements with voluntary pension funds operated by universal pension fund companies,
- **the Act on Financial Market Supervision of 21 July 2006.**

#### **Act of 28 July 2011 amending the Act on the Organisation and Functioning of Pension Funds (Journal of Laws of 2011, No. 187, item 1111)**

This act fully implemented Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision with respect to the admissibility of managing the funds accumulated as part of fixed benefit-occupational pension schemes operated by foreign employers, through insurance companies, by an employee pension fund managed by an employee pension fund company.

#### **Act of 19 August 2011 on Payment Services (Journal of Laws of 2011, No. 199, item 1175)**

The Act implements into Polish law Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market (the PSD Directive). It provides a uniform legal foundation for the provision of payment services and

conduct of business in this area. It defines a fixed group of payment service providers, such as banks or savings and loan associations. It also introduces a new category of payment service providers, being payment institutions whose operations are supervised by the KNF upon obtaining a permit, whose grant is contingent on fulfilment of prudential requirements. As a consequence of Poland applying national regulations as permitted by Article 26 of the PSD, the act also permits regulated activities in the area of payment services, conducted by payment service bureaus. Activities of payment service bureaus conducted only on the domestic market and subject to fulfilment of less strict statutory requirements is limited with respect to the scope of services provided and the turnover, and, as in the case of payment institutions, is supervised by the KNF.

#### **Act of 19 August 2011 amending the Banking Law and the Consumer Loan Act (Journal of Laws of 2011, No. 201, item 1181)**

The Act amended the Banking Law of 29 August 1997 (Journal of Laws of 2002, No. 72, item 665, as amended) with respect to provisions governing the terms and procedure applied by banks in outsourcing banking activities to third parties (bank outsourcing), by broadening the list of activities that banks may outsource without authorisation from the KNF or through limited introduction of sub-outsourcing regulations. Moreover, with a view to eliminating construction-related doubts, the bill broadens the group of entities covered by the definition of entrepreneur given in the Banking Law.

#### **Act of 29 July 2011 amending the Banking Law and certain other acts (Journal of Laws of 2011, No. 165, item 984)**

The amendment introduces measures that allow borrowers concluding mortgage-backed loan agreements to make principal and interest payments directly in the indexation currency. Under the provisions stipulated by the amendment, a mortgage-backed loan agreement, denominated or indexed in a currency other than the zloty, cannot contain provisions that restrict the borrower's ability to obtain currency for the repayment of principal and interest payments directly in the indexation currency, and the repayment cannot result in additional costs to the borrower. The amendment also introduces additional mandatory components of the loan agreement for loans denominated or indexed to currencies other than the zloty (detailed terms of determining the methods and dates for calculating exchange rates under which the amount of the loan, its tranches and principal and interest payments are calculated and the principles of conversion to the currency of disbursement or loan repayment).

#### **Act of 10 June 2011 amending the Banking Law and certain other acts (Journal of Laws of 2011, No. 134, item 781)**

The amendment introduced provisions into the Banking Law to enable transformation of a branch of a credit institution operating in Poland into a Polish joint-stock bank, and set forth the terms, principles and procedures of such transformations. In essence, transformations of such branch offices involve the establishment by a credit institution of a Polish bank in the form of a joint-stock company, on the basis of an existing branch of that institution (by making an in-kind contribution of that branch's assets on the terms set forth in the Act) and does not constitute a company transformation as defined in the Commercial Companies Code of 15 September 2000 (Journal of Laws of 2000, No. 94, item 1037, as amended).

#### **Act of 28 April 2011 amending the Banking Law, the Act on Trading in Financial Instruments and the Act on Financial Market Supervision (Journal of Laws of 2011, No. 131, item 763)**

The act is aimed to implement Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (CRD), adopted by virtue of Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 (CRD II) and Directive of the European Parliament and of the Council of 24 November 2010 amending Directives

2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (CRD III).

The purpose of the act is primarily to implement, in its area of regulation, the provisions contained in CRD II, i.e. Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements and crisis management (OJ L 302 of 17 November 2009, p. 97). CRD II amends the CRD, i.e. Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ L 177 of 30 June 2006, p. 1, as amended), and the CAD, i.e. Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (OJ L 177 of 30 June 2006, p. 201, as amended). The provisions of the CRD and CAD, which establish capital adequacy requirements applicable to credit institutions and investment firms, set forth the principles of calculating own funds and their prudential supervision. For banks, these are implemented in the Banking Law of 29 August 1997 (Journal of Laws of 2002, No. 72, item 665, as amended) and in the resolutions of the Polish Financial Supervision Authority issued pursuant to that act, and for brokerages - in the Act on Trading in Financial Instruments of 29 July 2005 (Journal of Laws of 2010, No. 211, item 1384) and in the secondary legislation issued pursuant to that act. The provisions of CRD II are aimed to enhance the stability and security of the financial market. Any provisions of CRD II that were not included in the bill will be implemented in secondary legislation. Since, thus far, capital adequacy requirements have been applied, the bill in question also contains provisions that specify or add flexibility to existing regulations implementing the CRD and CAD to ensure more accurate and expedient accomplishment of the objective set out in the above directives.

With respect to CRD III, this regulation modified, among other things, the definition of entities linked by capital or organisational structure. It enabled the KNF to define the principles of determining the policy of variable components of the remunerations of persons in managerial positions at banks. Furthermore, the act also requires banks/brokerages to publicly announce the principles of determining remunerations for persons in managerial positions at banks/brokerages and entitles the KNF to order a reduction or discontinuation of payment of certain variable components of the remunerations of persons in managerial positions at banks.

#### **Act of 1 February 2011 amending the Act on the State Treasury's Support to Financial Institutions and the Act on the Recapitalisation of Certain Financial Institutions (Journal of Laws of 2011, No. 38, item 196)**

As a result of amending the Act of 12 February 2009 on the State Treasury's Support to Financial Institutions (Journal of Laws of 2009, No. 39, item 308, as amended) and the Act of 12 February 2010 on the Recapitalisation of Certain Financial Institutions (Journal of Laws of 2010, No. 40, item 226, as amended), the instruments stipulated therein may only be used upon obtaining an affirmative decision of the European Commission on the conformity of state aid with the common market. The ability to obtain support is contingent upon having an effective European Commission decision due to the fact that the European Commission's approval of an aid initiative is issued for a specific period of time. The above amendments consist in modifying the nature of the regulation from temporary to permanent.

#### **Act of 15 July 2011 amending the Act on the State Treasury's Support to Financial Institutions (Journal of Laws of 2011, No. 186, item 1101)**

As a result of amending the Act of 12 February 2009 on the State Treasury's Support to Financial Institutions (Journal of Laws of 2009, No. 39, item 308, as amended), three material

changes were introduced to the act with regard to the options of providing liquidity support to financial institutions:

- the option of extending a State Treasury guarantee for loans taken out by cooperative savings and loan associations and the National Cooperative Savings and Loan Association,
- broadening of the group of financial institutions to include the National Cooperative Savings and Loan Association and enabling the use of all support tools stipulated in the act,
- requiring the Polish Financial Supervision Authority to supervise the compliance by all financial institutions with the terms of their support agreements.

As in the case of banks, the activity of savings and loan associations, due to its similar scope (cooperative savings and loan associations offer products also available in the banking sector, such as loans, deposits, current and savings accounts) and the need for cooperative savings and loan associations to maintain a liquidity reserve, may be exposed to the risk of losing liquidity more so than in the case of other institutions set forth in Article 2 of the Act of 12 February 2009 on the State Treasury's Support to Financial Institutions (payment liquidity standards for banks and liquidity reserves for cooperative savings and loan associations are governed by statute).

#### **The Act of 16 September 2011 amending the Act on Investment Funds and the Corporate Income Tax Act (Journal of Laws of 2011, No. 234, item 1389)**

The act provides for the abandonment of licences for the establishment of closed-end investment funds dedicated to professional investors. Likewise, with respect to such funds, the Polish Financial Supervision Authority will not issue approvals for amendments to the fund's articles of association or a change of the fund depository, and such funds will be subject to supervision by the KNF in the scope of their financial position. The act also stipulates that the selling of certificates by way of a public offering, as well as their admission to trading on a regulated market or an alternative trading facility would require the KNF's approval, given that in such a case a given fund becomes available to retail investors. The process, initiated in 2011, continued in 2011. The act entered into force on 4 December 2011.

#### **Act of 16 September 2011 amending the Act on Trading in Financial Instruments and certain other acts (Journal of Laws of 2011, No. 234, item 1391)**

Under the measure adopted, omnibus accounts are accounts maintained by participants of the settlement and depository system, on which securities not owned by the formal accounts holders are recorded. Omnibus accounts may be maintained, subject to certain restrictions, solely for legal persons or other organisational units seated outside the Republic of Poland and foreign investment firms and banks. It should be noted that previously effective legal measures with respect to the ability of foreign investors to become involved in trading on the Polish market for financial instruments were expensive and complicated as they required a securities account functioning specifically on the Polish market. It significantly hampered further growth of the Polish capital market. Therefore, the essence of omnibus accounts lies in foreign entities' ability to conduct transactions on Polish financial instruments through a foreign depository institution, without having to open an individual securities account in Poland. The new regulations specify not only entities for which omnibus accounts may be maintained but also, among other things, the holders of securities recorded in such accounts, state the time of vesting under the securities and the terms of transmitting the benefits under the securities. It should also be noted that maintaining omnibus accounts for foreign securities depositories and clearing houses (e.g. Clearstream or Euroclear) helps increase the availability of Polish treasury securities to foreign investors, primarily by lowering costs and facilitating access to that market.



## 8. INTERNATIONAL COOPERATION

### 8.1. MAIN AREAS OF ACTIVITY

The priorities of the KNF's international activities in 2011 were shaped by the regulatory processes taking place in the European Union, concerning the design of prudential regimes and institutional solutions to mitigate the risk of a repeated financial crisis. Key initiatives in the area included:

- the CRD IV package - reviewing the capital requirements directive and the draft regulation on capital requirements,
- establishing the European framework for counteracting and managing banking sector crises,
- amendment to the directive on deposit guarantee schemes,
- amendment of the Solvency II Directive, drafting the accompanying second and third tier acts and continuing the preparations for implementing the Solvency II regime in Poland,
- drafting new legal acts governing trading in financial instruments on capital markets.

The KNF undertook a number of efforts to ensure that its views in the above areas were included in the legislative process. This was accomplished primarily by becoming involved in the work of the European Supervisory Authorities. It should be noted that a KNF representative was a member of the management board of the European Insurance and Occupational Pensions Authority. Other major areas of expressing the KNF's views on international affairs included: participating in the work of the European Systemic Risk Board, supporting the Ministry of Finance in its European efforts, and creating a shared host state strategy for CEE Forum members.

Another important task of the KNF carried out internationally was its involvement in the registration process for rating agencies. The KNF's efforts in the above areas will be explained later in the chapter.

#### 8.1.1. Amendment to the CRD Directive (CRD IV)

In July 2011, the European Commission announced the CRD IV package, which, as of 1 January 2013, was to supersede the current provisions of Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions. The draft CRD IV package comprises the directive to be implemented into national law and the regulation that will be applied directly in EU Member States. The draft directive contains, among other things, provisions concerning authorisations for the conduct of the activity of credit institutions, taking advantage of the freedom of business activity, powers of the supervisory bodies in home member states and host member states and the process of supervising credit institutions. Furthermore, the draft Regulation contains prudential requirements for credit institutions and investment firms.

Some of the most important issues proposed by the European Commission, which, in the KNF's view, give rise to some concerns, are: regulations introducing maximum harmonisation, the requirement to establish liquidity sub-groups, and significant reduction of powers of domestic supervisory bodies (including, in particular, with respect to supervising branches) and delegating supervisory powers to the European Commission.

Under the draft regulation, the principle of maximum harmonisation of legislation would be introduced to the European banking law to prevent national regulators and supervisory authorities from applying higher prudential requirements than those set forth in the regulation. The powers to impose more stringent requirements would be delegated to the European Commission. The KNF is concerned about the principle of maximum harmonisation of

banking regulations as the establishment of a rigorous regulatory standard on supervisory policy may jeopardise the stability of national credit institutions due to the disparity between the uniform banking sector regulations and local conditions.

Furthermore, the EC proposes a measure that involves covering almost all powers of domestic regulators with respect to institutions that belong to banking groups with a joint decision-making and binding mediation procedure. Implementation of that change may lessen the effectiveness of supervisory decisions on the national level.

The EC draft also stipulates delegation of powers to monitor the liquidity of branches of credit institutions to the home-country supervisor. The KNF believes that the proposal may result in a loss of control over the branches by local supervisory authorities, and a loss of the capability to respond if the branch poses a threat to the sector's stability in the host state. Therefore, the KNF is in favour of upholding the provision that entrusts the power to monitor the liquidity position of branches to the supervisory bodies of the host state.

Furthermore, a key change proposed by the EC is the need to release credit institutions from the obligation to observe liquidity requirements on an individual basis in the event of meeting specific conditions. In the KNF's view, enforcement of these requirements on a group or sub-group level will not result in increased group liquidity, but merely in liquidity shifts between group members.

In early 2011, working drafts of the directive and regulation were discussed by Member States during the CRD Working Group meetings at the European Commission, and in the latter half of the year - the EU Council's CRD IV working group. Due to Poland's takeover of EU Council presidency as of 1 July 2011, a representative of Poland's presidency team chaired the group's meetings. Members of the working group discussed the entire draft CRD IV package, which enabled Member States to express their views on the EC legislative proposal. The purpose of the discussion was to fine-tune the work of the Danish presidency, immediately following Poland's term, which is expected to work out the compromise version of the CRD IV and CRR in 2012.

### 8.1.2. Cross-border crisis management in the banking sector

In January 2011, the European Commission presented its consultation document entitled "Consultation on technical details of a possible European crisis management framework". The document was intended to present an overview of the measures that would prevent crises in the financial sector. The purpose of the proposed solutions was to ensure that all national supervisory authorities are provided with appropriate tools to identify problems at banks sufficiently early, and are able to respond to counteract the problem deterioration and to support recovery of financial institutions or groups of companies in difficulties. Additionally, the establishment of single rules for the resolution process was proposed. The rules would include measures taken by national resolution authorities to manage the crisis situation at a given bank institution or would facilitate coordinated resolution effort within a group.

Experts of the KNF Office, both in response to the consultations and during the efforts of the working group at the European Banking Authority, pointed to the possible negative effects on the Polish banking sector of the possibility of transferring assets from subsidiaries within a group other than on market terms.

### 8.1.3. Amendment to the Deposit Guarantee Schemes Directive

2011 saw a continuation of negotiations on draft amendment of the directive on deposit guarantee schemes, both during the Hungarian and Polish presidency. During the COREPER meeting held on 17 June 2011, member states adopted a general approach to

the Directive proposal. The compromise text of the EU Council is a considerable departure from the proposal put forth by the European Commission, for instance with respect to ex-ante financing. Furthermore, the Council's text stipulates a broader use of guarantee funds by using them in resolution proceedings.

The European Parliament also undertook parallel efforts regarding the directive by adopting, in mid-June 2011, a report containing measures that differed from the EU Council's proposal, for instance in terms of deadlines for disbursement, amount of ex-ante funds, the option to establish voluntary guarantee schemes and the use of guarantee funds in early intervention efforts. The Polish presidency of the latter half of 2011 made efforts in the form of dialogues (among the European Commission, EU Council and the European Parliament) to arrive at a shared stance. The KNF supported the Ministry of Finance in those efforts.

#### 8.1.4. Solvency II Project

The efforts to implement the Solvency II system carried out in the European Union in 2011 focused on:

- amending the Solvency II Directive (2009/138/EC) with the Omnibus II directive,
- preparing a bill delegated for the Solvency II directive,
- developing binding technical standards and supervisory guidelines for the Solvency II directive and holding formal or informal consultations with the market in that regard,
- preparing a practical implementation of the new regime, among other things, by conducting pre-application processes for internal models, organising the work of supervisory colleges, advising the European Commission on the assessment of equivalency between supervisory systems in non-EU countries and the Solvency II system.

The staff of the KNF Office was involved in the work both at the EIOPA level (working groups on the Solvency II project) and within the European Commission and the European Union Council (by supporting the Ministry of Finance, hereinafter, the "MoF").

Special commitment was required for the work on the Omnibus II directive in connection with Poland's presidency of the European Union Council in the latter half of 2011. The Council's arrival at a shared vision of the draft Omnibus II directive was a success of the Polish presidency, to which the KNF contributed by supporting Poland's Permanent Representation to the EU and the Ministry of Finance (among other things, by co-chairing meetings of the Council's working groups, preparing compromise versions of the draft Omnibus II directive presented to member states by the presidency). At the COREPER meeting held on 28 September 2011, a general approach was adopted, which paved the way for efforts aimed at final enactment of the directive in the European Parliament.

The KNF was also actively involved in working for the European Commission on a delegated (two-tier) bill, in particular by pursuing a re-calibration of the standard formula for the solvency capital requirement (SCR) for catastrophe risk under property and health insurance. As a result of joint efforts of the KNF, MoF and PIU (Polish Insurance Association), the national ratio was lowered in the delegated bill to 0.16 percent of the insurance sum (down from 0.30 percent). In 2012, the KNF will be involved in further efforts in this regard, i.e. the preparation of the draft technical standard that will set forth, among other things, relative ratios and the interdependency matrix for the zones in Poland, which will be used to calculate the capital solvency requirement for catastrophe risk.

At the national level, the KNF Office pursued activities designed to prepare the supervisory authority and the regulated entities to operate under the Solvency II regime, which involved coordinating the QIS5 study, conducting surveys, and organising seminars and meetings with representatives of Polish insurance and reinsurance companies. Particular attention should

be paid to very good working relationships with representatives of the Polish market, developed during the QIS5 study. Among other things, it helped identify irregularities in calibrating capital requirements for the risk of flooding in Poland and inconsistencies or inaccuracies in the methodology of determining technical and insurance reserves and capital requirements.

Due to the Omnibus II directives and the associated amendment of the Solvency II directive, the schedule of legislative works in the European Union was modified. It is expected that the Solvency II system will enter into force on 1 January 2014. However, as early as 2013, supervisory bodies will be required to issue, at the request of insurance companies, decisions on the application of selected provisions of the Solvency II system, such as decisions to approve an internal model for determining the capital solvency requirement. These timelines are expected to be finally confirmed by the enactment of the Omnibus II Directive in 2012.

### ***Fifth quantitative impact study (QIS5)***

In 2010, the fifth quantitative impact study (QIS5) was conducted insurance and reinsurance companies from European Union Member States. The purpose of the study was to assess the impact of the proposed measures of the Solvency II regime on the financial standing and solvency of insurers. In the first half of 2011, the results of the study were analysed and a final report was drafted.

In coordinating the implementation of the QIS5 in Poland, the KNF reviewed, at the turn of 2010 and 2011, the results of the Polish study participants and requested further explanation and supplements. Subsequently, it prepared the Polish report on the QIS5, which it submitted to the EIOPA (European Insurance and Occupational Pensions Authority) on 7 January 2011 (the report was not subject to disclosure).

The KNF also participated in drafting the European report on the results of the QIS5, published by the EIOPA at the beginning of March 2011. Two KNF employees were part of the EIOPA's QIS Task Force. They were responsible for preparing portions of the European report dealing with internal models of insurance companies, reinsurance companies and insurance capital groups, and drafted a chapter on own parameters used in calculating the capital solvency requirement using a standard formula.

The KNF presented an internal report summarising the fifth quantitative impact study at a presidium meeting of the Polish Financial Supervision Authority held on 7 March 2011, while the aggregate results of the QIS5 (both for Poland and Europe-wide) were presented to the Polish participants of the QIS5, first, at a meeting with the presidents of insurance and reinsurance companies held on 17 March 2011, and then with representatives of companies responsible for carrying out the QIS5 on 21 March 2011.

The QIS5 was carried out in accordance with the financial statements prepared as on 31 December 2009. The key findings of the QIS5 study in Poland for all insurance and reinsurance companies are as follows:

- the value of gross technical and insurance reserves calculated in accordance with the principles of Solvency II, compared to the current principles of calculating technical and insurance reserves, decreased by an average of 22 percent,
- the amount of own funds, calculated in accordance with the proposed principles of valuation of assets and liabilities in the Solvency II system was higher than the value of own funds calculated in accordance with the current principles of valuation by an average of 107 percent,
- the capital requirement under the Solvency II regime (i.e. the higher of the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR)) was higher than the current capital requirement (i.e. the higher of the required solvency margin and guarantee fund) by an average of 188 percent,

- 33 insurance/reinsurance companies had permitted own funds to cover capital requirements in the Solvency II regime, and 17 companies did not have permitted own funds to cover capital requirements.

### ***Commencement of efforts to prepare the insurance sector for internal model assessment***

The Solvency II regime enables insurance and reinsurance companies to determine the SCR in accordance with their risk profile and scope of their activity. The set of tools, systems and procedures to help accomplish that is referred to as an internal model. The model should meet a number of rigorous requirements set forth in the Solvency II directive and its application must be approved by a supervisory authority. Verifying and commenting on the model is a complex process that requires highly specialist knowledge of many areas, and the provisions of the Solvency II directive provide relatively little time to complete the process.

In view of its tasks, the KNF has long been taking numerous steps to prepare both the KNF and insurance market entities for the upcoming challenges associated with evaluating and approving the application of internal models. The biggest undertaking in this regard is the commencement of the pre-application process.

The pre-application process is a measure that embraces the above challenges and is an example of voluntary cooperation of insurance and reinsurance companies with the supervisory authority. Its purpose is to ensure better preparation of domestic insurance and reinsurance companies to file their requests for approval of model application. Furthermore, the pre-application process entails numerous benefits, connected above all with early diagnosing of gaps and identification of problem areas concerning the internal model. It also contributes towards accelerating the implementation of internal models and solutions concerning the Solvency II system in companies. Moreover, it provides a possibility to influence the form of the new regulations and to settle interpretation doubts or other issues essential for the Polish insurance market. Finally, insurance and reinsurance companies will be able to acquaint themselves with the expectations of the supervision authority with respect to internal models. In other words, in commencing the pre-application process, the Polish Financial Supervision Authority is continuing its mission to care for a stable functioning and safe development of the financial market, and is attempting to develop a dialogue between the insurance market and the supervision authority.

Choosing to commence the pre-application process in 2011 was the best possible decision in many respects. First of all, it offered sufficient time before implementing the legislative measures of the Solvency II regime. Moreover, many domestic insurance and reinsurance companies reached the appropriate level in their preparation for the new regulations to ensure the best possible use of the initiative. Furthermore, in the case of domestic companies forming part of insurance capital groups, many group guidelines on local implementation of internal models have already been prepared.

The KNF's efforts to conduct domestic pre-application processes had their formal commencement in January 2011, with the publication of the KNF guidelines ("Pre-application process concerning internal models for the purposes of Solvency II. Contents of the pre-application package"). The guidelines specified the contents of the pre-application package, i.e. materials and information that domestic insurance and reinsurance companies must submit to the KNF to commence the pre-application process. Two dates were also stipulated: 30 April 2011, the date of submission of a statement on commencing the pre-application process, and 30 September 2011, the date of submitting the remaining documents. The KNF also published an English version of the guidelines for the convenience of insurance and reinsurance companies forming part of foreign insurance capital groups.

In March 2011, the KNF sent a letter to the management board of domestic insurance and reinsurance companies, informing them of the publication of its guidelines and the benefits of participating in the pre-application process. The assumptions of the Polish pre-application process were also presented at the March meeting of the KNF's management with insurance sector representatives. The KNF also conducted a number of individual meetings with companies interested in the pre-application process, during which construction concerns and problem areas were addressed. In September 2011, the KNF published a document containing answers to 37 frequently asked questions concerning internal models and the pre-application process. Furthermore, the KNF held 34 meetings and 4 seminars on the functioning of an internal model in a given insurance company. It should be noted that the pre-application process garnered considerable attention on the Polish market. As on 31 December 2011, 15 Polish insurance companies (4 in section I and 11 in section II) requested to join the pre-application process. This accounted for 60 percent of the gross premium written market in 2010.

It should be noted that commencement of the pre-application process in Poland is also connected with embracing the expectations of supervisory colleges. Therefore, it was assumed that for domestic insurance and reinsurance companies forming part of foreign insurance groups, the Polish pre-application process is part of a group pre-application process. Group pre-application processes concern group internal models that are to be used to determine the solvency capital requirement for both the group and individual group companies. In its efforts in this regard, and in association with other supervisory authorities, the KNF reviewed the solutions adopted and the method of accounting for the specific nature of the Polish market. In 2011, KNF representatives participated in 11 seminars or study visits (excluding supervisory colleges) for six European insurance groups. The findings of the analyses and the results of the pre-application process efforts were regularly discussed with other supervisory authorities and formed one of the main topics of supervisory college meetings. As part of their efforts in the Polish pre-application process, KNF representatives participated in supervisory college meetings for 9 European insurance groups from 6 countries.

In 2011, KNF representatives were also actively involved in EIOPA initiatives aimed at sharing the experience gained during pre-application processes, streamlining the approach to assessing internal models and joint development of the Solvency II regime. These initiatives were carried out as part of the Internal Models Committee (IMC) at the EIOPA and by participating in Informal Supervisory Meetings (ISM). Participation in the IMC (11 such meetings were held in 2011) enables KNF representatives to include in the European legislation issues of importance for the Polish insurance market identified during the Polish pre-application process. One of these involved presenting a proposal for a consistent interpretation of outsourcing requirements in the context of internal models and commencing a dialogue in this regard with European Commission representatives. The ISM are intended to encourage the sharing of experiences and harmonisation of the approach towards both pre-application processes and internal model assessment. In 2011, KNF representatives participated in all twelve meetings which concerned, among other things, economic scenario generators, modelling certain types of risk (market, credit, reserve and contribution, operational and catastrophe risk), replicating portfolios, benchmark portfolios, validation and pre-application processes. It should be noted that in the above context, the pre-application process is an opinion-sharing platform for the Polish insurance market, the KNF and other supervisory authorities, which may result in improved and more transparent regulations, and thus a more stable and secure financial market.

### ***Preparation of the KNF Office and the industry to operate under the Solvency II regime***

In 2011, the KNF prepared informational materials for insurance and reinsurance companies entitled “The Solvency II Project - status of efforts in the first half of 2011 and proposed future actions”. Amongst other things, it contained a summary of the work completed in the European Union, including a detailed description of amendments to the Solvency II directive, proposed in the draft Omnibus II directive, as well as information on the KNF’s efforts in Poland. A summary of the second half of 2011 will be presented at the beginning of 2012. In June and December 2011, during meetings of the Polish Financial Supervision Authority, semi-annual information on the current initiatives in the Solvency II project and a future schedule was presented.

In 2011, the KNF Office delivered four training events under the CEDUR educational project for representatives of insurance and reinsurance companies, and for its own employees, where the topics included requirements of the Solvency II system, and four seminars under the project funded by the Norwegian Financial Mechanism. In December 2011, the KNF held a seminar to help market companies to submit comments to draft tier 3 acts with respect to reporting requirements for insurance companies to supervisory authorities and public disclosures under the Solvency II regime, submitted for public consultations by the EIOPA.

In December 2011, the KNF sent out a survey to Polish insurance and reinsurance companies asking them to assess their preparedness for operating under the Solvency II regime. Another purpose of the survey is to provide an estimate of the cost incurred by a company in connection with adjusting to operating under the Solvency II regime, including the cost of organisational, staff and technical adjustments. Insurance and reinsurance companies were asked to submit their answers to the KNF by 25 February 2012.

Other efforts aimed at preparing the regulator and the regulated entities to the new reality of functioning under the Solvency II regime included the QIS5 and pre-application processes. This goal was also shared by the KNF’s 2011 efforts that involved: stress tests conducted by Polish insurance and reinsurance companies, risk analyses conducted by those companies with respect to their current activities and evaluation of the status of internal efforts to create and effective management system and conducting own risk and solvency assessments (ORSA), and the KNF’s assessment of Polish insurance and reinsurance companies as part of the Supervisory Review and Assessment process (BION). Detailed information in this regard is set forth in the Insurance Supervision chapter, in the Reporting and Analytical Activity section of this Report.

#### **8.1.5. Drafting new legal acts governing trading in financial instruments on capital markets**

In November 2011, during Poland’s EU Council presidency, the European Parliament and the European Union Council agreed the final wording of the Regulation on short selling and certain aspects of credit default swaps, which is now awaiting publication. Given the many months of negotiations and numerous controversies surrounding the wording of the act, it may be deemed a success on the part of the Polish presidency. Work on other acts that will affect trading in financial instruments was not completed in 2011, but many of them have reported considerable progress in the negotiations. These include: the Regulation on OTC derivatives (EMIR), amendment of the markets in financial instruments directive (MiFID), market abuse directive (MAD) and on undertakings in collective investment (UCITS V), as well as market transparency. As regards the above legislative project negotiated in the EU, the KNF: - provided support in its area of expertise for the Ministry of Finance, which represented the Polish Government in EU inter-institutional negotiations, submitting individual opinions during the public consultations conducted by the European Commission.

The following problem areas were identified: incomplete adjustment of Poland's current settlement infrastructure laws to the framework of the Regulation on OTC derivatives (EMIR), undesirable, from the point of view of supervisory authorities, complexity of the proposed division of MiFID-approved trading platforms, actual regulatory sanctioning of competition disparities between transparent regulated markets and non-transparent platforms organised by investment banks (also the MiFID), threat of lessened credibility of issuers as a result of implementing regulations depriving investors of quarterly financial information (amendment of the Transparency directive), questionable usefulness of regulatory sanctioning of markets designated specifically for small and medium-sized companies with lower disclosure obligations and practical problems with proper calibration of the pan-European criteria of allocating issuers to the small and medium-sized sector (also Transparency).

### 8.1.6. Developing cooperation among host-country supervisors

In 2011, the KNF continued its efforts to strengthen its partnerships with financial supervisory authorities from the new EU Member States. The most important platform for these partnerships is the CEE Forum, an informal forum for supervisory authorities from Central and Eastern Europe. Its primary goal is to enable establishment of common strategies in respect of the various regulatory initiatives launched in the European Union to protect the interests of host states to the greatest extent possible.

The CEE Forum was founded in 2010 at the KNF's initiative. At the beginning of 2011, the partnerships with host states were already yielding results in the form of four Forum candidates being appointed to the management boards of the European Supervisory Authorities (including a KNF representative appointed to the management board of the European Insurance and Occupational Pensions Authority). In the months that followed, Forum representatives managed to secure other strategic positions in the ESA (an employee of the Czech National Bank became the chairman of the Permanent Regulation and Policy Committee at the European Banking Authority, while a KNF employee was appointed chairman of one of the key sub-groups in that committee).

Members of the CEE Forum attempt to coordinate positions later presented in the EU and provide mutual support to ensure favourable regulations which, although drafted and adopted in Brussels, have a significant impact on the condition of the Polish financial sector and the financial security of Poles. Efforts undertaken as part of the Forum are guided by the central principle which is to ensure that host countries have appropriate mechanisms in place to protect the stability of the financial sector in a market dominated by entities owned by foreign financial groups.

In 2011, three high-level CEE Forum meetings were held, during which the parties discussed current EU regulatory projects. 2011 also saw two meetings of CRD IV package experts. In March 2011, supervisory authorities from eight CEE Forum member states issued a joint letter to the European Commission outlining their comments to the liquidity requirements proposed in CRD IV. This subject was also covered in the open letter of the banking supervision chairmen from Poland, Hungary and Bulgaria, published in September in the UK's "The Financial Times". In the last quarter of 2011, efforts were undertaken to draft proposals for detailed amendments to the CRD IV package. In January 2012, the proposal was submitted to the Danish EU Council presidency. Six CEE Forum member states signed the KNF's Chairman's letter.

The CEE Forum also facilitated partnerships under Pillar 2, aimed at experience-sharing (with respect to implementing the methods of assessing adequacy of banks' economic capital) and attempting to identify possible areas conducive to international cooperation. The results of the cooperation would primarily pertain to efforts undertaken in working groups at the European Banking Authority.



### 8.1.7. Supervising rating agencies

In 2011, rating agency registration proceedings were under way in EU member states. Supervisory authorities that formed part of supervisory colleges made joint decisions on the registration of the largest rating agencies (Standard&Poor's, Moody's and Fitch). The colleges were to verify whether the agencies, often branded as responsible for the financial crisis, have introduced solutions which prevent conflicts of interests and ensure a professional and transparent rating process. In the process of transposing supervision to the EU level, an important role was played by the KNF-headed task force of the European Securities and Markets Authority.

## 8.2. COOPERATION AS PART OF THE EUROPEAN FINANCIAL SUPERVISION SYSTEM

As of 1 January 2011, the European Financial Supervision System was launched. Its primary goal is to ensure proper implementation of financial sector regulations in a manner that helps maintain financial stability and guarantees confidence in the financial system as a whole and duly protects the interests of consumers of financial services.

The European Financial Supervision System is composed of:

- the European Systemic Risk Board (ESRB),
- the European Supervisory Authorities (ESA):
  - the European Banking Authority (EBA),
  - the European Insurance and Occupational Pensions Authority (EIOPA),
  - the European Securities and Markets Authority (ESMA),
- the Joint Committee of the European Supervisory Authorities,
- competent member state bodies or supervisory bodies specified in the relevant EU legislation.

One of the key elements in the EU financial supervision reform is the appointment of three European Supervisory Authorities (ESAs) in place of existing committees of European supervisors (CEBS, CEIOPS, CESR). The seats of the newly-established European Supervisory Authorities are located in the locations of the existing committees, i.e. London, Frankfurt and Paris.

Through their guidelines and standards, the European Supervisory Authorities help harmonise the provisions governing the functioning of the financial sector in the EU. They also perform other roles, such as analysing the developments in the financial sector, coordinating stress tests (EBA, EIOPA) or supervising rating agencies (ESMA). They were also given powers to issue decisions binding upon national supervisory bodies during crisis and in cases where a dispute between national supervisors must be resolved in the process of binding mediation.

### 8.2.1. European Banking Authority (EBA)

2011 was the first year of operation of the European Banking Authority, which superseded the Committee of European Banking Supervisors (CEBS).

In 2011, six meetings of the Board of Supervisory Authorities, the most important body of the EBA, composed of representatives of national supervisory authorities, were held. The KNF was represented during each meeting and participated in written procedures. 71 documents (some of them in packages) were presented for the Board's review. Due to it being the first

year of the Authority's operation, a large percentage of those documents concerned the EBA's regulations and internal structure.

The EBA performs a wide range of tasks concerning the banking sector, payment institutions and electronic payments, as well as corporate governance, audits and financial reporting. The key decisions adopted by the Board of Supervisory Authorities of the EBA in 2011 concerned:

- stress-testing a sample of 90 European banks, including Poland's PKO BP,
- preparing the EBA's positions regarding documents setting out the framework of crisis management in the financial sector and a draft CRD IV package,
- adopting a recommendation concerning the establishment by banks of a temporary capital buffer with regard to the risk involved in government securities,
- drafting an implementing draft of the technical standard concerning supervisory reporting and presenting it for public review.

Some of the most important initiatives to be continued by the EBA in 2012 include:

- drafting supervisory and implementing regulations for technical standards arising from the CRD IV/CRR draft;
- efforts associated with crisis management in the banking sector, including possible drafting of technical standards on the basis of an anticipated EC legislative proposal
- conducting another stress test upon completing the process of recapitalisation of banks, under the EBA Recommendation.

## 8.2.2. European Insurance and Occupational Pensions Authority (EIOPA)

In its first year of operation, the EIOPA was involved in two large projects which engaged different groups within the Authority: developing the internal structure and managing the work and continuing to prepare supervisory bodies and insurance companies for the entry into force of the Solvency II regime. Relevant work was carried out within the working groups dedicated to the Solvency II project (FinReq, IMC, IGSRR, IGSC, ITDC). In addition, other EIOPA working groups continued their work.

Some of the most important efforts undertaken by the EIOPA, in association with the Board of Supervisory Authorities (the authority's crucial body), are:

- preparing draft technical standards and guidelines required under the Solvency II draft, with respect to:
  - the structure of the term base risk-free interest rate, counter-cyclical premium, insurance agreement limit, determining the SCR using the standard formula for market risk, symmetrical adjustment of shock depth for share price risk as part of the standard SCR formula, list of local government units whose bonds are underwritten by EU member state governments,
  - internal management and reporting,
  - the policy of modifying internal models, the method of determining the probability distribution function and its consistency with the valuation methodology, use of expert assessments, the rules and tools of validating internal models, usability tests, partial internal models, profit and loss allocation, external models and data, calibration standards, processing of requests for approval of an internal model by supervisory authorities,
- preparing a response to the European Commission request for advice on reviewing the directive on the activities and supervision of institutions for occupational retirement provision,
- conducting first Europe-wide stress tests for the insurance sector in the history of the EIOPA as a new supervisory authority.

A representative of the KNF Office served on the management board of the EIOPA.

### 8.2.3. European Securities and Markets Authority (ESMA)

2011 was the first year in the operations of the European Securities and Markets Authority (ESMA). In that year, 129 documents (some of which were part of packages) were presented for the review of the Board of Supervisory Authorities (key decision-making body, composed of representatives of national authorities). Due to it being the first year of the Authority's operation, a large percentage of the documents concerned the ESMA's regulations and internal structure. However, it should be noted that despite the need to devote more time to organisational matters, the ESMA regularly manages more than ten separate workstreams, and new tasks and problem areas are consistently added. The documents tend to concern specific market participants, i.e. investment firms, UCITS funds, issuers and trading platforms, but in practice they often have cross-sectoral importance (for credit institutions and insurance firms).

As part of the ESMA's 2011 efforts:

- decisions were made with respect to specific obligations of credit rating agencies (CRA) and the method of supervising their activities, which supervision became, as of 1 July 2011, the ESMA's exclusive power,
- the ESMA's position was adopted with respect to accounting for public debt in the financial statements of issuers on the regulated market, prepared in accordance with the IFRS,
- a set of advice for the EC was adopted with respect to implementing regulations for the directive governing the investment policy, obligations and supervision over any undertakings for collective investment other than harmonised funds (UCITS), i.e. the directive on alternative investment fund managers. The Directive is a special act as it introduces micro-level supervisory measures to obtain supervisory insight into macro threats on the markets.

Furthermore, work was carried out with respect to adopting the implementation technical standards (binding upon market entities and supervisory authorities) with regard to: The Regulation on short selling and certain aspects of credit default swaps and the Regulation on OTC derivatives (EMIR).

### 8.2.4. European Systemic Risk Board (ESRB)

The European Systemic Risk Board is responsible for macroprudential supervision of the European financial sector to prevent systemic risks from jeopardising the financial stability in the EU. The ESRB is an element of the European Financial Supervision System, established in January 2011. Its primary goal is to ensure proper implementation of financial sector regulations in a manner that helps maintain financial stability and guarantees confidence in the financial system. One of the ESRB's primary responsibilities is issuing warnings on identified systemic risks and guidelines regarding actions to be taken by competent bodies. The ESRB may issue general or specific warnings and guidelines. Since the inception of the ESRB, representatives of the KNF have been involved in the Board.

## 8.3. ACTIVITIES WITHIN EUROPEAN INSTITUTIONS

Engagement in the work of European institutions represents an important aspect of the KNF Office's activities. Active presence at the EU forum and initiatives designed to ensure that Poland's position is duly reflected in the documents being drafted are necessary to secure adoption of measures favourable to the Polish market. Participation in the EU legislative

process, involvement in the work of expert and working groups, as well as contributing to the final shape of the European Commission's legislative proposals - all these efforts help promote solutions favourable from the Polish regulator's perspective. It should be noted that the KNF Office not only provided support to the Ministry of Finance, but also participated in discussions with the European Commission, and maintained continuous communication with the heads of European regulators and central banks.

## 8.4. COOPERATION IN SUPERVISORY COLLEGES

### 8.4.1. Banking sector

In 2011, the KNF Office participated in 32 meetings of supervisory colleges established by home-country regulators of banking groups which have operations in Poland (including one bank from outside the EU). The meetings were organised by regulators from 13 European countries (Italy, the Netherlands, Belgium, Austria, Portugal, Germany, France, Denmark, United Kingdom, Spain, Ireland and Greece) and from the USA, and involved 22 banking groups. As a result of the participation in the meetings, the KNF Office was able to:

- obtain information on the evaluation of the economic and financial standing and the risk assessment performed by the home-country regulators of particular financial groups which own banks subject to supervision in Poland,
- obtain information on the completed and planned supervisory measures towards particular financial groups,
- obtain information on plans relating to the improvement of the process of information exchange between the regulators,
- initiate and maintain working contacts with regulators from different countries,
- participate in the discussion on the manner of organisation and proceedings of supervisory college meetings and their role in the SREP process,
- perform a joint risk assessment of the supervised groups (assessment by the home-country and host-country regulator),
- obtain information on the role and scope of cooperation with the European Banking Authority (EBA).

Regular exchange of information on the financial standing of the parent bank and all other members of the group helps to precisely identify potential risks connected with the group's individual business areas, which may have an effect on the undertakings operating in Poland. It is especially important in the context of intervention measures undertaken by the KNF Office, acting as the supervisory authority for the Polish banking sector, to ensure security of funds at Polish banks.

Exchange of information and views between the host-country regulators helps to ensure constant monitoring of the quality of assets and the liquidity position, as well as the capital needs of banks forming part of a group.

### 8.4.2. Insurance sector

In 2011, representatives of the KNF Office attended 24 meetings of supervisory colleges of insurance groups (including ING, Allianz, VIG, Uniqua, MunichRe, Aviva, Generali, AEGON, KBC, AXA), with the aim of exchanging information between the regulators engaged in supervision over insurance companies belonging to insurance groups and of evaluating the financial standing of groups and the manner in which they conduct their activities, as well as 11 audits and seminars on internal models, carried out as part of the pre-application process in supervisory colleges. At the supervisory college meetings, the staff of the KNF Office presented overviews of the financial standing and manner of operation of the Polish members of the insurance groups to which the meetings related. In addition, they had an

opportunity to hear similar presentations delivered by other supervisors and take part in discussions about the risk factors and threats associated with the operations of the insurance groups concerned. The experience sharing helped the KNF Office to deepen its understanding of the processes taking place at domestic insurance and reinsurance companies in connection with their membership in insurance groups. The meetings also addressed the readiness of insurance undertakings/groups to operate under the Solvency II regime and certain issues related to internal models.

In 2011, the supervisory college of the PZU Group was established in which the KNF is a group supervisor. The first meeting of that college was held in November 2011.

### 8.4.3. Rating agencies

The KNF participated in the work of each of the three colleges conducting the registration proceedings for the major rating agencies: Standard & Poor's, Moody's and Fitch. In the course of the proceedings, which took approximately a year, a number of issues were identified, which challenged the conformity of the companies from the three groups above with the requirements of the EU regulation on rating agencies. Ultimately, the agencies introduced a number of major internal changes, primarily in terms of managing conflicts of interests with respect to areas such as intra-group relations and the rating process. In the course of the registration proceedings, the KNF issued a decision on the registration of one company from a rating agency group.

## 8.5. COOPERATION WITH FOREIGN REGULATORS

In 2011, the KNF also cooperated with banks and consolidating supervisors with respect to:

- analysis of applications and planned applications for issue of a decision /opinion on approval of the use of statistical methods to assess capital requirements for:
- credit risk (IRB),
- operational risk (AMA),
- market risk, including: delta calculation models used to calculate an equivalent for option contracts entered into on the OTC market, and sensitivity models used to measure underlying positions on trading book instruments to assess the capital requirement for general interest rate risk,
- participation in projects organised by a consolidating supervisor, including participation in an inspection relating to the ICAAP assessment.

## 9. PROTECTION OF FINANCIAL MARKET PARTICIPANTS

One of the statutory objectives behind financial market supervision is to ensure protection of interests of market participants. The KNF's supervisory activities in this respect involve monitoring of market practices on an ongoing basis and intervention measures, focusing in particular on those areas of the regulated entities' operations which are exposed to the risk of law infringement or abuse of rights of non-professional market participants.

The KNF Office monitors market practices by exercising its supervisory powers, which allow it to demand information and clarifications directly from the regulated entities, and by obtaining relevant data on its own. The supervisory activities are undertaken as a reaction to problems identified on the market, and in response to requests for intervention, queries and complaints filed with the KNF.

The tasks performed by the KNF to protect non-professional participants of the financial market include in particular:

- conducting explanatory proceedings following complaints filed by non-professional financial market participants against regulated entities,
- supervision over advertising communication by financial market participants,
- supervision over market practices by financial market participants,
- analytical activities,
- legislative activities,
- educational activities,
- expert and administrative support for the Conciliatory Court at the KNF.

## 9.1. EXPLANATORY PROCEEDINGS FOLLOWING COMPLAINTS

In performance of its task of protecting the interests of the insuring, the insured, holders of rights under insurance policies, pension fund members, banks' clients, as well as small retail investors, the KNF accepts complaints and responds to other individual interventions concerning various irregularities revealed in the operations of the regulated entities. The objections to the operations of such entities, voiced in the complaints received by the KNF, offer a valuable insight into market developments.

The investigation conducted by the KNF concerns the conduct of a regulated entity in the case covered by the complaint. As part of the proceedings, the regulator may decide to take steps intended to establish the facts and legal aspects of the case with a view to applying (if required) supervisory measures and notifying the party concerned of how it can enforce its claims under the applicable laws if the KNF determines that a given dispute arises on the grounds of civil law.

In response to the analysed complaints and in order to counteract the identified irregularities, the KNF exercised a number of supervisory measures aimed at eliminating the practices which infringed on the interests of non-professional financial market participants.

In the period covered by the report, the KNF Office received:

- 3,588 notifications of irregularities in the operations of the banking sector,
- 3,429 complaints against insurance companies, including 222 complaints against life insurers and 3,108 complaints against non-life insurers, as well as 2 complaints regarding brokerage activities and 97 complaints concerning the operations of branches of insurers from the EU-member states,
- 801 complaints alleging irregularities in the operation of open-end pension funds,
- 216 notifications of irregularities in the functioning of the capital market.

In 2011, the KNF received a total of 8,034 complaints from customers of the insurance sector, capital market entities, banking sector entities and open-end pension funds. Compared to 2010, when 8,642 complaints were received in the corresponding reporting period, there was a slight decrease, i.e. by approximately 7 percent, but their subject matter did not differ greatly.

## 9.2. ANALYTICAL ACTIVITIES AND INTERVENTIONS

As part of the measures taken in response to the problems raised in complaints, the KNF performed analytical activities and carried out interventions in different sectors of the financial market, including in particular the following areas (by sector of the financial market):

#### Insurance sector:

- insurance companies' practice with respect to claims adjustment procedures under mandatory third-party liability agreement for possessors of motor vehicles before the deadlines referred to in Article 14.1-14.3 of the Act on Compulsory Insurance, Insurance Guarantee Fund and Polish Motor Insurers' Bureau,
- insurance companies' practice with respect to adjusting claims for floor-related damage,
- one insurance company's practice of computing interest for late payment of damages minus disbursed funeral payments under the Retirement and Disability Pension Act from the Social Insurance Fund, due to identified irregularities, guidelines were issued for the insurance company,
- one insurance company's practice with respect to the terms of fulfilling the obligation to respond to the Insurance Ombudsman by the deadline set forth in Article 29 of the Act on Insurance and Pension Funds Supervision and the Insurance Ombudsman, due to identified irregularities, guidelines were issued for the insurance company,
- one insurance company's practice of refunding a portion of a premium under obligatory civil liability insurance for possessors of motor vehicles in the event of temporary disuse of a vehicle,
- one insurance company's practice of refusing to accept statements of withdrawal from the mandatory third-party liability insurance if the last day for submitting the statement falls on a non-business day,
- one insurance company's practice of creating a black list of vehicles for which the insurance company refused to offer third-party liability and own damages coverage agreements,
- one insurance company's practice of correcting inaccurate valuation of insurance capital fund units,
- ambiguous provisions of the general terms and conditions of own damages insurance offered by one insurance company with respect to the duration of coverage, timing of vehicle inspection and the company's approval thereof, which determines whether the company accepts the liability and offers coverage for the vehicle.

#### Pension fund sector:

- analysis of the practice of certain pension fund companies which involved not entering the names of fund members who filed complaints on transfer lists despite timely and correct submission by such members of proper notices,
- analysis of one pension fund's practice concerning the terms of disbursement of funds accumulated in the account of a deceased member,
- analysis of the terms of transferring funds acquired pursuant to Article 128.1 of the Act on the Organisation and Functioning of Pension Funds,
- analysis of the procedure followed by entities in connection with the amendment of the Act on the Organisation and Functioning of Pension Funds, effective as of 1 May 2011, in terms of regulations concerning transfer fees, including a refusal to accept notices of switching open-end funds on forms applicable before the amendment.

#### Banking sector:

- imprecise provisions of the credit card agreement resulting in a bank collecting charges challenged by its customers,
- one bank's practice of refusing to accept, in the process of reviewing loan applications, online personal income tax forms confirmed by an Official Acknowledgement of Receipt (UPO),
- the issue of security of transactions concluded with PayPass cards and the terms of liability for transactions effected using such cards up to the maximum available limit for these types of transactions by unauthorised parties upon card cancellation,
- one bank's terms of offering long-term financial products to the elderly,

- the terms of offering term deposits and reimbursement of funds upon expiry of the deposit agreement,
- one bank's practice regarding the timing of exercising declarations of will to revoke account authorisations,
- certain banks' practice of applying Article 60 of the Banking Law,
- one bank's processing of loan agreements acquired from another bank under an agreement on the purchase of a block of receivables,
- certain banks' practice of debt collection activities and the terms of charging customers therefor,
- certain banks' practice of replacing damaged Polish legal tender,
- a bank's unreasonable practice of charging a higher margin after security has been provided in the form of mortgage registered for the benefit of the bank,
- one bank's practice of unlawful charging of fees for early repayment of a mortgage loan,
- analysis of certain banks' practice of applying par. 24.4 of Recommendation T regarding repayment of a loan in the currency to which the loan is indexed,
- performance by banks of the requirements of the Act of 29 July 2011 amending the Banking Law and certain other acts.

#### Bancassurance:

- the issue of a bank's unilateral decision to replace one insurance company providing low-contribution insurance coverage with a company other than that specified in the mortgage loan agreement,
- one bank's practice of using ambiguous provisions on offering insurance coverage to a borrower in revolving loan agreements,
- one bank's practice of unlawful verification of the insurance coverage required from customers, which resulted in charging them with the cost of additional insurance agreements concluded by the bank.

#### Capital market:

- one investment fund company's practice of performing the obligation to report changes in the composition of the board of investors to the registry court,
- the issue of the date of execution by an investment fund company of the instruction to repurchase units accumulated in an individual pension savings account (IPSA) in the context of the Act on Investment Funds and the Act on Individual Pension Savings Accounts,
- fulfilment by one brokerage of the obligation to prepare PIT-8C forms for 2010 in a timely manner.

### 9.3. SUPERVISION OVER MARKET PRACTICES BY FINANCIAL MARKET PARTICIPANTS

The monitoring of market practices employed by the regulated entities and directly affecting their clients results from the comprehensive approach to the protection of interests of non-professional financial market participants.

Activities undertaken by the KNF in 2011 were aimed at identifying and eliminating market practices representing a breach of legal regulations or the interests of non-professional financial market participants in a particular area, by employing appropriate supervisory measures, inspiring market self-regulation, or initiating educational activities. Activities undertaken by the KNF in relation to the market practices of regulated entities included in particular:



### 9.3.1. Binding the consumer with an electronic contract form

In 2011, the practice of providing contract forms in electronic format was analysed, i.e. the compliance of financial institutions with Article 384.4 and Article 384(1) of the Civil Code in relation to agreements entered into with consumers within the meaning of Article 22(1) of the Civil Code. The analyses revealed a variety of practices employed by financial institutions in that regard. An opinion of the regulator was issued, therefore, in order to standardize the practices and define detailed principles in compliance with relevant legal regulations. The opinion was provided to trade associations (Polish Banks Association, Polish Insurance Association and the Chamber of Brokerage Houses), pointing out in particular the manner in which financial institutions make contract forms available in electronic format, provide and present information about amendments to the contract form, and ensure that the consumer is afforded sufficient time to decide whether or not they wish to withdraw from the contract after such amendments are made.

### 9.3.2. Uniform complaint handling procedure by financial institutions

An analysis of practices employed by financial institutions as regards the handling of complaints lodged by non-professional participants of the financial market revealed irregularities in the handling of such complaints, and the non-existence of uniform and explicit procedures to be followed by financial institutions when handling complaints lodged by their clients. That, in turn, translated into a constantly growing number of complaints lodged directly with the regulator.

Taking into account the experience of following common complaint handling procedures in EU Member States, the analysis findings and the best practices operated by some institutions present on the Polish financial market, KNF adopted a resolution on *Complaint Handling Principles by Financial Institutions* aimed at ensuring the clarity and transparency of the Polish financial market in that regard.

### 9.3.3. Analysis of bank practices in the organization of promotions and promotional sale of banking services

In result of an analysis of bank practices employed in the organization of promotions, a number of irregularities was identified in the wording of promotional regulations. Some regulations developed by banks included provisions which were incomprehensible and ambiguous, provisions which appeared to meet the statutory description of prohibited contractual provisions, and provisions whose wording appeared to be identical to abusive clauses listed in the register of prohibited contractual provisions.

In response to these findings, activities have been undertaken aimed at improve the wording of promotional regulations by ensuring the banks' appropriate legal supervision of their final provisions.

### 9.3.4. Making the execution of financial service agreements conditional on the conclusion of an agreement concerning another financial service as part of a combined offer

Contract forms available in both the banking and insurance market have been examined in order to determine whether the structure of combined offers involved prohibited contractual provisions or unfair market practices. In addition, the observed selling practices employed by

financial institutions and their agents have been analyzed as well. The examination revealed that the legally doubtful combination of services most often now takes the form of informal practices employed by representatives or agents of financial institutions. Financial institutions were therefore instructed to take efforts aimed at eliminating such incidents, e.g. by adopting an appropriate commissioning system.

#### 9.3.5. Review of practices employed by insurers with regard to the reimbursement of the leasing costs of replacement vehicles following KNF recommendations

In relation to activities undertaken in the previous years with a view to regulating the issue of adjusting losses resulting from the inability to use a damaged vehicle, the practices employed by insurers and complaints lodged in that respect with the KNF and the Insurers' Ombudsman were analyzed in 2011. The analysis revealed that insurance companies in principle admit claims concerning the reimbursement of the costs of leasing a replacement vehicle brought by natural persons not operating a business. Thus, the problem of insurance companies claiming that only entities operating a business were entitled to reimbursement of the costs of leasing a replacement vehicle, and only in individual cases, has been effectively eliminated. Another issue yet to be considered is the reasonability and the amounts of claims.

#### 9.3.6. Making the payment of damages under compulsory fire and accident insurance of buildings forming part of an arable farm conditional on the submission of documents confirming that the claimant owns the buildings

It resulted from what the regulator had learned that the holders of arable farms in owner-like possession encountered problems in obtaining damages under the compulsory fire and accident insurance of buildings forming part of their arable farms. During the loss adjustment procedure, insurers required that the holders demonstrate they were also the owners of such buildings. That prevented holders from taking advantage of legal presumptions related to the holding of arable farms. The opinion issued by the regulator in that regard was provided to 26 insurers, 25 of which accepted the regulator's guidelines. One of the insurers was instructed to modify its loss adjustment procedures, and declared its willingness to comply.

#### 9.3.7. The effect of the death of clients having the status of consumers on their bank account agreements and loan liabilities

In 2011, the regulator analysed the practices employed by a selected group of banks as regards the effect of the death of their clients on bank account and consumer loan agreements. The analysis revealed inconsistencies in the banks' practices in that respect. In addition, an asymmetry was identified in the practices employed by some banks in their response to being notified of the client's death with respect to his or her bank account agreement (in which case funds so far held in the account were in principle turned into a non-interest bearing deposit) and loan agreements (in which case banks in principle continued to charge interest and default penalties; some banks applied statutory or maximum interest rates as from the death of their client).

Considering the findings of that analysis, the Polish Banks Association and the National Association of Cooperative Banks were requested to develop uniform best practices for the

entire banking market as regards the procedure to be followed in such cases in compliance with applicable legal regulations.

### 9.3.8. Other activities related to the elimination of market practices infringing the interests of the clients of financial institutions

These activities were, without limitation, concerned with:

- bank practices related to the surcharging of pay cards with the amounts of transactions entered in the authorization and settlement system by payment card processing centres/merchants;
- the practice of denying bank account access in the event a client fails to acknowledge a statement on having read information required by the MIFID Directive concerning investment products;
- bank practices concerning the cancellation of building society passbooks issued to minors;
- bank practices related to the requirement to grant an irrevocable power of attorney to a bank-appointed legal advisor to act in all matters related to loan security and to negotiate an in-court settlement related to the performance of loan agreements (in the event the agreement is terminated by the bank);
- bank practices related to the execution of bank account garnishment;
- insurer practices consisting in requesting telephone and address details of potential clients without legal cause and without clearly informing those concerned of the fact they are not required to provide such details;
- the practice of wording the general terms and conditions of insurance in a way potentially misleading the reader as to the scope of coverage;
- the practice of making the payment of damages conditional on producing the document confirming the conclusion of an insurance agreement;
- the practice of Segment I and II insurance companies using annexes and errata to the general terms and conditions of insurance, making it difficult for the client to study the contract form in force;
- the practice of Segment I insurance companies related to the manner of receiving statements from clients following the conclusion of an insurance agreement;
- the practice related to the setting of fees charged by insurance companies for the purchase of a life insurance policy with capital insurance funds (Segment I Group 3) in the initial years of the term of an insurance agreement;
- the practice of insurers related to the actual coverage afforded by insurance products offered by way of security for bank loans;
- the practice of adding or removing capital insurance funds in the context of its effect on insurance agreements and consequences for the insured;
- the charging of fees for reminders sent in the event of late payments of insurance premiums.

### 9.3.9. Analysis of the reliability of advertising communication by regulated entities

In order to protect the interests of non-professional financial market participants against unreliable advertising information, the KNF monitored the content of advertising communication by reviewing information and advertising materials published by, at the request of or on behalf of entities regulated by the KNF.

The monitoring was targeted at advertising communications published in selected newspapers and broadcast on selected television channels. Websites maintained by the

regulated entities and popular websites where communications of advertising nature are disseminated were also subject to review. In addition, random checks of advertising and information leaflets of the regulated entities have been performed. Information on irregularities reported by the recipients of financial services was collected as well, including information provided using a form available at the KNF website to report concerns related to the content of advertisements.

The content of advertising communication was analysed in order to establish whether it involved a breach of legal regulations or the interests of non-professional financial market participants, in particular whether advertisements misled the audience at the pre-contract stage.

In 2011, the KNF challenged 5 potentially misleading messages contained in communications advertising financial institutions. The regulator intervened in cases of unreliable information concerning, e.g., the amount of insurance premiums in the case of compulsory civil liability insurance of motor vehicle owners, the costs of additional services offered in relation to bank accounts, and the assessment of service quality.

In the above cases, the KNF took appropriate measures to ensure that the dissemination of inaccurate advertising content was discontinued.

### 9.3.10. Enhanced protection of capital market participants

The postulates presented by the KNF in February 2011 in its report on *Enhancing the Protection of Capital Market Participants* (hereinafter referred to as "Report") have largely been implemented by the KNF Office by drafting relevant amendments to legal regulations. The amendments included, without limitation, enhancement of the liability of persons managing public companies and imposing restrictions on transactions based on confidential information. Appropriate arrangements were proposed to increase transparency of the ATS market and enhance the liability of ATS-listed companies for providing untrue information. It was also pointed out that investment firms were only allowed to transact business to the extent specified in their licence, and that sanctions may be imposed for using the name "brokerage house" without authorization. It was postulated that the *Best Practices of Warsaw Stock Exchange Listed Companies* be amended, and consequently a provision was added on the requirement for issuers to refer to untrue information disseminated on the market. The KNF is currently finalizing works on proposed amendments to the Regulation of the Minister of Finance on current and periodical reports provided by security issuers and the conditions of recognizing the equivalence of information required by the laws of non-EU Member States. The Regulation stipulates a closed catalogue of events related to the issuer's business the occurrence of which results in the requirement to submit a report, while the definition of confidential information requires that reasonably expected events be reported as well. In order to deliver the postulate contained in the report concerning the need to standardize information requirements for issuers, it is expected that the closed report of current reports on the operations of issuers will be replaced with an open catalogue of confidential information selected on the basis of past experience and the guidelines contained in the document entitled *Level 3 - second set of CESR guidance and information on the common operation of the Directive to the market*, published in July 2007. The report also referred to the need to enhance communication with the market and to publish descriptions of cases representing precedents. Information provided after a decision to impose a penalty has been made includes a more detailed description of the case, which allows other market participants to avoid such infringements in the future. The regulator has also commenced works on issuing opinions in particularly complex cases in which certain behaviour is identified as inadmissible in the light of applicable regulations, which should contribute to improving the issuers' compliance with disclosure requirements.

## 10. EDUCATIONAL AND INFORMATIONAL INITIATIVES

### 10.1. EDUCATIONAL INITIATIVES

#### 10.1.1. Training seminars and workshops delivered as part of CEDUR

Implementing the regulator's statutory tasks with respect to financial education, the KNF organized 49 training seminars and workshops in 2011 as part of the CEDUR initiative, addressed to the following groups of participants:

- representatives of regulated entities,
  - representatives of the judiciary and prosecution bodies,
  - local and regional consumer ombudsmen,
  - notaries,
  - teachers of Basic Entrepreneurship,
- attended by the total of nearly 3200 participants.

The seminars were organized in 2011 in continuation of the project launched in the previous year under the CEDUR brand, which contributed to enhancing the positive image of KNF's educational mission and increased target group awareness of the project. CEDUR seminars taught by KNF staff afforded an opportunity to share unique knowledge and regulatory experience and attracted a large number of participants.

The organization of CEDUR seminars contributed to achieving the purpose of regulating the financial market and other tasks imposed on the KNF:

- ensuring proper operation of the financial market (in particular by organising seminars for the judiciary and law enforcement officers, as well as seminars on new market regulations for representatives of the regulated entities),
- ensuring stability of the financial market (in particular by organising seminars on risk management standards: capital requirements for banks, investment firms and - as part of the Solvency II project - insurance companies),
- ensuring protection of the interests of financial market participants (in particular by organizing seminars for local and regional consumer ombudsmen, and workshops for educationalists and teachers of Basic Entrepreneurship).

In a survey, the participants described the seminars as being of high quality, both in terms of content and form. One of the key advantages of CEDUR seminars highlighted by their participants was the opportunity to exchange views directly with the regulator's representatives. Information gained from the survey is also used to plan themes of future educational events addressing the needs of the respondents.

#### 10.1.2. Other direct educational activities

In performance of its educational tasks, the KNF also undertook a number of other activities in 2011 aimed at disseminating and popularizing knowledge on the functioning of the financial market, employing various educational methods: both direct (workshops, lectures, lessons etc.) and indirect (publications, multimedia forms, competitions).

One of the initiatives, which attracted the participation of representatives of financial institutions, government administration and the academic community, was the organization of lectures by outstanding economists:

- Professor Roger B. Myerson (2007 Nobel Prize in Economic Sciences), entitled: *Booms and Busts in the Credit Market: Should Moral Hazard Be Blamed?*- June 4th 2011;
- Professor Myron S. Scholes (1997 Nobel Prize in Economic Sciences, entitled: *Uncertainty and Financial Regulation* - August 30th 2011.

On April 12th 2011, in response to requests received from market participants, the KNF organized a conference entitled: *Reducing Crime on the Capital Market*, focused on identifying possible directions of changes in the prosecution of infringements on the capital market. Discussion panels devoted to the enhancement of prosecution on the capital market and the resolution of court cases related to the capital market provided an opportunity for KNF experts and representatives of the academic community, law enforcement bodies and an organization associating individual investors to share their views. Moreover, conference participants learned about the specific nature of preparatory proceedings concerning capital market crime and combating crime on the capital market from the KNF perspective. The panel also discussed the advantages of establishing a court dedicated to the capital market. During the conference, a free supplement to *Dziennik Gazeta Prawna* was published by the KNF, entitled *Combating Organized Crime*, with articles by KNF experts concerning the manipulation of financial instruments, the mechanisms of financial pyramid schemes, and insider trading.

Another special educational project addressed to school and college students was the participation of KNF representatives in the XV Science Festival. The KNF organized 4 weekend meetings, 13 Youth Club meetings, and 11 festival lessons for primary and middle school students, attended by 742 participants.

In 2011, the KNF participated for the first time in the largest outdoor popular science event in Europe - 15th Science Picnic of Polish Radio and the Copernicus Science Centre. Those visiting the KNF pavilion could play multimedia games devoted to finance, participate in a financial market quiz, and receive a courtesy diploma. The organizers estimate the number of visitors at above 100,000.

### 10.1.3. Indirect educational activities

During the reporting period, the KNF launched an animated miniportal devoted to finance, addressed to primary school grades 1-3 and integrated education teachers, called *Wędrówki Złotówki* ([www.wedrowkizlotowki.pl](http://www.wedrowkizlotowki.pl)). The portal features an animated character named Złoty, visiting various sectors of the financial market represented by their characteristic buildings, e.g. the Warsaw Stock Exchange or the Central Bank. In each of these buildings, Złoty meets a character representing a person working in a particular sector, e.g. a banker or a broker. Listening to their short conversations, illustrated with animated movies, children learn the main concepts and mechanisms in the functioning of the financial market in Poland.

In 2011, the KNF also developed and introduced a *Personal Budget* application - *maFin - Mobile Financial Assistant*, designed to help monitor and analyze personal spending and budget planning, available free to the users of mobile devices.

In 2011, the 2nd edition of the KNF Chairman's Award for the Best Ph.D. Thesis on the theory and practice of financial supervision in Poland was held. Participants in the competition included academic graduates from all over Poland.

In 2011, a "Cross-Sectoral Report on the Functioning of the Polish Financial Market" was published (as part of the *Materials and Studies of the KNF Office series*), as well as a brochure on "Pyramid Schemes and Other Frauds on the Financial Market" (as part of the *Handbook for Consumers of Financial Services series*). The publications are available at the KNF website - [www.knf.gov.pl](http://www.knf.gov.pl).

During the reporting period, an educational publication on voluntary pension savings was prepared as well, published as a supplement to *Wprost* weekly on June 27th 2011.

## 10.2. INFORMATIONAL ACTIVITIES

As part of its information activities, the KNF delivered the following tasks:

- maintained direct contacts with external entities, e.g. through its specialized Information Centre;
- maintained contacts with and provided answers to questions from media representatives;
- presented the positions and results of work of the KNF and the KNF Office to the public;
- informed the public of activities, initiatives and programmes managed by the KNF;
- commented on developments on the financial market.

In 2011, there were 48 967 media publications containing references to the KNF or the KNF Office, including 43 905 publications in the internet (with approx. 34,300 ESPI reports), 4274 in the press (including 480 in regional press), 471 on the radio and 317 on TV. Parallel to cooperation with national media, the KNF also carried out information campaigns targeted at local communities, including 5 releases dedicated to regional media.

As required by the Act on Access to Public Information, dated September 6th 2001 (Dz. U. No. 112, item 1198, as amended) and its accompanying regulation of the Ministry of Internal Affairs and Administration, the KNF is required to publish certain information on the web pages of *Biuletyn Informacji Publicznej* (BIP, Public Information Bulletin) assigned to particular entities, representing an autonomous part of the KNF's on-line service.

In accordance with the Act on Access to Public Information, 84 requests for access to public information were considered in 2011.

The main tool employed by the KNF to provide information is through its on-line service. Information on the KNF acting in the capacity of the financial market regulator presented on the website includes, without limitation: the KNF's statutory tasks and composition, official communiqués of its meetings, description of the organisational structure of the KNF Office, scope of duties of the individual departments, contact details, public procurement announcements, career opportunities, and public warnings. In addition, the website provides general information on the regulated markets, including: an up-to-date list of entities operating in particular markets, financial data and statistics, publications (reports and thematic papers), legal acts, including the EC legislation, and information on the KNF's activities as part of EU institutions.

The website is addressed mainly to those seeking information on the activities of the regulator, as well as data and analyses on the regulated markets.

In 2011, the KNF website received almost 10 million visits.

Cooperating with the media, the KNF follows an open communication policy. Its tasks in that area include, without limitation:

- presentation of positions and results of the works of the KNF and the KNF Office to the public;
- informing the public of activities, initiatives and programmes managed by the KNF and the KNF Office;
- commenting on financial market developments;
- answering questions from media representatives.

In 2011, two aspects were afforded special attention in relations with the media: communicativeness and constantly increasing the role of the internet as a channel of communication. Detailed activities related to cooperation with the media involved:

- information releases;
- press conferences;
- traditional interviews;
- on-line service;
- articles authored by KNF representatives.

## 10.3. COOPERATION WITH THIRD PARTIES

### 10.3.1. Cooperation with financial market participants

Like in the previous year, regular meetings of the KNF Office's senior personnel with representatives of regulated entities and financial trade organisations were held in 2011. They were divided into four thematic groups: the banking sector, capital market, insurance, pensions market, and cross-sectoral issues. The main purpose of the initiative is to improve the standards of communication and cooperation with the market and to facilitate the assessment of satisfaction of all market participants. In the reporting period, the KNF organized 27 "Market Meetings", more than twice as many as in the previous year.

### 10.3.2. Cooperation with the National Bank of Poland

The KNF is engaged in ongoing bilateral cooperation which involves the exchange of information necessary for the central bank and the financial market regulator to perform their respective statutory duties. The National Bank of Poland provides data concerning prudential reporting in the banking sector. The KNF, on the other hand, provides the NBP with data on the capital market and insurance and pension sectors, which is subsequently used by the NBP for the purposes of macroeconomic analyses and reporting to the European Central Bank. The KNF also provides the NBP with data necessary for the assessment of compliance with regard to the banks' mandatory reserves. Their principles of cooperation are laid down in an agreement between the President of NBP and the KNF Chairman under Article 17.2 of the Act on Financial Market Supervision. On January 26th 2011, the parties executed an annex to the agreement concerned with the principles of cooperation and exchange of information. The annex was the result of talks held in 2010 between the National Bank of Poland and the Polish Financial Supervision Authority, and represented the first amendment to the agreement entered into in 2007. The annex included, without limitation, an adjustment of the principles of using prudential reporting data received from the banking sector by the KNF in line with new IT solutions (data replication, downloading from the NBP server); providing access for the KNF to the Reporting Information System web portal on terms reserved for banks (except for the possibility of uploading data into the system); adding detailed provisions concerning the scope of regulatory data the NBP may request in relation to refinancing loans for banks and the manner of providing such information; regulating the issue of access to data kept in the Register of Bank Numbers (EWIB); adjusting the scope of data provided by the KNF from the pension sector and the capital market to amended legal regulations; and implementing higher standards of safe electronic communication between the two institutions.

The KNF also worked with the NBP on the contents of the Reporting Information System and supervisory initiatives pertaining to bank reporting. Eight comprehensive inspections were performed by the KNF to check the correctness of calculating the amount of and transferring mandatory reserves at commercial banks.



### 10.3.3. Cooperation with the Bank Guarantee Fund

The terms of cooperation between the KNF and the Bank Guarantee Fund are laid down in the “Agreement on Cooperation and Exchange of Information between the Polish Financial Supervision Authority and the Bank Guarantee Fund” of June 12th 2008.

During the reporting period, pursuant to Article 4.3 of the Bank Guarantee Fund Act of December 14th 1994, a representative of the KNF Chairman participated in the Fund’s Board meetings. Cooperation between the KNF and the BGF also involved the exchange of information under the above-mentioned agreement, both at the initiative of the KNF and in reply to enquiries submitted by the BGF to the KNF concerning particular banks or issues.

### 10.3.4. Participation in the works of the Inter-Institutional Organizational Structure for Euro Changeover in Poland

In 2011, representatives of the KNF representatives were actively engaged in the works of the inter-institutional organizational structure for Euro Changeover in Poland established by the Council of Ministers in November 2009<sup>11</sup>. In particular, they participated in the following meetings of the various bodies of that structure:

- two meetings of the National Euro Coordination Committee, whose role is to initiate and monitor the activities of administrative bodies related to the preparations to euro changeover in Poland;
- meetings of Inter-Institutional Working Teams for Euro Changeover Preparations in the Republic of Poland, whose works focused in 2011 mainly on contributions to the National Euro Changeover Plan (NPWE). The teams also delivered other important tasks in 2011, in particular:
  - the Working Team for the Financial Sector (ZRSF; a KNF representative is the Team’s deputy leader) held 3 meetings, working on the contribution to the NPWE as well as a supplement to the *Analysis of the experience of other EU Member States which have adopted the euro*. The Team has also reviewed and identified issues related to adjusting the financial sector to accommodate the changeover, characterized by much complexity and requiring appropriate legislative adjustments (interventions).
  - Working Team for Consumer Protection (ZROK, having a KNF representative as its member) held 3 meetings to finalize an extended version of its analysis of currency changeover actions taken by other member states adopting the euro in the area of unfair market practices and dual display of prices (including by financial institutions). The Team has also carried out a comparative analysis on the employment of co-regulation and self-regulation to protect consumers from unreasonable price increases during the changeover (a SWOT analysis). The contribution to the NPWE was supplemented with a detailed time schedule of practical ZROK activities related to consumer protection during preparations to the changeover in Poland. As part of the twinning cooperation (consisting in the sharing of experience by experts from the eurozone) concerning the protection of clients, a schedule was prepared as well as the topics and detailed questions concerning relevant experience.
  - Working Team for Macroeconomics (ZRME, having a KNF representative as its member) held 4 meetings to discuss various analytical studies carried out by the Team (e.g. progress in the preparation of an analysis of market, product and labour flexibility in Poland, or the consequences of the inflow of EU funds on the macroeconomic situation, the level of currency exchange rates, and the prospects of

---

<sup>11</sup> Regulation of the Council of Ministers dated November 3rd 2009 on establishing a National Euro Coordination Committee, a Coordination Board and Inter-Institutional Working Teams for Euro Changeover Preparations in the Republic of Poland (Dz.U. of 2009, No. 195, item 1505, as amended).

meeting the convergence criteria). As part of the euro studies series, the Team published a report, prepared by KNF experts in 2010, on the *Sources of Increased Lending in the Context of Currency Integration. Causes of Lending Booms in Ireland, Spain and Portugal*<sup>12</sup>.

- Working Team for Legislative Alignment (ZDRP) - a KNF Office representative participated in 5 team meetings. The work of the team is oriented towards introducing major changes in the existing legal framework, which must be enacted before the adoption of the common currency in Poland. In 2011, the Team developed a document presenting an analysis of the experience of Member States related to the introduction of the euro, and identified areas requiring legislative amendments in Poland as part of the contribution to the NPWE.
- In October 2011, the Coordination Board appointed a Task Group for Financial Stability, with 3 representatives of the KNF, NBP and the Ministry of Finance each. The Group's objective is to exchange information between the institutions concerned and make arrangements for the identification of potential threats in the financial sector and prevention of excessive increase in lending in the context of currency integration. The advisability of undertaking these tasks results e.g. from the conclusions of the above-mentioned KNF report. In the 3 countries analyzed in the Report, an unsustainable increase in lending and the prices of assets had been observed in the context of a decrease in real interest rates during the preparations and/or after joining the eurozone. In 2011, the Group held one meeting.

#### 10.3.5. Cooperation with the Audit Supervision Committee and the auditing community

The tasks of the Auditor Relations Committee appointed in 2009 include in particular:

- coordination of the KNF relations with auditors;
- developing the principles of relations between the KNF and auditors;
- cooperation with representatives of the KNF in the Audit Supervision Committee;
- making or commenting on proposals for the standardization of legal regulations concerning the relationship between auditors and the regulator;
- organization of periodical meetings with auditors devoted to issues related to the functioning of the financial market;
- initiating meetings with auditors in the event problems are identified such as require the adoption of a common position;
- drafting amendments and issuing opinions on amendments to financial review standards;
- coordination of the works of the KNF related to regulations and guidance concerning financial review on the international forum.

In 2011, the Auditor Relations Committee delivered tasks related to:

- cooperation with KNF representatives in the Audit Supervision Committee for the purposes of materials drafted for ASC meetings;
- commenting on draft guidelines for amending the Act on Qualified Auditors, Their Self-Government, Entities Qualified to Audit Financial Statements and on Public Supervision dated May 7th, 2009;
- commenting on documents received from the Ministry of Finance in preparation to meetings of the EC Audit Regulatory Committee with regard to issues concerning qualified auditors;

---

<sup>12</sup> R. Woreta, R. Sankowski, P. Sepielak, *Źródła narastania akcji kredytowej w warunkach integracji walutowej. Przyczyny boomów kredytowych w Irlandii, Hiszpanii i Portugalii*, Materials and Studies of Office of the Polish Financial Supervision Authority, September 2010; and Europracowania, No. 13/2011, Working Team for Macroeconomics and the Office of the Polish Financial Supervision Authority, November 2011.

- organization of meetings between KNF representatives and qualified auditors reviewing the financial statements of security issuers, banks and firms;
- publication of an Announcement on disclosure requirements in relation to the auditing of financial statements prepared by entities regulated by the KNF;
- publication of the results of an analysis of data related to the auditing of financial statements prepared by regulated entities in the years 2004 - 2009 (except for listed companies);
- commenting on Recommendation H concerning internal bank auditing;
- commenting on the draft Directive amending the Directive on statutory audit of annual accounts and consolidated accounts and EC Regulation on specific requirements regarding statutory audit of public-interest entities.

During the reporting period, issues related to the insurance sector discussed during the meetings of KNF senior management and qualified auditors included:

- the role of the qualified auditor in the financial system, and cooperation between the regulator and qualified auditors;
- areas of risk identified by qualified auditors during the examination of financial statements prepared by firms for the year 2010;
- the experience of qualified auditors in cooperation with audit committees.

### 10.3.6. Cooperation with other institutions

During the reporting period, the KNF cooperated in particular with:

- the Polish Insurance Association (PIU) in the course of conferences organized by the PIU in which KNF employees participated as speakers, and during the works of groups operating as part of the PIU:
  - Accounting Subcommittee, whose tasks include analysing balance sheet regulations applicable to the insurance market, identifying accounting problems, and proposing amendments to relevant regulations; making comments to draft amendments concerning insurance accounting and reporting regulations, and organization of conferences related to accounting and reporting;
  - Audit and Internal Control Subcommittee and Working Group on Developing Standards of Cooperation between Internal and Qualified Auditors;
  - Prevention of Insurance Fraud Committee investigating particular types of fraud and specific phenomena, such as the practices of some loss adjustment firms;
- Polish Association of Brokers and Investment Advisers in relation to the supervision of security brokers and investment advisers;
- National Criminal Information Centre (KCIK) in relation to tasks specified in the KNF regulations under the Act on the Collection, Processing and Disclosure of Criminal Information dated July 6th 2001 (Dz. U. of 2001, No. 110, item 1189, as amended);
- the Ministry of Science and Higher Education (MNiSW) in relation to the requirements of the Act on the Recognition of Professional Qualifications Obtained in EU Member States dated March 18th 2008 (Dz. U. of 2008, No. 63, item 394);
- Accounting Standards Committee, whose tasks include, without limitation, the issuance of National Accounting Standards, commenting on legal accounting regulations, and analysing and commenting on draft National and International Accounting Standards and their amendments.

## 11. KNF OFFICE

The Polish Financial Supervision Committee and its Chairman deliver their tasks through the KNF Office operating under the Charter granted by way of Regulation No. 172 of the Chairman of the Council of Ministers dated November 22nd 2006 (M.P. of November 24th 2006), as amended. The last amendment to the Charter was introduced by way of Regulation No. 107 of the Chairman of the Council of Ministers dated December 28th 2011, amending the Regulation on the Polish Financial Authority Charter (M.P. 2011 No. 118 item 1196) in force since January 1st 2012. The Regulation provided for a new organizational structure of the KNF, presented in Chart 2<sup>13</sup>. Under the amended Charter, the KNF is headed by the KNF Chairman with the assistance of Deputy Chairmen and Directors of organizational units.

The purpose of the amendment was to improve the efficiency of the KNF by speeding up the decision-making process, and improving the allocation of resources and the flow of information, in particular by abandoning the separation into divisions at the KNF Office.

The tasks of KNF organizational units are laid down in organizational regulations adopted by way of a regulation of the KNF Chairman.

---

<sup>13</sup> The KNF organizational structure as on December 31st 2011 is presented in Chart 1.

Chart 1. KNF Organizational Structure as on December 31st 2011

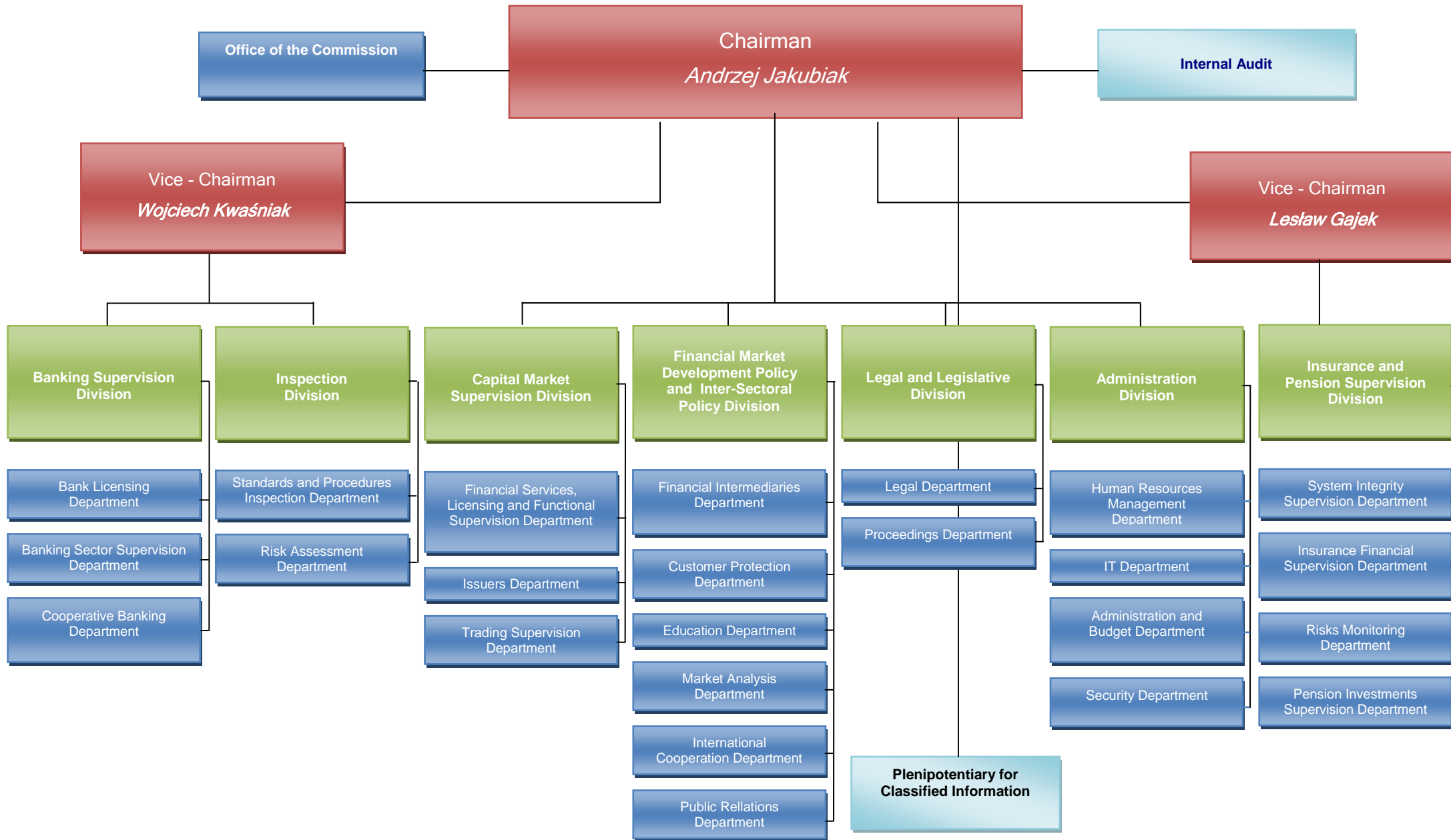
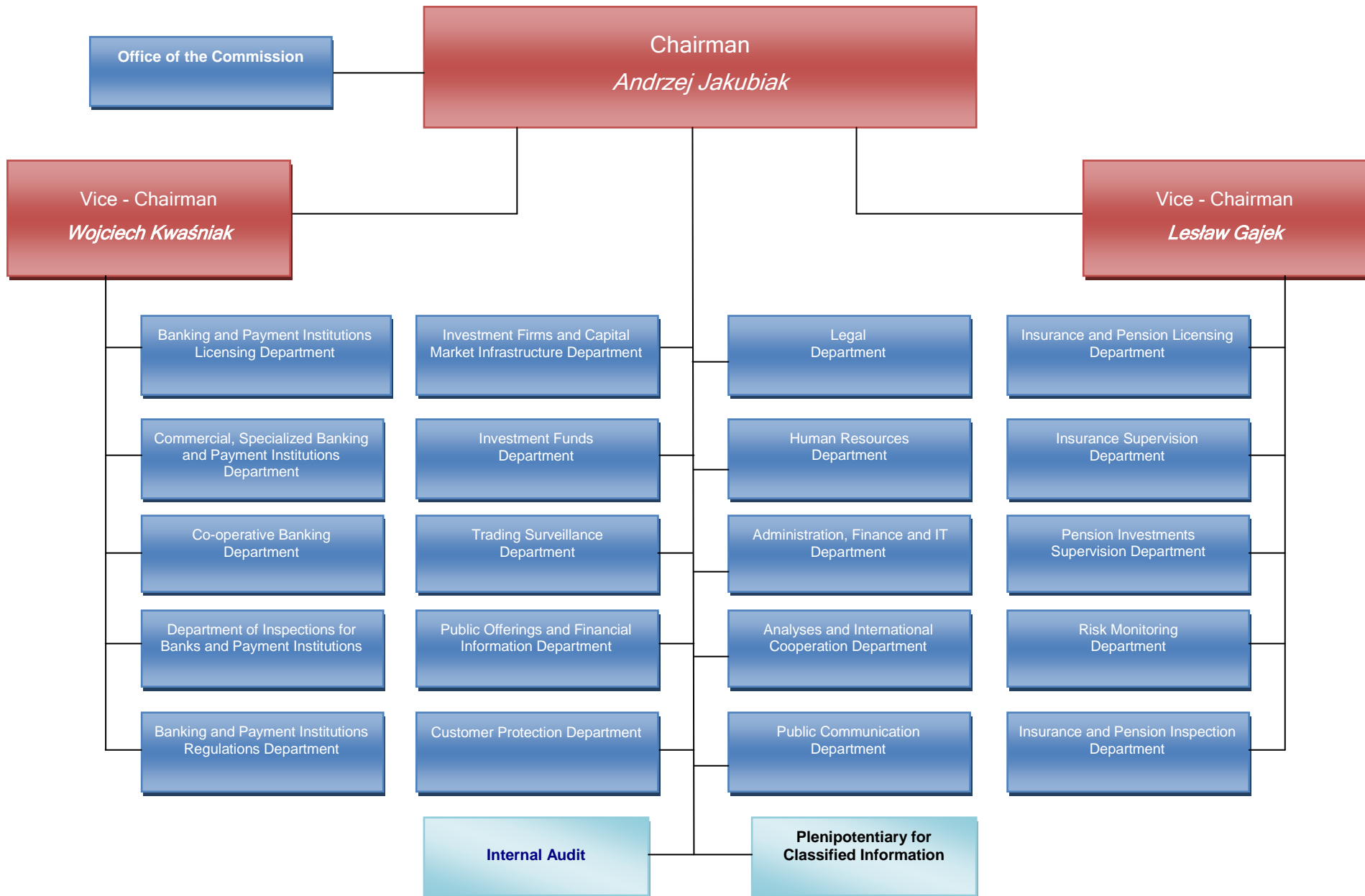


Chart 2. KNF Organizational Structure as from January 1st 2012



## 11.1. BUDGET OF THE KNF OFFICE

The KNF Office is an entity financed from the mandatory payments collected from regulated entities. As a public sector entity, the KNF Office manages its finances in accordance with applicable laws, in particular the Act on Public Finance of August 27th 2009 (consolidated text Dz.U. of 2010, No. 113, item 759, as amended), the Public Procurement Law of January 29th 2004 (Dz.U. of 2004, No. 19, item 177, as amended), the Budget Act, as well as the annual financial plan.

Fees for official duties connected with examinations for brokers and actuaries represent state budget revenue not allocated to cover the costs of supervision. Fines imposed by the KNF Office on regulated entities and on members of their governing bodies for any illegal activity also count towards state budget revenue.

The budget revenue of the KNF Office in 2011 measured on an accrual basis and cash basis amounted to PLN 272,538,446 and PLN 213,695,812, respectively. A bulk of the revenue was derived from payments made by regulated entities to cover the costs of supervision. Fines imposed on regulated entities and paid by them as well as other revenue not classified as costs of supervision totalled PLN 5,073,074.

The expenditure allocated in the 2011 state budget for the KNF's operations amounted to PLN 202,674,000, which was 2.4% more than in the preceding year. The actual spending was PLN 166,678,915, i.e. 18% below the planned amount.

In 2011 the KNF Office continued Project PL0435, named Strengthening of Administrative and Institutional Capacities of the KNF Office in the Area of Correct Implementation of the Community Laws Governing Financial Markets, co-financed with funds from the Norwegian Financial Mechanism. The actual spending from the amount of PLN 716,277 allocated in the 2011 Budget Act was PLN 716,264.

In performance of the Minister of Finance's Regulation on the detailed manner, procedure and deadlines for the preparation of materials for the draft budget act for 2011, dated May 20th 2009, the KNF developed, and submitted to the Minister of Finance, its draft budget for the budget year, prepared in the traditional manner and in a breakdown by activity. Tables 36 and 37 show the KNF's budget expenditure and revenue for 2011 - actual and planned in the Budget Act, with a specification of key expenditure and revenue items versus the corresponding amounts for 2010.

**Table 28. Execution of the KNF Office's 2011 budget revenue plan**

Budget revenue	2010 planned (PLN '000)	2010 actual		2011 planned (PLN '000)	2011 actual (accrual basis)		Planned - 2011 vs. 2010 (%)	Actual - 2011 vs. 2010 (%)
		(PLN '000)	(%)		(PLN '000)	(%)		
1	2	3	4	5	6	7	8	9
Fees towards the costs of supervision over insurance and brokerage activities paid by insurance companies	19,797.0	21,087.3	107	24,321.0	27,950.7	115	123	133
Fees towards the costs of supervision over open-end pension funds paid by pension fund companies	13,858.0	14,675.7	106	16,214.0	18,731.4	116	117	128
Fees towards the costs of supervision paid by the capital market	31,676.0	33,124.3	105	38,508.0	41,058.8	107	122	124
Fees towards the costs of supervision paid by supervised banks	132,643.0	162,598.1	123	123,631.0	178,350.1	144	93	110
Fees for official duties connected with examinations for brokers, actuaries and insurance agents	360.0	502.1	139	350.0	449.7	128	97	90
Fines imposed on the industry	2,500.0	3,656.3	146	4,000.0	5,516.1	138	160	151
Other	45.0	1,332.3	2961	45.0	481.6	1 066	100	36
<b>Total</b>	<b>200,879.0</b>	<b>236,976.0</b>	<b>118</b>	<b>207,069.0</b>	<b>272,538.4</b>	<b>132</b>	<b>103</b>	<b>115</b>

Source: KNF Office

**Table 29. Execution of the KNF's 2011 expenditure plan**

Budget expenditure	2010 planned (PLN '000)	2010 actual		2011 planned* (PLN '000)	2011 actual*		Planned - 2011 vs. 2010 (%)	Actual - 2011 vs. 2010 (%)
		(PLN '000)	(%)		(PLN '000)	(%)		
Payroll, including overheads	113,536.0	110,118.7	97	115,292.9	112,467.5	98	102	102
Non-payroll expenditure	84,438.0	68,066.1	81	87,620.0	54,211.4	62	104	80
including:								
out-of-pocket expenses	48,438.0	44,113.5	91	57,920.0	36,824.6	64	120	83
spending on assets	36,000.0	23,952.5	67	29,700.0	17,386.8	59	83	73
<b>Total</b>	<b>197,974.0</b>	<b>178,184.8</b>	<b>90</b>	<b>202,912.9</b>	<b>166,678.9</b>	<b>82</b>	<b>103</b>	<b>94</b>

Source: KNF Office

\*Excluding expenditure on the Norwegian Financial Mechanism.



**Table 30. Costs of supervision over particular markets in 2011 vs. 2010**

Market	2010		2011		relative to previous year	
	planned (PLN '000)	actual (PLN '000)	planned (PLN '000)	actual (PLN '000)	planned (2010=100)	actual (2010=100)
Capital market	31,676	34,315	38,508	32,899	121.6	95.9
Insurance market	19,797	21,742	24,321	21,563	122.9	99.2
Pension market	13,858	14,713	16,214	14,324	117.0	97.4
Banking market	132,643	107,415	123,631	98,000	93.2	91.2
<b>Total</b>	<b>197,974</b>	<b>178,185</b>	<b>202,674</b>	<b>166,786</b>	<b>102.4</b>	<b>93.6</b>

Source: KNF Office

Pursuant to Article 2.1 of the Act on the Supreme Audit Office, dated December 23rd 1994, performance of the state budget in part 70 - the KNF is inspected annually by the Supreme Audit Office. The results of the inspection, i.e. publicly available information on the inspection results and a post-inspection statement, are published on the website of the Public Information Bulletin of the Supreme Audit Office. Moreover, pursuant to Art. 182 of the Act on Public Finance of August 27th 2009, a report on the execution of the KNF Office's budget, in the form of tables and descriptions, is submitted to the Ministry of Finance, and by the end of the second quarter of each year a report on the execution of the KNF Office's budget is submitted to the Public Finance Committee of the Sejm (lower chamber of the Polish Parliament) and to the Budget and Public Finance Committee of the Senate (upper chamber of the Polish Parliament).

As regards the budget by activity, the KNF performs activities falling in the scope of its statutory tasks, which include ensuring correct operation of the financial market, as well as its stability, security and transparency, building confidence in the financial market, and protection of the interests of its participants. The KNF's duties also include supporting the development of the financial market, educating the public on the market's operation, maintaining dialogue with the market participants, and ensuring the market's transparency.

The principal goals to be accomplished by the KNF are as follows:

- ensuring security of funds in bank accounts,
- ensuring that insurance companies meet the legal requirements relating to licensing and authorisation in order to protect the interests of the insured and insuring parties,
- ensuring that activities of universal pension fund companies and open-end pension funds comply with applicable laws and are consistent with interests of pension fund members,
- improvement of investors' security and higher involvement of the general public in capital investments,
- promote the understanding of financial market's operation and institutions.

The Polish Financial Supervision Authority singled out four sub-activities in function 4 and 1 sub-activity in function 17, to which for 2011 it allocated PLN 167,502 thousand out of the planned amount of PLN 203,629 thousand. The KNF Office's budget by activity is presented in Table 39.

**Table 31. State budget expenditure by activity (part 70 - the Polish Financial Supervision Authority) in 2011 (PLN '000)**

No.	Function/activity/sub-activity	Planned		Actual
		2011, as per the Budget Act	as amended	
4.	Management of public finances	202,674	202,913	166,786
4.4.	Supervision over the capital, insurance, pension and banking markets	202,674	202,913	166,786
4.4.1.	Supervision over capital market entities	38,508	38,918	32,899
4.4.2.	Supervision over insurance companies	24,321	24,664	21,563
4.4.3.	Supervision over the pension market	16,214	15,945	14,324
4.4.4.	Banking supervision	123,631	123,386	98,000
17.4.3	Project implementation as part of the EEA Financial Mechanism and the Norwegian Financial Mechanism	470	716	716
	<b>Total (functions 4 and 17)</b>	<b>203,144</b>	<b>203,629</b>	<b>167,502</b>

Source: KNF Office

## 11.2. HUMAN RESOURCES MANAGEMENT

The staffing level in accordance with the 2011 Budget Act was 906 FTEs. As on December 31st 2011, the KNF had 895 FTEs, with the average staffing level of 904 throughout the year. In 2011, the KNF recruited 90 persons and laid off 86 persons, which resulted in a turnover rate of 9.73%, compared to 7.1% in 2010.

**Table 32. Staffing level at the KNF Office in 2008-2011**

Item	2008	2009*	2010	2011
Average staffing level throughout the year	812	891	902	904
Staffing level at year end	827	918	898	895

Source: KNF Office

\*In the employment plan provided for in the 2009 Budget Act, the number of FTEs at the KNF was increased by 60.

The priority tasks delivered in 2011 by the KNF in the area of human resources management included the implementation of an *Integrated ERP Enterprise Management System*, and the launch of an *Employee Portal*. The purpose of implementing the *Integrated ERP Enterprise Management System* was to provide a comprehensive IT tool supporting management processes by enabling effective planning, organization and monitoring of the workflow in human resources management processes.

In 2011, as part of activities aimed at improving employee qualifications, a series of highly specialised training sessions was organised in response to the requirements voiced by the particular organisational units of the KNF Office. To meet the staff expectations as fully as

possible, all training programmes were prepared based on relevant guidelines and detailed descriptions of programme assumptions, consulted with relevant experts and approved by the management of the organisational units which proposed subjects for the training programmes. During the year, trainings on 80 subjects were organized, including 12 e-learning sessions available to all employees. Group training processes were supported by individual training courses, with the total of 494 participants in 2011, including 390 in domestic and 104 in international trainings sessions.

The intensity of 2011 training is illustrated by the ratio of 4.6 training man-days, i.e. 37 hours of training, per employee. The number of training courses in 2011 was comparable to the previous year. Like in 2010, parallel courses were delivered as part of the Norwegian Financial Mechanism.

### 11.3. CONSTITUTIONAL TRIBUNAL JUDGEMENT ON THE CONSTITUTIONALITY OF REGULATIONS LEAVING KNF EMPLOYEES OUTSIDE OF THE CIVIL SERVICE

At the trial of June 9, 2011, the Constitutional Tribunal heard the application submitted by the Ombudsman concerning the constitutionality of regulations resulting in the employees of the KNF being left out of the corps of civil servants (File Ref. No. K 2/09). In its judgment of June 15th 2011, the Constitutional Tribunal ruled that the challenged regulations, i.e. Article 10.3 and Article 74.2 and 74.3 of the Act on Supervision over the Financial Market of June 21st 2006, are compliant with Article 153.1 of the Constitution. The Tribunal pointed out that pursuant to Article 153.1, organs of government administration employ civil servants, but resolved that in the light of statutory regulations the Polish Financial Supervision Authority is a special body of public administration, enjoying a high degree of independence, situated outside of government administration structures. KNF officers come from various segments of the executive (the Council of Ministers, the President, NBP). That means the KNF cannot be considered an organ of government administration within the meaning of Article 153.1 of the Constitution. Consequently, the Tribunal ruled that the provisions of Article 10.3, Article 74.2 and Article 74.3 of the Act on Supervision over the Financial Market are compliant with Article 153.1 of the Constitution.

### 11.4. CODE OF ETHICAL CONDUCT FOR KNF EMPLOYEES

Adherence to high ethical standards is essential for the proper operation of all institutions, whether public or private. Given the ethos of civil service, standards of conduct expected of employees of state administration bodies are particularly high and should be adhered to with particular care. The KNF Office has consistently striven to maintain high professional standards, and to exercise its supervision over the financial market in a rigorous and transparent manner. As an important element of that policy, a *Code of Ethical Conduct for KNF Office Employees* was introduced in January 2011.

The preparation of an internal code of ethics was justified in the light of the fact that the KNF Office staff are not part of the corps of civil servants, who are bound by the rules of ethical conduct laid down in a special regulation of the Chairman of the Council of Ministers. A lack of such rules with respect to the employees of the KNF Office could be viewed - from the internal and external perspectives alike - as a lack of due regard to ethical aspects of the organisation's activity - contrary to the objectives pursued in building the KNF Office's organisational culture ever since its inception.

The Code of Ethics consists of 20 principles laid down in a separate document, attached as an Annex to the Regulation of the KNF Chairman. The provisions of the Code of Ethics apply to all KNF employees and contain universal rules of behaviour applicable to all situations related directly or indirectly to their status as KNF employees. The purpose of that regulation is to appropriately guide the behaviour of KNF employees and to formally emphasize the importance of the ethical elements of its functioning. In the Preamble to the Code of Ethics, the close relationship between the ethical behaviour of employees and the mission of the KNF has been highlighted, as well as the key values identified in the strategy the KNF Office has adopted.

Following consultations among the employees of KNF, the Code of Ethics was announced by way of a Regulation of the KNF Chairman and has been in force since January 10, 2011.

Irrespective of the ethical principles laid down in the Code, certain new organizational arrangements have been made related to the functioning of the Code of Ethics at the KNF. These included the appointment of an Ethics Committee and an Ethics Officer. The Ethics Committee is a body representing the employer in matters related to ethics. It is headed by the Legal Department Director. The Ethics Officer is elected from among the employees through universal and direct voting for a term of two years. The tasks of the Ethics Officer include communication of ethical standards to KNF employees, as well as providing explanations and answers to questions received from employees. Any disputable issues or doubts related to the ethical principles adopted by the KNF are settled by the Ethics Officer in cooperation with the Ethics Committee. In March 2011, a universal and direct election was held among the KNF employees, resulting in the election of Ms. Kinga Bryl as the Ethics Officer for a term of two years.

## 11.5. INSPECTIONS BY EXTERNAL BODIES

In 2011, two inspections were carried out by the Supreme Audit Office at the KNF to:

- examine the execution of the state budget in 2010;
- review *Selected Aspects of Security in the Financial Sector*.

Following the audit carried out on January 10th - March 31st 2011, the Supreme Audit Office issued a positive opinion on the execution of the state budget for the year 2011 as regards Part 70 - Financial Supervision Authority. The *Selected Aspects of Security in the Financial Sector* review commenced on July 18th 2011 has not been finished by the end of this reporting period, but the audit report provided in January 2012 contains a positive overall assessment.

## ANNEXES

### PUBLICATIONS AND STUDIES PREPARED BY THE KNF OFFICE IN 2011

No.	Title	Date
<b>Banking sector</b>		
1.	Examination of Risks Involved in Foreign Currency Mortgage-Secured Credit Exposures	3 February 2011
2.	Econometric Analysis of Demand for Loans in the Polish Economy	16 February 2011
3.	Banks Dependent on Foreign Financial Institutions - Selected Aspects of Financial System Stability in CEE Countries	22 February 2011
4.	Databases of the Real Estate Market in Poland - Main Findings of an Analysis Carried out by the KNF	8 April 2011
5.	Execution of the Banks' 2010 Financial Plans and their Financial Plans for the Year 2011	29 April 2011
6.	Transborder Banking - a Legal and Economic Study	3 June 2011
7.	Results of an Analysis on Housing Loans taken out by Households	7 September 2011
8.	Materials Prepared for a Presentation for the Polish Financial Supervision Authority Chairman for the 4th European Forum of Cooperative Banks and SMEs	26 September 2011
9.	Macroeconomic Results of Higher Capital Standards: A Simulation Analysis for Poland	29 September 2011
10.	Information on CRD IV and the possibility to include share funds in own funds prepared for KNF Deputy Chairman W. Kwaśniak	26 October 2011
11.	Crisis Management at Large Transborder Bank Corporations	15 November 2011
12.	Lists of quarterly reports on Economic and Financial Indices submitted by cooperative banks to associating banks	16 November 2011
13.	Presentation: Improving Security on the Housing Loan Market - Supervision Policies	30 November 2011
14.	List of Subordinated Loans Extended to Cooperative Banks and Included in their Supplementary Capitals, submitted on a quarterly basis to the Banking Guarantee Fund	19 December 2011
15.	List of CAEL Ratings Assigned to Cooperative Banks by the KNF, submitted on a quarterly basis to associating banks and on a yearly basis to the Banking Guarantee Fund	30 December 2011
<b>Insurance market</b>		
16.	Report on the Condition of the Insurance Sector After Q3 2010	16 March 2011
17.	The Operation of Foreign Insurance Companies in Poland and Polish Insurance Companies Abroad in the Years 2007 - 2009	22 April 2011
18.	How to Enjoy Your Holidays - Information on Tourist Insurance	10 May 2011
19.	Report on the Condition of the Insurance Sector in Q4 2010	13 May 2011
20.	Report on the Condition of the Insurance Sector after Q1 2011	25 August 2011
21.	Report on the Condition of the Insurance Sector after Q1 and Q2 2011	20 October 2011
22.	Report on the Condition of the Brokerage Market in 2010	16 November 2011
23.	Activities of Insurance Brokers in 2010	16 November 2011
24.	Occupational Pension Funds - Are They Worthwhile?	20 December 2011

25.	Selecting the Form of Occupational Pension Funds - Does It Matter?	20 December 2011
26.	The Employer's Difficult Financial Situation Does Not Have to Result in Closing Down the Occupational Pension Fund	20 December 2011
27.	Annual Bulletin: The Market of Occupational Pension Funds in 2010	22 December 2011
<b>Pension market</b>		
28.	The Market of Open-End Pension Funds in 2010	1 April 2011
29.	Individual Pension Accounts in 2010	10 May 2011
30.	The Financial Standing of Universal Pension Fund Companies in 2010	10 May 2011
31.	Occupational Pension Funds in 2010	26 May 2011
32.	Investment Activities of Pension Funds in the Period March 31st 2008 - March 31st 2011	20 July 2011
33.	The Market of Open-End Pension Funds in Q2 2011	20 September 2011
34.	The Financial Standing of Universal Pension Fund Companies in H1 2011	23 November 2011
35.	Pillar III, or What You Should Know About Pension Savings	20 December 2011
<b>Capital market</b>		
36.	Enhanced Protection of Capital Market Participants	28 February 2011
37.	Compliance of Financial Statements Prepared by Issuers of Securities with IFRSs. Review carried out in 2010.	8 March 2011
38.	Combating Financial Crime (Supplement to <i>Dziennik Gazeta Prawna</i> )	13 April 2011
39.	Report on the review of the financial statements by issuers of securities in the context of their compliance with IFRSs. The review carried out in 2010.	30 May 2011
40.	Information on Marketing in Poland of Shares of Foreign Investment Funds in the Period July 1st - December 30th 2010	7 June 2011
41.	Report on the Financial Standing of Investment Fund Companies in 2010	7 June 2011
42.	What You Should Know About Contracts For Difference (CFDs)	22 June 2011
43.	The Application of UCITS IV From July 1st 2011	30 June 2011
44.	Evaluation of the kdpw_stream System for Compliance with ESCB-CESR Recommendations	2 September 2011
45.	Introduction of Adequate Regulation of Non-Public Closed-End Investment Funds	4 November 2011
46.	Report on the Financial Standing of Brokerage Houses in 2010 and H1 2011	12 December 2011
<b>Cross-Sectoral Studies</b>		
47.	Cross-Sectoral Report on the Functioning of the Polish Financial Market	31 May 2011
48.	Post-Crisis Activities of Financial Supervision	1 June 2011
49.	The Polish Financial Supervision Authority - Five Years of Existence	28 June 2011
50.	An Analysis of Data on the Examination of Financial Reporting by Regulated Entities in the Years 2004-2009 (except for listed joint-stock companies)	1 July 2011
51.	KNF Position on the Rotation of Auditors	4 July 2011
52.	Pyramid Schemes and Other Frauds on the Financial Market - Handbook for Consumers of Financial Services	16 December 2011

Source: KNF Office

## List of tables

Table 1. Major indicators of the performance of insurance undertakings in 2008-2011 (financial data in PLN million) .....	16
Table 2. Net asset value of open-end pension funds as at year end, 2008-2011 .....	17
Table 3. Number of open-end pension fund members as at year end, 2008-2011 ...	19
Table 4. Net assets of occupational pension funds, 2008-2011 (as at December 31st) .....	21
Table 5. Investment performance of occupational pension funds, 2008-2011 (rate of return or percentage index change) .....	22
Table 6. Development of occupational pension schemes, 2008-2011 .....	22
Table 7. Value of assets accumulated in IKEs by type of institution in 2008-2011 ...	24
Table 8. Number of institutions conducting brokerage activities and operating securities accounts in 2008-2011 .....	28
Table 9. Number of client accounts operated by brokerage houses and by banks that conduct brokerage activities in 2008-2011 .....	28
Table 10. Value of assets in client accounts operated by brokerage houses and banks that conduct brokerage activities in 2008-2011 .....	28
Table 11. Rates of return of Warsaw Stock Exchange indices in 2008-2011 (%).....	29
Table 12. Number of instruments traded on the Warsaw Stock Exchange in 2008-2011 .....	29
Table 13. Warsaw Stock Exchange capitalisation at year end in 2008-2011 (PLN million) .....	29
Table 14. Trading volumes on the Warsaw Stock Exchange in 2008-2011 (PLN million) .....	30
Table 15. Data concerning the NewConnect alternative trading system in 2008-2011 .....	30
Table 16. Data on the off-exchange market in 2008-2011.....	31
Table 17. Characteristics of public offerings conducted in 2011.....	33
Table 18. Value and number of public offerings for cash in 2008-2011 .....	34
Table 19. Aggregate costs of investment fund management companies in 2008-2011 (PLN million)* .....	38
Table 20. Indicators of coverage of statutory requirements in 2008-2011 (%).....	46
Table 22. Average capital requirements (in PLN million) and capital requirement coverage ratios at brokerage houses in 2008-2011.....	52
Table 23. Number of current and periodic reports of investment fund management companies and investment funds and of reports from depositaries analysed in 2008-2011 .....	55
Table 24. Number of investment fund management companies undergoing BION assessment for 2011 .....	61
Table 25. Inspection activities conducted by the KNF Office in banks in 2011 .....	65
Table 26. Post-inspection recommendations to banks in 2011 in the area of credit risk .....	66
Table 27. Post-inspection recommendations to banks in 2011 in the area of liquidity risk.....	67
Table 28. Post-inspection recommendations to banks in 2011 in the area of market risk.....	67
Table 29. Post-inspection recommendations to banks in 2011 in the area of operational risk.....	68

Table 30. Post-inspection recommendations for banks in 2011 in the area of capital adequacy.....	68
Table 31. Post-inspection recommendations for banks in 2011 in relation to the process of management.....	69
Table 32. Number and type of proceedings conducted by the KNF in 2008-2011 .....	84
Table 33. Notifications filed in 2008-2011 by type of offence.....	87
Table 34. Indictments filed with courts in 2008-2011, by type of offence .....	88
Table 35. Convictions and conditional discontinuations in 2008-2011, by type of offence.....	89
Table 36. Execution of the KNF Office's 2011 budget revenue plan.....	128
Table 37. Execution of the KNF's 2011 expenditure plan.....	128
Table 38. Costs of supervision over particular markets in 2011 vs. 2010 .....	129
Table 39. State budget expenditure by activity (part 70 - the Polish Financial Supervision Authority) in 2011 (PLN '000) .....	130
Table 40. Staffing level at the KNF Office in 2008-2011 .....	130