



**REPORT ON THE ACTIVITIES
OF THE POLISH FINANCIAL
SUPERVISION AUTHORITY
IN 2010
(short version)**

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Letter from the Chairperson of the Polish Financial Supervision Authority



Having emerged from the financial crisis in 2007-2009, last year the Polish financial market was trying to find a new balance and path for development. At such times, the regulator plays a vital role in creating appropriate conditions to secure the development of financial institutions. This role calls for the use of an array of new supervisory tools, as well as the PFSA Office's internal realignment and outward-looking initiatives, which require cooperation with other institutions, particularly with the Ministry of Finance.

In 2010, the Polish banking sector generated profits which were more than a quarter higher than in the previous year, while its equity exceeded PLN 100bn, having grown by 12% over the year. On the other hand, last year saw the deployment of a number of supervisory measures, including the entry into force of Recommendation T and the implementation of Recommendation S (II), as well as a broad-based stress testing exercise. The Recommendations are aimed to reduce the sector's exposure to credit risk, while alleviating the currency mismatch problem, which should improve the management of loan portfolios and prevent further deterioration in the quality of loans in a longer term. As for the stress testing, it was undertaken with a view to identifying potential sources of threats to the banking sector. Stress tests were run both at the EU level by the Committee of European Banking Supervisors (CEBS) (where they covered one of the largest Polish banks), and – primarily – at the local level, where they covered the largest banks operating on the Polish market.

The year 2010 was relatively favourable for the Polish insurance sector, whose solvency ratios were at safe levels. In general, the sector's financial performance in 2010 improved on the previous year, despite high technical losses sustained by insurance companies as they had to pay compensation for damage caused by inundation and flooding. The preparation of the regulator and insurance market participants for the adoption of the Solvency II regime – a new model of the insurance market supervision based on risk analysis – was taken through further stages, which involved a review of risks identified in the operations of insurance undertakings, a quantitative review, and the introduction of an obligation to perform stress tests.

Last year also saw a new wave of investor interest in the Polish capital market. Public share offerings of significant value were brought to the Warsaw Stock Exchange, including the successful IPOs of Tauron Polska Energia (a power utility), PZU (an insurance company) and the Warsaw Stock Exchange itself. During the year, the PFSA Office deployed an electronic system supporting the supervision of trading on the regulated market, a list of the most common errors and irregularities found in prospectuses was published, and a series of regulatory activities were undertaken in an effort to prepare brokerage houses to the implementation into Polish law of the Markets in Financial Instruments Directive (MiFID).

The scale and complexity of the operations conducted by the entities regulated by the PFSA have reached a level where it was necessary to extend the risk analysis-based supervision to all sectors, and to establish a separate Inspection Division within the existing PFSA Office. Supervision based on risk analysis relies on the supervisory review and assessment (BION) methodology, which determines the intensity of supervisory activities, chiefly inspections. The BION procedure relies on all information available to the regulator, in particular on the information obtained in the course of licensing procedures, communication with owners, reviews of periodic reports, inspections, visits and supervisory meetings, and on information sourced from responses to the PFSA Office's additional enquiries (questionnaires, supervisory requests, surveys, etc.). The BION process makes it possible to apply supervisory measures that adequately correspond to the score assigned to each institution, with a view to improving its position in areas generating excessive risk. The establishment of the Inspection Division will facilitate a more thorough analysis of the risks incurred by financial institutions which operate on different markets but cooperate or have close equity links with one another.

In line with the government plans to reduce the administrative burden imposed on the Polish private sector, the PFSA Office developed a *Package for Reducing Red Tape in the Financial Market*, which was discussed with the regulated entities. The goal behind the package is to simplify procedures to an extent facilitating operations on the financial market and improving the effectiveness of supervision over the financial sector. As part of the package, in 2010 the PFSA Office implemented some of the proposed procedures and launched new channels of communication with the market. The other proposals entail amendments to certain laws and the launch of a legislative process, which the PFSA Office is seeking to initiate.

In 2010, a new EU-wide financial supervision system was taking shape. The PFSA Office was involved in the work on its remodeling. The negotiations led to the adoption of measures enhancing the stability and security of the Polish financial market. When establishing European regulatory institutions, their ability to identify risks associated with cross-border operations was strengthened. At the same time, the powers of local regulators in the area of liquidity and solvency, factors of key importance in ensuring the stability of local markets, were maintained. When putting the new supervisory architecture in place, it was assumed that each crisis, even if its impact is global, has a local source, and that the local level is where the crisis can be averted.

Pursuing its statutory mission of promoting financial education, in 2010 the PFSA organised 74 educational events as part of the CEDUR (Educational Centre for Market Participants) initiative, which attracted a total of over five thousand participants. Moreover, our training centre for supervisors of all financial sectors in countries covered by the Training Initiative for Financial Supervision (TIFS) hosted over 40 representatives of supervisory institutions from 19 states, mainly from Central and Eastern Europe.

Sustainable development and security of the financial market remain, as much as ever, our priority objectives. I am confident that 2011 will foster their pursuit.

Stanisław Kluza

A handwritten signature in black ink, appearing to read 'S.K. - Kluza', written in a cursive style.

Chairperson of the Polish Financial Supervision Authority

Polish Financial Supervision Authority



I. Polish Financial Supervision Authority

The PFSA is a collective body composed of the Chairperson, two Vice-Chairpersons and four members: the minister competent for financial institutions or such minister's representative, the minister competent for social security or such minister's representative, the President of the National Bank of Poland or a Vice-President delegated by him or her, and a representative of the President of the Republic of Poland.

IN 2010, THE PFSA WAS COMPOSED OF:

Chairperson

STANISŁAW KLUZA

Vice-Chairperson

LESŁAW GAJEK

Members:

Representative of the Minister of Finance

DARIUSZ DANILUK

Representative of the Minister of Labour and Social Policy

MAREK BUCIOR

President of the National Bank of Poland or Vice-President of the National Bank of Poland delegated by him or her

PIOTR WIESIOŁEK – Vice-President of the National Bank of Poland – until June 15th 2010

WITOLD KOZIŃSKI – Vice-President of the National Bank of Poland – from June 15th 2010

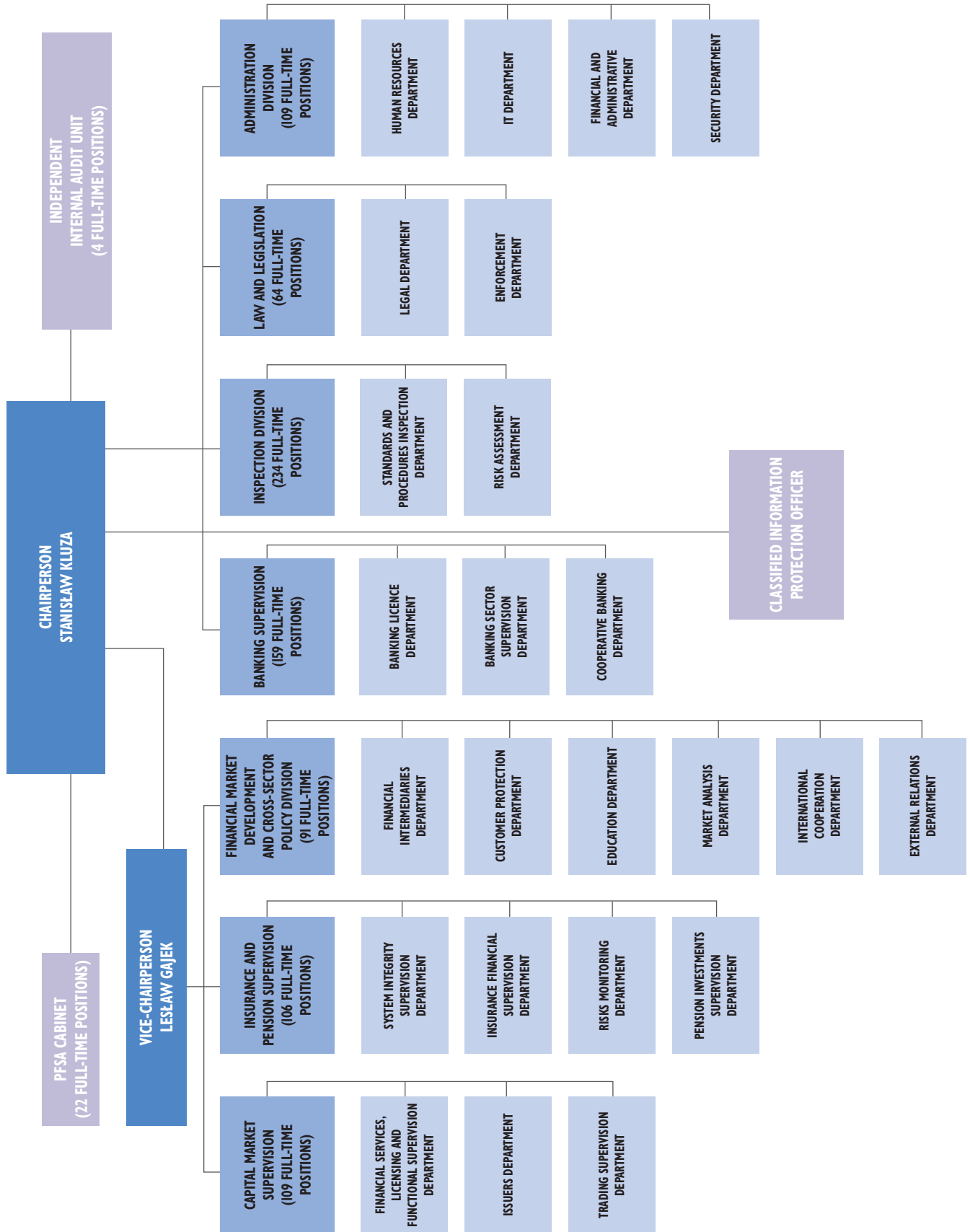
Representative of the President of the Republic of Poland

DANUTA WAWRZYŃKIEWICZ – until August 29th 2010

JERZY PRUSKI – from August 30th 2010

The PFSA and its Chairperson perform their duties through the PFSA Office ("PFSA Office"). The PFSA Office is led by the PFSA Chairperson, aided by Vice-Chairpersons, heads of divisions and heads of organisational units.

Organisational Chart of the PFSA Office



Financial Market in Poland

2

2

2.13

+0.05

+0.78

0%



2. Financial Market in Poland

2.1. Overview

In 2010, the financial markets in Europe felt the ripples of the economic crisis of the previous years, mainly in the form of mounting fiscal problems of some euro-zone members. At the same time, a recovery was underway in the major global economies. The developments in the global economy affected the Polish market mainly through the trade exchange and prices of financial instruments and commodities.

The slow pace of recovery in the euro zone resulted in a low level of demand.

In the post-crisis period, the mutual links between domestic and foreign sectors gained in importance. At the same time, the links between the individual financial market segments in Poland remain relatively insignificant. It should be also noted that in terms of bilateral exposures, the Polish financial system in 2010, as in the previous years, grew extensively and there were no major changes in the intensity and directions of the links existing within the system.

■ TABLE I. ASSETS HELD BY FINANCIAL INSTITUTIONS IN 2008-2010 (PLNBN)

	2008	2009	2010
Banking sector	1,035.4	1,057.4	1,158.0
Cooperative savings and loan associations (SKOK)	9.4	11.6	13.5 *
Insurance sector	138.0	139.1	145.1
Open-end pension funds (OFE)	138.3	178.6	221.3
Brokerage houses	7.2	8.3	9.2 **
Investment funds	73.9	93.4	115.6

* As at the end of September 2010.

** The data for 2010 should be viewed as preliminary data – the financial year of two brokerage houses is defined as the period from April 1st to March 31st. The total asset amount in the table does not include the figures of those brokerage houses.

The banking sector plays a key role in the domestic financial system, which is reflected in the value of its assets and the importance of its links with the non-financial, household and public sectors, resulting from the banks' function as financial intermediaries. The banking sector is also very important due to its balance-sheet links with other financial market segments. For example, an increase of the aggregate balance-sheet total of Polish banks in 2010 (by approx. 9.5%) was connected with, inter alia, an increased exposure of the domestic banks to the securities market.

On the other hand, for insurance companies deposits with local banks are the key instrument used to manage current liquidity and are also a component of their investment portfolio related to certain types of insurance products ("polisolokaty" - term deposits offered as insurance policies, and structured

instruments offered by Segment I entities). In 2010, there was a growing concentration of bank deposits placed by insurance companies, which was caused by the higher risk incurred by the insurance companies using that strategy.

The signs of a declining, albeit at a slower rate, risk aversion were also visible in the domestic equity market. Over 2010, the WIG index grew by 18.77% and outperformed WIG20, the index of the twenty largest companies on the WSE, which increased by 14.88%. To compare, over the previous year, the indices gained 46.85% and 33.47%, respectively. On the other hand, lower market volatility¹ (24.5% on average in 2010 versus 43.3% in 2009) and higher liquidity reflected in the volume of completed trades had a positive effect on the value of the indices. In 2010, the value of trading in equities was PLN 468.6bn against PLN 351.9bn in the previous year.

¹ Implied volatility for 30-day at-the-money options on the WIG 20 index.

2010 was one of the record years as far as the number of public offerings is concerned. The value of public offerings carried out during the year topped PLN 25bn, and was by 82% higher than in 2009. The main reason behind this increase was the more intense activity of the State Treasury in the capital market, which together with Eureko BV sold PZU S.A. shares with the total value exceeding PLN 8bn and carried out two major privatisation offerings: Tauron PE S.A. and Giełda Papierów Wartościowych w Warszawie S.A. - the Warsaw Stock Exchange, valued at PLN 4.2bn and PLN 1.2bn, respectively. Following its share offering, the Warsaw Stock Exchange became another global exchange whose shares are listed on a regulated market.

As the equity market grew strongly, so did the share of equity instruments in the portfolios of open-end pension funds (OFEs), which increased from 30.9% as at the end of 2009 to 36.7% as at the end of 2010. The value of equity investments of open-end pension funds grew over that period from PLN 54.6bn to PLN 80.7bn. The value of all purchases of equity instruments carried out by OFEs in 2010 was higher than the value of the funds' sale transactions. Such balance of purchase and sale transactions in periods of declining stock exchange indices shows that pension funds are using lower valuations to accumulate shares, which is consistent with the long-term investment horizon of OFEs. Pension funds play a major role in the domestic equity instrument market and account for a substantial portion of the demand on the stock exchange. The value of shares held in OFEs' portfolios, measured by a share in the total capitalisation of the WSE, increased steadily and exceeded 10% at the end of 2010.

In the course of 2010, the value of assets under management of investment fund management companies (TFIs) grew by PLN 30.7bn. The net balance of subscriptions and redemptions in the domestic equity investment funds was only PLN 0.3bn in 2010 (compared with a net balance of PLN 9.4bn for all fund groups). The main factor driving the 17.6% growth in the net asset value of equity funds over the year was appreciation of the stock prices of companies listed on the public market. The increased net asset value had a direct effect on the financial result of TFIs through higher management fees, which are charged based on the value of assets under management.

The banking sector is characterised by a low exposure to the risk of price volatility on the equity market. The value of the equity instrument portfolio in the banks' asset structure changed in the course of 2010 from PLN 8.3bn to PLN 11bn, and its share in the balance-sheet total grew slightly, from 3.9% to 4.5%.

Both the value of the equity portfolio of insurance companies (shares, investment fund units and investment certificates) and its share in the total investment portfolio increased slightly in

2010. Insurance companies increased their allocation of assets to equity instruments at a slower rate than OFEs did, and despite the increased weight of equities in their portfolios, the share of this asset class in the investments of insurance sector institutions is almost two times lower than prior to the financial crisis.

The liquidity of the domestic money market improved. As at the end of 2010, the spread between 3M WIBOR rate for interbank deposits and OIS (*Overnight Indexed Swap*²) was 95 basis points against 147 basis points in December 2009. However, medium and long-term transactions are less liquid and the activity in that money market segment has not yet returned to the pre-crisis levels.

Changes in interest rates are an important driver of the profitability of financial market institutions as they affect the value of debt instruments held in their portfolios, the rates of return on new investments, and the revaluation of items of equity and liabilities in the balance sheet; they are also reflected in the cost of financing.

In the case of Polish banks, the direct effect of changes in long-term interest rates, which are usually deemed equivalent to Treasury bond yields, on their profitability is limited. In 2010, the value of debt securities held by banks in their portfolios increased from PLN 227.8bn to PLN 233.2bn, with the value of Treasury bonds in the portfolios totalling PLN 126bn.

In line with the long-term horizon of investments of open-end pension funds, OFEs follow a stable policy on the debt instrument market. 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' performance in the future. The value of OFEs' debt securities portfolio grew in 2010 from PLN 121.9bn to PLN 131.7bn.

For insurance companies, the interest rate risk is one of the key risks, which is due to the nature of such institutions' investment strategy based on fixed-income instruments, especially Treasury bonds. Nonetheless, the changes in interest rates which took place in 2010 were small enough not to have any significant effect on the financial performance of such institutions, while other risks turned out to be more important, including in particular the strictly insurance-related risks. The value of debt securities held by insurance companies fell from PLN 60.5bn as at the end of Q4 2009 to PLN 57.5bn as at the end of Q3 2010.

In 2010, funds investing in PLN-denominated bonds reported net subscriptions of PLN 2.3bn, with the net asset value increasing to PLN 11.5bn. Like in the case of equity funds, the higher asset value translated into higher incomes of investment fund management companies (TFIs).

² A type of an interest rate swap in which the variable interest rate is calculated as the geometric average of interest rates on overnight deposits.

Similarly to investment funds, the OFE sector is closely linked to the capital market, and in line with the requirements of Pillar II of the pension system, debt instruments should constitute the core element of the investment portfolio. OFEs

invest mainly in the Treasury securities market – as at the end of 2010, non-Treasury securities accounted for only approx. 4.5% of the total debt securities portfolio.

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 2010, the value of the banking sector's assets totalled PLN 1,158.0bn, up by 9.5% on 2009, and accounted for 82.0% of Poland's GDP (in 2009: 78.8%). Figure 1 presents key data on the Polish banking sector in 2007–2010.

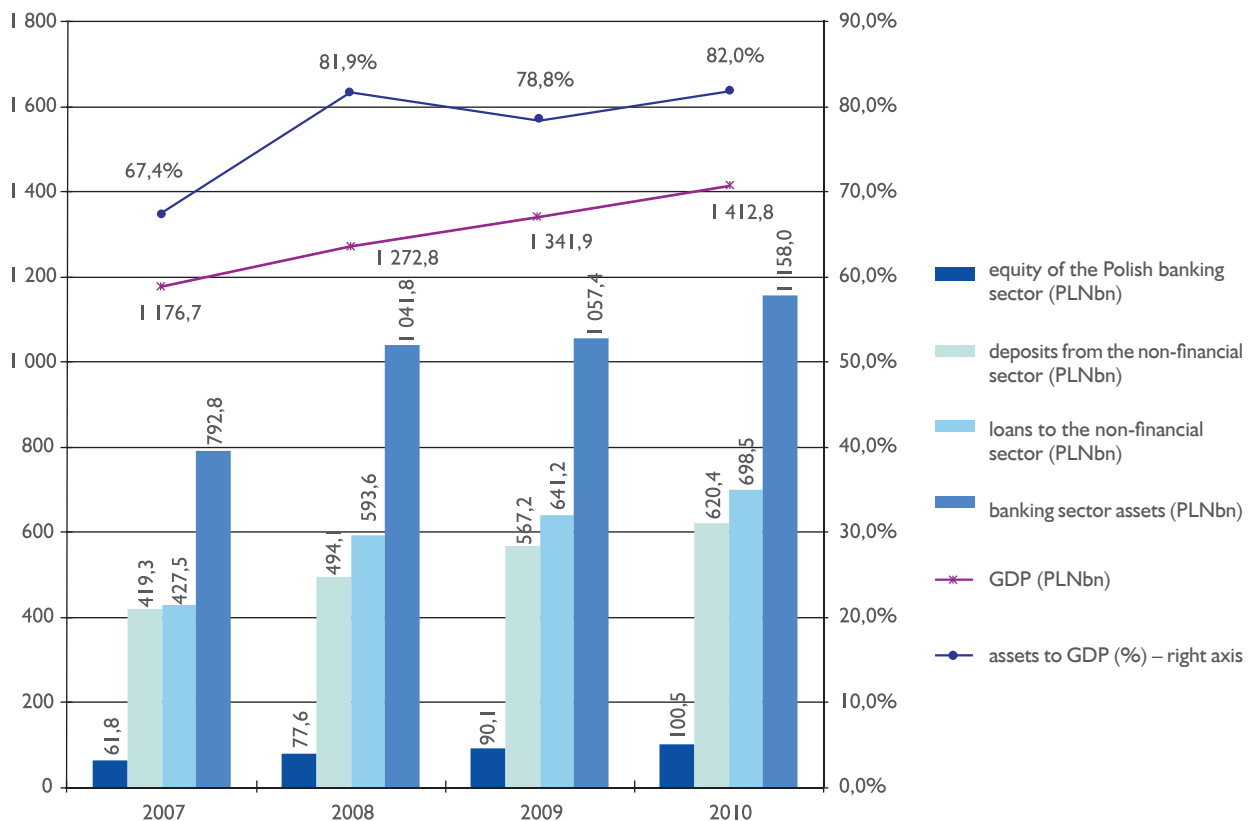
In 2010, the number of commercial banks in Poland was 49 and remained unchanged. The number of branches of credit institutions grew from 18 to 20. The number of cooperative banks did not change and remained at 576.

In the period under review, there were minor changes in the ownership structure in the sector. The State Treasury

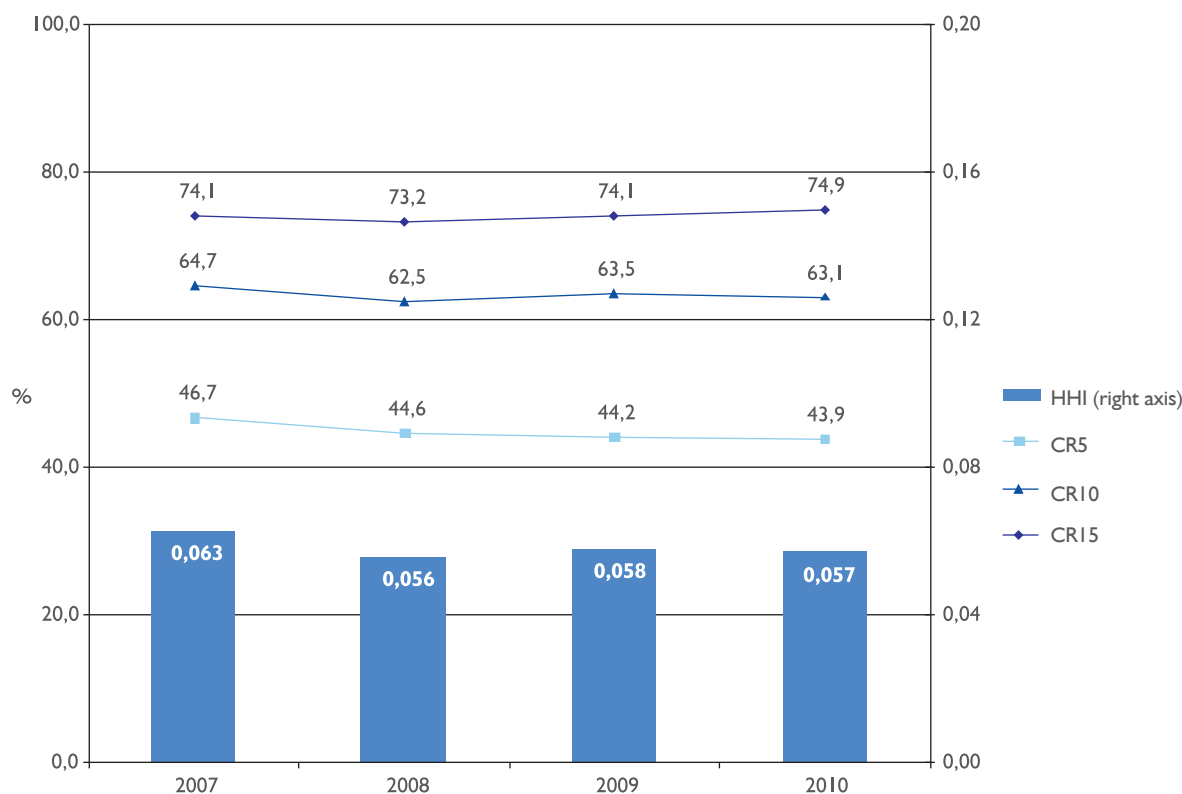
continued to control four banks (including two banks directly), representing 21.5% of the total assets of the banking sector. Foreign financial institutions owned 39 banks and 20 branches of credit institutions, accounting for 66.2% of the sector's total assets. Six private banks with Polish majority owners and 576 cooperative banks accounted for 6.2% and 6.1%, respectively, of the sector's total assets.

Given the concentration of the Polish banking sector, its position is largely driven by the standing of the ten largest banks. As at the end of 2010, the assets of the ten largest banks in Poland accounted for 63.1% of the banking sector's total assets.

■ FIG. 1. HIGHLIGHTS OF THE POLISH BANKING SECTOR, 2007–2010



■ FIG. 2. ASSET CONCENTRATION IN 2007-2010



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

HHI (Herfindahl-Hirschman Index) - a measure of market concentration, specifying the estimated level of concentration in a given industry and the level of competition in a given market; it is 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 banking sector's total assets).

The value of shareholders' equity is a key factor determining the banking system's resilience to the economic cycle, as well as to internal and external shocks. In 2010, shareholders' equity of Polish commercial banks grew by 11.4% (PLN 9.6bn) and of Polish cooperative banks – by 14.6% (PLN 0.9bn). In the period covered by this report, the major source of additional equity for domestic banks was the retaining of the 2009 profit, which was opted for by most of the banks.

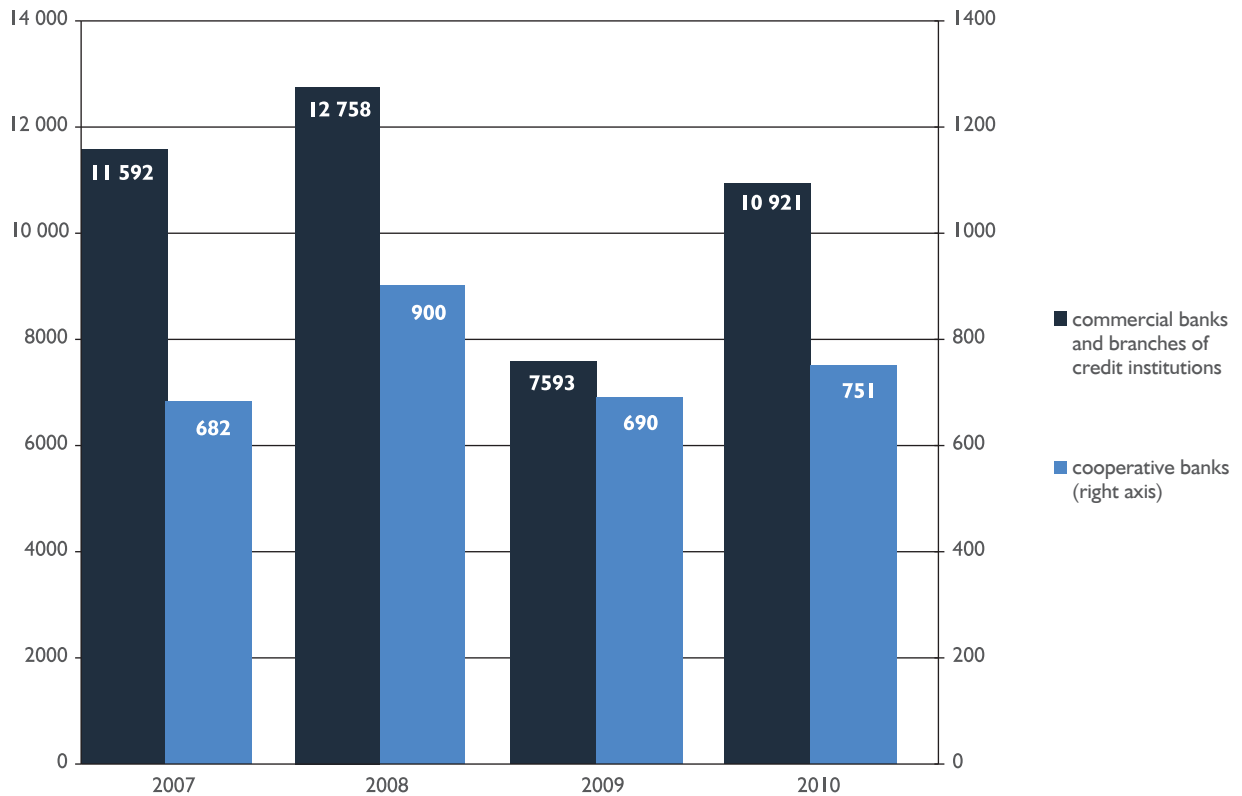
In the period under review, overall net profit earned by the banks was PLN 11.7bn, up by 40.9% relative to 2009. The aggregate net profit of commercial banks and branches of credit institutions went up by 43.8%, while the net result of cooperative banks increased by 8.9% (see Figure 3).

The adequate dividend policy helped preserve the stability of the banking sector. Increased shareholders' equity promoted growth of the entire banking sector and supported new lending. Some banks additionally secured financial backing from their foreign parents (subordinated loans). In 2010, four cooperative banks obtained subordinated loans totalling PLN 10m from a foreign entity. The loan proceeds were allocated to Tier II and Tier III capital, which was approved by the PFSA.

The increase was large enough to cover higher total capital requirements. As a consequence, the average capital adequacy ratio of the Polish banking sector rose from 13.3% as at the end of 2009 to 13.8% as at the end of 2010 (commercial banks: from 13.3% to 13.8%, cooperative banks: from 13.4% to 13.6%), well above the required minimum. In December 2010, solvency ratios at all cooperative banks exceeded the required 8% level.

Receivables from the financial sector were up by 10.8% (from PLN 85.9bn as at the end of 2009 to PLN 95.2bn as at the end of 2010), while liabilities to the financial sector increased by 15.5% (from PLN 253.0bn as at the end of 2009 to PLN 292.1bn as at the end of 2010). The higher negative balance of liabilities to and receivables from the financial sector seen in the recent years stemmed from the rapid development of small and medium-sized banks and branches of credit institutions, which, due to an underdeveloped deposit base, borrowed money on the market or relied on the financing provided by their foreign parents. Some large banks, despite having access to a robust deposit base, used funds obtained on the market to scale up their new lending business and increase market shares. It should be noted that capital funds of non-residents

■ FIG. 3. NET PROFIT OF COMMERCIAL BANKS, BRANCHES OF CREDIT INSTITUTIONS AND COOPERATIVE BANKS, 2007–2010 (PLNM)



were largely sourced from their parent companies (often 50–100% of the funds) and constitute long-term investments. The majority of parent companies declare their readiness to provide additional liquidity and finance growth of their Polish subsidiaries, which helps reduce liquidity risk.

In 2010, the overall growth in the value of loans advanced to the non-financial sector was 8.9% (they grew to PLN 698.5bn), and was a combined effect of a rise in loans to households by 14.2%, to PLN 475.4bn, and a decline in loans to businesses by 1.1%, to PLN 219.7bn.

The value of deposits from the non-financial sector rose by 9.4% (PLN 53.2bn). Overall, clients from the non-financial sector held over PLN 620bn-worth of deposits in bank accounts, including PLN 53.8bn in the accounts held with cooperative banks.

The banking sector remained stable during 2010. Favourable developments in the sector included growing deposit base, especially in Q4 2010, and an increase in the share of PLN-denominated loans in total housing loans. The banks also retained some of their earnings, thereby increasing the value of shareholders' equity. It should be noted, however, that banks were also affected by certain adverse factors, such as deterioration in the quality of the loan portfolio and uncertainty as to the future macroeconomic developments, which resulted in further tightening of the lending policy in certain areas (mainly consumer finance and the SME sector). Combined with a lower demand for loans from some customers (especially large enterprises), those adverse factors led to a slowdown in new lending to businesses.

2.3. Insurance sector

As at the end of 2010, 65 domestic insurance companies held authorisations to conduct insurance activities in Poland (31 life insurers and 34 non-life insurers, including one reinsurer). Three insurance companies are undergoing liquidation (UNIVERSUM Towarzystwo Ubezpieczeń na Życie S.A. w likwidacji (in liquidation), TUW Bezpieczny DOM w likwidacji (in liquidation) and WÜSTENROT ŻYCIE TU S.A. w likwidacji (in liquidation)). The total number of insurance companies remained unchanged on 2009. Medica Polska Ubezpieczenia Zdrowotne TU S.A., an insurer falling within Group 2, Segment II of insurance business classification, obtained an authorisation to conduct insurance activities. Two insurers, HDI Asekuracja TU S.A. and HDI-GERLING TU S.A., merged. The merged company currently operates under the name of HDI Asekuracja TU S.A.

The establishment of a new insurance company, Medica Polska Ubezpieczenia Zdrowotne TU S.A., was a significant event on

the insurance market in 2010. The insurer conducts insurance activities only within the scope of Group 2, Segment II of insurance business classification. The strategic objective of the newly established insurance company is to focus on highly specialised areas and offer only insurance that guarantees services and payments connected with an illness or other medical condition requiring medical treatment in the territory of the Republic of Poland.

As at the end of 2010, 562 insurance companies from the EU and EEA member states submitted notifications of intent to provide insurance services in Poland under the freedom to provide services, while 14 insurance companies and one reinsurer submitted notifications of intent to provide services in Poland through a branch under the freedom to provide services. In 2010, the PFSA received 54³ notifications of intent to conduct cross-border insurance activities from foreign insurance companies and 14 notifications of abandoning insurance activities in the

■ TABLE 2. HIGHLIGHTS OF THE OVERALL PERFORMANCE OF THE INSURANCE SECTOR, 2007–2010 (PLNM)

INCOME STATEMENT HIGHLIGHTS				
	2007	2008	2009	2010
Gross premiums written	43,801.79	59,366.93	51,405.85	54,164.08
Gross claims paid	19,989.15	30,037.57	39,415.45	35,534.04
Net operating expenses	9,014.10	10,166.05	11,244.38	11,591.01
Acquisition cost	6,088.49	7,324.76	8,089.08	8,405.49
Administrative expenses	3,499.26	3,479.40	3,648.12	3,685.23
Balance on technical account	4,700.32	4,182.69	4,070.52	2,303.89
Net financial result	5,306.32	5,794.78	6,641.36	6,742.18
BALANCE-SHEET HIGHLIGHTS				
Investments (item B under assets)	81,251.02	99,642.34	94,047.91	91,824.16
Capital and reserves	32,827.62	35,710.00	29,184.34	30,695.73
Subscribed capital	4,972.29	5,231.59	5,440.62	5,762.00
Gross technical provisions	89,989.66	97,994.14	100,211.62	109,762.63
Total assets	126,965.50	137,994.58	139,068.56	145,121.81
SELECTED FINANCIAL RATIOS (%)				
Net operating expenses to premiums written, net of reinsurance	21.64	18.02	23.29	22.83
Balance on technical account to gross premium written	10.73	7.05	7.92	4.25
Net profit/(loss) to capital and reserves	16.16	16.23	22.76	21.96
Net profit/(loss) to assets	4.18	4.20	4.78	4.65

The 2010 data provided in tables 3, 4 and 5 was derived from quarterly financial statements of insurance companies (unaudited).

³ One insurance company which previously operated as the main branch of a foreign insurer registered in a state outside the EU/EEA territory, submitted a notification of intent to conduct insurance activities through an insurance company branch from the EU/EEA territory.

territory of the Republic of Poland by an insurer registered in a EU member state. Five notifications of intent to conduct insurance activities by domestic insurance companies in the

territory of EU member states and two notifications of intent to abandon insurance activities by domestic insurance companies in the territory of EU member states were also submitted.

2.4. Pension sector

The Polish Financial Supervision Authority supervises the capital part of the pension system, comprising the so-called Pillar II and Pillar III. Pillar II comprises open-end pension funds (“open-end pension funds”, “OFEs”) and pension fund management companies (“pension fund management companies”, “PTEs”), which form a component of the obligatory part of the Polish pension system. OFEs are a special type of legal persons and represent asset estates managed by PTEs, which are also created pursuant to the Act on Organisation and Operation of Pension Funds. Pillar III,

comprising occupational pension funds (PFEs) managed by occupational pension fund management companies (PrTEs), occupational pension schemes (PPEs) and individual pension accounts (IKEs), is another component of the Polish pension system, which is complementary to the obligatory part of the system. Pillar III, in which participation is voluntary, is organised on an institutional basis, unlike other forms of individual accumulation of savings for pension purposes. The development of the market is supported by such incentives as tax exemptions and social security contribution allowances.

2.4.1. Open-end pension funds and universal pension fund management companies

As at the end of 2010, authorisations were held by 14 open-end pension funds and the same number of pension fund management companies managing the funds.

Contributions in the amount of 7.3% of gross pay, which are transferred to OFEs by the Social Insurance Institution (ZUS), are converted into fund units valued on a daily basis. Fund members are not responsible for the liabilities of the pension fund or the pension fund company.

■ TABLE 3. NET ASSET VALUE OF OPEN-END PENSION FUNDS AS AT YEAR END, 2007-2010

OPEN-END PENSION FUND	NET ASSET VALUE (PLNM)				MARKET SHARE (%)
	2007	2008	2009	2010	2010
AEGON OFE	2,945.3	5,897.3	7,275.1	9,088.6	4.1
Allianz Polska OFE	3,458.5	3,644.8	5,052.9	6,511.4	2.9
Amplico OFE*	11,467.6	11,116.8	13,702.8	16,905.6	7.6
Aviva OFE Aviva BZ WBK**	37,324.0	36,116.9	45,188.5	52,889.1	23.9
AXA OFE	6,194.1	6,557.6	9,251.4	12,833.3	5.8
Generali OFE	5,264.5	5,476.0	7,724.9	10,426.0	4.7
ING OFE	32,870.2	33,058.4	43,245.3	53,202.0	24.0
Nordea OFE	4,950.6	5,122.8	6,905.6	9,337.6	4.2
Pekao OFE	2,245.2	2,218.3	2,841.1	3,411.4	1.5
PKO BP Bankowy OFE***	4,274.6	4,030.4	4,911.8	6,565.2	3.0
OFE Pocztylion	2,826.1	2,777.5	3,477.3	4,263.7	1.9
OFE Polsat	1,276.2	1,243.6	1,689.6	2,050.4	0.9
OFE PZU Złota Jesień	19,301.4	18,952.3	24,751.3	30,659.6	13.9
OFE Skarbiec-Emerytura****	3,547.5	N.A.	N.A.	N.A.	N.A.
OFE WARTA	2,085.2	2,048.5	2,612.6	3,107.2	1.4
Total:	140,030.9	138,261.4	178,630.1	221,251.1	100.0

* Until October 8th 2009 – AIG OFE

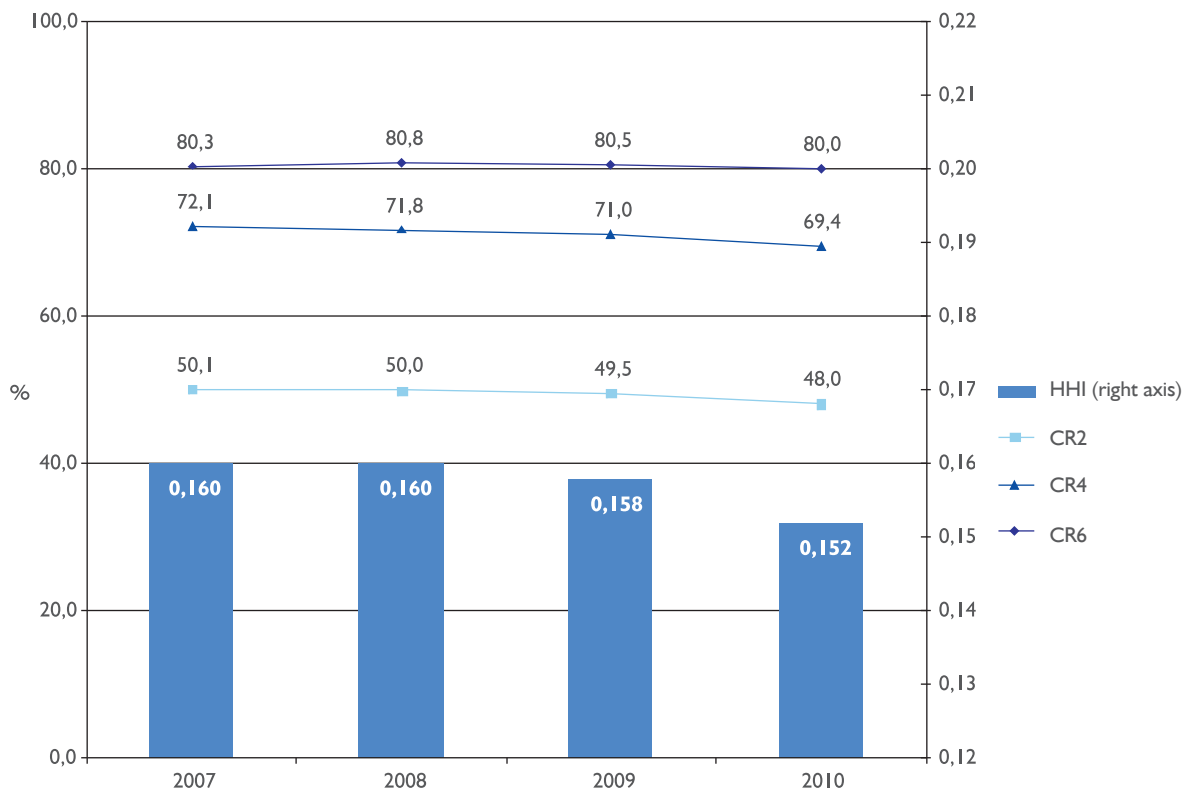
** Until May 31st 2009 – Commercial Union OFE BPH CU WBK

*** Until December 23rd 2009 – Bankowy OFE

**** November 7th 2008 saw the closing of liquidation of OFE Skarbiec-Emerytura and transfer of its assets to AEGON OFE.

Source: in-house materials prepared based on daily reports of open-end pension funds.

■ FIG. 4. CONCENTRATION OF NET ASSETS OF OPEN-END PENSION FUNDS, 2007–2010



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 Fig. 2.

Source: in-house materials prepared based on daily reports of open-end pension funds.

As at December 31st 2010, the open-end pension funds' assets stood at PLN 221.3bn, having increased by 23.9% (PLN 42.6bn) over the year. The value of contributions transferred to open-end pension funds by the Social Insurance Institution (ZUS) in 2010 was nearly PLN 23.2bn, while the return on funds' investments accounted for the remaining almost PLN 19.5bn of the assets growth. In 2010, the rates of return generated by open-end pension funds ranged from 9.3% to 11.9%; the weighted average rate of return reached 11.0%.

In response to the growth of equity prices on the Warsaw Stock Exchange (the "WSE"), the structure of the open-end pension funds' portfolios changed significantly in 2010. The funds considerably increased their exposure to equity instruments, from 30.9% of the portfolio value as at the end of 2009 to 36.7% as at the end of 2010, while reducing exposure to debt instruments, chiefly bonds and treasury bills, from 69.1% to 63.3% of the portfolio value, respectively. On the back of the positive performance of equities on the WSE (the WIG index gained 18.8%), the open-end pension funds reported rates of return markedly exceeding the inflation rate.

The equity investments of the open-end pension funds comprised primarily large-cap stocks covered by the WIG20 index, whose share in the total portfolio was 21.6% as at the end of 2010. The debt portion of the portfolios was dominated by Polish Treasury instruments (52.4% of the total portfolio), mainly fixed-rate bonds (39.8% of the total portfolio). Pension funds' foreign investments accounted for 0.69% of the portfolio value as at the end of 2010, having fallen by 0.06pp from the 2009 level. Under Polish law, open-end pension funds may only invest up to 5% of their assets in foreign instruments.

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 as at the end of 2009, was 69.4% (71.0% in the previous year). In 2006-2010, the structure of the OFE market was relatively stable, although there were some distinctive changes in the market shares of some funds.

As at September 30th 2010, the net asset value of three open-end pension funds exceeded the 10% market share limit and

pursuant to Art. 39.2 of the Social Insurance System Act of October 13th 1998 those funds will not be able to participate in the drawings of new members carried out by the Social Insurance Institution in 2011.

As at the end of 2010, there were 14.9m members of the open-end pension funds. The market share of the four largest funds, in terms of the number of members, fell year on year and as at year end stood at 60.6%, against 62.8% a year earlier.

■ TABLE 4. NUMBER OF OPEN-END PENSION FUND MEMBERS AS AT YEAR END, 2007–2010

OPEN-END PENSION FUND	NO. OF MEMBERS ('000)				MARKET SHARE (%)
	AS AT DEC 31 2007	AS AT DEC 31 2008	AS AT DEC 31 2009	AS AT DEC 31 2010	2010
AEGON OFE	351.1	770.3	764.6	834.4	5.6%
Allianz Polska OFE	327.0	354.7	398.2	448.5	3.0%
Amplico OFE*	1,070.3	1,113.2	1,101.3	1,135.7	7.6%
Aviva OFE Aviva BZ WBK**	2,725.2	2,859.6	2,893.7	2,786.2	18.7%
AXA OFE	608.5	680.2	799.8	983.9	6.6%
Generali OFE	538.9	605.9	681.3	788.0	5.3%
ING OFE	2,591.6	2,787.7	2,903.8	2,929.8	19.6%
Nordea OFE	731.6	776.4	828.0	868.5	5.8%
Pekao OFE	291.8	333.9	348.5	349.5	2.3%
PKO BP Bankowy OFE***	445.9	436.5	418.0	468.3	3.1%
OFE Pocztylion	431.4	445.5	467.0	518.1	3.5%
OFE Polsat	301.3	328.3	322.7	311.1	2.1%
OFE PZU Złota Jesień	1,959.1	2,018.1	2,121.9	2,193.5	14.7%
OFE Skarbiec-Emerytura****	446.4	N.A.	N.A.	N.A.	N.A.
OFE WARTA	313.9	313.4	318.7	315.4	2.1%
Total	13,134.0	13,823.7	14,367.5	14,931.0	100.0%

* Until October 8th 2009 – AIG OFE

** Until May 31st 2009 – Commercial Union OFE BPH CU WBK

*** Until December 23rd 2009 – Bankowy OFE

**** November 7th 2008 saw the closing of liquidation of OFE Skarbiec–Emerytura.

Source: Social Insurance Institution (ZUS).

In 2010, like in the previous years, the major items in the income statements of pension fund management companies were revenues related to the management of open-end pension funds, including:

- revenue from charges on contributions (40.5% of total revenue),
- revenue from the fee for the management of the open-end pension funds (44.9% of the total revenue).
- and costs:
- acquisition costs (37.5% of total costs of pension fund management companies),
- costs directly related to the management (operation) of the pension fund management companies (16.8% of total costs),
- costs of charges on contributions and charges on transfer payments made to the Social Insurance Institution (ZUS) and the National Depository for Securities (NDS) (15.7% of total costs),
- transfer agent costs (11.1% of total costs).

In 2010, revenues of pension fund management companies were lower than a year or two years earlier. This was caused by the introduction of a limit on charges deducted from contributions, which was set at 3.5% as of January 1st 2010. The related drop in revenue was not offset by higher revenues in other categories. As a result, in 2010, the total revenue of pension fund management companies derived from the management of open-end pension funds amounted to PLN 1.8bn, down by 10% year on year. In the same period, the costs of management of open-end pension funds grew by 2.4%, to PLN 1.2bn. In 2010, the result on technical activity slightly exceeded PLN 580m and was down by 29.1% year on year.

An analysis of individual items of the income statement shows a clear connection between the amounts of revenue, costs and profit and the size of open-end funds managed by a pension fund company. The strongest market position is enjoyed by the companies managing the largest pension funds. They

generated the highest revenue and a positive financial result (profit) and were able to leverage significant economies of scale in terms of their expenses.

2010 saw a deterioration in net financial results of most pension fund management companies. Only two companies

improved their results year on year. In 2007-2009, only one pension fund company reported a net loss. In 2010, as many as three pension fund management companies posted losses. In 2010, the aggregate net financial result of all pension fund management companies amounted to over PLN 588m and was down by 22.9% relative to the previous year.

2.4.2. Occupational pension funds and occupational pension fund management companies

Occupational pension funds (PFEs) and occupational pension fund management companies (which manage occupational pension funds) are special types of financial institutions which operate exclusively within Pillar III.

The shareholders of the occupational pension fund management companies are employers which run pension schemes under which contributions are paid into pension funds managed by such pension fund management companies. Occupational pension fund management companies are non-profit organisations and their costs which are not covered by fees are financed by the shareholders/employers. The representatives of the members of occupational pension funds that pay contributions to the funds managed by them make up half of the supervisory board of the occupational pension fund company. The regulations relating to the investments

of pension funds provide for an option to delegate asset management to third parties.

As at December 31st 2010, there were five occupational pension fund management companies on the market, and they managed five occupational pension funds. The first occupational pension fund company was established in 1999, while the last one started operations towards the end of 2004. Thus, the entities operating on this market are at various stages of development.

As at the end of 2010, the value of assets accumulated in the occupational pension funds (PFE) stood at PLN 1,555m. The net asset value of occupational pension funds grew by PLN 222.6m, or 16.7%, relative to 2009. In the period under review, PLN 167.7m of base and additional contributions were transferred to the accounts of the members of occupational pension funds.

■ TABLE 5. NET ASSETS OF OCCUPATIONAL PENSION FUNDS, 2007–2010 (AS AT DECEMBER 31ST)

ITEM	NET ASSETS (PLNM)				MARKET SHARE (%)
	2007	2008	2009	2010	2010
PFE TELEKOMUNIKACJI POLSKIEJ	713.70	672.92	831.06	934.5	60.1
PFE Nowy Świat	199.43	189.14	245.36	274.6	17.7
PFE Słoneczna Jesień	114.02	145.57	218.25	294.8	19.0
PFE UNILEVER POLSKA	12.61	16.26	20.28	27.2	1.7
PFE NESTLE POLSKA	9.73	11.86	17.80	24.2	1.6
Total	1,049.50	1,035.75	1,332.75	1,555.4	100.0

Source: Occupational pension funds (data based on the funds' statutory quarterly filings with the PFSA Office).

Contributions to occupational pension funds are free of any charges, and some occupational pension fund management companies do not charge management fees, which – from the participants' perspective – makes this form of saving more profitable: the entire amount of contributions paid to such financial institutions is transferred to the accounts of the occupational pension fund members.

In 2010, the average rate of return reported by the occupational pension funds was 10.03% (in 2009: 14.82%). The slower year-on-year growth in the value of an investment unit was due to the lower rates of return which could be earned on the equity securities market.

■ **TABLE 6. INVESTMENT PERFORMANCE OF OCCUPATIONAL PENSION FUNDS, 2007-2010 (RATE OF RETURN OR PERCENTAGE INDEX CHANGE)**

ITEM	2007	2008	2009	2010
PFE average rate of return	5.54	-11.03	14.82	10.03
PFE lowest rate of return	4.52	-13.86	12.74	9.60
PFE highest rate of return	6.23	-6.34	17.41	10.52
Inflation rate	2.5	4.2	3.5	2.6
WIG change	10.39	-51.07	46.85	18.8
WIG20 change	5.19	-48.21	33.47	14.9

Source: Occupational pension funds (data based on the funds' statutory quarterly filings with the PFSA Office).

2.4.3. Occupational pension schemes and individual pension accounts

Occupational pension schemes and individual pension accounts, in which participation is voluntary, are organised on an institutional basis, unlike other forms of voluntary individual accumulation of savings for pension purposes, and funds are accumulated in them on the terms and conditions provided for in the law. In comparison with the regulations governing the operation of Pillar II, the laws governing the activities of institutions operating within Pillar III provide a narrower scope of administrative regulation, owing to 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 social security contribution allowances. The regulations governing the activities of institutions operating within Pillar III and products offered on the market are designed to:

- ▶ protect interests of the members of occupational pension schemes,
- ▶ guarantee that the accumulated assets are applied towards pension financing,
- ▶ guarantee that pension capital is accumulated regularly, over a long term.

■ **TABLE 7. DEVELOPMENT OF OCCUPATIONAL PENSION SCHEMES, 2007-2010**

	2007	2008	2009	2010
Number of PPEs	1,019	1,078	1,099	1,113
Number of PPE members ('000)	312	325	334	342
Value of assets accumulated (PLNm)	3,806	3,608	4,998	6,286

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

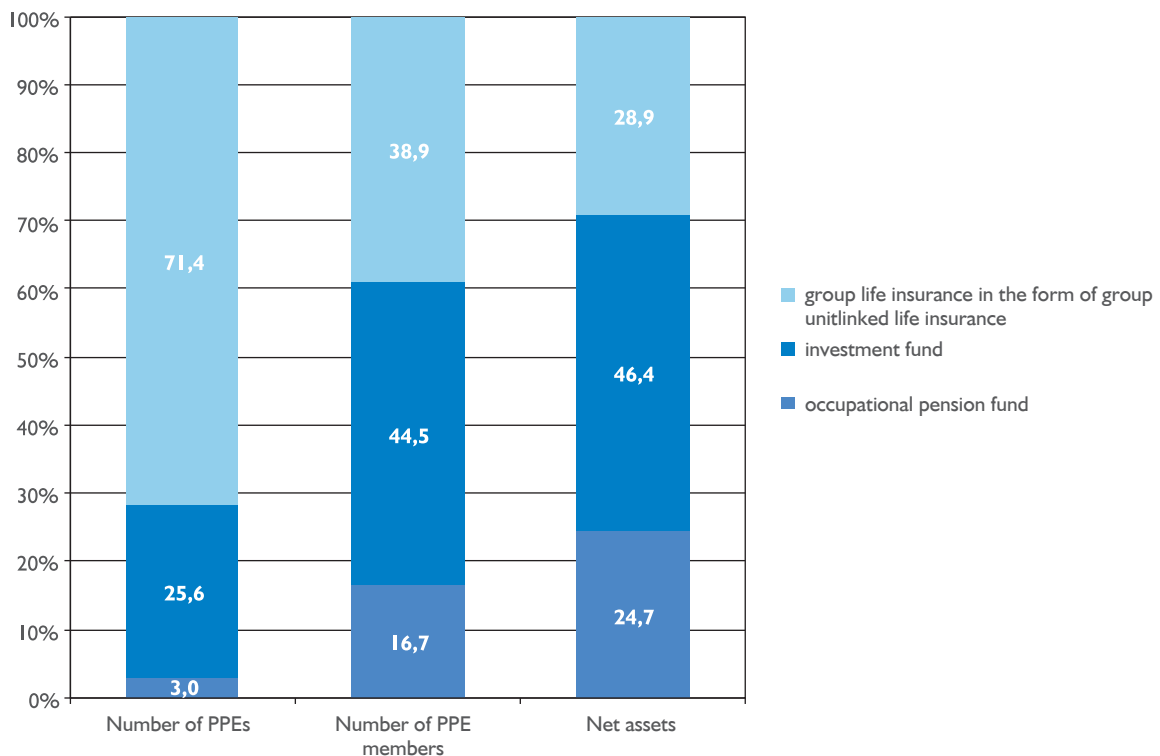
- ▶ an occupational pension fund,
- ▶ agreement for employee group life insurance in the form of group unit-linked life insurance,
- ▶ agreement for payment of contributions to an investment fund, and
- ▶ foreign management.

As at December 31st 2010, there were 1,113 occupational pension schemes, including:

- ▶ 33 schemes operated as occupational pension funds,
- ▶ 795 schemes operated under agreements for employee group life insurance in the form of group unit-linked life insurance,
- ▶ 285 schemes operated under agreements for payment by employers of employee contributions to investment funds.

As at the end of 2010, occupational pension schemes had 342.5 thousand participants, and the value of their assets stood at PLN 6,286m, which means the value of assets accumulated in the accounts of PPE members grew by PLN 1,288m (or approx. 26%) relative to 2009.

■ FIG. 5. STRUCTURE OF THE PPE MARKET IN 2010 (%)

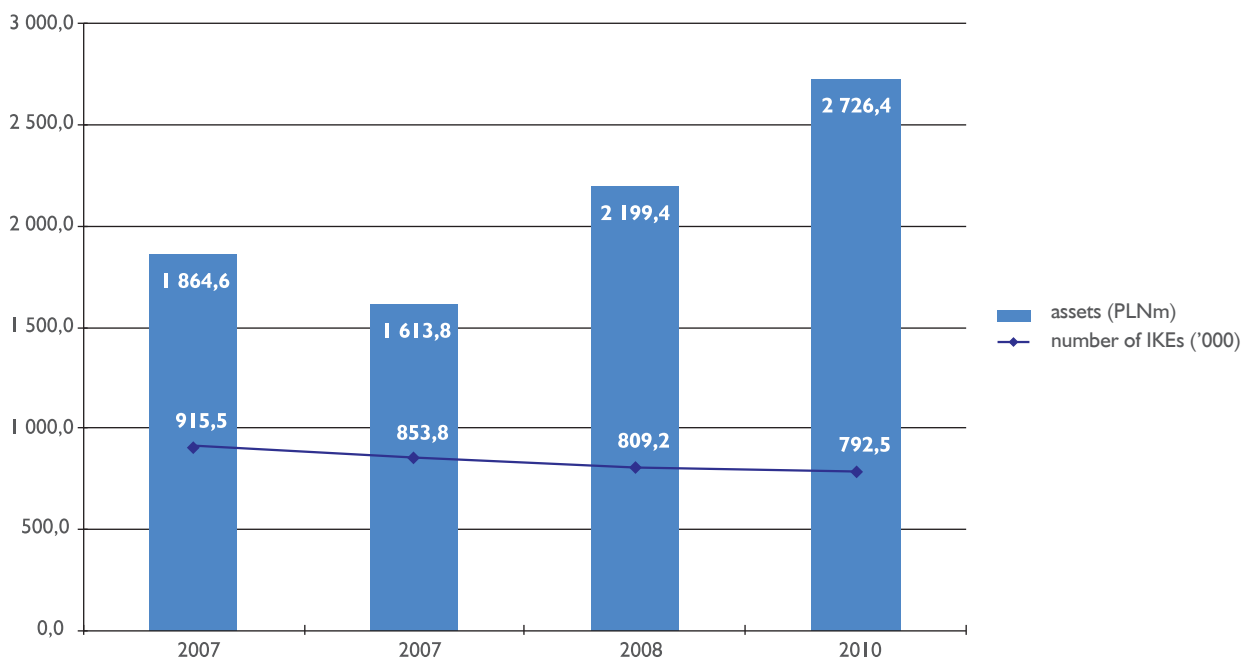


An individual pension account (IKE) is operated pursuant to a written agreement concluded by the saver with:

- ▶ an insurance company (unit-linked life insurance agreement),
- ▶ an investment fund,
- ▶ an entity conducting brokerage business,
- ▶ a bank.

An exemption from capital gain tax is offered as an incentive to invest in individual pension accounts. The tax exemption offered to those who invest their savings in individual pension accounts is limited to PLN 9,579 (the limit applicable in 2010). In 2010, the amount of an average payment into the individual pension accounts was much below the applicable limit and stood at PLN 1,971. As at the end of 2010, the average balance of funds accumulated in the individual pension accounts stood at PLN 3,440.

■ FIG. 6. DEVELOPMENT OF INDIVIDUAL PENSION ACCOUNTS, 2007-2010



As at December 31st 2010, entities operating IKE schemes maintained 792.5 thousand accounts with PLN 2,726.4m of assets accumulated in the accounts. Despite the drop in the number of the individual pension accounts by 2.1% (or 16.7 thousand) in 2010 relative to 2009, the value of assets accumulated in individual pension accounts grew by 24.0% (or PLN 527m) during the year.

In 2010, savers contributed into the IKE accounts a total of PLN 496.5m, or 2.1% less than in 2009. In spite of the above, in 2010 the inflows of new funds into the IKE accounts less outflows (i.e. net inflows into IKE accounts) amounted to PLN 352.5m, up by 13.4% relative to 2009. The return on investments contributed PLN 174.5m to the growth of assets accumulated in IKE accounts.

■ TABLE 8. ASSETS ACCUMULATED IN IKE ACCOUNTS BY TYPE OF INSTITUTION, 2007-2010

ENTITY OPERATING IKE SCHEME	ASSET VALUE (PLN '000)				SHARE IN TOTAL ASSETS (%)
	2007	2008	2009	2010	2010
Insurance company	722,646	716,738	964,146	1,167,642	42.8
Investment fund	846,458	564,263	800,436	972,295	35.7
Entity conducting brokerage business	96,157	121,060	190,659	293,762	10.8
Bank	199,309	211,728	244,180	292,696	10.7
TOTAL	1,864,570	1,613,789	2,199,421	2,726,395	100.0

2.5. Capital and commodity markets

Participants of the capital and commodity markets supervised by the Polish Financial Supervision Authority include entities operating on the market of securities and other financial

instruments, undertakings for collective investment and entities operating on the commodity market.

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

Investment firms are an indispensable element of the capital market infrastructure, because, pursuant to the law, investing on the capital market may only be carried out through the agency of investment firms. The catalogue of brokerage activities that investment firms are authorised to conduct includes, without limitation, accepting and transferring orders to purchase or sell financial instruments, purchasing and selling financial instruments for the firm's own account, managing portfolios including one or more financial instrument(s), investment advisory services, and offering financial instruments.

Both domestic and foreign investment firms may operate in Poland. Domestic investment firms include brokerage houses and banks conducting brokerage activities. To conduct brokerage activities, a PFSA authorisation is required. Moreover, brokerage activities in Poland may also be conducted by foreign investment firms under the single licence (or European passport) principle, and foreign legal persons domiciled in a member state of the *Organisation for Economic Co-operation and Development* (OECD) or the *World Trade*

Organization (WTO). Under the single licence principle, an investment firm (or any other institution) domiciled in an EU member state, which has been authorised to provide services in its home state, may also operate in other EU countries, both in the form of cross-border operations and through a branch.

Similarly as in the previous year, in 2010 there was a clear tendency for large business entities, particularly financial institutions, to purchase shares in brokerage houses. The resulting changes in ownership will surely contribute to greater stability of brokerage houses and will provide them with a possibility of offering a broader array of products and services.

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

■ **TABLE 9. NUMBER OF ENTITIES CONDUCTING BROKERAGE ACTIVITIES AND OPERATING SECURITIES ACCOUNTS, 2007-2010**

TYPE OF ENTITY	2007	2008	2009	2010
Brokerage houses	41	45	46	50
Banks conducting brokerage activities	12	13	13	14
Custodian banks	13	13	13	14
Total	66	71	72	78

Tables 10 and 11 contain key data on clients of brokerage houses and of banks conducting brokerage activities through brokerage offices.

■ **TABLE 10. NUMBER OF CLIENT ACCOUNTS OPERATED BY BROKERAGE HOUSES AND BANKS CONDUCTING BROKERAGE ACTIVITIES, 2007-2010**

	NUMBER OF CLIENT ACCOUNTS				% OF TOTAL
	2007	2008	2009	2010	2010
Brokerage houses	646,652	614,328	812,954	1,323,959*	67.1
Banks conducting brokerage activities	555,434	547,422	532,325	649,680*	32.9

* Change in manner of disclosure, non-homogenous population.

■ **TABLE II. VALUE OF ASSETS IN CLIENT ACCOUNTS OPERATED BY BROKERAGE HOUSES AND BANKS CONDUCTING BROKERAGE ACTIVITIES, 2007-2010**

	VALUE OF CLIENT ASSETS DEPOSITED IN ACCOUNTS (PLNM)			
	2007	2008	2009	2010
Brokerage houses	113,230	63,447	98,825	136,499
Banks conducting brokerage activities	39,652	25,949	39,443	55,532
CLIENT ASSETS UNDER MANAGEMENT (PLNM)				
Brokerage houses	117,512	73,589	79,045	84,412
Banks conducting brokerage activities	313	294	329	2,177
TOTAL	270,707	163,279	217,642	278,620

Data sourced from monthly MRF-form statements as at December 31st 2007, December 31st 2008, December 31st 2009 and December 31st 2010.

2.5.2. Organised securities markets

Warsaw Stock Exchange

In 2010, rates of return of the key indices of the Warsaw Stock Exchange (the “WSE”) were lower than a year earlier.

Indirectly, that could have been caused by the difficult macroeconomic situation in certain European countries (problems in Greece, Ireland, Portugal) and the related lack of confidence among investors.

■ TABLE 12. RATES OF RETURN OF THE WARSAW STOCK EXCHANGE INDICES, 2007–2010 (%)

ITEM	2007	2008	2009	2010
WIG	10.39	-51.07	46.85	18.77
WIG20	5.19	-48.21	33.47	14.88
mWIG40	7.90	-62.48	55.24	19.57
sWIG80	25.17	-56.95	61.85	10.18
WIG-PL	9.23	-50.62	44.93	18.70

Source: http://www.gpw.pl/analizy_i_statystyki

Despite the relatively low rates of return of key WSE indices (as compared with 2009), there was clearly stronger interest from potential issuers in raising capital through share issues and in introducing shares to trading on the regulated market. In 2010, the number of floatations significantly exceeded the corresponding figure recorded a year earlier. Among the new WSE entrants there were five companies having their registered offices abroad, reflecting the growing international interest in

the Polish stock exchange. In 2010, there were three significant IPOs on the WSE equity market, including Powszechny Zakład Ubezpieczeń SA (floated on May 12th 2010), TAURON Polska Energia S.A. (June 30th 2010) and Giełda Papierów Wartościowych w Warszawie SA - the Warsaw Stock Exchange (November 9th 2010). Given their size (in the case of PZU and Tauron PE S.A.) or unprecedented nature (in the case of the WSE), these offerings attracted vast investor interest.

■ TABLE 13. NUMBER OF INSTRUMENTS TRADED ON THE WARSAW STOCK EXCHANGE, 2007–2010

ITEM	2007	2008	2009	2010
Companies	351	374	379	400
<i>Including foreign</i>	23	25	25	27
IPOs	81	33	13	34
Delistings	14	10	8	13
Bonds	57	51	51	50
<i>Including foreign</i>	4	3	3	3
Futures	42	40	37	55
Options	98	138	110	106

Source: http://www.gpw.pl/analizy_i_statystyki_pelna_wersja

Higher valuations of the listed companies, going hand in hand with an increase in their number, in a natural way increased the WSE capitalisation in 2010 as compared with the previous

year. However, capitalisation of the entire market did not reach the record level attained in 2007.

■ TABLE 14. WARSAW STOCK EXCHANGE'S CAPITALISATION AS AT YEAR END, 2007–2010 (PLNM)

ITEM	2007	2008	2009	2010
Polish companies	509,887	267,359	421,178	542,646
Foreign companies	570,370*	197,756	294,643	253,836
Polish bonds	348,535	362,704	411,018	486,505
Foreign bonds	719	586	586	586
TOTAL	1,429,511	828,405	1,127,425	1,283,573

Source: http://www.gpw.pl/analizy_i_statystyki_pelna_wersja

* The substantially higher capitalisation of foreign companies as at the end of 2007 compared with the other years was driven mainly by two factors: a substantially higher share price of UNICREDIT S.P.A. as at the end of 2007 as compared with the later periods (the company floated its shares on the Polish stock exchange at the end of 2007; since then its shares have accounted for approximately half of the total capitalisation of all foreign companies listed on the WSE), and the delisting of Bank Austria Creditanstalt AG shares in May 2008.

In 2010, trading volumes in the equity, futures and options segments were higher than in 2009, but fell in the bonds segment. To note, “in September 2010, equity trading

volumes on the WSE were higher than the combined trading volumes of the Vienna, Budapest, Prague and Ljubljana stock exchanges⁴.”

■ **TABLE 15. TRADING VOLUMES ON THE WARSAW STOCK EXCHANGE, 2007–2010 (PLNM)**

ITEM	2007	2008	2009	2010
Equities	479,480	331,316	351,885	468,576
Bonds	3,495	4,999	2,951	2,855
Futures	674,132	613,495	517,366	681,296
Options	28,511	16,590	16,781	33,775

Source: http://www.gpw.pl/analizy_i_statystyki_pelna_wersja

In July 2010, the Warsaw Stock Exchange simplified the rules governing short sale transactions (i.e. selling borrowed instruments in order to later repurchase them). Relevant amendments to the Rules of the Warsaw Stock Exchange were approved by the PFSA on April 13th 2010 once the wording of the Rules was modified in compliance with PFSA’s position. The purpose of the new regulations was to facilitate the execution of short sale transactions while at the same time ensuring an appropriate level of security, including security of settlement and security of trading (for instance the possibility of suspending acceptance of short sale orders was introduced). On the WSE market investors may short sell shares of selected companies and bonds. As at December 31st 2010, 140 stocks and 38 bonds were admitted for short selling.

Alternative trading facility (NewConnect)

In addition to the regulated market, the Warsaw Stock Exchange operates an organised equity market in the form of an alternative trading facility under the name of NewConnect. The operator’s

intent was to create a market dedicated to start-up businesses active in the new technologies sectors (IT, electronic media, biotechnology, etc.) whose market capitalisation is expected to stay relatively low (up to PLN 20m or so). The market entry formalities are simplified and the floatation costs are lower compared with the regulated market. Moreover, issuers are subject to less strict disclosure requirements (e.g. in a majority of cases the publication of quarterly reports is not obligatory and semi-annual reports are exempt from the audit requirement). Also the entry process is much speedier compared with the regulated market and takes only about three months.

In 2010, the number of floatations on NewConnect was the highest since the launch of this platform, which shows it is attracting strong interest both from potential issuers and from investors, despite the fact that the risk of investment in shares listed on NewConnect is potentially higher than in the case of WSE-listed equities. To note, eight companies initially listed on NewConnect were delisted from the platform and in 2010 floated their shares on the WSE.

■ **TABLE 16. HIGHLIGHTS OF THE NEWCONNECT ALTERNATIVE TRADING FACILITY, 2007-2010**

ITEM	2007	2008	2009	2010
NCIndex at year end	144.17	38.19	49.70	63.44
Rate of return of NCIndex in current year (%)	44.17	-73.51	30.14	27.65
Capitalisation of Polish companies at year end (PLNm)	1,185	1,396	2,457	4,971
Capitalisation of foreign companies at year end (PLNm)	-	41	97	167
Number of companies at year end	24	84	107	185
Number of new offerings	24	61	26	86
Number of trading sessions	83	251	252	253
Trading volume (PLNm)	302.6	840.0	1,162.0	3,694.0
Number of trades per session	719	980	1,285	3,470
Average trading volume per session (PLNm)	3.6	3.3	4.6	14.6

Source: http://newconnect.pl/index.php?page=statystyki_rynku_roczne

⁴ http://www.gpw.pl/aktualnosci?ph_tresc_glowna_start=show&ph_tresc_glowna_cm_n_id=44688

BondSpot S.A.

In September 2009, a change of the name of MTS-CeTO S.A. to BondSpot S.A. (“BondSpot”) was registered. The company operates the Polish Regulated OTC Market (“ROTC”) and is regulated by the PFSA. Although one of the objectives behind the establishment of the OTC market was to give smaller companies access to a market through which they would be able to raise capital, taking advantage of lower costs, time savings

and laxer disclosure requirements, the market no longer attracts share issuers. Instruments traded on the ROTC include mainly Treasury bonds and other debt securities; since September 30th 2009 they have been listed in the Catalyst system⁵. Trades are executed via member investment firms. Other participants of the ROTC include entities acting exclusively in their own name and for their own account which have been admitted to operate on the market. As at the end of 2010, shareholders in BondSpot S.A. included mainly the WSE, banks and brokerage houses.

■ TABLE 17. DATA ON THE OTC MARKET, 2007-2010

ITEM	2007	2008	2009	2010
ITO index at year end	41,197.2	30,154.3	32,342.9	- *
Rate of return of ITO Index in current year (%)	30.58	-26.80	7.26	- *
Capitalisation of companies at year end (PLNm)	475.3	380.6	314.0	214.6
Number of listed instruments	84	77	70	88
Number of trading sessions	249	251	252	253
EQUITIES				
Trading volume (double counted) (PLNm)	343.0	6.0	1.7	0.6
Number of trades	39,448	2,298	715	388
Number of instruments	5	5	4	1
Average trading volume per session (PLN'000)	1,378.0	23.9	4.7	2.3
COVERED BONDS				
Trading volume (double counted) (PLNm)	4.0	74.5	36.5	99.8
Number of trades	7	87	59	19
Number of instruments	11	14	16	17
BONDS				
Trading volume (double counted) (PLNm)	68.4	202.6	4,995.8	261.5
Number of trades	1,335	452	140	156
Number of bonds listed	68	58	50	70

* On July 27th 2010 BondSpot S.A. ceased to calculate and publish the ITO equity market index.

As at the end of 2010, 88 instruments were listed on the ROTC market. As far as equities are concerned, investor interest in this market segment flagged and the number of listed stocks

declined further (as at the end of 2010 shares of one company only were listed, compared with four companies in 2009), which translated into 66% lower trading volume.

⁵ Catalyst is the name of an authorisation and trading facility for debt instruments, launched on September 30th 2009. It is run via the WSE's and BondSpot's trading platforms and comprises four individual markets. Two of them – operated by the WSE in the form of a regulated market and an alternative trading facility – are dedicated to retail investors, whilst the corresponding two markets operated by BondSpot are dedicated to wholesale clients. All of them are markets for non-government debt securities, i.e. municipal and corporate bonds, as well as mortgage bonds.

2.5.3. Settlement and depository system

Krajowy Depozyt Papierów Wartościowych S.A. (the “Polish National Depository for Securities” or the “Polish NDS”) is a central institution responsible for operating and supervising the settlement and depository system supporting financial instruments trading in Poland. The Polish NDS performs the function of a clearing house and a depository for financial instruments listed on the WSE, BondSpot, NewConnect and interbank markets. It is owned in equal parts by the WSE, the State Treasury and the National Bank of Poland. The key tasks performed by the Polish NDS include: clearing and settlement of transactions

executed on the organised market, registering and safekeeping financial instruments subject to conversion into book-entry form, overseeing outstanding securities’ issue volumes, performance of issuers’ obligations towards holders of their securities, managing the Settlement Guarantee Fund, managing the mandatory Compensation Scheme, as well as the tasks related to the social security system. Activities of the Polish NDS are subject to supervision by the PFSA, exercised in particular through the right to approve or refuse approval of amendments to the Rules of the Polish NDS and to carry out inspections at the Polish NDS.

2.5.4. Public offerings of financial instruments other than investment certificates

An offer of securities to the public, defined as an offer of securities, made in any form and by any means, addressed to at least 100 persons or to an unspecified addressee, may be carried out exclusively by means of a public offering. As a rule, a public offering involves the requirement to prepare a prospectus which must then be approved by the PFSA and published. However, the applicable laws provide for a number of situations where carrying out a public offering does not entail the obligation to prepare a prospectus.

A substantial improvement was also recorded in the segment of capital raising through public offerings (the primary market). The number of share subscriptions carried out through the public offering procedure more than doubled. However, in value terms, subscriptions fell by a half in 2010. To note, the high value of this type of offerings recorded in 2009 was attributable to two public offerings: the PKO BP SA rights issue and the Polska Grupa Energetyczna SA privatisation offering, whose aggregate value exceeded PLN 11bn and which could distort the actual condition of this segment of the public offerings market. The fact that in 2010 issuers more often than in 2009 raised funds through share issues indicates that the Polish capital market largely overcame the negative phenomena which emerged in the wake of the global financial crisis and aggravated in the second half of 2008 and in the first quarter of 2009.

2010 was one of the record years as far as the number of public offerings is concerned. The value of public offerings carried out during the year topped PLN 25bn, and was by 82% higher than in 2009. The key factors behind the considerable improvement on the public offerings market included the offering of PZU SA carried out in late April/ early May by the State Treasury and Eureko NV, valued at more than PLN 8bn, as well as two offerings of companies owned by the State Treasury, including Tauron PE SA (PLN 4.2bn worth of shares sold in June) and Giełda Papierów Wartościowych w Warszawie SA - the Warsaw Stock Exchange (PLN 1.2bn worth of shares sold in late October/early November).

Significantly higher issuer activity was also seen in other market segments, namely the bond and the structured product public offering markets.

The number of public offerings placed on the market in 2010 was 179. Their structure is shown in Table 18.

■ TABLE 18. PUBLIC OFFERINGS CARRIED OUT IN 2010

186 PUBLIC OFFERINGS, INCLUDING: 70 OFFERINGS CARRIED OUT BY FOREIGN ISSUERS			
179 CASH OFFERINGS			7 NON-CASH OFFERINGS
108 public offerings of shares including: 41 offerings exempt from the requirement to prepare and seek approval of the prospectus, 34 offerings carried out by foreign issuers	8 public offerings of bonds including: 28 offerings exempt from the requirement to prepare and seek approval of the prospectus, 1 offering carried out by a foreign issuer	35 public offerings of structured products all carried out by foreign issuers	
34 public sale offerings			

The aggregate value of public cash offerings executed in 2010 amounted to PLN 25,389.6m, including PLN 6,073.5m in share subscriptions, PLN 2,130.0 in bond issues, PLN 15,942.6m in

share sale offerings and PLN 1,243.5m in public offerings of structured products.

■ TABLE 19. VALUE AND NUMBER OF PUBLIC CASH OFFERINGS, 2007-2010

YEAR	2007		2008		2009		2010	
	NUMBER OF OFFERINGS	VALUE (PLNM)	NUMBER OF OFFERINGS	VALUE (PLNM)	NUMBER OF OFFERINGS	VALUE (PLNM)	NUMBER OF OFFERINGS **	VALUE (PLNM)
issues of shares	132	9,831.30	88	4,312.70	34	12,310.9	74	6,073.5
issues of bonds	12	851.2	7	900	7	1,077.8	36	2,130.0
share sale offerings	36	3,192.90	8	1,016.20	20	112.1	34	15,942.6
offerings of structured products	3	45.4	27	1,072.50	21	414.5	35	1,243.5
total public offerings	183	13,920.80	130	7,301.40	82	13,915.3	179	25,389.6
including: initial public offerings	77	8,297.90	43	4,419.90	22	7,539.2	60	15,899.5

* In aggregate, three structured bond offerings were carried out in 2007. In previous reports on the activities of the PFSA, these were reported on together with corporate bond offerings. However, given the dynamic development of the structured product market in 2008 (including both structured bonds and structured certificates), a decision was made to report on this product group as a separate category. To ensure comparability, structured product offerings were also separated from the 2007 bond offerings data.

** In 2010, seven non-cash public equity offerings were also carried out.

2.5.5. Undertakings for collective investment

An investment fund is a legal person the exclusive business of which is to invest cash collected through public, and in certain statutorily defined cases – also non-public, offering 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 an estate comprised of participant contributions and assets acquired for such contributions. An investment fund is managed by an investment fund company, which is its governing body. The assets of a fund (i.e. of a fund's participants) are not included in the bankruptcy estate of the investment fund company which manages the fund.

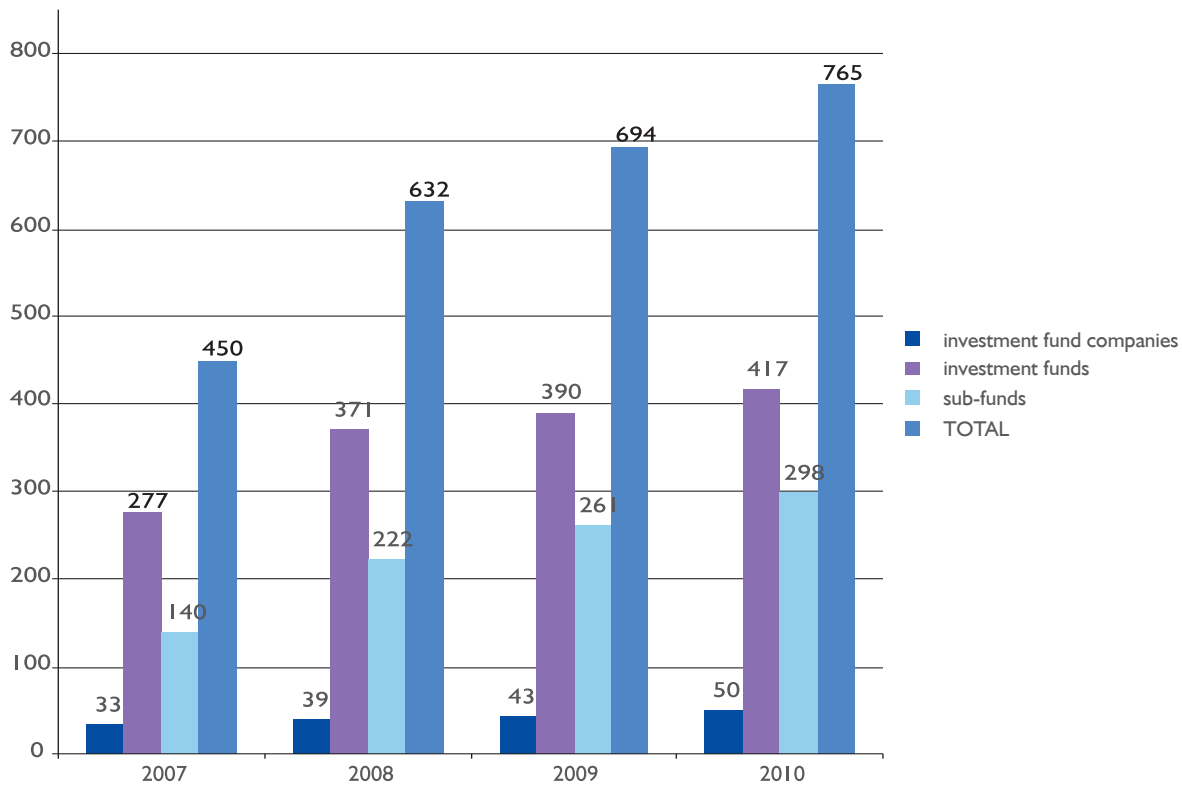
Upon its entry into the register maintained by the Regional Court in Warsaw, a fund acquires legal personality and from

this moment can start independent operations. The register of investment funds is publicly open, which means that it can be inspected by any person without such person being obliged to demonstrate the legal or practical interest in doing so.

2010 saw further growth in the number of investment fund management companies, investment funds and sub-funds under PFSA's supervision, as shown in Fig. 7.

As at December 31st 2010, PFSA authorisations were held by 50 investment fund management companies, which managed a total of 417 investment funds, including 71 open-end investment funds, 47 specialist open-end investment funds, and 229 closed-end investment funds.

FIG. 7. TOTAL NUMBER OF INVESTMENT FUND MANAGEMENT COMPANIES, INVESTMENT FUNDS AND SUB-FUNDS UNDER PFSA'S SUPERVISION (CUMULATIVELY, BROKEN BY TYPE), 2007-2010



The Polish Financial Supervision Authority also exercises supervision over foreign investment funds and sub-funds comprising foreign investment funds, which market their shares in the Republic of Poland. Given some denotifications of foreign funds in 2010, the number of such entities decreased, which is shown in Fig. 8.

2010 brought a further increase in the value of assets under management of investment fund management companies, in continuation of the trend which commenced in 2009. Although the assets still did not reach the 2007 levels, the increase seen over the last two years was quite considerable. Over 2010, the value of assets managed by investment fund

management companies grew by PLN 30.7bn, to PLN 134.2bn as at December 31st 2010.⁶

The increase in the value of assets under management of investment fund management companies translated into higher revenue from fund management, improving the companies' financial performance in 2010. As at the end of 2010, the aggregate profits of investment fund management companies reached PLN 442m, and were by PLN 76m higher than in 2009⁷. Table 19 shows the amounts and structure of operating costs, income and net financial result of investment fund management companies in 2007-2010.

⁶ Based on monthly reports filed by the investment fund management companies. Such reports are not audited or reviewed by qualified auditors, so they may be subject to later revisions.

⁷ Based on monthly reports filed by the investment fund management companies. Such reports are not audited or reviewed by qualified auditors, so they may be subject to later revisions.

FIG. 8. TOTAL NUMBER OF FOREIGN INVESTMENT FUNDS AND SUB-FUNDS COMPRISING FOREIGN INVESTMENT FUNDS UNDER PFSA'S SUPERVISION (CUMULATIVELY, BROKEN BY TYPE), 2007-2010

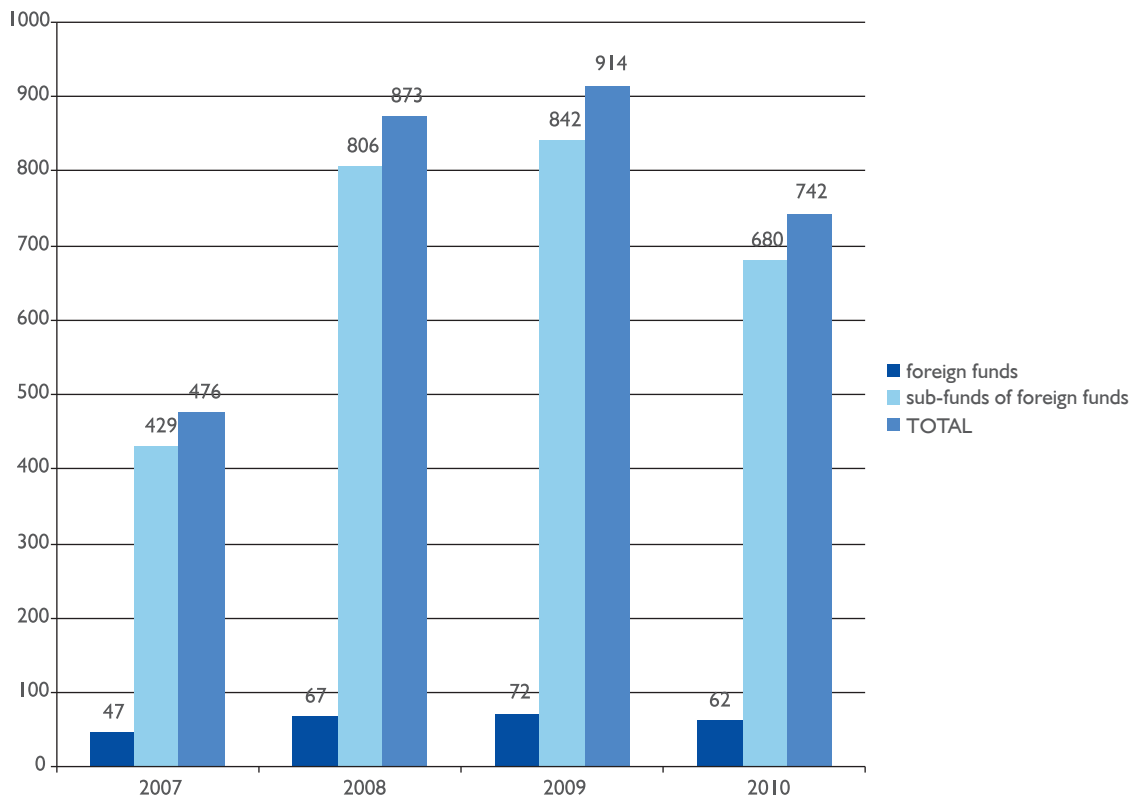
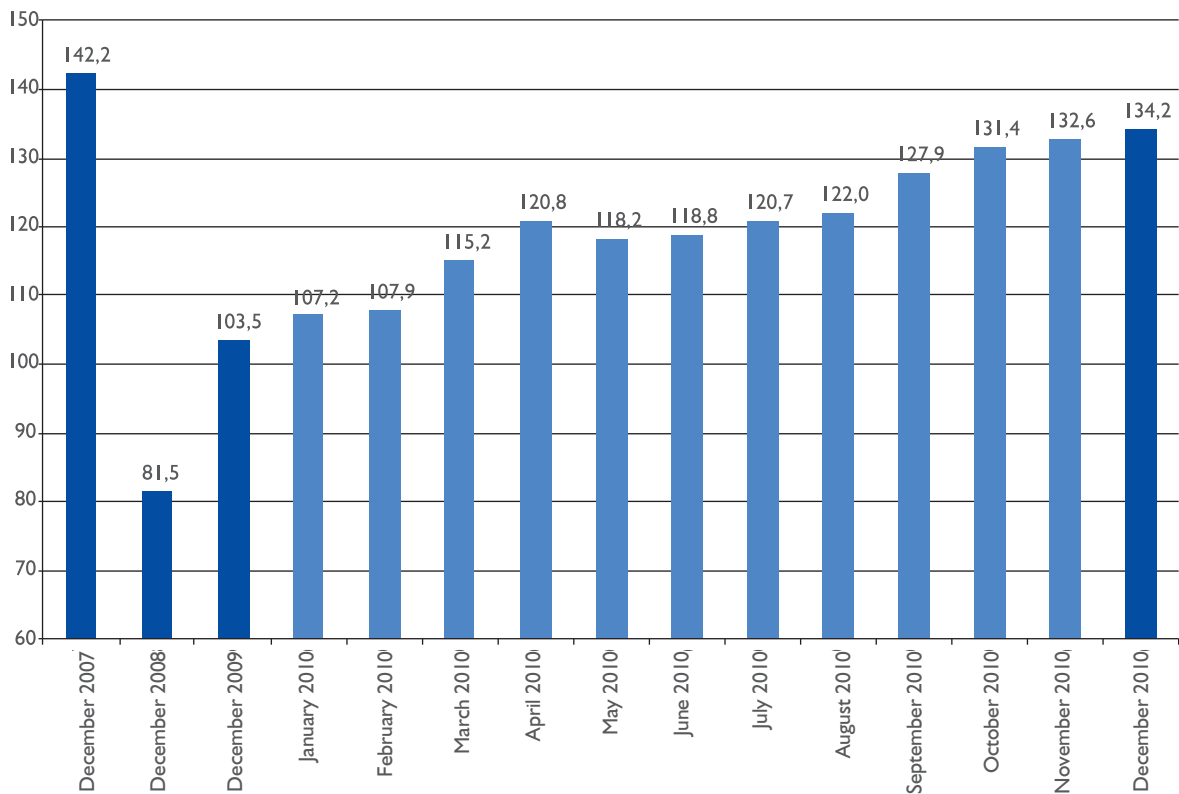


FIG. 9. VALUE OF ASSETS UNDER MANAGEMENT OF INVESTMENT FUND MANAGEMENT COMPANIES AT YEAR ENDS IN THE PERIOD 2007-2009 AND AT MONTH ENDS IN 2010 (PLNBN)



■ TABLE 20. AGGREGATE COSTS, INCOME AND NET FINANCIAL RESULT OF INVESTMENT FUND MANAGEMENT COMPANIES, 2007-2010 (PLNM)*

	2007	2008	2009	2010	
Total income	4,515	2,677	1,975	2,434	100.0%
Total expenses, including:	3,254	1,957	1,525	1,887	77.5%
– fixed costs	418	399	436	497	20.4%
– variable costs, including:	2,836	1,558	1,089	1,390	57.1%
– variable distribution costs*	2,123	1,079	735	1,028	42.2%
Net financial result	1,020	579	366	442	18.2%

* Costs related directly to acceptance and execution of orders for subscription, redemption and conversion of units in investment funds or acceptance of subscription orders for investment certificates and allotment of investment certificates, representing the distributor's fees or incurred in connection with the funds' promotion or marketing.

2.5.6. Commodity Market

Apart from the capital market, there is also a commodity market in Poland, although its breadth is limited. Since the middle of 2000, an electricity exchange has been operated by Towarowa Giełda Energii S.A. ("TGE"). TGE operates five markets, where the traded commodities include mainly electricity, property rights and CO₂ emission allowances. At the same time TGE holds electricity auctions (information on a planned auction is given 30 days in advance). Transactions carried out on the TGE are settled by Izba Rozliczeniowa Giełd Towarowych S.A., which performs the function of an Exchange Clearing House. 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 TGE's Management Board. TGE has seventeen shareholders, the largest of which is the State Treasury (with a 22.3% interest). TGE is regulated by the PFSA.

2010 saw an unprecedented growth in trading volumes across all TGE markets. In the discussed year, TGE concentrated on electricity as the key traded commodity. Total trading volume on the TGE was 81,757,763 MWh (a more than 20-fold increase on 2009), which accounts for 53% of the total energy generation in Poland, and included:

- 7,577,583 MWh in total traded on the Day-Ahead Market, being the oldest market of the TGE, where electricity is traded for delivery on the next day. Compared with the previous

year, trading volume on the Day-Ahead Market soared by an unprecedented 146.59%. The Day-Ahead Market is a spot market, which means that electricity prices are determined by a number of constantly fluctuating factors (such as the temperature, current demand or available production capacities). Accordingly, the price of electricity varies significantly both within hourly and daily intervals. In 2010, the average price of electricity on the Day-Ahead Market was 199.57 PLN/MWh. The price was the lowest in March – 179.67 PLN/MWh, and the highest in December – 220.05 PLN/MWh. On an annual basis, the average price of electricity in 2010 was by 15.73% higher than in 2009;

- 74,147,690 MWh in total traded in 2010 (with most of the concluded contracts relating to 2011) on the Commodity Derivatives Market, where electricity is traded for future delivery. Compared with 2009, trading volume on the Commodity Derivatives Market rose by 11,165.44%. The total amount of contracted electricity amounted to 49,161,120 MWh. The average price of electricity for delivery in all hours of the day in 2011 under transactions executed in the previous year, i.e. in 2010, amounted to 193.36 PLN/MWh;
- 49,033,100 MWh (up by 9.98% year on year) traded in total on the Property Rights Market, where members of the exchange can sell or buy rights to guarantees of origin for energy produced from renewable sources or by highly-efficient or methane-fired cogeneration systems.

2.6. Actions taken in response to the financial market situation

In 2010, many of the actions taken by the regulator were in response to increased risk on financial markets following the crisis. As the security of banking operations required that equity held by banks be increased to adequate levels, in 2010 the regulator upheld its recommendation for banks to retain profits earned in the previous year. The regulator also took measures to support the recapitalisation processes at banks.

Considering the limited access to sufficient amounts of medium-term and long-term financing, it was imperative that small and medium-sized banks and branches of credit institutions without strong deposit bases be offered support from their foreign parent companies and that the effectiveness of the implemented liquidity standards be evaluated. The PFSA Office monitored the banks' receivables from and liabilities to the financial sector on an ongoing basis and maintained communication with the parent companies of Polish-based credit institutions. The majority of parent companies declared their readiness to provide additional liquidity and finance growth of their Polish subsidiaries, which helped reduce liquidity risk. Capital funds of non-residents were largely sourced from their parent companies (often 50–100% of the funds) and constituted long-term investments, thus providing a reliable source of financing for their operations.

The crisis which disrupted global financial markets exposed deficiencies in risk management at financial institutions and uncontrolled development of complex financial instruments. In many countries, preventing the collapse of financial systems also required intervention measures involving huge fiscal costs. It became apparent that risk management, being the responsibility of financial institutions, with the minimum standards set by the regulator, needed to be strengthened.

The Polish financial sector was able to avoid the materialisation of worst-case scenario, maintaining profitability and sufficient capital adequacy ratios. No need arose to support banks with taxpayer's money, however the crisis demonstrated how volatile exchange rates and prices of stocks, commodities and other assets can be, and shed light on certain inadequacies in risk management at banks, including lack of foresight as to the possible materialisation of combined market and credit risks (which led to the currency option problem in Poland). Therefore, the regulator's priority in 2010 was to establish to what extent the MiFID Directive (Markets in Financial Instruments Directive) was implemented at financial institutions and to enhance risk management systems at banks, including by supplementing regulatory recommendations, as well as by continued monitoring of the implementation of S(II) Recommendation and adopting Recommendation T.

The recommendations aim to improve the quality of credit portfolios by pointing out that good credit is credit that does not put an excessive financial burden on the borrower, which may potentially lead to problems with debt repayment or even a default in the event of adverse changes in the borrower's income. The cost of bad loan write-offs is passed onto clients who pay their liabilities as they fall due (in higher product prices), depositors (in lower rate on deposits) and owners (in lower dividends or no dividends at all). The recent crisis proved that if a problem starts to affect the entire system, the costs of improper credit risk management may have to be borne by all taxpayers.

In view of financial difficulties suffered by some borrowers and borrower groups, comprehensive and ad hoc comparisons were made, compliance with concentration limits was monitored, and equity and personal links between banks and particular borrower groups were analysed. As in previous years, in 2010 comparative analyses were prepared to examine the manner in which debt owed by the same borrower is classified by different banks and how shareholder structures of some major bank clients are presented; if any discrepancies were identified, relevant steps were taken with respect to the regulated entities involved.

Due to increased concentration of insurance company deposits, which represent a basic current liquidity management tool and a component of deposit portfolios associated with certain types of insurance products, the PFSA Office probed the level of protection against excessive deposit concentration in place at insurance companies. The regulator's position on the issue, pointing out that excessive concentration of deposits in a single entity or asset class should be limited, was presented during meetings with insurance company representatives and in letters sent to insurance companies.

Heavy rains and subsequent flooding in May and June 2010 had severe implications for insurance companies. The PFSA Office analysed the data concerning direct and indirect consequences of flooding obtained from insurance companies to be able to monitor on an ongoing basis the possible increase in the number of claims paid and the financial standing of insurance companies. In addition, an analysis was conducted to assess the feasibility of insurance companies' financial plans, which revealed that their performance was seriously threatened by potentially high disbursements of compensation under flood risk insurance.

Responding to the impact of the financial crisis on the pension sector, the PFSA Office reiterated its earlier proposals for the

necessary changes in the organisation and operation of open-end pension funds and pension fund management companies. The regulator recommended the launch of funds with diversified risk profiles, which would make it possible to adjust the investment policy of a fund to the life cycles of its members and to protect persons in the pre-retirement age group against the possible consequences of sharp declines in asset prices on financial markets.

The PFSA Office also advocated a solution whereby capital requirements for pension fund management companies would be linked to their exposures to operational risk involving the risk of pension funds incurring a deficit (capital adequacy considerations were presented in the PFSA Office's report *An Analysis of the Impact of Deficit Risk and Capital Adequacy Levels on the Financial Standing of Pension Fund Management Companies*; the report was not published). The regulator also recommended that operating costs be reduced and effectiveness of the pension system be improved by changing the rules governing the conclusion of pension fund membership agreements. The PFSA Office proposed to eliminate competition based on client acquisition networks, which generates significant costs, and focus on competition in terms of the price of pension products, reflected in the fees charged by pension fund management companies (client acquisition issues were presented in the report *Irregularities in the Acquisition of New Clients by Open-End Pension Funds*, which is available on the PFSA website).

Furthermore, the regulator took steps to implement regulations promoting greater security of pension fund investments, recommending the adoption of a regulatory framework which would adjust the range of permissible investments to the development of the financial market. To this end, the PFSA Office, upon request from the Minister of Labour and Social Policy, arranged for a working group project to legislate the rules under which pension funds could engage in securities lending.

In the face of limited supervisory resources and challenges posed by the recent financial crisis, an important cross-sector

task was to implement a system of supervision based on the BION risk analysis and supervisory assessment (BION is short for *badanie i ocena nadzorcza* - supervisory review and assessment). This set of tools enables a more effective allocation of the PFSA Office resources, which are assigned to areas and entities with high risk profiles. Furthermore, it helps pool all the information obtained by the regulator during, for instance, licensing procedures, communication with owners, reviews of periodic reports (supported by the PFSA Office's IT systems), inspections, visits and supervisory meetings, or sourced from the responses to the PFSA Office's additional enquiries (questionnaires, supervisory requests, surveys, etc.).

The actions initiated in response to the financial crisis were complemented by the analytical work performed in 2010, seeking to assess the effectiveness of preventive measures implemented by institutions key to the Polish financial market, i.e. the National Bank of Poland, Ministry of Finance and the Polish Financial Supervision Authority and its Office. The analysis showed that the measures formed three complementary lines of crisis prevention initiatives, which had a stabilising effect on the financial market. The analysis and its findings were presented in the report *The Polish Financial Market in the Face of the 2008-2009 Financial Crisis*, published in May 2010.

It is also worth noting that the crisis prompted a global debate on the need to overhaul the financial market architecture and the regulatory framework governing financial supervision. A heated debate on future shape of the supervisory architecture took place among the EU institutions. The PFSA Office was actively involved in the negotiations - it participated in working groups, public consultation exercises, and international conferences and, most importantly, it provided support to the Ministry of Finance in inter-governmental negotiations. The negotiations delivered solutions favourable for Poland's interests, mainly because the key role of local regulators was preserved (including their power to supervise and enforce compliance of local entities with capital requirements) and the scope of powers of new supervisory bodies as regards group supervision was extended.

2.7. Package for reducing red tape in the financial market

In the reported year, the PFSA Office started to prepare the *Package for Reducing Red Tape in the Financial Market*. The goal behind the package is to simplify procedures to an extent facilitating operations on the financial market and improving the effectiveness of state supervision over the financial sector.

An initial draft of the package was presented to market organisations in July 2010, along with an invitation to submit their own proposals on how to eliminate excessive bureaucratisation. A working group was established at the PFSA Office, to analyse the solutions put forward by market organisations. The proposed solutions were included in the package to the extent the burden placed on the market and the supervision authority by the existing requirements translated into better risk management.

Part of the measures proposed in the package fall directly within the competence of the PFSA Office and involve a change in the existing approach or implementation of new procedures. As regards measures involving changes in legislation, given that the PFSA Office cannot propose bills, the proposed solutions were submitted to the Ministry of Finance (financial market regulator) and the Ministry of Economy, which is working on de-bureaucratisation of the economy.

The Package for Financial Market De-bureaucratisation is available on the PFSA Office's website⁶.

Transfer of possibly the widest scope of regulatory activities to an electronic platform

The PORTAL System

One of the objectives of the package is to create a secure channel for communication with regulated entities. An electronic platform is being developed, named "Portal", to ensure a secure electronic exchange of information between regulated entities and the PFSA Office. Portal is also intended to optimise information exchange processes.

The platform launch will be preceded by a pilot phase, to which selected regulated entities from the banking sector and the capital market have been invited. Currently, the system has three basic functionalities: chat, articles, and surveys. After its launch in production environment, further functionalities are to be enabled and the system is to be used by the other sectors of the financial market.

The participation of regulated entities in the project is voluntary. The "Portal" system can be used on the basis of

individual agreements between regulated entities and the PFSA Office. In a longer term the implementation of the Portal project will also involve legislative changes designed to place regulated entities under a statutory obligation to communicate with the regulator through PFSA's Portal.

Introduction of electronic applications for entry into the register of insurance agents, change of an existing entry or deletion from the register

As part of efforts targeted at improving supervision over the activities of insurance agents, in 2010 the PFSA Office introduced changes in the operation of the register of insurance agents. The changes involved the launch of electronic applications for entry in the register of insurance agents, for change of entry, and for deletion from the register, and were intended to significantly streamline and accelerate the applications processing. The launch of the system was preceded by multi-stage work involving modification and adaptation of the register of insurance agents to the requirements of the regulation and needs of insurance companies. Insurance companies were invited to a meeting where they were briefed on the planned changes and on what they entailed for the registration process. Before the changes were implemented, pilot tests were performed in cooperation with insurance companies. Information on the new procedures and instructions for the register users were placed on the PFSA Office's website.

December 1st 2010 saw the entry into force of the Regulation of the Minister of Finance on applications for entry or change of entry in the register of insurance agents (Dz. U. of 2010, No. 173, item 1170), dated September 8th 2010. The system was launched on the effective date of the Regulation - now insurance companies apply for entry, change of entry and deletion of insurance agents in the IT system through the website or electronic in-box. The PFSA Office provides the IT system free of charge. The new system also enables insurance companies to obtain, in electronic form, information on the entries, changes and deletions made by the supervision authority, which helped to substantially speed up the process of data transmission from the register to insurance companies.

In 2010, the PFSA processed 120,868 applications for entry, change of entry or deletion from the register of insurance agents. The launch of electronic submission of applications will significantly shorten the time required to process the submitted applications for entry or change of entry in the register of insurance agents.

⁶ http://www.knf.gov.pl/dla_rynku/Informacje_dla_podmiotow_nadzorowanych/index.html

Insurance Supervision System (ISS)

Since the beginning of 2010, insurance and reinsurance companies have been submitting reports to the supervision authority through the new Reporting Application of the Insurance Supervision System (ISS), completed in December 2009. In the first two reporting periods (Q1 and H1 2010) reporting was made concurrently in two systems (old and new one). This double reporting was necessary to ensure data security and to perform data consistency checks.

Reporting was transferred to the new application gradually. In 2010, the ISS Application was used by insurance companies to submit quarterly financial statements and statistical reports, KNF-02 statistical reports, as well as monthly reports on the levels of solvency ratios and technical and financial performance. Other reports, submitted by insurance companies outside the ISS Application, were migrated into the system (the companies' financial plans for 2010, portfolio reports, reports on individual pension accounts, ORSA surveys and stress tests).

Trading Supervision System (TSS)

In the period covered by this Report, the PFSA Office proceeded with further stages of the implementation of the Trading Supervision System ("TSS"). The aim of the project was to provide IT and analytical support to the PFSA Office in the area of supervision over trading on the regulated market in Poland. The TSS was implemented as a safe and efficient environment supporting the execution of supervision processes by the PFSA through collecting, processing and presenting information on trading on the regulated market, obtained from the WSE, the Polish NDS and other sources. With respect to the reporting function, the system creates a flexible reporting environment for organising transaction data derived from different sources, produces reports facilitating an analysis of such data, and provides necessary alert functionalities.

In order to ensure compliance of the TSS's operations with the regulations and standards of the European Union, reports on MiFID transactions as well as information derived from the Instrument Reference Data (IRD) bases and Market Calculation were incorporated into the system's database. 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 regulatory institutions are the competent authority. The Market Calculation base facilitates the designation of liquid stocks.

"Applications Submitted to the PFSA Office" System

In response to requests from financial institutions, a search engine for applications submitted to the PFSA Office was placed in service. The search engine contains 113 various

application forms along with lists of documents to be attached to a given application. Only applications for which it is impossible to create a form or specify a closed list of attachments were not provided.

The key benefits of the system include streamlining of application submission and processing as well as standardisation of applications contents.

Establishment of the Inspection Division at the PFSA Office

Following an amendment to the PFSA Office's Charter, on July 2nd 2010 an Inspection Division was set up at the Office. This marked another stage in the process of integrating supervision over individual sectors of the financial market which in the past were supervised by separate regulators, and involved standardisation and optimisation of on-site supervision procedures, performed at the offices of regulated entities. Along with creation of the Inspection Division, inspection procedures followed in different sectors of the financial market were made uniform – to the extent possible given the characteristics of particular sectors – and changes in regulations applicable to inspection activities were proposed.

Introduction of registers for outsourcing arrangements relating to banking and insurance activities

The current regulatory framework governing outsourcing in banking activities includes reporting requirements that create a burden on banks and the supervision authority that is incommensurate with supervision-related benefits.

Based on the proposals put forward by banking sector players, regarding changes in those Banking Law provisions which govern outsourcing in banking activities, as well as the conclusions based on supervisory experience in this area, a draft of amendments to the Banking Law has been developed and submitted by the Ministry of Finance for further legislative procedure.

The proposed changes include abolishment or modification of certain regulations, which will help to significantly lessen the burden that banks currently have to cope with due to the existing regulations on outsourcing in banking activities. The proposals include, inter alia:

- ▶ replacing the obligation to notify the supervision authority of an intention to enter into, amend, terminate, or of the expiry of, an outsourcing contract, with a requirement for banks to keep registers of such contracts,
- ▶ expanding the catalogue of activities for which no authorisation by the PFSA is required,
- ▶ introducing the same legal requirements for outsourcing to Poland-based entrepreneurs and entrepreneurs from member states,

- limitation of the requirement to submit reports prepared by entrepreneurs cooperating with banks to the supervision authority,
- modification of the requirement to put information on the entrepreneurs in the place where the activities are performed, on notice boards at branches of the bank, by allowing banks to provide information on the entrepreneurs in a generally accessible manner.

Changes related to outsourcing should also be made with respect to insurance companies. The current requirement is to report engagement of third parties to perform specific activities (making declarations of will in cases concerning compensation or other claims under agreements) – this requirement should be replaced with a system reflecting the changes proposed in this respect for banks (keeping a register of outsourcing contracts).

Draft changes to regulations governing outsourcing in insurance activities were submitted by the PFSA Office to the Ministry of Finance in September 2010.

The key benefits of changes in outsourcing in banking and insurance activities include:

- elimination of irrelevant reporting to the supervision authority,
- banks and insurance keeping only registers of outsourcing contracts.

Supervision over closed-end investment funds issuing non-public investment certificates

The principal goal behind the PFSA Office's supervision over investment funds is the protection of unit holders. In the course of its supervision activities the Office thoroughly analyses applications for operating licences for investment fund management companies (companies managing investment funds) in terms of the financial, organisational and personnel resources of the applicant, and then analyses applications for the creation of investment funds, in particular the articles of association and prospectus of a new fund, to make sure that they do not contain provisions or clauses non-compliant with the law or prejudicial to the interests of unit holders. This means that the PFSA Office acts as the protector of the interests of fund unit holders.

Such a supervision model is not adequate for closed-end investment funds issuing non-public certificates offered to private investors to whose order and for whom a given fund was set up. As professionals, such investors do not need protection from the supervision authority. Moreover, there are cases where the PFSA Office, performing its statutory duties in the course of licensing proceedings, corrects the articles of association of a fund to ensure their compliance with generally accepted interests of unit holders, which however contradicts the will of the investor. In consequence, protection is given to a professional investor who neither needs nor expects it.

The PFSA Office proposes to lift the requirement to seek PFSA's authorisation to create a non-public closed-end investment fund. The supervision authority would only receive information on the creation of such an entity as well as its periodic financial statements. The PFSA would not have to approve the articles of association of a fund, leaving the investment policy, fees or strategy changes at the discretion of the fund. Another idea currently under consideration is the introduction in the legal regime of a new type of management company, specialising exclusively in customized investment funds. Once the change is approved by the legislator, the creation of new closed-end investment funds would involve lower costs, and the product itself would more closely meet investors' needs.

The key benefits of discontinuing supervision over closed-end investment funds issuing non-public investment certificates include:

- abandonment of inadequate requirements for tailor-made products for professional investors, who expect greater flexibility rather than protection by state supervision bodies,
- lower costs and shorter time of launching closed-end investment funds issuing non-public certificates,
- rationalisation of supervision over investment funds – focus on supervision over mass products – open-end investment funds.

Proposal to discontinue state licensing for brokers and investment advisers

In 2010, the PFSA Office drafted a proposal to discontinue state licensing for natural persons practising certain professions and terminate direct supervision over such persons. This concerned in particular persons employed in financial market institutions, holding specific professional licences: securities broker, investment adviser, commodities broker, actuary, natural person acting as agent for an investment firm. Another objective behind the project is to ensure uniform regulation across the sectors with respect to licensing, and to concentrate supervision efforts on large entities – financial market institutions. The current dual supervision over the financial markets, meaning supervision over both financial institutions and natural persons, does not facilitate effective supervision as the attention of the supervision authority, instead of being fully focused on financial institutions, is also devoted to overseeing natural persons employed by the institutions. A practice has emerged to employ licensed individuals at financial institutions because the institutions are obliged to do so, but since there is no statutory obligation that specific activities be performed by those persons, in practice the activities are often performed by persons without a licence.

The proposal was to abolish regulated professions (securities broker, investment adviser, commodities broker) as well as state examinations for obtaining a professional licence. Instead,

it provided for a requirement that certain “sensitive” functions at financial market institutions be performed by employees having specific knowledge and professional qualifications, which are tested by market institutions rather than by the supervision authority through state examinations. The proposal also envisaged a supervisory measure - examinations testing the knowledge of individuals employed at financial institutions in the event that the supervision authority becomes aware of any irregularities in their work.

Lower number of supplements to prospectuses

At the end of 2010, the PFSA Office launched a campaign designed to reduce the number of supplements to prospectuses, by drawing issuers’ attention to frequent cases of unnecessary submission of supplements containing information whose publication is not actually required by applicable laws and leads to an information surplus, which may divert investors’ attention from factors vital in investment decision making. The approach adopted by the PFSA found expression in the official position of the PFSA Office, published on the Office’s website in mid November. Acting in compliance with the position should reduce the amount of work for issuers’ and improve clarity of their communications.

Streamlining the catalogue of issues reserved for the exclusive competence of the PFSA acting in gremio

The proposal is to both reduce and concurrently make uniform, within particular sectors, the categories of issues reserved, under Art. 12.2 of the Act on Market Supervision of July 21st 2006, for the exclusive competence of the PFSA Office acting in gremio. The proposal is to increase the number of issues which may be submitted, by way of authorisation, for resolution by the PFSA Chairperson, PFSA Deputy Chairperson or employees of the PFSA Office. This should, on the one hand, reduce the number of less important issues considered at meetings, and on the other hand, speed up the process of their consideration as there will be no requirement to address them at meetings. Given the objective to ensure effective operation of the supervision authority, the list of such issues should not be excessively expanded, but should certainly include decisions which are crucial for particular entities’ participation in trade (in particular matters related to the grant of authorisation or entry in the register as a pre-condition for launch of operations), as well as particularly severe supervisory sanctions (especially fines). The scope of the planned reduction will be determined at a PFSA meeting and then submitted as a legislative proposal to the Minister of Finance.

Removal of the requirement to obtain an authorisation to keep commodity accounts and registers

The PFSA Office proposes to remove the requirement to obtain an authorisation to keep commodity accounts and registers by entities referred to in Art. 9.3.4 of the Commodities Exchange Act (e.g. power utilities).

The proposal follows from the nature of activities performed by those entities on a commodities exchange under their authorisation. Unlike other entities, e.g. investment firms, which are authorised to intermediate in such brokerage activities on the commodities exchange as purchase or disposal of commodities for a third party’s account or offering advice on trading in such commodities, power utilities and legal persons, as customers entitled to use transmission services, may enter into transactions on a commodities exchange to a limited extent – exclusively in their own name and for their own account.

The Act Amending the Act on Trading in Financial Instruments and Some Other Acts, dated September 4th 2008, materially changed the existing model of supervision over the commodities market in Poland. Commodity derivatives now belong to the group of financial instruments referred to in Art. 2 of the Act on Trading in Financial Instruments. Therefore organised trading in commodity derivatives can take place only on regulated markets (an exchange or OTC market) or via alternative trading facilities operated by investment firms or regulated markets. This has necessitated a transfer of the regulations governing commodity derivatives from the Act on Commodities Exchanges to the Act on Trading in Financial Instruments. In consequence, the limitation of the subject matter of the Act on Commodities Exchanges solely to regulations governing the physical commodity market, excluding property rights, which due to the nature of entities trading in property rights (power utilities) will not qualify under the Act on Trading in Financial Instruments as financial instruments, also limits the nature and scope of the authorisation granted by the PFSA. As a result of legislative changes, the purpose of accounts and registers has been limited to the registration of only property rights (derivative instruments which, however, are not financial instruments) in accounts and entry of various types of energy and production limits in registers.

The current practice is that an authorisation to keep commodities registers or accounts, granted to power utilities by the PFSA, covers only the registration of electricity and property rights from physical market of commodities acquired

in one's own name and for one's own account. Moreover, there are no detailed legal requirements directly applicable to the registration of commodities by power utilities.

Given the reduction in the number of commodity types, the nature of transactions (in one's own name and for one's own account) and the small group of entities concerned, it can be concluded that under the current legal framework granting an authorisation to keep commodity accounts or registers generally does not facilitate trading in the commodity market, does not enhance liquidity on the market, and does not support correct operation of the market, but rather places an additional burden on enterprises and the PFSA Office.

Streamlined registration of employee pension schemes

At the end of 2010, the PFSA Office developed and placed on its website forms of agreements for setting up employee pension schemes. The development and publication of the forms on the website will significantly reduce errors occurring in agreements attached by employers setting up an employee pension scheme to applications for entry of their schemes in the register of employee pension schemes, and will help to limit the number of incorrectly submitted applications. This step will streamline the process of creating employee pension schemes. At the same time, the acceleration and simplification of proceedings for registration of employee pension schemes may be an incentive for employers to set up such schemes.

Moreover, the availability on the PFSA Office's website of the form of the application for entry of a scheme in the register of employee pension schemes and the use of the form by employers submitting applications has clearly helped to eliminate formal defects in the applications, and thus markedly shortened the formal and legal analysis of applications for entry of schemes in the register of employee pension schemes, by eliminating the need to frequently call upon employers to rectify numerous formal errors. This in turn has automatically shortened the duration of proceedings for entry of schemes in the register of employee pension schemes.

Removal of the obligation to hold administrative proceedings prior to imposition of fines by the PFSA on the capital market

The proposal is to remove the obligation to hold administrative proceedings prior to issuing decisions imposing a fine on the individual categories of entities operating on the capital market. Such decisions are issued based on the provisions of the Act on Trading in Financial Instruments, dated July 29th 2005, the Act on Public Offering and Introduction of Financial Instruments to Organised Trading, and Public Companies, dated July 29th 2005, the Act on Investment Funds of May 27th 2004, and the Act on Commodity Exchanges of October 26th 2000.

The obligation to hold administrative proceedings prior to imposing a fine on an entity operating on the capital market has no rationale as no such obligation exists with respect to analogous decisions regarding banks, insurance companies or pension fund management companies. The obligation to hold administrative proceedings makes the process more complicated, and formal requirements related to administrative proceedings provide their participants with an array of opportunities to prolong the proceedings and try to avoid administrative liability. A sufficient solution in this case are the general provisions of Art. 89 of the Polish Code of Administrative Procedure, which make the requirement to hold administrative proceedings contingent on the merits of a given case or procedural considerations.

Proposal to remove certain information requirements

The PFSA Office has commenced work on draft amendments to Resolution No. 389/2008 of the PFSA, containing a proposal to remove the requirement to provide documents confirming the education background of a candidate for the post of member of a bank's management board, and replace it with a requirement that such candidates make representations specifying in detail the schools and courses they completed.

Off-site supervision

3



3. Off-site supervision

Off-site supervision of the financial market involves ongoing monitoring and assessment of the overall situation in the sector as well as of the position of individual institutions, identification of the existing or potential risks, and, where necessary, implementing intervention measures.

Based on the submitted reports, surveys and other available information, financial institutions' economic and financial standing and exposure to particular risks are regularly analysed and assessed. The assessment covers mainly changes occurring at the regulated entities and compliance with the applicable regulations, notably those pertaining to capital adequacy.

3.1. Banking supervision

The aim of the supervision exercised by the Polish Financial Supervision Authority over the banking sector is to ensure security of funds in bank accounts and compliance of banks' operations with applicable laws and relevant authorisations.

In 2010, the PFSA continued to implement the measures enabling continuous monitoring of the regulated entities' operations and, in particular, their liquidity positions. They allowed the PFSA to monitor the banks' liquidity positions on an ongoing basis. As a result of these efforts, the liquidity risk did not materialise at any of the regulated banks. The PFSA immediately reacted to any signs of problems experienced by groups of companies, which could affect the situation of their subsidiaries operating in Poland, by focusing on meetings with banks' management boards, and communicating with their home supervision authorities. The possible impact of obligations imposed by the European Commission on banking groups which received state aid on the operations of their Polish subsidiaries was also monitored.

The PFSA paid particular attention to transactions with possible features of unjustified repatriations of funds to parent companies. In its regular monitoring activities no such

transactions were identified. In addition, the regulator issued a recommendation that banks should assume a careful approach towards dividend payment and allocate the largest possible part of 2009 earnings to equity.

The supervisory efforts were focused on a number of areas: additional regulatory instructions and recommendations, monitoring tasks, meetings with banks' managements, communication with home regulators, and participation in the work of the Financial Stability Committee. The efforts included:

- an analysis of the level of conformity at banks with the amended Act on Trading in Financial Instruments,
- continued monitoring and analysis of FX derivative transactions entered into with non-financial entities,
- working with government bodies on the best possible solution to the problem of FX derivative transactions executed by companies in the context of unpredicted market changes,
- analyses and opinions concerning the assumptions underlying bank merger processes,
- actions with respect to cooperative banks failing to meet the minimum equity requirement of EUR 1m.

3.1.1. Monitoring of the financial standing of banks

The supervisory activities involved ongoing monitoring and quarterly analyses of the banks' financial and economic positions. Based on the analysis results, the banks were awarded points according to the CAEL rating system⁹ and areas of potential risks that should be subject to detailed investigation during the inspection were identified. The conclusions were presented in executive summaries. According to the principle of supervision transparency, information on the CAEL ratings

(along with rating justification) was communicated to the management and supervisory boards of the banks, and in the case of banks under recovery proceedings and banks using loans from the Banking Guarantee Fund ("the BGF") – also to the BGF. CAEL ratings are assigned on a quarterly basis.

In the area of consolidated supervision, the regulator reviewed consolidated financial statements of banks and the economic

⁹ Components of the CAEL rating system are: C – capital adequacy, A – asset quality, E – earnings, L – liquidity.

and financial standing of banking groups and holding companies. Direct off-site supervision involved the selection of banks for comprehensive and problem-oriented inspections, and the results of the selection process were passed to the PFSA Office's organisational units responsible for inspection. Also, relevant data was gathered for the purposes of inspections carried out at banks. As for supervision of cooperative banks, 813 periodic analyses were prepared, including 235 analyses of the largest banks.

In 2010, the working group for the supervisory review and assessment (BION) methodology completed its work aimed to modify the BION testing procedure and unify the BION testing rules. The BION methodology was notified to all banks. In the course of work on the implementation of the methodology at cooperative banks, eight BION-related regulatory statements were given to associating banks, which included explanations or supervisory guidance. In December 2010, new questionnaires were sent to banks. The first BION scores will be assigned to banks based on the data as at December 31st 2010.

In view of financial difficulties suffered by some borrowers and borrower groups, comprehensive and ad hoc comparisons were made, compliance with concentration limits was monitored, and equity and personal links between banks and particular borrower groups were analysed. As in previous years, in 2010 comparative analyses were prepared to examine the manner in

3.1.2. Monitoring of banks' compliance with applicable regulations

Banks' compliance with applicable laws (such as the Banking Law, regulations issued by the Minister of Finance and the PFSA resolutions) was subject to regular analyses, which also covered compliance with prudential standards. Furthermore, the correctness of reports prepared by banks was reviewed. If any errors or deficiencies were discovered, the bank was required to make the necessary corrections. As for supervision of cooperative banks, 193 letters were drafted concerning the classification of credit exposures to particular risk categories and information was prepared on solvency ratios and equity of cooperative banks for use by the Financial Stability Committee.

In the period under review, as in 2009, all commercial banks held equity in the required amount. As at the end of 2010, all cooperative banks met the minimum equity requirement of

which debt owed by the same borrower is classified by different banks and how shareholder structures of some major bank clients are presented; if any discrepancies were identified, relevant steps were taken with respect to the regulated entities involved.

The PFSA continued to implement the measures taken in the previous year with respect to the regulated entities to enable continuous monitoring of their operations and, in particular, their liquidity positions. The PFSA immediately reacted to any signs of problems experienced by groups of companies, which could affect the situation of their subsidiaries and branches operating in Poland, by focusing on meetings with banks' management, communicating with their home supervision authorities, participating in meetings of supervisory bodies, and regulatory activities.

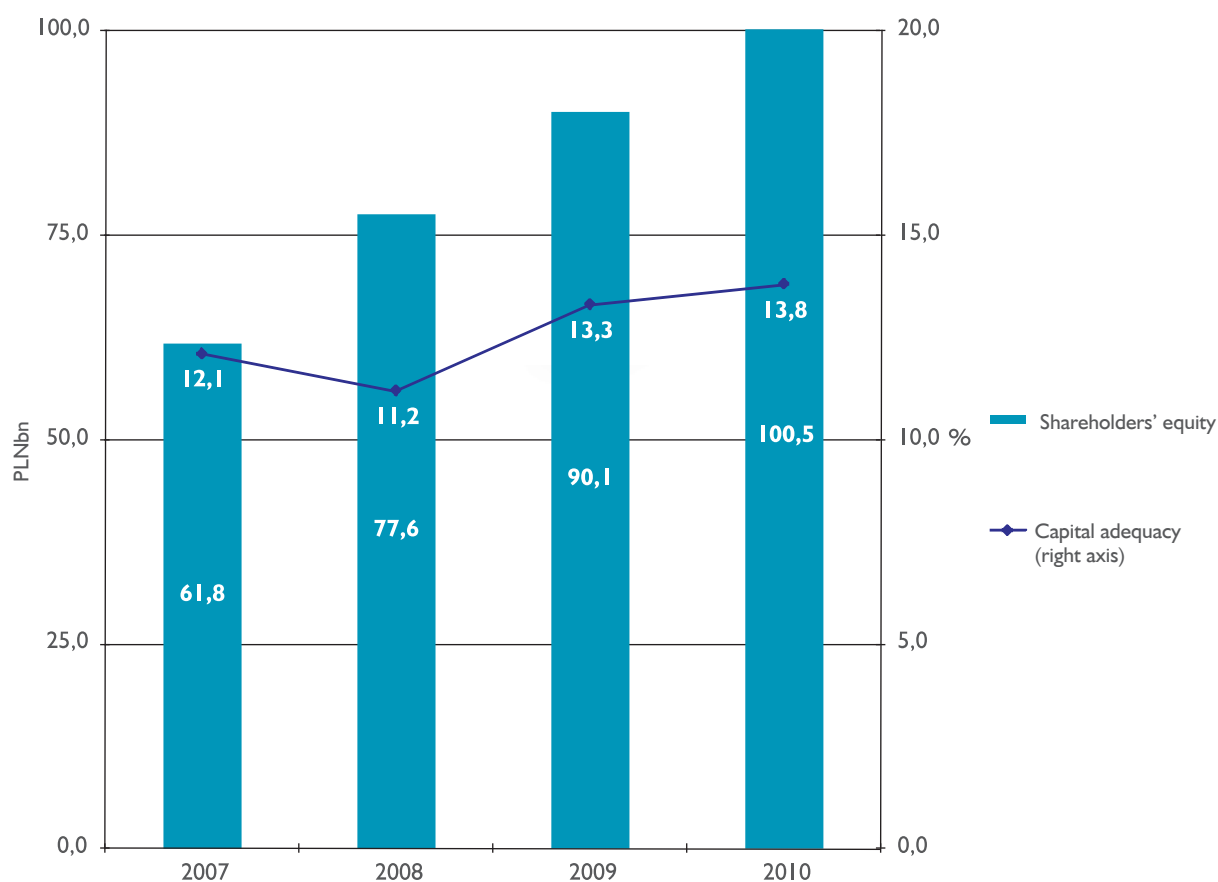
Furthermore, the Polish Financial Supervision Authority performed comprehensive off-site supervision tasks dealing directly with operations of individual banks, which enhanced the security of the Polish banking sector, and approved Reports on the Situation of Banks, prepared for each quarter of 2010 (based on monthly and quarterly reports filed by banks with the National Bank of Poland and based the Report on Financial and Economic Ratios, which provided peer reference). Said documents (and their English translations) are widely available through the PFSA website.

EUR 1m (in 2009, one bank failed to meet the requirement as a result of having incurred a balance-sheet loss).

The key capital requirement for the banking sector was the credit risk requirement, which amounted to PLN 50.8bn, representing 87.3% of the total capital requirement (PLN 58.2bn). The requirement's portion related to operating risk was PLN 6.3bn, which accounted for 10.8% of the total requirement. The share of the requirements relating to other types of risk was marginal.

The discharge by banks of an obligation to file consolidated financial statements of banks, banking groups, subsidiary companies and closely related undertakings, as stipulated under Art. 141g of the Banking Law, was monitored.

■ FIG. 10. SHAREHOLDERS' EQUITY AND CAPITAL ADEQUACY RATIO OF THE POLISH BANKING SECTOR, 2007-2010



3.2. Supervision over insurance market

The insurance market supervision covers institutions active in the insurance and reinsurance business. The purpose of the insurance market supervision is to ensure stability of the insurance market, surveil the legal compliance of the insurers' and reinsurers' business, and protect the interests of the insuring parties, the insureds, and the beneficiaries and holders of rights under insurance agreements.

Key activities related to the ongoing off-site supervision involve:

- monitoring solvency of the companies, monitoring the safety, liquidity and profitability of investments and of the matching of assets with technical provisions,
- monitoring the discharge by insurers and reinsurers of their reporting and disclosure obligations towards the supervision authority and insurance clients, based on their financial statements and other information required by the applicable laws¹⁰,
- taking the legally defined steps and carrying out supervisory activities with respect to the regulated entities, and issuing administrative instruments, including decisions and rulings, in such cases,
- issuing recommendations in connection with the ongoing supervision exercised over insurance and reinsurance companies, monitoring the companies' compliance with such recommendations, and imposing relevant sanctions in the case of non-compliance,
- considering the regulated entities' applications to be granted certain rights or to be granted authorisations for certain activities subject to financial supervision,
- issuing opinions in the scope of accounting, reporting and actuarial science.

¹⁰ Insurers and reinsurers are required to file with the PFSA the following types of financial statements: quarterly and annual financial statements, consolidated financial statements, statements concerning coinsurance and transactions carried out within an insurance group, actuary's reports, statements concerning unit-linked insurance plans and IKE individual retirement accounts.

3.2.1. Monitoring of the financial standing and investment policies of insurance and reinsurance companies

As part of its remit to exercise off-site supervision of the financial standing and investment policies of insurance and reinsurance companies, the PFSA's key objective is to ensure ongoing monitoring and safeguard the financial stability of the market, and take appropriate remedial measures in the event of any identified threats. The overall goal of those activities is to guarantee that insurance companies have the ability to pay benefits due to entitled persons.

In assessing the financial standing of both life and property insurers, and their solvency in particular, the PFSA relied chiefly on their quarterly and annual financial statements and monthly reports on solvency ratios filed with the regulator. The financial statements are subject to a review, whose results are then compiled into uniform reports intended as the basis for further decision making by the regulator. In 176 cases, the PFSA Office requested insurance companies to provide relevant corrections or supplementary information to the financial statements. Following the review of reports on the status of insurance portfolios for 2009, prepared by insurance companies' actuaries, the PFSA Office requested insurance companies (mainly from Segment II) to provide additional information or explanations, or to make the necessary corrections to the filed reports.

In 2010, the PFSA Office continued to analyse the degree of bank deposit concentrations and to assess the level of protection of insurance companies against the risk of excessive investment concentration, taking into account their surplus solvency margins. The analysis and assessment were performed based on the information submitted to the regulator under an obligation imposed on insurance companies in 2008 to file monthly reports on key solvency ratios, quarterly reports on investments and transactions executed within an insurance group, and, in the case of insurance companies in Segment I, reports on insurance products with embedded structures.

The regulator continued to hold meetings with insurance company representatives and sent letters to insurance companies encouraging them to reduce excessive concentration of investments in a single entity or a single asset class. In reaction to the PFSA Office's supervisory actions, insurance companies took steps to limit concentrations in credit institutions.

During the year, the operation of the automobile insurance system in 2005-2009 was subject to analysis, which covered a

review of premium rate structures, results of operations, and discharge by insurance companies of disclosure requirements related to changes in compulsory insurance rates. The results of the analysis served as the basis for preparation of the report *Automobile Insurance in 2005-2009*. Also, certain supervisory initiatives were undertaken which helped improve the performance by insurance companies of disclosure obligations as regards changes in the rates charged on compulsory motor TPL insurance. The next stage of the supervisory process was to analyse the adequacy of premiums charged by the insurance companies which repeatedly failed to report profit on this particular segment of insurance operations.

After analysis of the value of deferred tax assets and liabilities, it was discovered that in some cases deferred tax assets were incorrectly accounted for under equity and that insurance companies failed to create appropriate provisions. In such cases, relevant supervisory actions (including regulatory instructions) were taken with respect to the insurance companies concerned.

The regulator reviewed the data received from insurance companies concerning direct and indirect consequences of heavy rains in May and June 2010. The purpose of these efforts was to monitor on an ongoing basis the financial standing of insurance companies faced with the prospect of a sharp increase in the number of claims paid to the insured. In addition, an analysis conducted to assess the feasibility of insurance companies' financial plans revealed that their performance was seriously threatened by potentially high disbursements of compensation under flood risk insurance (relating to the floods of May and June 2010).

In the period under review, reports on the condition of the insurance sector after the first and second quarters of 2010 were being drafted. The conclusion drawn from the performed analysis was that the insurance market was stable. The identified instances of non-compliance with solvency requirements were temporary in nature and could be eliminated with appropriate recapitalisation and restructuring measures, such as reduction in operating expenses, changes in the rates of insurance premiums, or linking remuneration of insurance intermediaries to the loss ratio of an insurance contract portfolio. At the same time, major areas of concern were identified with respect to property insurance, i.e. extremely strong competition and large amounts of disbursements under flood insurance claims.

3.2.2. Oversight of the implementation of recovery plans and legal compliance by insurance companies

Following a review of the financial statements filed by the insurance companies, it was established that the available solvency margin was below the mandatory minimum prescribed by law (i.e. the higher of the required solvency margin and guarantee fund) in six cases. The PFSA issued three decisions approving recovery plans submitted by the relevant insurers,

and then monitored how the plans were implemented to bring the insurers into conformity with the legal requirements pertaining to available solvency margins. No final decisions were issued in 2010 under three other procedures. In one case, a sanction was imposed on an insurance company for non-compliance with solvency requirements.

■ TABLE 21. STATUTORY REQUIREMENT COVER RATIOS (%)

	2007	2008	2009	2010
Segment I insurance companies				
Available solvency margin to required solvency margin	347.33	285.77	345.96	316.58
Available solvency margin covering guarantee fund to guarantee fund	897.92	789.08	937.50	858.62
Assets covering provisions to technical provisions	108.8	108.6	108.88	109.06
Segment II insurance companies				
Available solvency margin to required solvency margin	667.05	642.71	363.16	390.48
Available solvency margin covering guarantee fund to guarantee fund	1,729.86	1,712.29	974.19	1,053.78
Assets covering provisions to technical provisions	153.9	154.8	116.73	124.52

The 2010 data shown in Table 35 was sourced from quarterly financial statements of the insurance companies (unaudited).

In exercise of ongoing supervision over the insurance sector, the PFSA Office:

- analysed internal regulations in place at insurance companies (including rules governing the creation of technical provisions and premium rate structures, and regulations required under the Solvency II regime) - 56 cases,
- reviewed the performance of regulatory instructions issued to insurance companies following inspections carried out by the regulator - 13 cases;
- as part of its remit to exercise ongoing supervision, reviewed the performance of instructions to bring the operations of insurance companies in compliance with applicable laws - 19 cases.

Following a review of performance of the obligation to set up audit committees by insurance companies, which was undertaken in 2010, it was established that in one third of the cases an audit committee was created and in two thirds of the cases responsibilities of an audit committee were assigned to the supervisory board. It was established based on the information obtained that detailed scopes of responsibilities of audit committees were defined in a separate set of rules (or a resolution under which the committee was created) or, alternatively, in amended rules of procedure for the supervisory board. In reaction to the findings, relevant recommendations on the operation of audit committees were issued.

Furthermore, in 2010 the PFSA Office continued its efforts aimed at preparing the regulator and the regulated entities to the new reality of functioning under the Solvency II regime. In order to assess the level of preparation of insurers and reinsurers for the implementation of corporate governance requirements stipulated under Solvency II, a self-assessment survey was conducted covering risk, solvency, and risk management at insurance and reinsurance companies (the survey was continuation of the 2008 survey on risks at insurance companies and the 2009 and 2010 questionnaire on the operation of corporate governance systems at insurance companies). Based on the survey, it was concluded that much work was needed to bring the risk and capital management systems in place at the majority of insurance and reinsurance companies in compliance with the requirements of the Solvency II directive. Currently, the progress in drafting relevant regulations by insurance companies is monitored.

In March 2010, a survey concerning internal models was conducted among domestic insurance and reinsurance companies. The survey forms were sent to 27 domestic insurance companies which in the previous survey of November 2nd 2009 indicated that they were working on internal models to be used in the future to calculate the SCR solvency requirement under the Solvency II regime. The survey was designed as a source of intelligence for the PFSA officials as

regards the progress of work on the implementation of internal model requirements stipulated by the Solvency II directive, methods/models applied in modeling particular risks, key variables used in internal models, the expected start date of the pre-application process and planned date for submitting the relevant applications. The results of the survey will help the Insurance and Pension Supervision Department of the PFSA Office carry out tasks related to the internal model approval process to be implemented in the future under the Solvency II regime.

In September 2010, the report *Approval of Internal Models Used by Insurance Companies to Calculate the Solvency Capital Requirements under the Proposed Solvency II Regime* was drafted. The purpose of the report was to present the progress of work at domestic insurance and reinsurance companies on the development of internal models, as well as experience of foreign regulators related to the internal model approval process. Based on this information, steps to be taken by the PFSA Office in order to gradually introduce supervisory practices facilitating proper execution of the internal model approval process under Solvency II were identified and specified in the report.

To analyse risks inherent in current operations of an insurance or reinsurance company and to assess the progress of work on developing an effective risk management system, including own risk and solvency assessment (ORSA), on August 11th 2010 the PFSA Office sent an own risk and solvency assessment and risk management survey forms to insurance and reinsurance companies. Based on the responses provided, a summary report was drafted in December 2010 containing highlights concerning risk and capital management systems and the assessment of particular risks taking into account the quality of management. The full report presenting the results of the survey will be prepared in the first quarter of 2011.

In 2010, work on the application of stress tests for the purpose of exercising supervision over insurance and reinsurance companies was continued. The purpose of stress testing is to improve the quality of risk management at insurance and reinsurance companies and to prepare them for the implementation of certain solutions required under the

Solvency II initiative. The results of stress testing are also used by the PFSA Office in BION processes.

In January 2010, insurance and reinsurance companies returned the results of pilot stress tests performed using input data sourced from the 2008 financial statements. The results served as the basis for preparation of the report *Results of Pilot Stress Testing in the Insurance Sector*. The results also helped revise the stress testing methodology, following which insurance and reinsurance companies were asked to perform stress tests on the 2009 data using the revised methodology. Simultaneously, the PFSA Office conducted its own stress tests using the reporting data held by the regulator, and presented the results in the report *Results of Stress Testing of the Insurance/Reinsurance Sector for 2009*. The report contained a description of the methodology used, the results of internal and external stress tests, and a comparison between them.

Guided by the stress testing results, the regulator requested selected insurance companies to provide information on the proposed distribution of their 2009 profits to be able to assess their financial standing in the light of negative test results. . For a detailed description of stress tests performed in the insurance sector, see Section 3.6.

Regulations governing the insurance business place insurance companies under various disclosure obligations towards the regulator and consumers. The duty of the regulator in this respect is to verify whether a disclosure was actually made and to verify its content. The timely and full discharge of disclosure obligations is one of the key duties of insurance companies, which ensures that the regulator and users of insurance services are given access to selected operational data.

The results of analysis performed by the PFSA Office suggest that insurance companies, save for rare exceptions, fulfil the disclosure requirements as stipulated under applicable laws. The instances of non-compliance are considered on a case by case basis to determine whether the imposition of fines provided for under the law is justified. Under proceedings conducted by the PFSA, a fine was imposed on one insurance company.

3.3. Supervision over pension market

Offsite supervision over the pension market covers the financial standing as well as operating and investment activities of pension funds (2nd and 3rd pillar of the pension system), occupational pension schemes, and individual pension accounts (3rd pillar of the pension system). The PFSA Office also monitors the

above institutions in terms of compliance with applicable laws and their articles of association as well as in terms of fulfilment of disclosure requirements. The goal behind the supervisory efforts is to protect the interests of pension fund members and participants in occupational pension schemes.

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

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

- analysis of capital market transactions in terms of 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 of pension funds with respect to compliance with the overriding principle of investment profitability and security,
- review of the valuation of financial instruments held in pension funds' investment portfolios,
- analysis of the structure of pension funds' investment portfolios and its changes over time, as well as of accepted risk levels,
- analysis of available financial instruments offered on the capital market in terms of their usefulness for the investment activities of pension funds,
- assessment of the effectiveness of the investment activity of pension funds considering the conditions prevailing on capital markets and macroeconomic environment,
- analysis of internal procedures and declared rules of conducting investment activities at regulated entities.

A special task of the supervision authority is to review pension funds' detailed valuation methodologies applied to financial instruments for which there is no market or it is impossible to value them on the basis of market inputs, while observing the principle of conservative valuation. During the period covered by this report, 190 valuations submitted by open-end pension

funds and 17 methodologies proposed by occupational pension funds were subject to approval by the supervision authority. The authority issued eight instructions to change the valuation methodology in the case of open-end pension funds, and four instructions in the case of occupational pension funds.

As financing provided by employers accounts for a high share of current financing of occupational pension fund management companies, supervision over occupational pension fund management companies is largely exercised on an indirect basis, with particular focus on monitoring the continuity of financing. This supervision is necessary to ensure the financial security and business continuity of the companies. It was found that shareholders in occupational pension fund management companies cover the operating costs of the companies on an ongoing basis, and balances of amounts due at the end of particular quarters result directly from the adopted settlement systems. Another characteristic feature of occupational pension fund management companies is that they rely to a larger extent on outsourced processes compared with pension fund management companies. As a result, supervision activities partly cover entities other than occupational pension fund management companies.

In the period covered by this Report, the PFSA calculated and published the average weighted rates of return of all open-end pension funds twice – for the periods March 30th 2007 – March 31st 2010 and September 28th 2007 – September 30th 2010. In both periods, all open-end pension funds achieved rates of return above the required minimum.

■ TABLE 22. STATUTORY RATES OF RETURN OF OPEN-END PENSION FUNDS CALCULATED AND PUBLISHED BY THE PFSA IN 2010 (%)

OPEN-END PENSION FUND	RATES OF RETURN FOR THE PERIOD FROM MARCH 30TH 2007 TO MARCH 31ST 2010
Generali OFE	4.824%
OFE Allianz Polska	4.780%
Amplico OFE	4.617%
AXA OFE	4.132%
AEGON OFE	3.458%
OFE Pocztynion	3.051%
OFE PZU „Złota Jesień”	2.818%
Nordea OFE	2.373%
ING OFE	2.317%
PKO BP Bankowy OFE	2.299%
Pekao OFE	1.538%
Aviva OFE Aviva BZ WBK	1.280%
OFE WARTA	0.514%
OFE POLSAT	0.000%
Weighted average rate of return	2.901%
Minimum rate of return	-1.099%

OPEN-END PENSION FUND	RATES OF RETURN FOR THE PERIOD FROM SEPTEMBER 28TH 2007 TO SEPTEMBER 30TH 2010
Generali OFE	5.224%
AXA OFE	5.057%
Amplico OFE	4.888%
Allianz Polska OFE	4.803%
PKO BP Bankowy OFE	4.249%
OFE Pocztynion	4.181%
Nordea OFE	3.576%
AEGON OFE	3.417%
OFE PZU „Złota Jesień”	3.145%
ING OFE	2.993%
OFE WARTA	1.612%
Pekao OFE	1.566%
Aviva OFE Aviva BZ WBK	0.923%
OFE POLSAT	0.521%
Weighted average rate of return	3.360%
Minimum rate of return	-0.640%

In addition to supervision over the financial standing of pension fund management companies and investment activities of pension funds, the PFSA Office issued opinions interpreting the laws and regulations in force. The following reports on activities of the pension providers were submitted at the PFSA meetings:

- *Financial Standing of Universal Pension Fund Management Companies in 2009,*
- *Investment Activities of the Pension Funds in the Period March 30th 2007 – March 31st 2010,*
- *Financial Standing of Universal Pension Fund Management Companies in H1 2010,*

- *Investment Activities of the Pension Funds in the Period September 28th 2007 – September 30th 2010.*

In addition to the reports referred to above, the supervision authority also receives annual statements on the operation of occupational pension schemes by employers. All the information sent to the PFSA Office in the reported year was used to prepare and publish monthly, quarterly and annual statistical and financial data concerning open-end pension funds, occupational pension schemes and individual pension accounts, as well as information on transfers and membership draws for open-end pension funds.

3.4. Supervision over capital and commodity market

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

- monitoring of the current standing of regulated entities on the basis of statements, reports and information submitted by the entities,
- checking compliance with capital requirements,
- preparation of opinions relating to materials for supervisory board meetings and general shareholder meetings of the companies operating the regulated market, the depository for securities, and the commodity market, as well as participation in the meetings,
- checking regulated entities' compliance with disclosure requirements.

3.4.I. Supervision over entities operating on the securities market

Investment firms and custodian banks

The PFSA supervises the financial standing of investment firms and custodian banks by analysing their financial statements submitted in accordance with applicable laws.

The principal supervision activities include reviewing financial statements submitted by regulated entities in performance of their legal obligations and reviewing reports on internal control at entities conducting brokerage activities, as well as issuing instructions and monitoring their implementation.

■ **TABLE 23. AVERAGE CAPITAL REQUIREMENTS (PLNM) AND AVERAGE CAPITAL REQUIREMENTS COVERAGE RATIOS AT BROKERAGE HOUSES AND BANKS CONDUCTING BROKERAGE ACTIVITIES, 2007-2010**

	2007		2008		2009		2010
	BROKERAGE HOUSES	BANKS CONDUCTING BROKERAGE ACTIVITIES	BROKERAGE HOUSES	BANKS CONDUCTING BROKERAGE ACTIVITIES	BROKERAGE HOUSES	BANKS CONDUCTING BROKERAGE ACTIVITIES	BROKERAGE HOUSES
Average regulated capital	28.33	51.11	33.83	44.06	33.53	43.40	46.20
Average total capital requirement	5.71	3.81	4.78	2.68	5.41	3.08	19.66
Average deviation of regulated capital from total capital requirement	22.44	47.30	28.98	41.38	28.07	40.32	26.54
Average fixed cost capital requirement	3.99	6.78	5.06	5.26	7.03	4.37	not applicable
Average deviation of regulated capital from fixed cost capital requirement	24.18	44.33	28.70	38.80	26.45	39.03	not applicable
Average deviation of regulated capital from minimum founding capital	25.73	47.91	31.44	41.23	30.47	40.49	43.70
Average coverage of total capital requirement with regulated capital*	4.96	13.41	7.07	16.46	6.20	14.10	2.35
Average coverage of the fixed cost capital requirement with regulated capital*	7.10	7.54	6.68	8.38	4.77	9.93	not applicable
Average coverage of minimum founding capital with regulated capital*	14.07	17.79	15.67	17.26	15.25	16.86	26.67

* Data expressed in abstract units, representing the average quotient of the regulated capital to the individual capital requirements. Data sourced from monthly MRF-form statements as at December 31st 2007, December 31st 2008, December 31st 2009, and December 31st 2010.

January 1st 2010 saw the entry into force of the amended Act on Trading in Financial Instruments, dated July 29th 2005 as well as of the regulation of the Minister of Finance on the scope and detailed rules for determination of the total capital requirement, including capital requirements, for brokerage houses, and on the maximum ratio of loans and debt securities in issue to capital, dated November 18th 2009 (Dz.U. No. 204, item 1571), regulating capital adequacy for brokerage houses. Compared with the legislation previously in force, the manner of calculating regulated capital and capital requirements for particular risk types was modified. The change involved primarily the inclusion of a new requirement type for the total capital requirement, namely the operational risk requirement, and introduction of the requirement for brokerage houses to

estimate internal capital as a separate item compared with the level of regulated capital. The regulations on estimating internal capital took effect on June 17th 2010.

The inclusion of the operational risk requirement into the total capital requirement increased the overall capital requirement for brokerage houses. Given the capital surpluses at brokerage houses, changes in the regulations did not result in problems with fulfilling the capital adequacy requirements.

Pursuant to the Regulation of the Minister of Finance on supervisory review and assessment of brokerage houses, dated November 20th 2009, in September 2010 the PFSA Office commenced supervisory assessments of brokerage houses.

3.4.2. Supervision over securities issuers other than investment funds

The tasks of the Financial Supervision Authority include supervision over the performance of obligations stipulated in the Public Offering Act and the Act on Trading in Financial Instruments by issuers whose securities are admitted to trading on the regulated market. In this capacity, the PFSA reviews all inside, current and periodic information submitted by those issuers in terms of compliance with formal and legal requirements. In particular, the PFSA checks whether the information was submitted on time and whether it contains all elements required by law.

In 2010, the supervisory authority reviewed for compliance with the applicable laws approximately 26 thousand current, periodic and confidential reports filed by public companies, and approximately 2.5 thousand notifications submitted by buyers and sellers of major holdings of shares in public companies, pursuant to Art. 69 of the Public Offering Act (Dz.U. of 2009, No. 185, item 1439, as amended), as well as approximately 2.5 thousand notifications submitted by obliged entities under Art. 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 inside information related, whether directly or indirectly, to the issuer, and are authorised to make decisions concerning the issuer's development and economic prospects - Dz.U. of 2010, No. 211, item 1384, as amended).

Moreover, the PFSA issues decisions concerning requests submitted on the basis of the Public Offering Act (Dz.U. of 2009, No. 185, item 1439, as amended):

- under Art. 58.1 (request for granting the status of an information agency),
- under Art. 62.1 (request for release from the obligation to disclose information other than inside information),
- under Art. 62.4 (request for consent for an issuer based in a non-member state, for whom Poland is the home state, to file - instead of certain current and periodic information specified in Art. 56 of the Public Offering Act - information required by the laws of the state where the issuer is based, provided that such information is equivalent to the information specified in Art. 56 or is deemed equivalent pursuant to regulations issued under Art. 60.2 or the rules referred to in Art. 61,
- under Art. 71 (request for release from the obligation to provide the notification referred to in Art. 69 of the Act),
- under Art. 91 (request for an authorisation to convert shares into certificated form), and checks whether its decisions are complied with.

In 2010, the PFSA issued one decision on granting the status of an information agency and 12 decisions on conversion of shares into certificated form.

Moreover, the PFSA drafted an amendment to the Minister of Finance's Regulation on current and periodic information to be published by issuers of securities and conditions for recognition as equivalent of information whose disclosure is required under the laws of a non-member state, dated February 19th 2009 (Dz.U. of 2009, No. 33, item 259). The proposal is to lift the obligation to publish current reports on economic events. The requirement to publish price-sensitive information on important economic events would follow only from Art. 56.1.1 of the Public Offering Act (Dz.U. of 2009, No. 185, item 1439, as amended), referring to inside information. Upon occurrence of significant economic events issuers would not have to apply the universal materiality criterion imposed by the Regulation but would rather assess on a case by case basis the accuracy and potential effect on the price or value of a security.

The activities performed by the PFSA Office in 2010 as part of supervision over reporting by securities issuers other than investment funds included:

- review of financial statements (including consolidated financial statements) of 64 issuers in terms of their compliance with applicable accounting standards, especially International Accounting Standards / International Financial Reporting Standards ("IAS/IFRS"), selected based on the selection rules referred to in Standard No. 1 - Enforcement of Standards on Financial Information in Europe - of the Committee of European Securities Regulators (CESR); the results of the review are used to prepare a report, which is then published on the PFSA website;
- preparation and delivery of 119 positions and opinions, including 80 for external entities, concerning, among other things, application of IAS/IFRS, historical financial information presented in prospectuses, correctness of fulfilment by issuers of disclosure requirements related to periodic reports, and in connection with proceedings conducted by the PFSA Office with respect to reporting by securities issuers.

In 2010, as a result of activities undertaken on the basis of the above-mentioned regulations, the PFSA published information on an illegal action taken by an issuer in connection with a public offering of securities and seeking of admission of securities to trading on the regulated market. The case in question involved failure to publish, in the form of a supplement to an approved prospectus, information on material factors relevant to the assessment of the offered securities.

Tender offers to acquire or exchange shares in a public company

One of the PFSA's duties is to oversee formal and legal compliance of announcing and carrying out tender offers to acquire or exchange shares in a public company in connection

with shareholders exceeding particular thresholds of total vote. If an announced tender offer does not meet statutory requirements, the PFSA may demand that the terms of the offer be changed or supplemented, or may require explanations regarding the offer. 2010 saw the announcement of 26 tender offers to acquire or exchange shares in a public company, with a total value of approximately PLN 6bn. In 2009, the aggregate value of shares covered by tender offers was approximately PLN 3.2bn, which means that the value of public company acquisitions almost doubled relative to the previous year. From the above total number of tender offers, 10 were announced

in connection with exceeding the 33% threshold of total vote in public companies, and another 10 tender offers were announced in connection with exceeding the 66% threshold of total vote and covered all remaining shares in the companies. Moreover, in 2010 two tender offers were announced for all remaining shares in the companies, and the offers were connected with the procedure of conversion of the shares back into certificated form (rematerialisation of the shares). In the case of one tender offer, the PFSA demanded that the terms of the tender offer be changed, as one of the terms for acquisition of shares under the offer was inadmissible under Polish law.

3.4.3. Supervision over undertakings for collective investment

The supervisory duties of the PFSA in relation to investment fund management companies and investment funds, once they receive the required authorisations, include monitoring of their current condition through analysis of current reports, current information, and periodic statements and reports.

Performing its supervisory tasks in relation to investment fund management companies and investment funds, the PFSA also regularly reviews the information sent by investment fund depositaries under Art. 231 of the Act on Investment Funds of May 27th 2004 (Dz.U. No. 146, item 1546, as amended).

■ TABLE 24. NUMBER OF REVIEWED CURRENT AND PERIODIC REPORTS OF INVESTMENT FUND MANAGEMENT COMPANIES AND INVESTMENT FUNDS, AND INFORMATION FROM DEPOSITARIES, 2007-2010.

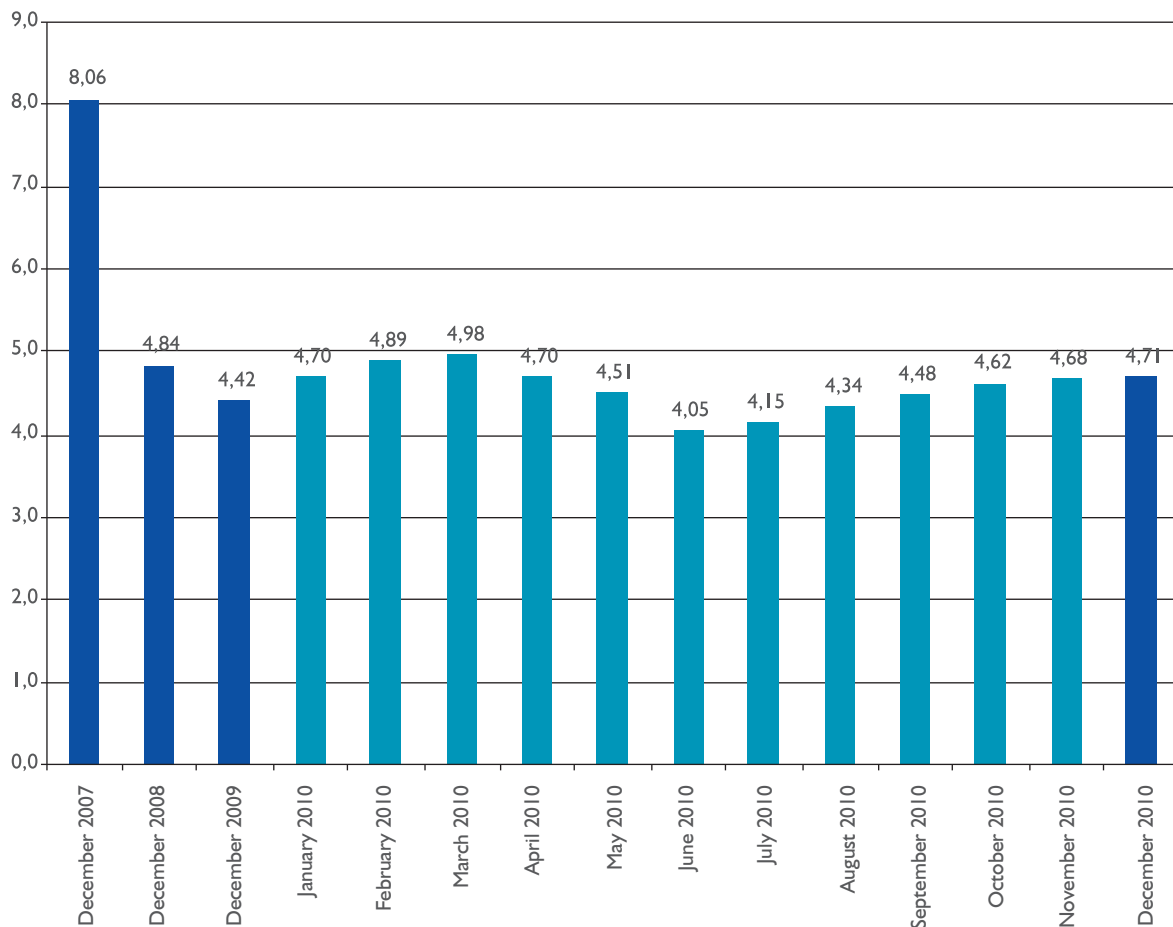
TYPE OF REPORT/INFORMATION	NO. OF REPORTS			
	2007	2008	2009	2010
Current and periodic reports of investment fund management companies	1,972	2,115	3,291	2,361
Current and periodic reports of investment funds	9,724	11,973	13,381	12,957
Information from depositaries	2,514	3,227	2,437	2,421
Total	14,210	17,315	19,109	19,749

The PFSA also supervises the fulfilment of capital requirements by the investment fund management companies. Fig. 11 presents the average values of the capital coverage ratio

for the sector of investment fund management companies as at year end in 2007-2009 and in each month of 2010.¹¹

¹¹ Based on monthly reports filed by the investment fund management companies. Such reports are not audited or reviewed by qualified auditors, and so they may be subject to later revisions.

FIG. II. AVERAGE CAPITAL COVERAGE RATIOS OF THE INVESTMENT FUND MANAGEMENT COMPANIES AT YEAR END IN 2007-2009 AND IN 2010 (EQUITY TO MINIMUM CAPITAL REQUIREMENT)



The data presented in the above chart shows that in 2010 the capital position of the investment fund management companies was stable. The average capital coverage ratio for the entire sector of investment fund management companies exceeded 4, which means that the capital of the investment fund management companies was on average four times higher than the minimum obligatory equity required under the Act on Investment Funds.

As part of its annual activities, the PFSA also prepares reports on such matters as the financial standing and capital position of investment fund management companies and distribution activity of foreign investment funds in Poland. The reports are published on the PFSA's website.

3.5. Supervision based on risk analysis using the supervisory review and assessment (BION) methodology

Given the number of regulated entities¹² and the scale of their operations, there was a need to systematise the manner in which financial supervision is exercised, so as to ensure that supervisory measures are adequate to the level of risk incurred. For this reason, the PFSA Office launched a supervision system based on risk assessment.

Prudential supervision based on risk assessment, understood as an organisational concept whereby the processes, organisational solutions and allocation of resources are subordinated to the results of a risk assessment exercise, is supported by BION - supervisory review and assessment, carried out on a continuous basis.

The starting point for the BION methodology was the scoring model initially applied only to banks, but then significantly developed and extended to cover the remaining markets regulated by the PFSA Office, i.e. the insurance, pension and capital markets. The results of the BION exercise determine the intensity of follow-up supervisory activities, in particular inspections. This ensures a more efficient allocation of the PFSA Office resources, which are assigned to areas and entities with the highest risk profiles.

The BION procedure relies on all information available to the regulator, in particular on information obtained in the course of licensing procedures, communication with owners, reviews of periodic reports, inspections, visits and supervisory meetings, and on information sourced from responses to the PFSA Office's additional enquiries (questionnaires, supervisory requests, surveys, etc.). The BION process is supported by the PFSA Office's IT systems designed to handle the exchange of supervisory information with financial institutions, including:

- the Insurance Supervision System,
- the Indirect Supervision System,
- the Trading Supervision System, and
- the PORTAL System

In preparing the BION handbooks, a harmonised approach was adopted for all segments of the financial industry, taking into account the specifics of the individual sectors.

As part of the BION process, the regulator assesses:

- the risk exposure of the financial institution,
- the quality of management of the material risks incurred by the financial institution,
- the amount of capital held to cover the risks incurred by the financial institution, and
- the financial institution's compliance with the applicable laws and internal regulations.

Following the assessment, the financial institution is assigned, and confidentially advised of, a score which is the resultant of component scores assigned to the key risk areas and the quality of their management. The risks are assessed on a scale of 1 to 4, where 1 represents the best score and 4 represents the worst score, implying 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 reviewed area). One of the components of the final score is the risk management score, which rewards the institution for its implementation of risk identification and mitigation procedures.

A benefit offered by the BION approach is that it provides a mechanism for applying supervisory measures adequate to the score assigned to a given institution, aimed at improving the institution's position in areas generating excessive risk. The key criterion for determining the priority and frequency of supervisory measures is the actual risk exposure.

The risk class maps and definitions with respect to the financial market sectors covered by the BION methodology are available on the PFSA's website at: http://www.knf.gov.pl/o_nas/urzed_komisji/bion/index.html

In 2010, the working group for the supervisory review and assessment (BION) methodology completed its work aimed to modify the BION testing procedure and unify the testing rules in the banking supervision. The BION methodology was provided to all banks (cooperative banks received the document through the agency of associating banks). In December 2010,

¹² The entities active on the Polish financial market include 49 commercial banks, 576 cooperative banks, 20 branches of foreign EEA credit institutions, 63 insurance and reinsurance companies, 17 branches of foreign EEA insurance and reinsurance companies, 208 actuaries, 144.8 thousand persons engaged in insurance intermediation activities, 958 insurance and reinsurance brokers, 64 investment firms, 14 branches of foreign EEA investment firms, 67 investment firm agents, 2,385 securities brokers, 50 investment fund management companies, 417 Polish investment funds with 298 sub-funds, 62 foreign investment funds with 680 sub-funds, 70 distributors intermediating in selling and redeeming investment fund units, 14 universal pension fund management companies, 117 thousand agents of open-end pension funds, 5 occupational pension fund management companies, 336 investment advisers, 385 Polish public companies subject to disclosure requirements, 46 power utilities keeping commodity registers or accounts, and 204 commodity brokers.

the first new questionnaires were sent to cooperative banks. The first BION scores will be assigned based on the data as at December 31st 2010, in the first quarter of 2011.

Work on developing a draft BION methodology for the insurance industry was completed in the first half of 2010. It involves an analysis of all information on the insurer or reinsurer available to the regulator, in particular information obtained in the course of licensing procedures, desktop analysis and on-site inspections at the insurance/reinsurance company, and information sourced from additional enquiries/surveys addressed to the insurance/reinsurance company, followed by selection of risks subject to assessment, as well as of appropriate financial metrics, their weights for the purpose of determining the aggregate score and the border system. In addition, a pilot BION exercise was carried out at selected insurance/reinsurance companies.

Based on the results of the pilot BION assessment of the insurance industry carried out in the first half of 2010, on consultations with selected (Q3 2010) and then with all (Q4 2010) insurance and reinsurance companies, as well as on meetings with the companies, work on a new version of the BION methodology was continued. It was focused mainly on reviewing the metrics and criteria relied on in credit risk assessment and quantitative management assessment. In 2010, analytical work on the feedback received from the industry and proposed changes to the BION methodology was not yet completed.

A new version of the BION method will be supported by two handbooks: an external handbook for the industry and an internal handbook for employees performing BION reviews of the insurance industry. The handbook for insurance/reinsurance companies will differ from the internal handbook in that it will lack detailed descriptions of the individual metrics and qualitative criteria, and the manner of their analysis. Based on the newly developed version of the BION methodology, the scores assigned to the insurance/reinsurance companies for 2009 were reviewed, whereupon their strengths and weaknesses were identified.

In the first and second quarters of 2010, a pilot BION exercise was carried out in the pension industry. It covered all universal pension fund management companies. A *Risk Management Survey for Universal Pension Fund Management Companies* was distributed among the relevant institutions. Based on its findings, as well as financial metrics calculated in accordance with the method described in the BION handbook, the first supervisory assessment was performed. Based on its results, in the second and third quarters work was under way to recalibrate the BION methodology. One of its focuses was to analyse the sensitivity of the score to changes of the weights applied to various risks. The results obtained in the process were incorporated into the new version of the methodology.

The adequacy of selected risk indicators and survey questions was reviewed. In the fourth quarter, the revised BION methodology was distributed for consultation among universal pension fund management companies. Another supervisory assessment exercise is due in the first quarter of 2011.

To help brokerage houses prepare for changes in the legal regime resulting from the implementation of Directives 2006/48/EC and 2006/49/EC on the capital adequacy of brokerage houses, a number of meetings were held with representatives of brokerage houses in 2009 and in the first half of 2010 to review the progress of the preparations. As a result of the meetings, brokerage houses were assigned preliminary supervisory scores. Feedback received from surveys carried out among the meeting participants was used to revise the BION supervisory review method applicable to brokerage houses. The surveys found that the brokerage community regarded the pilot BION process as useful. The proper BION process has been run since September 2010.

In line with the assumptions related to the implementation of the BION process with respect to investment fund management companies, three BION exercises were undertaken in 2010: at the end of the first, second and third quarters. By the end of February 2011, scores will be assigned to the entities which underwent the BION assessment at the end of the fourth quarter.

The assessment focused on three areas relating to:

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

The risk area was split into four key risks:

- market risk,
- credit risk,
- operational risk, and
- hard to measure risk.

Considering the specific nature of the operations conducted by investment fund management companies, the risks with the highest impact on their overall risk assessment were those associated with unreliability of the technical infrastructure (e.g. IT network failures) and the organisational system (e.g. a dysfunctional internal control system), and with human errors on the part of investment fund management companies' employees, i.e. operational risk and hard to measure risk. The two risk types accounted for 85% of the overall net risk assessment.

In addition to the degree of exposure to various financial instruments, the assessment of the risk incurred by investment fund management companies takes into account the methods

employed to manage the risk. Accordingly, it was assumed that the investment fund management companies rated highly for the management of a specific risk will receive a better overall score even if their exposure to the risk - excluding the impact of its management - is considerable. For the purposes of the BION process, it was assumed that risk assessment which takes into account the impact of the risk management process would be called “net risk assessment”.

The assessment of the capital area focused primarily on the compliance of investment fund management companies with the provisions of Art. 50 of the Act on Investment Funds of May 27th 2004 (Dz. U. of 2004, No. 146, item 1546, as amended).

The management area was assessed on the basis of the following components:

- the management system, corporate governance and operational effectiveness of investment fund management companies,
- the organisation and HR policies of investment fund management companies,
- compliance,
- the management information system, the information flow system, compliance with the disclosure requirements and

the quality of reports submitted to the PFSA by investment fund management companies,

- the internal control system.

In the course of the BION assessment of individual areas, multiple information sources were relied on, including sources available internally at the PFSA Office, as well as external sources available only from regulated entities. Internal information sources used to inform the risk assessment process included:

- the PFSA Office’s internal databases,
- complaints filed against investment fund management companies to the PFSA Office,
- the Electronic Market Supervision System database, including monthly reports and the internal control report,
- the findings of inspections carried out at investment fund management companies.

External information affecting the assessment of the risk and management areas was sourced from a survey conducted among investment fund management companies.

With respect to entities found to incur excessive risk, the supervisory activities have been strengthened to correspond to the scale and nature of the risk incurred.

3.6. Stress testing

3.6.1. Stress testing of the banking industry

In 2010, the PFSA Office performed stress testing of the banking industry. The tests run at Polish banks were designed to assess the sensitivity of their capital positions and capital needs which might arise in the event of adverse macroeconomic developments. It was up to the banks to select a testing model and adopt additional assumptions regarding changes in macroeconomic indicators. The banks were tested using a base case scenario and two stress (shock) scenarios, capturing the PFSA Office’s general predictions of economic developments and developments on the financial markets in 2010-2011.

To review the adopted methodology, a pilot test was run at one of the banks. Subsequently, the reviewed assumptions and result tables were provided to Poland’s largest banking institutions to make the requisite calculations and for the purpose of balance-sheet, income statement, solvency and capital adequacy modelling. The in-house estimates prepared by the tested banks were based on their own methodologies.

The results obtained under the respective scenarios were analysed to determine the impact of a simultaneous change of several factors on the bank’s standing, the main emphasis being placed on the forecast quality of the loan portfolio.

When making the calculations, the banks were required to pay special attention to the liquidity risk and the interest rate risk. In addition, it was assumed that each tested bank would be reviewing its liquidity position. The risk factors were to be considered for both the assets and the equity and liabilities carried on the balance sheet. Under each stress scenario, the banks estimated not only their net cash flows, but also their cash inflows and outflows.

As soon as the data were sent in, they were reviewed in the light of the amounts previously reported by the banks and the forecasts prepared on the basis of models developed by the PFSA Office. The process consisted of two parts: analysis of the data sent in by the banks and a stress test performed after taking into account a number of supervisory adjustments.

The supervisory adjustments were based on an approach whereby the quality and forecast impairment of a bank’s loan portfolio depend on the GDP growth rate and fluctuations in real interest rates. The adjustments consisted in differentiating the approach to the housing loan portfolio and the consumer loan portfolio by introducing additional adjustment factors based on an analysis of the structure of impairment losses on

the individual categories of receivables. Furthermore, changes in the value of loan collateral accepted by the banks were accounted for. A comparison of the adjusted values and the values provided by the banks constituted the basis for assessing impairment losses and provisions that would be charged to the bank's income statement if the conditions described under the individual scenarios were to materialise.

Considering the introduced change in the volume of impaired loans and assuming that such loans are not yielding any income, the interest income projections of the banks were accordingly adjusted. The amount by which the net financial result projected by the banks was ultimately adjusted reflected the above changes, as well as the resulting income tax adjustment (based on the effective income tax rate adopted by the banks). Subsequently, the adjustment of the net financial result had

3.6.2. Stress testing of the insurance industry

In 2010, work was continued to employ stress testing techniques in the supervision over the insurance market to improve the quality of risk management at insurance and reinsurance companies and prepare them for the implementation of the proposed Solvency II regime.

Following a series of meetings between representatives of the PFSA Office and the industry, in 2009 a stress testing methodology was finally developed. Stress tests were to cover the following types of risks:

- ▶ interest rate risk,
- ▶ equity risk,
- ▶ expense risk,
- ▶ mortality risk (in the case of life insurers only),
- ▶ lapse risk (in the case of life insurers only),
- ▶ catastrophe risk (in the case of non-life insurers only).

By January 15th 2010, the insurance/reinsurance industry submitted the results of pilot stress tests performed using input data sourced from the 2008 financial statements. The results were compiled and compared with the results of stress tests carried out internally by the PFSA Office. The results were then summarised in a report entitled: *Results of Pilot Stress Testing in the Insurance Sector*, presented to the Polish Financial Supervision Authority at its 99th session held on March 23rd 2010.

During a meeting between representatives of the PFSA Office and the insurance/reinsurance industry held on June 2nd 2010, the aggregated results of the pilot stress tests and the revised testing methodology were presented. In relation to the pilot stress tests, the following key changes were introduced to the stress testing methodology applicable to the insurance industry (mainly at the request of the industry itself):

- ▶ a stress test was added for the longevity risk assuming a 25% fall in the mortality rates for each age group,

an effect on the capital adequacy calculation by changing the value of the bank's equity.

At the same time, an attempt was made to adjust the value of risk-weighted assets to reflect the change in the proportion of unimpaired and impaired loans. The resulting data made it possible to determine a new capital adequacy ratio and assess the banking sector's capital needs which might arise if that value fell below the regulatory minimum.

Conclusions drawn from the results of the stress testing exercise will be incorporated into the off-site BION analysis and inspection procedures to enable an in-depth review of the selected areas. Stress testing will be undertaken on a regular basis. In future tests, the scope of supervisory adjustments is expected to be extended to cover the trading book.

- ▶ in the stress test covering the interest rate risk:
 - a limitation was included on account of the interest rate resulting from the three-year rate of return on assets that cover technical provisions,
 - technical provisions covered with bonds held to maturity were excluded (subject to the fulfilment of certain conditions),
 - assets and technical provisions related to life insurance products combining the features of a life insurance policy and a bank deposit (called "antybelki" - because they are used to avoid tax on capital gains introduced by former finance minister Marek Belka) and structured insurance products were excluded, if cash flows from the assets were matched by cash flows from liabilities under the existing insurance agreements,
- ▶ in the stress test covering the expense risk:
 - it was left for the insurer/reinsurer to decide whether to apply stress testing to historical or to projected future costs,
 - the idea to increase future costs by 1 percentage point above the adopted cost inflation rate was abandoned,
 - the client acquisition costs were only raised to a level where the company would decide to discontinue sales of a non-profitable product,
- ▶ in the stress test covering the mortality risk, the shock depth was changed from a 10% to a 15% rise in the mortality rates for each age group,
- ▶ in the stress test covering the lapse risk, the idea to differentiate between shock depths based on the agreement terms was abandoned.

The insurance/reinsurance companies performed stress tests using input data for the year 2009 until the end of July 2010. Concurrently, the PFSA Office performed its own stress tests using internally available data reported by the industry. A report entitled *Results of Stress Testing of the Insurance/Reinsurance Sector for 2009*, containing a summary of the

methodology employed, the results of the internal and external stress tests and a comparison of their results, was presented to the Polish Financial Supervision Authority at its 113th session on November 9th 2010. The results of stress testing of some insurance/reinsurance companies were additionally presented at meetings of the Coordination Committees/Supervisory Colleges as part of the supplementary supervision over insurance groups.

A comparison of the results of stress tests performed using data for 2009 and for 2008 indicates that the stability of the sector improved. In the case of all stress tests except for tests covering the risk of changes in costs incurred and the risk of disasters, 2009 saw a year-on-year improvement in the ratio of available solvency margin to required solvency margin and equity. Moreover, the number of insurers/reinsurers which failed to

meet the capital requirements under shock scenarios fell or, in few cases, remained unchanged. Only in the case of internal stress tests covering the risk of changes in costs incurred by Segment I insurance companies, the number of companies not meeting the capital requirements rose by one. Another thing worth noting is an improvement in the quality of performance, presentation and description of stress tests carried out by the insurance/reinsurance industry as at the end of 2009, relative to the pilot stress tests as at the end of 2008.

Having reviewed the stress testing results, the regulator requested selected insurance companies to provide information on the proposed distribution of their 2009 profits to be able to assess their financial standing in the light of negative test results. The stress testing results are also used by the PFSA Office for the purposes of the BION process.

Inspection tasks

4

4.1

2.1306

2.1306

4.2

0.08

0.457

0.95

4.2

4.089



4. Inspection tasks

In addition to off-site supervision activities designed to monitor financial institutions on an ongoing basis, and in addition to regulatory and licensing supervision, on-site inspections are a key element of the financial supervision model. The model complies with the core principles methodology recommended by the Basel Committee on Banking Supervision, according to which an effective banking supervision system should include on-site inspections.

In 2010, inspection procedures followed in different sectors of the financial market were standardised, to the extent practicable considering the characteristics of particular sectors, and changes in regulations applicable to inspection activities were proposed.

Another step following the standardisation of inspection procedures was the creation within the PFSA Office of a body responsible for inspections: the Inspection Division. This step facilitated a deeper and broader analysis of risks at financial institutions which operate on different markets but cooperate or have close equity links with each other. Thus, PFSA Office's

inspections may be focused to a larger extent on risk analysis. Assessments of regulated entities made at the PFSA Divisions (BION assessments), based on an analysis of the risk generated by the entities in the course of their operations, were one of the principal reasons for preparing an inspection plan for 2011. The creation of the Inspection Division also helped to accelerate the information flow and share experiences between inspectors.

The creation of the Inspection Division at the PFSA Office brought about the following benefits:

- comprehensive analysis of risks at financial groups,
- standardisation of inspection procedures across different sectors of the financial market,
- more effective planning of inspections at financial groups,
- faster information flow and exchange of experiences between inspectors.

Inspections in 2010 were carried out based on applicable laws and uniform investigation standards and procedures defined in the *On-site Inspection Handbook* and in supplementary inspection methodologies.

4.1. Inspections at banks

Standard activities falling within the scope of comprehensive inspections included investigation into the following areas: asset quality, liquidity, market risk, operational risk, financial performance, capital base, management in compliance with the laws governing banking activities and articles of association, and fulfilment of conditions specified in the authorisation to establish a bank. The scope of other inspection activities depended on the situation of a given bank, and focus was placed on the most important – for the system's and the bank's security – types of risk inherent in the business of particular banks.

In 2010, the banking regulator carried out the following inspections:

- 55 comprehensive inspections, including:
 - 8 inspections at commercial banks,
 - 47 inspections at cooperative banks,
- 20 problem-oriented inspections, including:
 - 16 inspections at commercial banks, including 5 related to an assessment of banks' applications for approval of the use of statistical methods to calculate capital requirements,
 - 4 inspections at cooperative banks,

- 3 explanatory proceedings, including:
 - 1 at a commercial bank,
 - 1 at a representative office of a credit institution,
 - 1 at a cooperative bank,
- 1 inspection related to the preparation of a commercial bank to launch operations.

As part of the cooperation between the PFSA Office and the National Bank of Poland, inspections designed to check the correctness of calculating and transferring the amount of mandatory reserves required for commercial banks were performed (as part of 8 comprehensive inspections).

During the inspections carried out at commercial banks in 2010, the following issues received particular attention:

- creditworthiness assessment by banks, with particular focus on the assessment of creditworthiness of clients who entered into derivative transactions with the bank,
- banks' management of risk related to mortgage-backed loans, including with respect to compliance with Recommendation S (II) issued by the PFSA in 2008, concerning best practices related to exposures under mortgage-backed loans,

- ▶ process of banks' adaptation to the requirements of Recommendation T issued by the PFSA in 2010, concerning best practices related to managing risk under retail loan exposures,
- ▶ compliance with Resolution No. 383/2008 of the PFSA, concerning banking risk management and internal control system, with particular focus on the system of internal limits,
- ▶ process of valuation of exposures under matured FX options,
- ▶ compliance with recommendations contained in Recommendation A of the PFSA (amended in 2010), concerning management of risk related to the execution by banks of transactions on the derivatives market, in particular the scope of information disclosed to the client at the time of offering FX derivatives,
- ▶ effectiveness of internal audit and internal control procedures,
- ▶ implementation of post-inspection recommendations.

Inspection findings were described in inspection reports, and information on irregularities identified at a bank with foreign

capital was also provided to the regulator of the bank's home country.

Information on regulatory instructions from the full version of the report:

Fulfilment of the PFSA's instructions is regularly monitored on the basis of banks' reports as part of desktop analyses and during another inspection at the bank, as well as at meetings of the supervisory authority with the bank's management and representatives of the home country's regulator. If a bank fails to properly implement the PFSA's instructions or to provide reliable information on their implementation, the PFSA may issue a warning to the bank. In 2010, the Chairperson of the PFSA issued six warnings to commercial banks, concerning e.g. failure to effectively implement the PFSA's recommendations or to comply with specific laws, thus giving rise to higher risk in the bank's operations.

4.2. On-site inspections at insurance companies

In 2010, inspections were carried out at 19 insurance companies (including five inspections commenced in 2009) with the aim of examining their operations and assets. The inspections focused on the following material aspects of the insurance companies' operations:

- ▶ measurement of technical provisions,
- ▶ management of the insurance company,
- ▶ accounting policies and preparation of financial statements,
- ▶ investment policies,
- ▶ reinsurance,
- ▶ compliance with disclosure obligations towards the insuring parties and the insureds,
- ▶ claims handling procedures,
- ▶ cost of insurance activities and settlements with insurance agents,
- ▶ assessment of insurance risk and risk management procedures,

- ▶ setting insurance premiums,
- ▶ matching of the maturities of assets covering technical provisions with the maturities of liabilities under insurance contracts.

One of the inspections mentioned above was a comprehensive inspection covering the main areas of the insurance company's activity. The other inspections were problem-oriented and in most cases covered two and more issues.

In 2010, 14 insurance companies where inspections had been carried out in previous years received post-inspection recommendations to align their operations with applicable laws and cease to breach the interests of the insuring parties, the insureds, as well as beneficiaries of and entitled persons under insurance contracts.

4.3. Inspections at institutions operating within Pillar II and Pillar III of the pension system

In 2010, a total of 14 inspections were carried out at the institutions operating within Pillar II and Pillar III of the pension system, including:

- ▶ 8 inspection proceedings at universal pension fund management companies and open-end pension funds,
- ▶ 2 inspections at depositaries of open-end pension funds,
- ▶ 1 inspection at third parties engaged by a fund or universal pension fund management company to perform certain activities, and
- ▶ 3 inspections at asset management companies concerning their management of the assets of occupational pension funds.

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

- organisation and management of a pension fund company (including functions performed by its governing bodies),
- organisation and operation of the internal control system,
- inspections at external entities (including shareholders),
- implementation of investment policies,
- agreements with shareholders, members of governing bodies and other group companies,
- outsourcing of certain activities of pension funds and pension fund management companies,
- client acquisition activity,
- accounting policies, accounting books, and preparation of financial statements,
- transfer of members as part of asset transfers between funds,
- maintenance of fund members' individual accounts,
- handling fund members' complaints.

Among the abovementioned inspections at universal pension fund management companies and open-end pension funds, six inspections were comprehensive and covered the full scope of the institutions' operations.

Two inspections were problem-oriented and were initiated after the PFSA became aware of potential materialisation of risks with respect to a regulated entity.

As part of inspections carried out at banks acting as depositaries for open-end pension funds, the PFSA made a thorough review of their operations connected with the deposit of open-end pension funds' assets.

Inspections at third parties engaged by a fund or pension fund company to perform certain activities were problem-oriented and were initiated after the PFSA became aware of the potential materialisation of certain risks with respect to the third parties. In the majority of cases, the activities outsourced to the inspected entities were the keeping of the register of open-end pension fund members and provision of related services, such as mailing or call centre service.

Inspections at asset management companies served to review their operations related to the management of occupational pension funds' assets.

Information on regulatory instructions from the full version of the report:

In 2010, the Financial Supervision Authority carried out seven post-inspection follow-up proceedings with respect to regulated entities, describing in the post-inspection notifications the irregularities identified during the inspections.

4.4. Inspections at investment firms

In 2010, 11 inspections were carried out at investment firms, including:

- 8 inspections at brokerage houses,
- 2 inspections at bank units conducting brokerage activities,
- 1 inspection at a bank conducting brokerage activities – a brokerage office.

The inspections focused on the following material aspects of the investment firm's operations:

- organisational structure, functioning, and technical conditions of operations,
- communication with clients,
- functioning of the internal control system,
- performance of activities related to commodity trading,
- provision of brokerage services consisting in:
 - acceptance and transfer of orders to buy or sell financial instruments,
 - execution of orders to buy or sell financial instruments for the party placing the order,
 - proprietary trading in financial instruments,
 - offering financial instruments,
 - keeping or registration of financial instruments, including the maintenance of securities accounts and cash accounts,

- management of portfolios comprising one or more financial instruments,
- investment advisory,
- financial standing.

After the regulations implementing the MiFID Directive into the Polish legal regime came into force in June 2010, five problem-oriented inspections were carried out at regulated entities in order to examine how they complied with the new regulations.

In 2010, two inspections at regulated entities operating on the capital market were carried out in close cooperation with the Banking Supervision Division. The purpose of the inspections was to coordinate supervisory activities over entities which were members of the same group but were supervised by different divisions of the PFSA Office.

Moreover, the PFSA reviewed 72 semi-annual reports on the activities and organisation of internal control at custodian banks and entities conducting brokerage activities for the second half of 2009, and 70 such reports for the first half of 2010.

As a result of inspections carried out at investment firms in 2010, post-inspection recommendations were issued to seven entities.

4.5. Inspections at undertakings for collective investment

In the period covered by this report, 15 inspections were carried out at undertakings for collective investment, including:

- 11 inspections at investment fund management companies,
- 2 inspections at representatives of a foreign fund,
- 1 inspection at a depositary,
- 1 inspection at a transfer agent.

The inspections focused on the following material aspects of the operations of investment fund management companies:

- organisational structure and functioning of their governing bodies,
- organisation and functioning of the internal control system,
- client complaints and enquiries,
- compliance of selected investment funds managed by investment fund management companies with the law or articles of association,
- how investment decisions were made by investment funds managed by an investment fund management company,
- timeliness of client order execution,
- compliance analysis of the asset valuation process,
- providing investment advice or management of portfolios comprising one or more financial instruments by investment fund management companies.

The scope of individual inspections was contingent on the size and scope of operations.

The inspection at the depositary was intended to examine whether the performance of depositary duties complied with the law or the agreement on the maintenance of a register of a fund's assets.

Inspections at representatives of foreign funds consisted in checking whether their performance of duties as foreign funds' representatives complied with the law and the agreement concluded with the fund.

The objective of the inspection at the transfer agent was to examine the maintenance of shareholder records for compliance.

As a result of the inspections carried out in 2010 at undertakings for collective investment, post-inspection recommendations were issued to five such undertakings.

4.6. Inspection regarding fulfilment of obligations related to prevention of money laundering and terrorist financing

Chapter 6 of the Act on Counteracting Money Laundering and Terrorist Financing of November 16th 2000 provides for the PFSA's right to carry out inspections of the obliged entities. Under Art. 21.3.2 of the Act and on the terms set out in separate regulations, the PFSA is designated as the body responsible for monitoring, as part of its primary supervisory functions, of the supervised institutions' compliance with the obligations established in the anti-money laundering and terrorism financing regulations. The institutions which are subject to the anti-money laundering and terrorism financing regime include entities operating on the capital market as well as in the banking and insurance sectors (life insurance).

In 2010, the PFSA Office carried out 48 inspections within the authorisation set out in the Act, including:

- 9 inspections at commercial banks,
- 18 inspections at cooperative banks,¹³
- 8 inspections at branches of credit institutions,
- 9 inspections at capital market institutions,
- 4 inspections at insurance market institutions – in the scope of life insurance.

The most common irregularities identified in the course of those inspections included:

- incorrect completion of transaction register fields,

¹³ In the first half of 2010, until a change of the Organisational Rules of the PFSA Office (Decision of the PFSA Chairman No. 48/2010 dated July 15th 2010) released DOR from inspection duties to the extent specified in the Act on Counteracting Money Laundering and the Financing of Terrorism (Dz. U. of 2003, No. 153, item 1505, as amended), 13 problem-oriented inspections at cooperative banks were carried out.

- ▶ registering transactions the value of which is equivalent to or does not exceed EUR 15,000, even though they were not classified as operations which appear to be linked and have been divided into operations of less value with the purpose of evading the registration requirement,
- ▶ registering transactions later than on the next working day after they were carried out,
- ▶ transferring information to the General Inspector for Financial Information after the deadlines set out in law.

In connection with the identified irregularities, the PFSA issued post-inspection recommendations to the management boards of the inspected entities, obliging them to take appropriate measures to remove the irregularities revealed by the inspections. In cases of criminal violations, appropriate notifications were sent to the competent Public Prosecutor's Office. In 2010, recommendations were issued to a total of 35 inspected entities. The institutions send written reports on the implementation of recommendations issued to them, and the PFSA monitors its progress.

Regulatory and prudential regime tasks

5

+0.5
nr

+0.45
162

5

nr 154

2010

nr 160



+0.51
5.4

5.3

5. Regulatory and prudential regime tasks

The key regulatory and prudential regime tasks which were completed in 2010 included the preparation of PFSA resolutions and prudential recommendations.

5.1. Resolutions of the Polish Financial Supervision Authority

The objective behind the adoption of the PFSA 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 September 16th 2009, Commission Directive 2009/27/EC of April 7th 2009 and Commission Directive 2009/83/EC of July 27th 2009;
- reflect amendment proposals submitted within the PFSA Office and by the banking sector.

In 2010, the Polish Financial Supervision Authority adopted the following resolutions:

- **Resolution No. 76/2010 of the PFSA of March 10th 2010 on the scope and detailed rules for determination of capital requirements for individual types of risk and Resolution No. 369/2010 of the PFSA of October 12th 2010 amending Resolution No. 76/2010 of the PFSA.**

The above resolutions introduced the following changes:

– changes made to transpose the amended CRD; the changes related in particular to:

- transitional periods for which banks applying advanced methods for calculation of credit risk or operational risk capital requirements (IRB, AMA) must calculate a relative capital requirement in order to avoid an excessive reduction of the capital requirement,
- rules for the identification of underlying positions for credit derivatives triggered by nth default for the purpose of calculation of the market risk capital requirement by banks transferring risk,

- rules for the calculation of the credit risk capital requirement using the Standardised Approach and the Internal Ratings Based (IRB) Approach,
- the option to classify units in undertakings for collective investment as a credit protection instrument,
- conditions to be met to classify an assignment of rights under insurance policies as a credit protection instrument and rules for using such protection instrument in the calculation of the credit risk capital requirement using the Standardised Approach and the Internal Ratings Based Approach,
- calculation of risk-weighted exposure amounts for asset securitisation in order to eliminate the conflict of interests between the banks originating or sponsoring securitisation and the original lenders, on one side, and the investing banks, on the other; to ensure that those entities have a common interest, the originating bank, the sponsoring bank or the original lender were required to retain significant net economic interest in the underlying assets,
- changes other than resulting from the amended CRD, made in response to proposals to clarify regulations, submitted within the PFSA Office and by the banks.
- **Resolution No. 77/2010 of the PFSA of March 10th 2010 on banks required to publish information specified by Resolution No. 385/2008 of the PFSA of December 17th 2008 on detailed rules and manner of disclosure by banks of qualitative and quantitative information pertaining to capital adequacy and the scope of information subject to disclosure.** Pursuant to Resolution No. 77/2010, all banks have been required to publish information specified by the resolution on detailed rules and manner

of disclosure by banks of qualitative and quantitative information pertaining to capital adequacy and the scope of information subject to disclosure.

- ▶ **Resolution No. 367/2010 of the PFSA of October 12th 2010 on other deductions from Tier 1 capital, their amount, scope and conditions of deduction thereof from a bank's Tier 1 capital, other items of a bank's balance-sheet included in Tier 2 and Tier 3 capital, their amount, scope and conditions of inclusion thereof in a bank's Tier 2 and Tier 3 capital, deductions from Tier 2 and Tier 3 capital, their amount, scope and conditions of deduction thereof from a bank's Tier 2 and Tier 3 capital, as well as the scope and manner of taking into account a bank's operation within a holding when calculating its own funds.** In connection with the changes introduced in Art. 61 of Directive 2006/48/EC and the CEBS guidelines and on the basis of observations related to the implementation by banks of the provisions of the resolution, the method of calculation of banks' own funds was defined in more detail. The number of items reducing Tier 1 capital, the number of items included in Tier 2 and Tier 3 capital, and the manner and the amount of inclusion of the so-called safety buffer (adjustment to the effect of measurement resulting from changes in the IAS) increased.
- ▶ **Resolution No. 368/2010 of the PFSA of October 12th 2010 amending Resolution No. 385/2008 of the PFSA on detailed rules 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 resulting from the transposition of the CRD, which expanded the scope of required disclosures relating to:

- using the Value-at-Risk approach in the calculation of capital requirements,
 - using the Advanced Measurement Approach in accordance with the resolution on capital adequacy in the calculation of operational risk capital requirements, and
 - clarification that in the case of banks using the Advanced Measurement Approach to calculate operational risk capital requirements, a 20% limit reducing the capital requirements applies to the acceptance of both insurance and other risk transfer mechanisms.
- ▶ **Resolution No. 434/2010 of the PFSA of December 20th 2010 on other items of a bank's balance-sheet included in Tier 1 capital, their amount, scope and conditions of inclusion thereof in a bank's Tier 1 capital.** Resolution No. 434/2010 of the PFSA eliminated the possibility of inclusion by banks (with effect from December 31st 2010) of the proceeds from new issues of convertible bonds and long-term bonds in their Tier 1 capital. At the same time, proceeds from issues of long-term bonds, meeting the requirements of Resolution No. 314/2009 of the PFSA and included in Tier 1 capital as at December 31st 2010 pursuant to a decision of the Polish Financial Supervision Authority, will have to meet the requirements relating to maximum amounts to be included in Tier 1 capital (pursuant to Art. 154.9 of Directive 2009/111/EC, grandfathering).

5.2. Recommendations of the Polish Financial Supervision Authority

In 2010, the following were implemented:

- ▶ amendment to Recommendation A concerning the management of the risk associated with entering into derivative transactions by banks (Resolution No. 134/2010 of the PFSA of May 5th 2010),
- ▶ amendment to Recommendation I concerning the management of currency risk at banks and the rules to be followed by banks in the execution of transactions exposed to currency risk (Resolution No. 53/2010 of the PFSA of February 23rd 2010),
- ▶ Recommendation T concerning best practices in managing the credit risk related to retail exposures (Resolution No. 52/2010 of the PFSA of February 23rd 2010),

Recommendations A and I

The purpose of Recommendation A is to provide banks with best practices in managing credit risk relating to derivative instruments (whose value depends on changes in price parameters based on market risk), and to define the rules which should be followed in relations with clients who enter into or have entered into such transactions.

The amendment to Recommendation I was made in response to the situation in the financial sector, caused by the effects of the global financial crisis, and to the developments in the Polish derivatives market in 2008 and 2009. The purpose of the

recommendation is to limit the weaknesses identified in the management of the risk associated with entering into currency derivative transactions by banks. It will enhance the currency risk management process at banks and will increase the overall stability and security of the banking sector.

Recommendation T

The development of Recommendation T was a reaction to, inter alia, the international financial crisis and a threat of its negative consequences for the Polish market. As a result, the purpose of the recommendation was to improve the management of the risk of retail exposures at banks and thus to limit credit losses. It should also be noted that Recommendation T limits currency risk and improves the effectiveness of Recommendation S (II) in reducing exposure to currency risk. Its implementation will raise the knowledge and awareness of banks' clients on the risks involved in their

transactions. The provisions of Recommendation T limit the frequency with which banks may change their lending policies and require that banks adopt a conservative approach and consider the long-term nature of mortgage loans in the context of risk management.

Accounting and reporting standards

The PFSA Office prepared a proposal of a draft regulation of the Minister of Finance on special accounting policies for banks. The document is designed to eliminate some of the differences between the Polish Accounting Standards (PAS) and the International Accounting Standards (MSR). The draft was consulted with the banking sector and with the Minister of Finance. In order to bring its provisions in line with the IAS/IFRS, further changes to the draft will be made after the final version of IFRS 9 is available. The regulation entered into force on October 31st 2010.

5.3. Draft resolutions of the Polish Financial Supervision Authority

In 2010, the following draft resolutions of the Polish Financial Supervision Authority were prepared:

- **draft amendment to Resolution No. 382/2008 of the PFSA of December 17th 2008 on detailed rules and conditions of qualifying exposures when determining whether an exposure concentration limit or a large exposures limit has been complied with, determination of exposures to which the regulations on exposure concentration limits and large exposures limits do not apply, and the conditions they must meet, determination of exposures with respect to which the Polish Financial Supervision Authority's approval is required for non-application of the regulations on exposure concentration limits and large exposures limits, as well as the scope and manner of taking into account a bank's operation within a holding when calculating the exposure concentration limits.** The resolution implements the provisions of CRD II; however, the most important changes resulting from the amended Capital Requirements Directive have been included in the draft Banking Law, and the resolution is only complementary to its provisions. The effective date of the resolution (whether it is adopted or not) depends on the date of the amendment to the Banking Law.
- **draft amendment to Resolution No. 383/2008 of the PFSA of December 17th 2008 on detailed rules 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. The amendment to the resolution will introduce the following changes:

- changes made to transpose the amended Directive, consisting in the introduction of:
 - a requirement for banks to develop risk management procedures enabling assessment of reputational risk; the resolution also extends the scope of application of securitisation risk management regulations to banks investing in securitisation,
 - provisions regulating remuneration policy and practice,
- changes other than resulting from the amended CRD, made in response to amendment proposals submitted within the PFSA Office and by the banks, consisting in:
 - defining the parameters for stress testing,
 - editing and supplementing the provisions on risk management and estimation and maintenance of internal capital and reviewing the estimation process.

- **draft Resolution No. 385/2008 of the PFSA of December 17th 2008 on detailed rules and manner of disclosure by banks of qualitative and quantitative information pertaining to capital adequacy and the scope of information subject to disclosure.** The preliminary draft amendment, taking account of the above amendment to the CRD, introduces changes to the disclosure of information on remuneration policy.

5.4. Draft recommendations of the Polish Financial Supervision Authority

In 2010, preliminary drafts of the following recommendations of the Polish Financial Supervision Authority were prepared:

- ▶ **Recommendation H concerning internal control and audit at banks.** The need to amend Recommendation H results from:

- introduction of provisions on internal control and audit at banks in the Banking Law of August 29th 1997 and in the resolution of the PFSA,
- 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 May 7th 2009,
- PFSA 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 takes account of the relevant international guidelines.

- ▶ **Recommendation J concerning the creation by banks of databases related to the real estate market.** In the second half of 2010, work was commenced on an amendment to Recommendation J. The draft amendment significantly expands and makes more precise the rules for the creation, management and use of real estate market databases in order to:

- encourage banks - especially those which focus on real estate market financing - to actively use the databases;
- define the minimum scope of data which should be stored in such databases;
- improve data management;
- formalise the way in which banks use the databases
- and (indirectly) facilitate better assessment of the value of collateral.

- ▶ **Recommendation M concerning the management of operational risk at banks.** The need to amend Recommendation M resulted primarily from the changed provisions of the Banking Law, resolutions of the PSA and CEBS guidelines. Accordingly, the draft Recommendation includes in particular:

- a new requirement to maintain the operational risk capital requirement,

- definition of operational risk and major types of operational risk incidents,
- classification of banks' operations into "Basel business lines".

- ▶ **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 planned changes in Recommendation R should 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. In Q4 2010, the work on the changes to Recommendation R was completed. The proposed changes result from the need to adjust the provisions of the recommendation to the current market practice.

- ▶ **Recommendation S (II) concerning best practices in managing credit exposures financing real estate and mortgage-backed credit exposures.** Following identification of irregularities in the course of performance of supervisory tasks, and on the basis of the National Bank of Poland's reports on the situation in the credit market, a decision was made to amend Recommendation S (II). The amendment is required in view of:

- the risk associated with a significant share of the portfolio of mortgage-backed credit exposures and credit exposures financing real estate in loans and advances to the non-financial sector,
- the need to adjust the provisions to Recommendation T,
- the need to strengthen the existing Recommendation S (II) - in particular by creating a barrier to the growth of the portfolio of loans denominated in foreign currencies,
- 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.

Simultaneously with the work on the draft amendment, the effect of the new provisions of Recommendation S (II) on market participants was also evaluated.

Protection of financial market participants

6

2%

14%

+ 0,05

30%

23%

+ 0,0006

6. Protection of financial market participants

One of the statutory objectives behind the financial market supervision is to ensure protection of interests of the market participants. The PFSA'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 PFSA 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 PFSA.

The tasks performed by the PFSA 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,

- supervision over activities of the regulated entities that may infringe the interests of non-professional financial market participants,
- analytical, legislative and educational activities,
- expert and administrative support for the Conciliatory Court at the PFSA.

The PFSA's performance of tasks relating to the protection of interests of insurance companies' clients and open-end pension fund members was subject to inspection by the Supreme Audit Office in the period covered by this report. The Supreme Audit Office assessed as appropriate the measures undertaken by the PFSA to counteract the irregularities in the operation of insurance companies and open-end pension funds that were identified in the complaints filed with the PFSA, as well as the measures related to the monitoring of market practices and elimination of the practices that are in conflict with the interests of non-professional market participants. Actions involving the monitoring of advertising communication and the outcomes of measures taken in connection with the reviews of contract forms were also assessed as positive. For a detailed description of the inspection findings, see Section 11.6. *Inspections by external bodies.*

6.1. 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 PFSA 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 PFSA, offer a valuable insight into market developments.

The PFSA does not investigate complaints raised by the clients of insurance companies, banks or other capital market participants, and does not take a standpoint in individual disputes between such entities and their clients. The investigation conducted by the PFSA concerns only 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 PFSA determines that a given dispute arises on the grounds of civil law. Findings of the analyses of the clients' complaints filed against the regulated entities are published in quarterly reports and may serve as a basis for identifying negative market practices and assessing whether the operations of financial market participants in the area of customer relations are carried out properly.

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

professional financial market participants. The supervisory measures covered a wide range of activities such as advising the regulated entities of the identified irregularities by way of notifications indicating the required scope of changes, issuing recommendations requesting the entity to bring its practice into compliance with the applicable laws, issuing administrative decisions requiring the implementation of such recommendations, or imposing administrative penalties in the event of infringement of the applicable laws by such entity.

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

- 3,525 notifications of irregularities in the operations of the banking sector,

- 3,309 complaints against insurance companies, including 236 complaints (6.99% of all complaints) against life insurers and 3,037 complaints (9.08%) against non-life insurers, as well as 2 complaints regarding brokerage activities and 65 complaints (1.93%) concerning the operations of branches of insurers from the EU-member states,
- 1,531 complaints alleging irregularities in the operation of open-end pension funds,
- 210 notifications of irregularities in the functioning of the capital market.

The table below presents a breakdown of complaints by sector of the financial market.

TABLE 25. NUMBER OF COMPLAINTS AGAINST REGULATED ENTITIES IN 2010

	NUMBER OF COMPLAINTS	SHARE IN TOTAL NUMBER OF COMPLAINTS (%)
Banking sector		
Commercial banks and branches of credit institutions	3,459	98.13
Cooperative banks	66	1.87
Total	3,525	100.00
Insurance sector		
Segment I - Life insurance	236	7.13%
Segment II - Non-life insurance	3,073	92.87%
Total	3,309	100.00%
Pension funds sector		
Open-end pension funds	1,531	100%
Total	1,531	100%
Capital market		
Investment fund management companies	47	22.38%
Investment firms	69	32.86%
Public companies	12	5.71%
Stock-exchange operators	2	0.95%
Conduct of market participants / Other capital market participants	80	38.10%
Total	210	100.00%

6.2. Analytical activities and interventions

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

Banking sector:

- The banks' practice in relation to determining the margins for mortgage loans after security has been provided in the

form of mortgage registered for the benefit of the bank. Particular emphasis was placed on the review of the time span between the change of the margin rate by the bank and registration of the mortgage.

- The practice of one of the banks which involved determining the basis for calculating low down-payment insurance premiums using a formula that exposed the borrowers to the risk of incurring additional costs of the currency spread. The

identified formula contained an algorithm which required the loan to be converted into another currency twice when calculating the amount of the premium.

- The practice of one of the banks which involved charging fees for withholding personal income tax and/or health insurance contributions payable upon receiving foreign pension. The bank charged its clients unjustified fees for services which it was obliged to perform as a remitter of personal income tax in accordance with the applicable laws.
- The practice of one of the banks which allowed credit card holders to execute transactions over the set credit limit. Despite a contractually defined credit limit, the clients were allowed to debit their accounts with amounts substantially above the limit, which might have particularly serious consequences in the event the client was unaware of the current level of credit limit utilisation or in the event of theft and unauthorised use of the client's credit card. The bank also charged extra fees for the above-limit indebtedness.
- The practice of one of the banks involving irregularities in the lending process, which related to the activities undertaken while executing loan agreements through credit intermediaries, as well as irregularities in the process of creditworthiness assessment and the use of information obtained from BIK S.A. (credit reference agency).
- The practice of one of the banks which involved charging institutional clients for the mandatory annual contributions payable by banks to the Banking Guarantee Fund. The bank's contract form contained a clause obliging the borrowers (holding no deposits with the bank) to incur charges in the amount equal to the amount of contributions payable by the bank to the Banking Guarantee Fund in respect of the clients' deposits.
- Debt collection practice of one of the banks consisting in charging unjustified fees for debt collection activities. The bank conducted intense debt collection activities, which involved both debt collection calls and payment reminder notices (performed and sent on the same day), and repeatedly charged the client with the costs of such activities. The PFSA questioned in particular the frequency of such activities, and the lack of correlation between the debt collection activities and the costs charged.
- Verification of the rules applied by the banks in submitting and deleting borrower-related information, gathered by commercial chambers established for the purposes of creditworthiness assessment and credit risk analysis. Particular attention was paid to whether the information was submitted legitimately and whether it was updated on an ongoing basis.

Insurance sector:

- Verification of compliance of the insurers' claims handling procedures with the deadlines defined in Art. 14.1-14.3 of the Act on Compulsory Insurance, Insurance Guarantee Fund and Polish Motor Insurers' Bureau, dated May 22nd 2003 (Dz. U. of 2003, No. 124, item 1152, as amended).
- Compliance by the insurers with the provisions of Art. 31.1, in conjunction with Art. 28, of the Act on Compulsory Insurance, Insurance Guarantee Fund and Polish Motor Insurers' Bureau, regarding termination of motor TPL insurance policies by vehicle owners within 30 days from the date of acquiring the vehicle, as well as the problem of double TPL insurance arising from such practice.
- The practice of insurance companies related to determining man-hour rates for the tinsmithing and varnishing services for motor vehicles to be used in determining the amount of compensation payable under TPL motor insurance, compared with the rules for determining such rates by car repair workshops.
- The practice of the Group 1 insurers related to providing information on the indexation of the sum insured, and in particular the use of tacit consent to indexation.
- The practice of the Group 2 insurers related to the claims administration procedure in cases when the liability of the insurance company is risk-based and arises from a personal injury of the passenger. The cases where the completion of the claims administration procedure was postponed because of waiting for the outcome of pending court proceedings have been subject to particular scrutiny.

Pension funds sector:

- The practice of one of the universal pension fund management 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 notices of execution of an agreement with another fund.
- Member acquisition activities conducted by one of the open-end pension funds that might have misled the fund members as to the choice of the most appropriate fund or the decision to move to another fund, and might imply that a member's data provided to an agent acting for one pension fund may have been used to contact the member in order to encourage him or her to move to another fund.

Capital market:

No problems that would require application of additional analytical measures have been identified during the analysis of the received complaints.

6.3. Supervision over market practices by financial market participants

The PFSA's 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. The activities of the PFSA Office conducted in 2010 focused on identifying and eliminating market practices violating the law or infringing interests of non-professional financial market

participants in particular areas. To achieve this objective, the PFSA Office undertook relevant supervisory measures, encouraged self-regulation of the market and implemented educational initiatives. The measures undertaken by the PFSA Office were targeted, inter alia, at the following market practices:

6.3.1. Refusal by insurance companies to pay benefits to the injured spouse of the offending party in an accident due to their being married in community of property

In 2009, the PFSA identified a malpractice of insurance companies consisting in their refusal to pay compensation for personal injuries under motor TPL insurance in cases when the injury was caused by the spouse of the person injured. In the opinion of the insurers, the compensation amount forms part of the spouses' common property, which means that the spouse who caused the injury would be both liable to pay and entitled to receive the compensation, and such circumstance precludes the insurer's obligation to pay the compensation.

According to the PFSA, inclusion of compensation amount in the spouses' common property does not affect the fact that the claims for compensation arising in connection with personal injuries caused by the injured person's spouse always form part of personal property of the injured. Therefore, contrary to the insurers' interpretation, the spouse of the offending party may not be treated as entitled to receive the compensation. In 2010, the PFSA continued its activities in this area, issuing regulatory instructions for seven insurance companies which admitted to have employed such practice. All the insurers declared to have implemented the PFSA's instructions.

6.3.2. Satisfaction of claims for reimbursement of costs of renting substitute vehicles under motor TPL insurance

In 2009, the PFSA Office investigated the practice of handling claims for reimbursement of costs of renting substitute vehicles. The analysis revealed discrepancies in the treatment of claimants who bring such claims against insurance companies. The differences were identified mainly with respect to the rules of reimbursing costs related to the use of substitute vehicles in cases when the claim is filed by a private individual who is not a sole trader.

In order to systematise the market practice, the PFSA Office developed relevant recommendations containing a set of model rules for the treatment of claims for reimbursement of costs incurred in connection with renting substitute vehicles. In 2010, thanks to the efforts of the PFSA and the Polish Chamber of Insurance, the insurers implemented the recommendations after detailed guidelines for claims adjusters have been developed by the Polish Chamber of Insurance.

6.3.4. Banks' practices relating to non-performing loans

The analysis performed in 2009 revealed irregularities in the banks' practices towards clients who do not fully repay their credit liabilities within the contractual deadlines (i.e. non-performing loans), in particular in the area of the so-called hard debt collection. In order to eliminate the identified irregularities, the inspections carried out in 2010 focused on verifying compliance by the selected banks with their internal debt collection procedures, assessing the effectiveness of the banks' internal audit systems, and evaluating the banks' creditworthiness assessment processes so as to urge the banks to fulfil the PFSA's requirements in this respect. The above

described irregularities in the areas falling outside the scope of the PFSA's supervision (such as debt collection companies acquiring debts from the banks) were also reported to the President of UOKiK (Office of Competition and Customer Protection) so that the bank's debt collection practices towards consumers are verified and relevant measures are applied in cases of alleged breach of the consumers' collective interest.

The activities conducted in this area led to a significant reduction in the number of complaints filed with the PFSA in connection with the banks' debt collection procedures.

6.3.4. Loan commitments provided by the banks

The analysis performed by the PFSA has identified several problems related to the provision of loan commitments by the banks, including in particular: the banks' conflicting interpretations of the concept of loan commitment, lack of precisely defined terms and conditions for granting loan commitments, etc. In response to these problems, the PFSA

issued a letter to the Polish Banks Association and the Polish Cooperative Banks Association requesting them to take adequate steps to determine uniform standards of best practice for providing loan commitments to natural persons executing mortgage loan agreements.

6.3.5. Bancassurance products – credit-related insurance

The PFSA investigated the banks' use of insurance policies as an instrument for reducing credit risk. Particular emphasis was placed on the analysis of group insurance policies purchased by the banks for the benefit of the borrowers. By subscribing to such insurance policy, the borrower was provided with insurance coverage and was obliged to cover the insurance premium, while the bank acquired the right to receive compensation. The analysis also covered several low down-payment insurance policies for mortgage loans, in the case of which the banks passed the cost of insurance premiums on to the client although the client was not the beneficiary of such insurance policy and could also be exposed to the insurer's recourse claims relating to the compensation paid to the bank. With respect to both types of insurance, the PFSA notified the President of UOKiK of the practices that may infringe collective consumer interests, consisting in:

- ▶ requesting the client to pay a fee to cover the costs of insurance in cases when a significant portion of the fee constituted the bank's remuneration, and

- ▶ requesting the client to cover the costs of insurance of the bank's financial interest.

As part of its activities, the PFSA also investigated the banks' practice of returning the unused portion of insurance premium in the event of loan prepayment under agreements executed both prior to and following the amendment to Art. 813.1 of the Polish Civil Code, effective from August 10th 2007, regulating the return of the premium for the period of unused insurance coverage in the event of expiry of the insurance relation before the lapse of the agreement term. The bank's practice related to offering insurance as loan security to persons who at the time of signing the contract did not meet the conditions for obtaining insurance coverage (including provision of job loss insurance to persons entitled to receive pension) was also subject to close scrutiny. Following the PFSA's intervention, the entities whose practice was deemed to infringe the interest of the insured introduced adequate amendments to the terms and conditions of insurance policies and changed their practice accordingly.

6.3.6. Impermissible overdrafts in current and savings accounts

In the course of monitoring market practices of the regulated entities, the PFSA revealed a malpractice of one of the banks consisting in permitting transactions that exceeded the balance of the client's bank account. The consumer should have the right to overdraw the account only subject to execution of a loan agreement, irrespective of the bank account agreement. The Terms and Conditions of Consumer Bank Accounts adopted by the bank did not regulate all aspects relating to impermissible overdrafts, in particular, they did not lay down any rules for incurring impermissible overdrafts and did not specify the overdraft limit. Moreover, the bank charged interest on the impermissible overdraft at the maximum interest rates.

Such practice infringed the interest of the bank's clients and violated the provisions of the applicable laws, such as the Banking Law of August 29th 1997 (in particular the provisions relating to creditworthiness assessment), the Consumer Loan Act of July 20th 2001, the Act on Prevention of Unfair Market Practices of August 23rd 2007, as well as Art. 385¹ and Art. 385^{3,7} of the Polish Civil Code of April 23rd 1964. As a result of the supervisory measures applied by the PFSA, the bank acknowledged the regulator's objections and took steps to amend the Terms and Conditions accordingly, and to bring its practice into compliance with the applicable laws.

6.3.7. Fairness of advertising communication by the regulated entities

In order to protect interests of non-professional financial market participants against unreliable advertising information, the PFSA monitored advertising communication, i.e. it reviewed information and advertising materials published at the request of, for or by the regulated entities.

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

periodic reviews. In addition, random checks of advertising and information leaflets of the regulated entities have been performed. Furthermore, the PFSA gathered information on irregularities related to advertising communications reported by the consumers of financial services through, inter alia, the PFSA's website, which enables submission of complaints on advertising communications via an on-line form.

The purpose of the reviews of advertising communications is to establish whether the reviewed content complies with the law and respects the interests of non-professional financial market participants – in particular whether these communications do not mislead the target audience at the pre-contractual stage. Advertising communications are assessed from the perspective of a consumer of financial services. The fairness of advertising communications was assessed globally, within the context of advertising campaigns, and taking into consideration the

manner and form of presentation of advertising information, which affects perception of its content.

The monitoring conducted in 2010 indicated that the reduced scope of irregularities related to advertising information published by financial market participants remained fairly unchanged relative to the previous year. This is to a large extent attributable to the activities undertaken by the Polish Financial Supervision Authority. In 2010, the PFSA Office questioned ten potentially misleading advertising communications published by financial institutions. The irregularities were mainly related to undue discharge of disclosure requirements for investment funds, automobile insurance, consumer loans and bank accounts. To counteract the identified irregularities, the PFSA Office conducted relevant supervisory interventions, requesting the entities to cease disseminating the improperly formulated advertising communications.

6.3.8. Enhanced protection of capital market participants

In the period covered by this Report, the PFSA set up a Team for Enhancing Protection of Financial Market Participants, whose main objective was to ensure successful implementation of the project aimed at increasing the protection of the capital market participants, including in particular the following areas:

- equal access to inside information;
- preventing disclosure of inside information;
- preventing unauthorised provision of financial services;
- reducing imbalances in access to publicly available recommendations;
- determining adequate relationship between the obligations arising from the act regulating inside information issues

and the regulation on disclosure of current and periodic information;

- precluding access to inside information by entities providing investor relations services;
- reducing the number of pre-arranged transactions during trading sessions;
- determining rules for rectification by public companies of any false or incorrect information circulated publicly.

Given the above, the Team assessed the actions necessary to enhance the protection of capital market participants and prepared a report containing the proposed measures to increase the protection of capital market participants.

6.3.9. Other activities

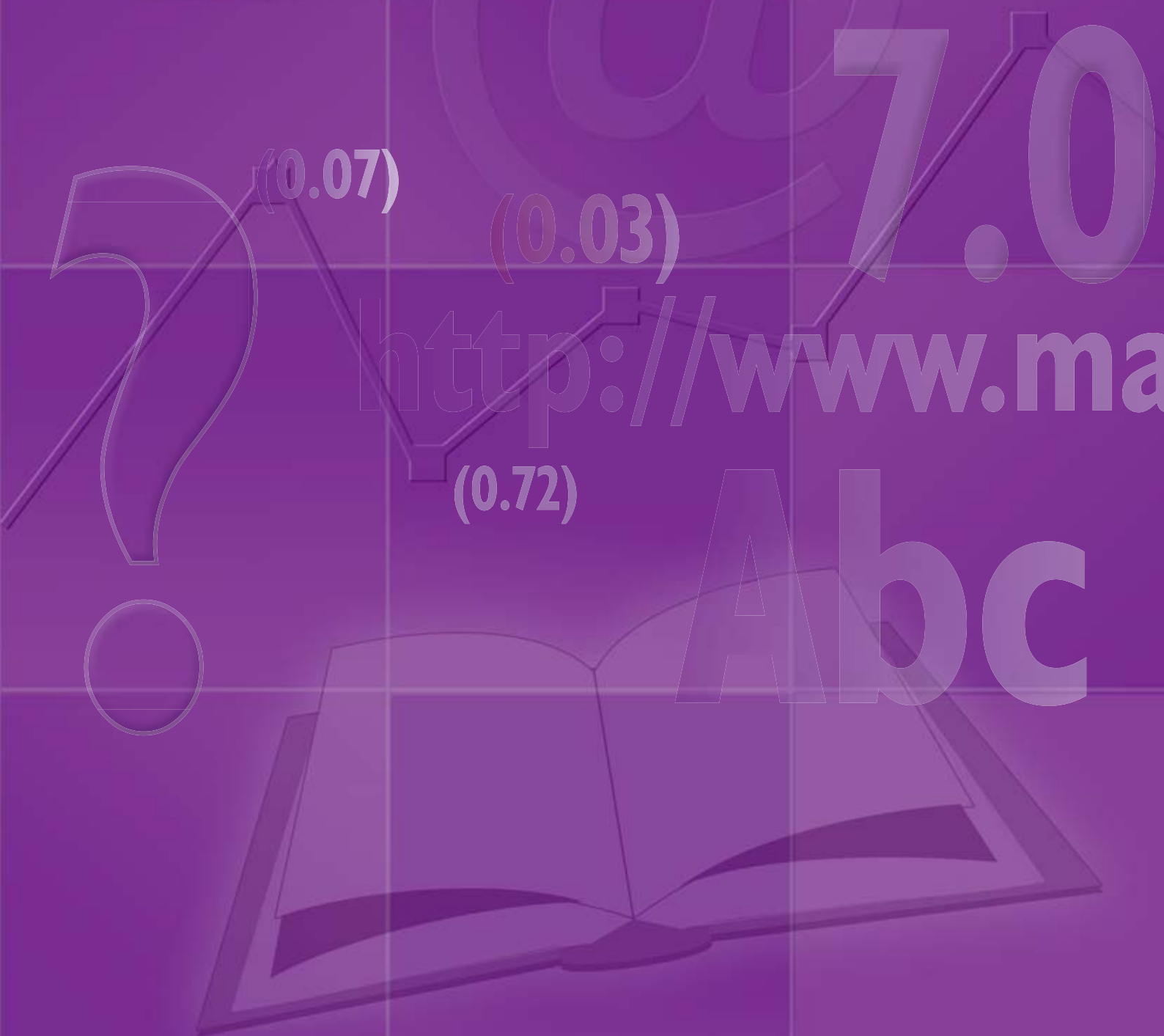
Other activities undertaken by the PFSA were aimed at eliminating the following market practices infringing the interest of financial institutions' clients:

- sending personalised credit cards to clients, charging or collecting fees despite no credit card agreement having been signed,
- banks' practices related to payment into or withdrawal from bank accounts of domestic and foreign currency coins,
- banks' practices related to transfer of bank accounts,
- donations to foundations indicated in contract forms,

- disclosures of personal data by publishing such data in the offers displayed on the ATM screens,
- banks' practices in the event of death of the holders of current and savings accounts,
- rejection by the banks of mortgages established by way of notarial deeds,
- procedure of handling complaints submitted to financial market participants by non-professional consumers of financial services.

Educational and information initiatives concerning the operation of the financial market

7



7. Educational and information initiatives concerning the operation of the financial market

7.1. Educational initiatives

7.1.1. Training seminars and workshops as part of the Educational Centre for Market Participants (CEDUR)

In 2010, performing the regulator's statutory tasks related to financial education, the PFSA Office organised, as part of the Educational Centre for Market Participants (CEDUR), 46 training seminars and workshops addressed to carefully selected groups of participants:

- representatives of regulated entities,
- representatives of the judiciary and prosecution bodies,
- local and regional consumer ombudsmen,
- teachers of Basic Entrepreneurship,
- members of the media,

attended in total by more than 3.3 thousand participants.

The seminars held in 2010 were a follow up on the project carried out last year under the CEDUR brand, which serves to promote the positive image of the PFSA Office's educational mission and enhance the project's recognition in target groups. The CEDUR training seminars, conducted by the PFSA Office's staff and enjoying strong interest among their participants, are an opportunity to share, in a clear and transparent manner, unique supervisory know-how and experience.

By organising such seminars, the PFSA not only fulfils its statutory task of educating the public on the operation of

the financial market, but also helps the PFSA to perform its financial market supervisory and other tasks, including:

- Ensuring proper operation of the financial market (in particular by organising seminars for the judiciary, prosecutors and law enforcement officers, as well as seminars on new market regulations for representatives of the regulated entities),
- Ensuring the 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 interests of financial market participants (in particular by organising seminars for media representatives, local and regional consumer ombudsmen, and workshops for methodologists 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 the seminars highlighted by their participants was the opportunity to exchange views directly with the regulator's representatives. The information gained from the survey is also used to plan themes of future educational events addressing the needs of the respondents.

7.1.2. Other direct educational activities

As part of its educational efforts, the PFSA Office also undertakes a number of other initiatives aimed at promoting and disseminating financial literacy and understanding of how the financial market operates, using for this purpose various methods of education: direct (workshops, lectures, lessons etc.) and indirect (publications, multimedia forms, competitions).

The key areas of the PFSA's interest with respect to financial education are:

- Promotion of financial literacy and building confidence in the financial market among prospective consumers of financial services,
- Support of initiatives of higher education institutions designed to improve the quality of content presented at financial-market-related conferences, seminars and workshops,

- Enhancement of professional qualifications of teachers of Basic Entrepreneurship at secondary schools in the area of economics and finance as well as protection of financial services consumers,
- Enhancement of the knowledge of the financial market among non economics students,
- Promotion of understanding of how the financial market operates (issues relating in particular to risk management, new legal and supervisory regulations as well as protection of market participants) among various stakeholder groups in the financial market.

An initiative which in addition to educational goals also served image-building purposes was a series of lectures by distinguished economists:

- Professor Eric Maskin (winner of the Nobel Prize in Economic Sciences 2007) gave a lecture entitled *Financial Crises: Why They Occur and What to Do about Them*; October 25th 2010,
- Professor Vernon L. Smith (winner of the Nobel Prize in Economic Sciences 2002) gave a lecture entitled *The Housing Bubble and Crash that Engulfed the Economy: Casual Similarities with the 1920s, and the Aftermath*; December 3rd 2010.

In the period covered by this report, the PFSA Office also organised two other meetings with recognised economists:

- special session entitled *Current Financial Crisis* (in response to a proposal of the Cracow University of Economics), with the participation of Professor Edward Prescott (winner of the Nobel Prize in Economic Sciences 2004), Professor Xavier Freixas (Pompeu Fabra University of Barcelona), and Professor Dimitrios Tsomocos (University of Oxford), held on June 11st 2010,
- lecture of honour by Professor Robert Mundell (winner of the Nobel Prize in Economic Sciences 1999), entitled *The European Fiscal Reform and the Plight of the Euro* (in response to a proposal of the Poznań University of Economics), held on June 30th 2010.

The lectures were attended by representatives of financial institutions, public administration, and academic circles.

A special and large-scale educational project, addressed to secondary school and academic students, was the participation of the PFSA Office representatives in the 14th Festival of Science. The PFSA experts once again prepared a series of

7.1.3. Indirect educational activities

In 2010, the PFSA continued to develop the ManyMany.info website (www.manymany.info) launched in 2009, addressed to secondary school and academic students. The website features further articles on the operation and components of the Polish financial market, as well as on protection of the market's clients. A "Personal Budget" application has also been placed

classes, workshops and lectures on the operation of the financial market. The PFSA Office organised six weekend meetings, six meetings as part of the Youth Club, three club meetings, seven festival lessons for primary and pre-secondary school students, and one meeting as part of a night with science.

As part of its educational projects, the PFSA Office took active part in nationwide initiatives organised by external institutions, designed to enhance economic knowledge and skills:

- 7th Nationwide Methodological Conference *Entrepreneurship in Times of Globalisation*, and the 3rd Nationwide Convention of Entrepreneurship Teachers, organised in the main part by the Pedagogical University of Kraków;
- 6th Nationwide Conference of Entrepreneurship Teachers, organised in the main part by the Foundation for Capital Market Education (Fundacja Edukacji Rynku Kapitałowego);
- workshops and conferences as part of the «Common Market» *Also for Criminals...* aid project, co-financed by the European Commission and carried out by the Police Academy of Katowice;
- workshops entitled *Cooperation between the Police and the Banking Sector to Prevent, Reveal and Combat Criminal Acts in the Operation of a Bank*, organised in the main part by the Police Academy of Szczytno;
- Summer School *Academy for Capital Market Leaders*, organised chiefly by Fundacja 2065 of Lesław A. Paga;
- 7th edition of the Good State Academy (Akademia Dobrego Państwa) (the group of topics concerning the financial crisis and its impact on the functioning of the state and free market economy), organised mainly by Klub Jagielloński of Kraków;
- The Economic Knowledge Contest, organised mainly by the Polish Economic Society.

As regards the implementation of educational projects, in 2010 the PFSA cooperated with:

- The Polish National School of Judiciary and Public Prosecution, the Internal Security Agency, Central Anticorruption Bureau, Polish Police Headquarters, Central Investigation Bureau, the Police Academy of Szczytno, the Police Academy of Katowice – in the organisation of seminars for the judiciary, prosecutors and law enforcement officers;
- General Prosecution Office of the State Treasury, Ministry of Economy and Ministry of Justice – in conducting seminars devoted to re-registration of pre-war commercial law companies.

on the website, promoting personal finance management and financial planning. Thanks to its user-friendly design, the website explains, in simple terms, the mechanisms of household budgeting, pensions, credit cards and other financial products. Apart from its educational content, the website allows its users to ask questions to the PFSA Office's experts and use advanced

calculators, including pension, household budget, mortgage, credit and investment fund fees calculators. Moreover, the service contains a blog and an interactive quiz. In 2010, the website was advertised on the Internet, in particular on community websites.

February 2010 saw the ending of a 24-episode series of educational TV programs devoted to economic and financial issues, entitled *Financial Mechanisms*, aired on TV Biznes and shown on the Internet (at www.gospodarka.gazeta.pl, “Market Mechanisms” tab). The PFSA oversaw the content of the programs. As the programs met with appreciation, a decision was made to continue the series and create a new series, entitled *Entrepreneurship*. By the end of 2010, ten further episodes of the *Market Mechanisms* series and 16 episodes of the *Entrepreneurship* series were shown on TVP Info and on www.tvp.pl, in the “Social Issues/Economy” section.

Since 2008, the PFSA Office has organised a contest for the best MA and PhD dissertations in topics related to financial market regulation and supervision. Winners of the contest receive the award of the PFSA Chairperson. 2010 saw the second edition of the contest for an MA dissertation devoted to the abovementioned issues. The contest participants included graduates of higher learning institutions from all over Poland.

In 2010, as part of its publishing activity the PFSA released the following publications:

- brochure entitled *ABC inwestowania w fundusze inwestycyjne* (*The ABC of Investing in Investment Funds*) as part of the *Poradnik Inwestora* (*Handbook for Investors*) series;
- brochure entitled *Vademecum członkostwa w otwartych funduszach emerytalnych* (*All about Membership in Open-end*

7.2. Information policy

7.2.1. Information activities

As part of the information policy, the Office of the Polish Financial Supervision Authority performs the following tasks:

- maintaining direct contacts with external entities, e.g. through a specialised Information Centre of the PFSA,
- liaising with members of the media and responding to their inquiries,
- presentation of positions and results of work of the PFSA and the PFSA Office to the public,
- informing the public of activities, initiatives and programmes managed by the PFSA,
- commenting on financial market developments.

In 2010, the media released 49,579 publications containing references to the PFSA or the PFSA Office, of which 43,876 were on-line publications (including approximately 30.4

Investment Fund) as part of *Poradnik klienta usług finansowych* (*Handbook for Consumers of Financial Services*) series;

- book *Rynek kapitałowy i terminowy* (*The Capital and Futures Market*);
- as part of the series *Materials and Studies of the Office of the Polish Financial Supervision Authority*, the following reports:
 - *Polish Financial Market in the Face of the 2008-2009 Financial Crisis*, containing an overview of an analysis of the effectiveness of precautions undertaken by the National Bank of Poland, Ministry of Finance and the Polish Financial Supervision Authority and its Office in the face of the crisis on international financial markets;
 - *Sources of Increased Lending in the Context of Currency Integration. Causes of Credit Booms in Ireland, Spain and Portugal*, containing a review of other countries’ experiences related to the introduction of the euro, in particular adverse interdependencies between a drop in real interest rates and unbalanced growth in lending;
 - *Structured Products in Poland in 2000-2010*, focused on the cross-sector nature of structured products, analysing rates of return and margins, and presenting examples of supervision over structured products in different countries.

The publications are distributed to libraries, secondary schools, colleges and financial market institutions.

In 2010, the PFSA also released a report entitled *Electronic Banking Services for Retail Clients – Overview and Risks* and its supplement, entitled *Handbook for Consumers of Electronic Banking Services*. The publications are intended for retail bank clients using or planning to use electronic banking services (bank card transactions, Internet banking, and telephone banking, including mobile banking). The publications are available on the PFSA’s website.

thousand ESPI reports) and 4,917 were press publications (including 448 in regional press), 463 references were made on the radio, and 323 on television.

Concurrently with the cooperation with nationwide media, the PFSA Office also ran information campaigns addressed to local communities. In 2010, workshops for regional media were organised, concerning the protection of non-professional participants of the financial market and legislative changes affecting main financial products. In addition, 11 press releases intended for regional media were developed, and 200 thousand leaflets containing basic information on the Polish financial market were distributed among the inhabitants of 89 towns and villages with population below 50 thousand.

As required by the Act on Access to Public Information, dated September 6th 2001 (Dz. U. No. 112, item 1198, as amended) and the accompanying regulation of the Ministry of Internal Affairs and Administration, the PFSA is obliged to publish

7.2.2. PFSA website

The main tool used by the PFSA to disseminate information is its official website at www.knf.gov.pl

The information on the PFSA acting in the capacity of the financial market regulator presented on the website includes: the PFSA's statutory tasks and composition, official communiqués of its meetings, description of the organisational structure of the PFSA 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

certain information on the web pages *Biuletyn Informacji Publicznej* (BIP, Public Information Bulletin) assigned to particular entities, representing an autonomous part of the PFSA's on-line service.

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 PFSA's activities as part of the EU institutions. In 2010, the PFSA website received almost 11 million visits.

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.

7.3. Cooperation with third parties

7.3.1. Cooperation with financial market participants

In 2010, regular meetings of the PFSA Office's senior personnel with representatives of regulated entities and financial trade organisations were held. They were divided into four thematic groups: banking sector, capital market, insurance market and pension market. 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 period covered by this Report, the PFSA Office organised 12 rounds of "Market Meetings".

7.3.2. Participation in the work of the Ministry of Finance's Financial Market Development Council

In 2010, representatives of the PFSA Office participated in the work of the Financial Market Development Council (RRRF) set up by the Minister of Finance as an opinion-giving and advisory body.

The PFSA Office representatives took part in the work of the following working groups:

- working group for the review of the banking law - its work involved discussions concerning possible changes to the rules and procedures for outsourcing of banking activities to third parties;
- working group for reverse mortgage - its work involved forming opinions on draft assumptions for the bill on reverse mortgage;
- working group for the review of the commercial insurance law - among other things, its work contributed to drafting a bill of January 23rd 2009 amending the Act on Compulsory Insurance, Insurance Guarantee Fund and Polish Motor

Insurers' Bureau, dated May 22nd 2003; the PFSA Office representatives actively participated in the work, presenting legislative proposals for improvements in the status of the insuring parties and the insured (e.g. improvements aimed at enhancing their understanding of how the automatic renewal of insurance coverage works or introducing solutions that would facilitate the making of declarations of will in performing and terminating insurance contracts through insurance agents);

- working group for financing the costs of supervision - two teams were established: a team for spending transparency and a team for defining the method and scope of calculating the contribution amount;
- working group for the amendment to the Act on Mortgage Bonds and Mortgage Banks - the PFSA Office representatives expressed a negative view on the proposal promoting a more widespread use of mortgage bonds as a source of funding mortgage loans by banks.

7.3.3. Cooperation with the National Bank of Poland

The cooperation framework is defined in an agreement concluded by the President of the NBP and the Chairperson of the PFSA under Art. 17.2 of the Act on Supervision over the Financial Market. Additionally, coordinators in charge of cooperation and information exchange were appointed at both the PFSA and the NBP.

The PFSA 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 statutory duties. In the first place, the NBP is a provider of data regarding prudential reporting of the banking sector. The PFSA, 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. Moreover, the PFSA furnishes the NBP with data needed to assess the adequacy of the amount of mandatory reserves held by banks.

The PFSA 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 PFSA Office to check the correctness of calculating the amount of and transferring mandatory reserves at commercial banks.

7.3.4. Inter-Institutional Working Teams for Euro Changeover Preparations

The PFSA Office representatives are actively engaged in the work of Inter-Institutional Working Teams for the Euro Changeover Preparations in Poland¹⁴ which are responsible for preparing the country for the adoption of the common currency:

- Working Team for the Financial Sector - the PFSA Office representative is deputy leader of the team, which met eight times in 2010. The overall objective of the team is to coordinate preparations of Polish financial institutions for the adoption of the common currency in the future.
- Working Team for Consumer Protection, which has a PFSA Office representative as its member, met six times in 2010. The key objective of the team is to prepare analyses on currency changeover actions taken by other member states in the area of unfair market practices, dual display of prices and definition of price monitoring rules.
- Working Team for Macroeconomics - the PFSA Office representative participated in six team meetings in 2010. During the year, the team focused on analysing lessons learnt by other member states while seeking to meet the convergence criteria and introducing the euro. The culmination of the work was the report *Sources of Increased Lending in the Context of Currency Integration. Causes of Lending Booms in Ireland, Spain and Portugal* drafted in September 2010. The report is part of the wider review of past experiences in currency integration. The key focus of the report is the analysis of economic changes occurring in those member states which experienced material adverse interdependen-

cies between a fall in real interest rates and an unbalanced surge in lending during preparations for and/or after joining the euro zone.

- Working Team for Legislative Alignment - the PFSA Office representative participated in seven team meetings in 2010. 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.

The PFSA Office representative also participates in the meetings of the National Euro Coordination Committee. The role of the Council of Minister's National Coordination Committee is to initiate and coordinate actions taken by the administrative bodies in connection with the future currency changeover.

In 2010, the PFSA Office worked on drafting the report *Sources of Increased Lending in the Context of Currency Integration. Causes of Lending Booms in Ireland, Spain and Portugal*, which was published in September 2010. The report is part of the wider review of past experiences in currency integration. The key focus of the report is the analysis of economic changes occurring in those member states which experienced material adverse interdependencies between a fall in real interest rates and an unbalanced surge in lending during preparations for and/or after joining the euro zone. The report was compiled as a result of the PFSA Office representatives participating in the work of the Working Team for Macroeconomics.

¹⁴ Regulation of the Council of Ministers dated November 3rd 2009.

Measures taken to counteract market abuse

8

8.0

(0.08)

+ 0.0081

+ 0.08

8. Measures taken to counteract market abuse

8.1. Explanatory and administrative proceedings related to supervision over the financial market

In 2010, the PFSA conducted

- Act on Trading in Financial Instruments – 9 proceedings,
- Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies – 52 proceedings,
- Act on Investment Funds – 10 proceedings,
- Act on Insurance Activity – 3 proceedings,
- Act on Compulsory Insurance – 20 proceedings,
- Act on Organisation and Operation of Pension Funds – 5 proceedings,
- other – 5 proceedings.

In 2010, 82 administrative decisions were issued in said cases, including:

- 61 first-instance decisions (49 decisions to impose a fine, 4 decisions to reject the application for relief from sanctions or to grant the application for relief from sanctions or for payment of a fine in instalments, 1 decision to impose a sanction and exclude an instrument from trading, and 7 decisions to

discontinue proceedings seeking imposition of a sanction), 21 decisions in cases remitted for reconsideration upon a party's request (including 19 decisions to uphold a first-instance ruling and 2 decisions to repeal a first-instance ruling and to lower the amount of imposed fine).

Furthermore, in 2010 the PFSA conducted nine 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 commencing administrative proceedings concerning violation of the law, to the extent falling within the scope of the PFSA's supervision. The proceedings pertained to:

- violation of professional secrecy,
- unlawful disclosure of inside information and insider trading,
- manipulation involving financial instruments,
- failure to discharge or improper discharge of disclosure obligations,
- execution of transactions during closed periods,

■ TABLE 26. NUMBER AND TYPE OF PROCEEDINGS CONDUCTED BY THE PFSA IN 2007-2010

TYPE	2007		2008		2009		2010	
	NO. OF PROCEEDINGS COMMENCED	NO. OF PROCEEDINGS CLOSED	NO. OF PROCEEDINGS COMMENCED	NO. OF PROCEEDINGS CLOSED	NO. OF PROCEEDINGS COMMENCED	NO. OF PROCEEDINGS CLOSED	NO. OF PROCEEDINGS COMMENCED	NO. OF PROCEEDINGS CLOSED
Administrative proceedings	37	35	71	68	62	64	69	64
Explanatory proceedings	27	50	13	8	7	9	6	5
Total	64	85	84	76	69	73	75	69

In 2010, the PFSA imposed fines in the total amount of PLN 6,350 thousand, including:

- on issuers – PLN 2,780 thousand,
- on investment fund management companies – PLN 900 thousand,
- on insurance companies – PLN 680 thousand,

- on pension fund management companies – PLN 300 thousand,
- on natural persons – PLN 1,690 thousand.

Furthermore, one sanction was imposed involving exclusion of an issuer's shares from trading on the regulated market for a specified period of time.

8.2. Administrative proceedings involving financial intermediaries

The PFSA'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,
- entities acting as intermediaries in selling and redeeming investment fund units,
- securities brokers, investment advisers and commodity brokers.

In 2010, 217 proceedings involving financial intermediaries were conducted by the PFSA, including in the scope of the following acts of law:

- Insurance Mediation Act – 5 cases,
- Act on Trading in Financial Instruments – 18 cases,
- Act on Investment Funds – 1 case,
- Act on Organisation and Operation of Pension Funds – 193 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 (Art. 46 of the Insurance Mediation Act of May 22nd 2003) – 3 proceedings,
- absence of compulsory third party liability insurance coverage against damage done to a person seeking insurance, the insuring party, the insured or the holder of rights under an insurance contract, including damage done by natural persons through which an insurance broker performs brokerage services, and entities referred to in Art. 25 (Art. 22.1 of the Insurance Mediation Act of May 22nd 2003) – 2 proceedings,
- violation of professional secrecy (Art. 159.1.2 of the Act on Public Trading in Securities, Art. 148.1 of the Act on Trading in Financial Instruments, internal regulations of an investment firm) – 4 proceedings,

- breach of the ban on holding multiple positions and violation of professional secrecy (Art. 47 of the Act on Organisation and Operation of Pension Funds, Art. 159.1.2 of the Act on Public Trading in Securities) - 1 proceeding,
- unlawful disclosure of inside information (Art. 156.2.1 of the Act on Trading in Financial Instruments) - 6 proceedings,
- insider trading (Art. 156.1.1d of the Act on Trading in Financial Instruments) - 4 proceedings,
- improper supervision over brokerage activities (Art. 98a.1 of the Act on Trading in Financial Instruments, regulations under the Act on Trading in Financial Instruments, internal regulations of an investment firm) – 2 proceedings,
- non-compliance with disclosure requirements by an agent of an investment firm (Art. 81.8 of the Act on Trading in Financial Instruments) - 1 proceeding,
- non-compliance with disclosure requirements by a distributor of investment fund units (Art. 32.9 of the Act on Investment Funds) – 1 proceeding,
- non-fulfilment of the registration criteria (conviction under a legally valid court ruling) - Art. 94.4.1 of the Act on Organisation and Operation of Pension Funds of August 28th 1997 (Dz.U. of 1997, No. 139, item 934, as amended) or performance of acquisition activities in violation of the law - Art. 94.4.2 of the Act on Organisation and Operation of Pension Funds - 193 proceedings.

In 2010, 217 administrative decisions were issued in said cases, including:

- 5 first-instance decisions to impose fines on insurance brokers in the total amount of PLN 9 thousand,
- 15 first-instance decisions in cases involving securities brokers and investment advisers (including 2 decisions to suspend licence for a period of one year, 3 decisions to remove a person from the register of investment advisers, and 10 decisions to discontinue administrative proceedings),
- 193 decisions in cases seeking removal from the register of persons entitled to perform client acquisition activities for open-end pension funds (including 104 decisions to remove a person from the register and 89 decisions to discontinue proceedings).

8.3. Notifications of suspected offence

In 2010, the PFSA Office filed 53 notifications of suspected offences with the Regional Public Prosecutor's Office of Warsaw, relating to violation of the following acts:

- Act on Trading in Financial Instruments (consolidated text: Dz.U. of 2010, No. 211, item 1384) – 16 notifications,
- Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies (consolidated text: Dz.U. of 2009, No. 185, item 1439, as amended) – 16 notifications,
- Act on Investment Funds (Dz.U. of 2004, No. 146, item 1546, as amended) – 1 notification,
- Banking Law (Dz.U. of 2002, No. 72, item 665, as amended) – 5 notifications,
- Act on Counteracting Money Laundering and Terrorist Financing (Dz.U. of 2010, No. 46, item 276, as amended) – 2 notifications,
- Accountancy Act (Dz.U. of 2009, No. 152, item 1223, as amended) – 3 notifications,
- Personal Data Protection Act (Dz.U. of 2002, No. 101, item 926, as amended) – 1 notification,
- Act on Insurance Activity (Dz.U. of 2010, No. 11, item 66, as amended) – 1 notification,
- Insurance Mediation Act (Dz.U. of 2003, No. 124, item 1154, as amended) – 1 notification,
- Cooperative Law (Dz.U. of 2003, No. 188, item 1848, as amended) – 1 notification,
- Electronic Signature Act (Dz.U. of 2001, No. 130, item 1450, as amended) – 1 notification,
- Criminal Code – 4 notifications.
- Commercial Companies Code – 1 notification.

■ TABLE 27. NOTIFICATIONS FILED IN 2007-2010 BY TYPE OF OFFENCE

OFFENCE	NUMBER OF NOTIFICATIONS			
	2007	2008	2009	2010
Violation of Art. 183 of the Act on Trading in Financial Instruments (market manipulation)	8	11	10	6
Art. 180 and 181 of the Act on Trading in Financial Instruments (unlawful disclosure of inside information and insider trading)	8	13	16	6
Art. 295 (unauthorised conduct of activities referred to in Art. 32.2, Art. 45.1 or 45.2 or Art. 209) and Art. 296 of the Act on Investment Funds (unauthorised use of the name referred to in Art. 14.4 of the Act)	14	2	2	-
Art. 100 of the Public Offering Act (misrepresentation and concealment of facts in a prospectus or in reports)	4	7	3	14
Art. 178 of the Act on Trading in Financial Instruments (unauthorized trading in broker-traded financial instruments)	4	1	4	3
Other	9	8	7	24
Total	47	42	42	53

Based on the notifications filed with the Public Prosecutor's Office in 2010, 41 preliminary investigation proceedings were

commenced, the commencement of investigation was refused in 4 cases, and 3 proceedings were discontinued.

8.4. Indictments

In 2010, the PFSA Office was notified that 6 indictments based on the notifications of suspected offence received from the PFSA Office were filed by the Public Prosecutor's Office with common courts of law. The indictments referred to the following regulations:

- Art. 183 of the Act on Trading in Financial Instruments:
 - Notification of October 24th 2007 – indictment of June 23rd 2010,
 - Notification of December 30th 2008 – indictment of August 12th 2010,

- Notification of March 5th 2009 – indictment of August 30th 2010;
- Art. 180 of the Act on Trading in Financial Instruments:
 - Notification of February 6th 2002 – indictment of November 29th 2010;
- Art. 179 of the Act on Trading in Financial Instruments:
 - Notification of December 8th 2004 – indictment of January 28th 2010;
- Art. 100 of the Public Offering Act:
 - Notification of October 30th 2007 – (subsidiary) indictment of July 14th 2010;
- Art. 297.2 of the Criminal Code:

- Notification of 2000 – indictment of December 31st 2009 (information delivered to the PFSA Office on May 10th 2010).

Moreover, in 2010, the PFSA Office filed a subsidiary indictment in a case under Art. 100 of the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading and Public Companies with the District Court of Warsaw. The indictment was filed after the Regional Public Prosecutor's Office in Warsaw had twice discontinued preliminary investigation proceedings. The notification of this case was filed on October 30th 2007.

■ TABLE 28. INDICTMENTS FILED WITH COURTS IN 2007–2010, BY TYPE OF OFFENCE

OFFENCE	INDICTMENTS			
	2007	2008	2009	2010
Violation of Art. 183 of the Act on Trading in Financial Instruments (financial market manipulation)	3	4	9	3
Art. 180 and 181 of the Act on Trading in Financial Instruments (unlawful disclosure of inside information and insider trading)	3	1	1	1
Other	-	4	3	3
Total	6	9	13	7

In 2010, the Public Prosecutor's Office issued 43 decisions concerning discontinuation of or refusal to start preliminary investigation proceedings – in cases covered by notifications filed with the Public Prosecutor's Office both in 2010 and in earlier years. The cases related to:

- Art. 183 of the Act on Trading in Financial Instruments – 6 decisions,
- Art. 180 and 181 of the Act on Trading in Financial Instruments – 14 decisions,
- Art. 179 of the Act on Trading in Financial Instruments – 2 decisions,
- Art. 100 of the Public Offering Act – 6 decisions,
- Art. 99 of the Public Offering Act – 2 decisions,
- Art. 171 of the Banking Law – 5 decisions,
- Art. 296 and 295 of the Act on Investment Funds – 3 decisions,

- Art. 77.2 of the Accountancy Act – 1 decision,
- Art. 47.1 and 47.2 of the Insurance Mediation Act – 1 decision,
- Art. 174 of the Polish Securities Act – 1 decision,
- Criminal Code – 2 decisions.

In several cases (mostly threatened by prescription) attorneys of the PFSA Office sent letters to the presidents of the courts before which the cases, notified by the PFSA Office (earlier: by the Polish Securities and Exchange Commission), were examined; in these letters, the attorneys pointed out the protraction of the proceedings and requested more frequent trials. In order to familiarise representatives of the judiciary and prosecutors with the characteristics of financial offences, attorneys of the PFSA Office were also involved in conducting training seminars on this subject.

8.5. Convictions and conditional discontinuation of proceedings

In 2010, courts passed the following convictions and decisions concerning conditional discontinuations of proceedings in cases brought under PFSA's notifications.

Sentence issued by the District Court of Warsaw Śródmieście in the case under Art. 177 of the Polish Securities Act (currently: Art. 183 of the Act on Trading in Financial Instruments – market manipulation). The Court sentenced one of the defendants to one year of imprisonment with execution suspended for four years and a fine of PLN 1,000,000. Each of the other three defendants was sentenced to ten months of imprisonment with execution suspended for three years and a fine of PLN 350,000. The PFSA's notification was filed on December 30th 2003.

Sentence issued by the District Court of Warsaw Śródmieście in the case under Art. 183 of the Act on Trading in Financial Instruments (market manipulation). The Court sentenced the defendant to a fine of PLN 20,000 (the sentence is not legally valid). The notification was filed on July 28th 2003.

Sentence issued by the District Court of Warsaw Śródmieście in the case under Art. 181.2 of the Act on Trading in Financial Instruments (insider trading). The defendant voluntarily submitted to penalty. The Court sentenced the defendant to a fine of PLN 90,000 (the sentence is legally valid). The notification was filed on April 4th 2006.

Sentence issued by the District Court of Dąbrowa Górnicza in the case under Art. 183.1 of the Act on Trading in Financial

Instruments (market manipulation). The Court sentenced each of the three defendants to a fine of PLN 150,000 and banned them from practising the profession of a securities broker for four years. The defendants appealed against the sentence. The Regional Court reversed the judgement due to perscription. The notification was filed on May 28th 2001.

Sentence issued by the District Court of Nowy Sącz in the case under Art. 181.1 of the Act on Trading in Financial Instruments (insider trading). The defendant voluntarily submitted to penalty. The Court sentenced the defendant to a fine of PLN 5,000 (the sentence is valid). The notification was filed on August 23rd 2007.

Sentence issued by the Regional Court of Kalisz, upholding the conviction passed by the District Court of Ostrów Wielkopolski in the case under Art. 183 of the Act on Trading in Financial Instruments (market manipulation). The District Court sentenced the defendant to six months of imprisonment with execution suspended for two years and a fine of PLN 2,000 (the sentence is legally valid). The notification was filed on June 30th 2008.

Sentence issued by the Regional Court of Poznań in the case under Art. 183 of the Act on Trading in Financial Instruments (market manipulation). The Court, while finding the defendant guilty of perpetrating the alleged act, refrained from imposing a penalty and ordered means of punishment in the form of payment of PLN 1,000 (the sentence is legally valid). The notification was filed on April 11th 2007.

■ TABLE 29. CONVICTIONS AND CONDITIONAL DISCONTINUATIONS IN 2007–2010, BY TYPE OF OFFENCE

LEGAL GROUNDS FOR CONVICTION	NUMBER OF CONVICTIONS			
	2007	2008	2009	2010
Art. 177 of the Polish Securities Act / Art. 183 of the Act on Trading in Financial Instruments (market manipulation).	8	7	5	5
Art. 176.1 and 176.2 of the Polish Securities Act / Art. 180 and 181 of the Act on Trading in Financial Instruments (unlawful disclosure of inside information and insider trading)	1	1	-	2
Other	2	3	1	-
Total	11	11	6	7

8.6. Powers exercised in criminal proceedings

In the scope of the PFSA's statutory powers, attorneys duly authorised by the Chairperson of the PFSA act as plaintiff's attorneys or as proxies for auxiliary prosecutors in criminal proceedings.

In 2010, attorneys duly authorised by the Chairperson of the PFSA acted as plaintiff's attorneys during preliminary

investigation proceedings in 35 cases, and as proxies for auxiliary prosecutors during court proceedings in 15 cases. The attorneys also lodged three appeals against sentences issued by first-instance courts (as at December 31st 2010, two of the cases were pending) and 26 complaints against decisions of the Public Prosecutor's Office concerning discontinuation of or refusal to start preliminary investigation proceedings.

■ TABLE 30. NUMBER OF INSTANCES OF ATTORNEYS DULY AUTHORISED BY THE CHAIRPERSON OF THE PFSA ACTING IN CRIMINAL PROCEEDINGS IN 2007–2010

	2007	2008	2009	2010
Acting as plaintiff's attorney	23	26	34	35
Acting as proxy for auxiliary prosecutor	27	25	15	15
TOTAL	50	51	49	50

Participation in legislative processes

9



9. 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 PFSA acts as advisor and gives opinions to authorities and agencies which, under separate legal regulations, initiate and conduct legislative work. The PFSA'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 2010, the Polish Financial Supervision Authority's experts were involved in drafting and advising on several dozen draft bills, bill assumptions and regulations.

9.1. Selected draft bills and draft bill assumptions

Bills amending the Act on Investment Funds dated May 27th 2004 (Dz. U. No. 146, item 1546, as amended).

Based on the earlier work and consultations regarding a change in the model of supervision over closed-end investment funds issuing non-public investment certificates, in the first quarter of 2010, a draft amendment to the Act on Investment Funds was prepared. Assumptions were also developed for the draft amendment. The draft 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 would not issue approvals for amendments to the fund's articles of association or a change of the fund depositary, and such funds would be subject to supervision by the PFSA in the scope of their financial position. The draft also stipulates that the marketing 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 PFSA's approval, given that in such a case a given fund becomes available to retail investors. The Ministry of Finance has commenced further work on the draft. In particular, in 2010, inter-ministry consultations and a conference devoted to the amendment were held.

The draft also includes the PFSA's proposal to introduce the requirement for custodian banks to employ exclusively persons without criminal record to perform custody activities. This provision is to replace the obligation to repeatedly submit to the PFSA Office certificates confirming no criminal record of such employees.

The second draft amendment to the Act was designed to implement Directive 2009/65/EC of the European Parliament and of the Council of July 13th 2009 on the coordination of laws, regulations and administrative provisions relating

to undertakings for collective investment in transferable securities (UCITS IV Directive).

Bill amending the Consumer Loan Act

The PFSA Office expressed its opinion on the bill prepared by the Office of Competition and Consumer Protection. The main goal of amending the Consumer Loan Act is harmonising the Act with the provisions of Directive 2008/48/EC of the European Parliament and of the Council of April 23rd 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC. The assumptions for the bill amending the Consumer Loan Act provide for a limited scope of regulation of mortgage secured loans; the regulation only covers disclosure requirements prior to agreement conclusion and disclosure requirements in the agreement itself. Failure to meet these requirements by the lender or loan broker will give the consumer right to use the sanction of the fee-free/interest-free loan. The rules for accessing consumer databases have also been amended. The PFSA Office participated in work on the bill both in the phase of developing assumptions for the draft and in the phase of inter-ministry agreements. In particular, the Office submitted an opinion that no amendment is required to the Banking Law where it pertains to access to banking secrets.

Act of December 16th 2010 amending the Act on the Banking Guarantee Fund (Dz.U. No. 257, item 1724)

The PFSA Office expressed its opinion on this bill prepared by the Ministry of Finance. The amendment was introduced to implement Directive 2009/14/EC amending Directive 94/19/EC on deposit-guarantee schemes. The amendments primarily related to the increase in the guaranteed amount paid out in the event of a bank's bankruptcy (the amount was increased to the PLN equivalent of EUR 100,000) and to the guaranteed

amount payment procedure, which has been shortened and made independent of the bankruptcy proceedings.

Bill amending the Banking Law

The subject matter of the bill is the amendment to the Banking Law of August 29th 1997 (Dz.U. of 2002, No. 72, item 665, as amended) to the extent it relates to the scope of provisions regulating the rules and procedures for bank outsourcing. 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. The PFSA Office's representatives participated in the work of the Working Group for the review of the banking law. The Group operates within the structures of the Financial Market Development Council appointed at the Ministry of Finance. Later the representatives participated in the development of assumptions for the bill and the bill itself.

Payment Services Bill

The goal of the bill is the implementation of Directive 2007/64/EC of the European Parliament and of the Council of November 13th 2007 on payment services in the internal market (the PSD Directive) into Polish law. The Payment Services Bill is to provide a uniform legal foundation for the provision of payment services and conduct of business in this area. It will define a fixed group of payment service providers, such as banks or savings and loan associations. It will also introduce a new category of payment service providers, being payment institutions whose operations will be supervised by the state and which would be required to obtain a permit, whose grant would be contingent on fulfilment of prudential requirements. As a consequence of Poland applying national anti-money-laundering regulations as permitted by Art. 26 of the PSD Directive, the bill will also permit 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 would be limited with respect to the scope of provided services and the turnover.

As it is planned that the PFSA will exercise supervision over domestic payment institutions and payment service bureaus, the PFSA Office's representatives participated in the subsequent phases of work conducted by the Ministry of Finance, including in particular in the scope of developing provisions pertaining to the rules of supervision over payment institutions and payment service bureaus.

Draft assumptions for the Reverse Mortgage Bill

The Financial Market Development Council at the Ministry of Finance initiated the work on the draft assumptions. The PFSA

Office expressed its opinion on the draft assumptions. The paramount idea of the reverse mortgage is a lack of obligation to repay the loan until the borrower's death. The claim of the lender is, as a rule, satisfied with the proceeds from the sale of the real estate. In accordance with the applicable provisions, satisfaction of claim by enforcement would be excessively time consuming and, moreover, would not guarantee the satisfaction of the lender's claim, because proceeds from the sale of real estate in the course of enforcement proceedings are usually remarkably lower than the market value.

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

In the environment of the growing market of compulsory business insurance, including in particular motor TPL insurance, in consideration of experience gathered over the several years of the operation of the Act, as well as the practice and suggestions of entities covered by it operation, a need was identified to take steps to amend the regulations stipulated in the Act or to make them more precise. The bill is designed to streamline the operation of the compulsory insurance market and systematize the regulations, as well as to enhance internal consistency of the Act, which will render its application easier. The PFSA Office participated in the work on the bill, prepared by the Working Group of the Financial Market Development Council. The PFSA arranged for a number of regulations to be included in the bill, which are designed to improve the situation of both the insuring parties and the insured by, inter alia, enhancing their understanding of the mechanism of automatic renewal of insurance coverage and facilitating making declarations of will relating to the performance and termination of insurance agreements through insurance agents.

Bill on Reducing Administrative Barriers to Citizens and Entrepreneurs (in the scope of self-amendment and what is known as the culture of declaration)

The PFSA Office, acting in cooperation with the Ministry of Economy, prepared a bill (self-amendment) liquidating direct supervision over natural persons operating within the structures of financial institutions.

The bill provided for the following amendments:

- abolishing the regulation of the professions of securities broker, investment advisor, commodity broker, investment firm agent and actuary;
- introducing legal instruments enabling the PFSA to verify on an ongoing basis the qualifications and skills of persons performing sensitive investment-related activities (portfolio management, investment advisory, customer assets control and actuarial activity), including in particular through the verifying examination;

- enhanced supervision over persons performing sensitive investment-related activities by the financial institutions which employ them, including in particular through the requirement to certify the relevant scope of professional expertise and implementation of internal standards to guarantee the security of customers' interests.

The PFSA Office participated in the parliamentary work on a bill which introduces the legal institution of declaration in a broad range of regulated activities.

Bill amending the Personal Income Tax Act

In response to the Ministry of Finance's request, the PFSA Office assessed the long-term budget effects of the proposed introduction to the Personal Income Tax Act of the option to treat as tax deductible deposits of up to PLN 4,800 annually in connection with the introduction to the Polish legal system of the new institution of "voluntary pension security".

It is the bill authors' intention to introduce into the legal system a new product representing broadly meant voluntary pension security. By its assumptions, the product is similar to the existing individual pension accounts (IKE). The new product will be available to a natural person who has concluded an agreement for purchasing pension security with a financial institution: investment fund, broker, insurance company or bank. Pursuant to the assumptions for the bill, a person depositing funds for additional pension security under such an agreement will have the right to reduce the tax base by the amount of funds saved under the new voluntary pension security system, up to the total amount of PLN 4,800 annually.

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

The purpose of the bill is to add a definition of a collective account, identify the group of entities for which a collective account may be maintained, and define the group of entities holding rights attached to securities registered in a collective account. The amended act will also define the moment a security is created, the moment a security is transferred, the moment rights under a security are acquired and lost, the consequences of registering securities in a securities account and the corresponding collective account (a few corresponding collective accounts). The amended act will further indicate solutions concerning the transfer of benefits from securities registered in a collective account.

Bill amending the Banking Law, Act on Trading in Financial Instruments and secondary legislation issued thereunder, as well as the Act on Supervision over the Financial Market

The draft amendments were prepared as it was necessary to reflect in the Polish legal system 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 September 16th 2009 (CRD II).

Bill amending the Act on Trading in Financial Instruments and the Act on Commodity Exchanges

Draft amendments to the Act on Trading in Financial Instruments pertain to numerous matters, including:

- authorising the PFSA to demand that the acceptance of orders of a specified type be suspended and to demand that trading in all financial instruments be suspended without the need to specify them individually;
- granting licences for brokerage activity to domestic entities;
- manner of service provision by foreign investment firms based in other member states;
- manner of operation of alternative trading facilities and of trading in commodities on regulated markets;
- making the definition of professional secrecy more precise;
- premises for entry into and removal from a relevant register of a securities broker, commodity broker and investment advisor;
- broadening the list of persons to whom the prohibition of acquiring securities during closed periods and penal sanction apply;
- increasing the upper limit of fines for the infringement upon information manipulation provisions;
- enhancing the transparency of the process of introducing securities to trading on alternative trading facilities;
- broadening the list of persons to whom the prohibition of using inside information applies and increasing the penal sanction for violating the prohibition;
- administrative sanctions for violating the statutory provisions.

The draft amendments were prepared, upon the PFSA Office's initiative, in the form of bill assumptions, followed by proposed wording of specific provisions. Work on the draft commenced in 2010 and will continue in 2011.

Draft assumptions to the bill amending the Act on Organisation and Operation of Pension Funds

The PFSA Office's participation consisted in the definition of: the legal form and organisation of pension sub-funds and a mechanism for their administrative and legal regulation, calibrating parameters of the new system, proposing mechanisms to guarantee capital adequacy of pension fund management companies, rules for conversion of assets, rules for benchmark determination, and rules for investment policy limitation, as well as in the identification of expected financial effects of the draft amendments.

Scope of rules governing the execution of securities lending agreements by pension funds, that is Art. 151 of the Act on Organisation and Operation of Pension Funds, and preparation of the relevant implementing regulations to the Act

The proposed regulation of pension fund activities with respect to their execution of securities lending agreements seeks to protect pension funds against the most prominent risks inherent in such operations, such as the loss of some or all assets on loan following the borrower's default, or unjustified depreciation of assets on loan. The regulation further seeks to protect pension funds against an unjustified increase in the value of assets on loan, resulting from orders to close open short positions by the sellers, and against a breach of investment security caused by improper accounting for securities loans when applying investment limits for pension funds. Certain mechanisms and solutions could be developed to mitigate the above risks.

The work performed by the PFSA Office led to a conclusion that the terms on which open-end pension funds could engage in lending securities for short selling should be precisely defined in relevant laws. The regulations should provide for at least the following areas: the method and terms of framework securities lending agreements, indication of criteria to be met by securities to be lent under a securities lending agreement, the permitted cap on a pension fund's exposure to securities lending, the method of accounting for securities on loan when applying investment limits in pension funds' operations, and the method of establishing collateral, along with the permitted collateral types.

Draft assumptions to the bill amending the Act on Organisation and Operation of Pension Funds

As part of implementation of Directive 2003/41/EC of the European Parliament and of the Council of June 3rd 2003 on the activities and supervision of institutions for occupational retirement provision, the PFSA Office presented a concept different from that developed by the Minister of Labour and Social Policy. In accordance with the PFSA Office's concept, fixed benefit-occupational pension schemes operated by foreign employers would be managed by domestic life insurance companies. The proposal was not adopted.

Bill amending the Act on Qualified Auditors, Their Self-Government, Entities Qualified to Audit Financial Statements and on Public Supervision

The bill, initiated by the PFSA Office, includes the following proposals for amendments to the Act on Qualified Auditors,

Their Self-Government, Entities Qualified to Audit Financial Statements and on Public Supervision of May 7th 2009 (Dz.U. of 2009, No. 77, item 629):

- changes to the rotation model for public interest entities,
- changes to the list of public interest entities,
- changes to the list of public interest entities on which the Act on Qualified Auditors imposes the requirement to establish an audit committee,
- more precise wording of the provisions on independence of the audit committee members,
- grant of broader powers to the Audit Supervisory Authority.

Draft assumptions to the Anti-Corruption Bill

The position of the PFSA Office on the bill proposed by Minister Julia Pitera, Secretary of State at the Chancellery of the Chairman of the Council of Ministers, included a proposal to add employees of the PFSA Office to the list of entities required to submit personal assets disclosures and to incorporate provisions to mitigate the PFSA Office's internal risk of the Office's employees engaging in investments on an organised securities market.

Bill amending the Act on Patient Rights and the Patients' Rights Ombudsman

The bill, prepared by the Ministry of Health and submitted for the Office's opinion, includes a regulation allowing the patient to pursue medical error compensation claims by way of a procedure before a provincial committee for medical errors, conducted as a settlement and mediation process, without the need to refer them to courts. The PFSA Office was involved in inter-ministry consultations on the bill. The PFSA's activities helped to refine the regulations, e.g. regarding the final nature of the provincial committee's decision (closing the court litigation option). Importantly, not all of the PFSA Office's comments on the bill were taken into account (e.g. temporary limitation of the right to pursue claims before the provincial committee).

Bill on medical activities

The purpose of the proposed regulation, prepared by the Ministry of Health, is to improve and standardize the legal framework under which medical services are provided. This single legislative act regulates in a comprehensive manner the rules of conducting medical activities and will apply to all entities providing such services. The PFSA Office provided an opinion on the bill at the stage of inter-ministerial consultations, and pointed to the need to add further clarity to the provisions on third-party insurance with respect to medical activities, and agreements which form the basis of financing such activities.

Bill amending the Act on Mortgage Bonds and Mortgage Banks

The work on the bill was initiated by the Financial Market Development Council at the Ministry of Finance. The current financial situation of banks requires them to seek sources of financing for long-term mortgage loans. The purpose of the amendment is to encourage a broader use of mortgage bonds as a form of mortgage loan financing by banks. The position of the PFSA Office on the bill is critical.

Mortgage bonds are marked by a high level of investment credibility and standardisation. Given their existing standard, mortgage bonds were included in the various acts of law in the categories of financial instruments which, owing to their security, are permitted investments or may serve as security. The above applies primarily to investments made by pension funds, investment funds and insurance companies, and NBP's acceptance of mortgage bonds as security for lombard loans and repo transactions. Considering the planned assignment of ratings to all securities, more liberal rules of mortgage bond issue will translate into poorer quality of mortgage bonds and their lower rating, which will affect their price from the perspective of capital raising.

The PFSA Office argues that the bank issuing mortgage bonds must meet all requirements which ensure the bond's quality. The issue of mortgage bonds by universal banks will render this instrument easier to issue, but markedly less secure. Therefore, more liberal rules of mortgage bond issue is not a good solution to the problem.

Bills amending the Act on State Treasury's Support to Financial Institutions of February 12th 2009 and the Act on Recapitalisation of Certain Financial Institutions of February 12th 2010

Work on the above acts of law was initiated by the Ministry of Finance. The PFSA Office's work included providing opinions

on the bills, participation in the committees of the lower and upper chamber of the Polish Parliament, or, earlier, as part of the Standing Committee of the Council of Ministers. The acts concerned the scope of activities of the Polish Financial Supervision Authority and the Office of the Polish Financial Supervision Authority. The new regulations included in particular:

- changing the Act validity period (the Act was effective for one year only) and replacing it with a long-term solution, with the support being made subject to the European Commission's approval,
- imposing on the PFSA a requirement to inspect the observance of terms and limitations imposed on financial institutions under the support agreement,
- support instruments,
- inclusion of cooperative savings and loan associations as institutions eligible to receive liquidity support.

Bill amending the Act on Trading in Financial Instruments, the Act on Public Offering and Conditions Governing Introduction of Financial Instruments to Organised Trading System and on Public Companies, the Act on Investment Funds, and the Act on Commodity Exchanges

The bill stipulates removal of the obligation to hold administrative proceedings prior to imposition of fines by the PFSA on the capital market. The amendments are included in one of the items of the *Package for Financial Market De-Bureaucratisation*. The purpose of the package is to limit burdensome bureaucratic procedures and activities of solely formal nature, which hold up significant resources, both on the part of regulated entities and the supervisory authorities, and do not improve market security or risk management quality.

International cooperation of the Polish Financial Supervision Authority

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10. International cooperation of the Polish Financial Supervision Authority

10.1. Main areas of activity

2010 saw continued and intense work on new regulations for the financial sector in various international forums. The efforts focused on designing prudential regimes and institutional solutions to mitigate the risk of a repeated financial crisis. Key initiatives of the European Union in the area included:

- enhancement of the European dimension of financial supervision,
- revision of the Capital Requirements Directive (so-called CRD IV),
- establishment of the European framework for counteracting and managing banking sector crises,

- amendment to the directive on deposit guarantee schemes,
- regulation of rating agencies.

The above matters were also assigned priority status in the international endeavours of the PFSA. Of key importance for the Office's international activities was also the development of cooperation under the Host Countries Forum initiated by the PFSA Office and the Solvency II project (new regime for insurance companies).

10.1.1. Participation in the discussion on the model of supervision in the European Union

Negotiations on the model for a new EU-wide financial supervision system, which commenced already in 2009, continued in 2010 in the EU Council and the European Parliament, with input from the European Commission. Participation in the negotiations was one of the Polish Financial Supervision Authority Office's priority projects. The PFSA Office's involvement included participation in working groups, public consultation exercises, international conferences and, most importantly, support to the Ministry of Finance in inter-governmental negotiations. The negotiations were concluded on November 24th 2010 with the adoption of the so-called financial supervision package, establishing the European System of Financial Supervision (ESFS).

The following legislative acts adopted by the European Parliament and the Council serve as the legal basis of the financial supervision reform:

- Regulation on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board,
- Regulation establishing a European Supervisory Authority (European Banking Authority),
- Regulation establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority),
- Regulation establishing a European Supervisory Authority (European Securities and Markets Authority),
- "Omnibus" Directive, amending sectoral directives,

- Regulation conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board.

Activities of the European Supervisory Authorities (ESA) will primarily involve coordination of national supervisors' activities with respect to cross-border financial groups, as well as performance of certain regulatory (publication of guidelines, technical standards and recommendations) and supervisory functions. The European supervision system reform is complemented by the establishment of the European Systemic Risk Board (ESRB), to operate with the European Central Bank. The objective of the ESRB will be to effectively monitor systemic risks as well as contribute to the smooth functioning of the internal market, thereby ensuring a sustainable contribution of the financial sector to economic growth.

Since the inception of the concept, the PFSA Office has been involved in the debate on the final model for the future financial supervision architecture in the EU.

PFSA Chairperson Stanislaw Kluza, promoted the PFSA Office's view on the desired architecture of an EU-wide supervisory system at a number of international conferences. At meetings with Members of the European Parliament from Poland and members of the ECON Committee - rapporteurs

for regulations on the European Banking Authority and the European Security and Markets Authority, and for the Omnibus I Directive, held in Strasbourg on January 20th-21st 2010, the PFSA Chairperson presented views of a national supervisor from a country where the financial market is dominated by foreign capital. The Chairperson brought up the need to have the scope of the so-called “binding mediation” precisely determined by the EU law and to leave the powers to determine and enforce capital requirements with the national authority. This enables keeping safe capital levels by the regulated entities, thus opening up opportunities for their safe and stable development.

On February 4th and 5th 2010, the PFSA Chairperson attended the European Financial Services Round Table, arranged by the EFR organisation, where top-level representatives of governments and supervisory authorities from the EU member states, EU and financial institutions gathered to discuss key topics related to the financial sector supervision and regulation. On September 29th and 30th 2010, at the Eurofi Financial Forum in Brussels, the PFSA Chairperson

10.1.2. Revision of the CRD Directive (CRD IV)

In December 2009, the Basel Committee on Banking Supervision issued two consultative documents comprising the reform plan for the New Capital Accord (Basel III). The papers indicated the need to enhance banking sector regulation in response to the global financial market turmoil. The first of the Basel documents, entitled *International Framework for Liquidity Risk Measurement, Standards and Monitoring*, contained proposals to introduce two uniform liquidity standards for the entire banking market: the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The second document, entitled *Strengthening the Resilience of the Banking Sector*, was a proposal for amendments to minimum capital requirements and establishment of capital conservation and countercyclical buffers.

Both documents formed the basis for the package of amendments to the CRD Directive (so called CRD IV), prepared by the European Commission in February 2010. Among the areas tackled by the EC’s consultative document were:

- ▶ liquidity standards,
- ▶ definition of capital,
- ▶ leverage ratio,
- ▶ counterparty credit risk,
- ▶ systemically important financial institutions,

presented the Office’s position on the anticipated role of the European Supervisory Authorities. On October 10th-16th, the Chairperson visited the United States, where he discussed new regulations for the financial sector with representatives of the International Monetary Fund, the World Bank, the US Treasury Department and the Federal Reserve.

The PFSA Office was also involved in the ongoing legislative process related to the new supervision architecture, primarily by supporting the Ministry of Finance during inter-governmental negotiations, in particular by preparing specific positions on compromise presidency proposals as they emerged, and on amendments proposed by the European Parliament and the European Commission.

The negotiations delivered solutions favourable for Poland’s interests, mainly because the key role of local supervisors was preserved (including their power to supervise and enforce compliance of local entities with capital requirements) and the scope of powers of new supervisory bodies as regards group supervision was extended.

- ▶ single EU-level set of banking regulations (also known as “single rule book”).

The EC’s proposals to preserve liquidity of credit institutions reached significantly beyond the Basel proposal, conditionally equipping the group supervisor with powers to transfer the application of liquidity requirements from the local level to the level of a cross-border bank sub-group. A consequence of the proposal may thus be the loss of control over liquidity position by local supervisory authorities, and the subsequent loss of the capability to respond if a threat to the sector’s stability emerges in the host state. The proposal raised the PFSA Office’s reservations.

In addition, the PFSA Office expressed its doubts as to the proposed waiving of the liquidity requirements for branches of credit institutions and the proposed removal of the national authority’s powers to supervise liquidity of branches. Based on the EC’s proposal, information on the liquidity position would be passed by the branch to the parent credit institution, which would submit it to the home-country supervisor, which in turn would pass it on to the host-country supervisor. Currently, the liquidity position information is submitted directly by a credit institution branch to the host-country supervisor, thus enabling the latter to assess the situation of the branch on an on-going basis.

10.1.3. Cross-border crisis management in the banking sector

In the period covered by this Report, work was in progress in Europe on solutions to prevent financial sector crises in the future. 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 counteract the deterioration of the situation and to support the recovery of financial institutions in difficulties. Additionally, the establishment of harmonised 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.

An issue of key importance for the PFSA Office was to prevent the introduction of a free transfer of assets solution. The documents presented by the European Commission indicated that the concept involved a permission to a transfer of assets within a group without the need to apply the arm's length principle. Transfer of assets on market terms (in accordance with the arm's length principle) is currently permitted and treated as a regular process in the business relations. If the rule was to be abolished, it would be possible to execute transactions between entities of the same group that put one party at a disadvantage (non-market terms) if the transaction could be justified by the interest of the entire group.

Experts of the PFSA Office 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.

The PFSA Office's position was that actions taken in response to a crisis, although coordinated at the European Union level, should be adjusted to the structure and level of financial markets development, as well as to the economic situation in the individual member states. The PFSA Office provided support to the Ministry of Finance in the preparation of opinions and instructions for the Polish representatives participating in the activities of the European Commission's Working Group on Early Intervention.

The PFSA Office's position on the resolution process was that the Banking Guarantee Fund should be involved. In the opinion of the PFSA Office, the deposit guarantee schemes in the EU could, like in Poland, perform a more active role in the crisis management process.

The PFSA Office was also involved in projects carried out by the CEBS working group for early intervention. The aim was to ensure effective and coordinated cooperation of supervisory authorities in the event of a financial institution's insolvency and to provide them with instruments for early identification of the problems faced by financial institutions. In addition, the PFSA Office representative ensured that CEBS' opinion concerning the European Commission communication on cross-border crisis management in the banking sector did not contain a positive recommendation of the proposed free asset transfer.

10.1.4. Amendment to the Deposit Guarantee Schemes Directive

In 2010, work commenced in the European Union on the amendment to the Deposit Guarantee Schemes Directive. The European Commission proposed new rules increasing the guarantee-covered amount (up to EUR 100,000) and the option for mutual loans between deposit guarantee schemes to accelerate payment of the guaranteed amounts and to enable payments by the home deposit guarantee scheme in the case of failure of a branch of a foreign credit institution (not all of the proposals were endorsed by the member states).

The PFSA Office supported the concept of a closer collaboration between national deposit guarantee schemes pending banking group liquidation. It endorsed the proposal for a mutual loans mechanism between guarantee funds operating in the European Economic Area if no funds are available to pay the guaranteed amounts. The solution would be the first genuine attempt to find funds within the banking system to pay its liabilities, rather than seeking funds from the budget, and thus the taxpayers.

The PFSA Office agreed to the launch of a system of loans on specifically defined terms, other than those originally

proposed, which would ensure equal terms of granting loans in proportion to a given market, rather than to a particular deposit guarantee scheme. The primary criteria for granting the loan should be as follows:

- ▶ each deposit guarantee scheme would lend an amount in proportion to the total of deposits in a given country, rather than to the size of a given scheme,
- ▶ the lender should grant the loan in proportion to deposits on a given market,
- ▶ all funds to pay the liabilities have been exhausted in the given DGS,
- ▶ the borrower is not required to repay another loan,
- ▶ the EBA has been notified that the conditions have been met and of the loan amount,
- ▶ the total amount of the loan may not exceed 0.5% of the funds to be paid by the scheme which incurs the loan.

However, in the course of the EU negotiations, the loan concept was finally discarded, and the issue of liability for deposits in a crisis situation was not properly addressed. Therefore, given potential insolvency of European guarantee funds and in order to ensure security of deposits, the PFSA

Office put forward a concept of additional insurance cover in the local deposit guarantee scheme for deposits placed with foreign branches of credit institutions. The PFSA Office believes that the requirement concerning additional insurance could be imposed by decision of the appropriate supervisory authority, upon obtaining an opinion from the head of the deposit guarantee scheme in cases where the conditions of Art. 65.1.b of the Treaty on the Functioning of the EU (public order or public security) are met, and the relevant guarantee fund

10.1.5. New capital market regulations

In 2010, the PFSA Office experts continued cooperation with the Ministry of Finance on implementing regulations to Directive 2009/65/EC of July 13th 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS IV Directive). One of the Office's proposals concerned the need to ensure that in the case of funds managed remotely on the basis of a passport and in the case of funds marketing units of UCITS in a host state, the official language of the host state should be a permitted language for complaints submitted by investors and further correspondence. The PFSA also made comments on the notification procedure for foreign funds. Implementing regulations to UCITS IV were adopted on July 1st 2010 and published in the Official Journal of the EU on July 10th 2010.

10.1.6. Credit rating agencies supervision

Under the Regulation on Credit Rating Agencies, in effect from December 2009, credit rating agencies wishing to continue to provide their services in 2010, were required to complete internal reorganisation in accordance with the requirements of the Regulation and apply for registration. The PFSA Office was involved in the drafting of the regulatory guidance to the Regulation and was (and still remains) a member of international supervisory colleges which evaluated the individual registration applications. The colleges verify whether

10.1.7. Building and developing cooperation among host-country supervisors

In 2010, the PFSA Office put forward a proposal to intensify cooperation among supervisory authorities from the new member states of the European Union. The states share a feature which is fundamental from the financial supervision perspective, namely vast portions of their financial markets are controlled by foreign capital (hence the notion of host countries, contrasted with home countries). Thus, their approaches to the various regulatory reforms in the EU are in most cases convergent. This renders those states natural partners in activities pursued in the international arena.

The PFSA Office's initiative was very well received. A kick-off meeting was held in Warsaw in March 2010 by representatives

fails to meet the obligation referred to in Directive 94/19/EC, under which the financing capacity of the deposit guarantee scheme must be in appropriate proportion to its liabilities. Importantly, Directive 94/19/EC sets a harmonized minimum, which is explicitly stated in the preamble. The preamble reads that harmonization must be confined to the main elements of deposit-guarantee schemes and should ensure payments under a guarantee within the shortest period practicable.

As regards the draft Alternative Investment Fund Managers Directive (AIFM Directive), particular emphasis in the cooperation with the Ministry of Finance was placed on matters concerning limited availability of passports to managers and alternative funds from third countries, introducing new requirements in the area, enabling such entities to use a passport, as well as introducing disclosure requirements in the case of alternative funds taking over control of companies.

In 2010, the European Parliament and the Council of the European Union finally approved the amendment to the Prospectus Directive (2003/71/EC). The text was officially published in December 2010, to be implemented into national laws by July 1st 2012.

the agencies, often branded as guilty of the financial crisis, have introduced solutions which prevent conflicts of interests and ensure a professional and transparent rating process.

As of July 1st 2011, the powers to register and supervise rating agencies will be conferred on the European Securities and Markets Authority (ESMA). A special working group, headed by the PFSA Office, was appointed to elaborate a model for performing this responsibility by the ESMA.

(at the level of managing directors) of supervisory authorities from Poland, the Czech Republic and Slovakia. The meeting concluded with a decision on the establishment of the Host Countries Forum, being an informal platform for cooperation on the financial sector regulations. In July, supervisors from ten Central and Eastern Europe countries were invited to the Forum, and subsequently the exchange of opinions on key EU regulatory reform aspects was launched.

The exchange of positions among the supervisory authorities participating in the Forum ensures a much deeper insight into the partners' respective views than ever before. This, in turn, enables establishment of common strategies in respect of the

various regulatory initiatives launched in the European Union to protect interests of host states to the greatest extent possible. Members of the 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 financial security of Poles. Actions under the Host Countries Forum are guided by the

10.1.8. Solvency II Project

2010 saw continued work in the EU on the Solvency II project, which focused on preparing initial drafts of implementing measures to the Solvency II Directive (Directive 2009/138/EC), carrying out the Fifth Quantitative Impact Study (QIS5), and preparing initial drafts of Level 3 measures. All the aforementioned work is scheduled to continue in 2011. Employees of the PFSA Office were involved in the work both at the CEIOPS level (working groups on the Solvency II project) and within the European Commission (by supporting the Ministry of Finance). In 2010, the PFSA Office also hosted and co-organised a CEIOPS seminar for supervisory authorities on the Solvency II regime requirements concerning the system of governance.

At the national level, the PFSA Office pursued activities designed to prepare the supervisory authority and the regulated entities to operations 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 undertakings. The PFSA Office also supported the Ministry of Finance in the work to prepare draft assumptions for the Act on Insurance and Reinsurance Activities (Solvency II), being an early stage of implementation of the Directive into the Polish legal system.

Fifth Quantitative Impact Study (QIS5)

The European Commission requested CEIOPS to conduct the Fifth Quantitative Impact Study among European insurance and reinsurance companies between August and November 2010, and to draft a report on the EU-wide results of the study by March 2011. The PFSA Office coordinated QIS5 in Poland and provided major input into preparation and conduct of the study at the European level.

The primary objectives of the study were:

- to collect detailed information on the quantitative impact on insurers and reinsurers' solvency balance sheets of the introduction of future level 2 implementing measures under Solvency II compared to the situation under Solvency I,
- to verify whether technical specifications of the study are aligned with the principles and calibration targets set out in Directive 2009/138/EC,
- to encourage insurance and reinsurance undertakings and supervisory authorities to prepare for the introduction of

central principle which is to ensure that host countries have appropriate mechanisms in place to protect the financial sector stability in a market dominated by entities owned by foreign financial groups.

Election of the PFSA Office representative to the management board of the EIOPA is the first positive effect of cooperation under the Forum.

Solvency II and to identify areas where their internal processes, procedures and infrastructure may need to be enhanced; and in particular, to encourage insurers and reinsurers to improve their data collection processes,

- to provide a starting point for an ongoing dialogue between supervisors and insurers and reinsurers in preparation for the new supervisory system.

During the work at the European level, the PFSA Office employees joined a CEIOPS QIS5 Task Force, which designed the methodology and tools for the exercise, coordinated QIS5 implementation at the EU level, and, in the first quarter of 2011 prepared a summary report on the EU-wide results of the study. Representatives of the PFSA Office coordinated efforts of the Task Force concerning internal models and took part in the work on the standard formula for the Solvency Capital Requirement (SCR). They also appeared as speakers at two seminars on QIS5 held by CEIOPS (for supervisory authorities and study participants).

As part of QIS5 coordination effort at the national level, the PFSA Office organised meetings and training on assumptions and methodology of the QIS5 exercise for representatives of insurance and reinsurance companies, as well as provided explanations on an ongoing basis. The PFSA Office submitted the report on QIS5 results for Poland to the EIOPA in January 2011.

50 Polish insurance and reinsurance companies (24 life insurers and 26 non-life insurers), which accounts for nearly two-thirds of the total, and 3 insurance groups took part in the QIS5. Insurers and reinsurers were asked to fill in one quantitative questionnaire and two qualitative questionnaires and submit them to the PFSA Office. Additionally, under the QIS5 data was collected from insurance and reinsurance companies to be used for calibration of the standard formula for the Solvency Capital Requirement with respect to premium risk and reserve risk for property and health insurance.

Preparation of the PFSA Office and the industry to operations under the Solvency II regime

Participation of insurance and reinsurance companies in QIS5 was an excellent opportunity to explore practical implications of the Solvency II implementation, and to assess one's

own preparedness for the operation under the new system (compliance with quantitative requirements).

A survey was conducted by the PFSA Office in 2010 among domestic insurance and reinsurance companies concerning their preparedness to the Solvency II system in terms of: own risk and solvency assessment (ORSA), risk management, as well as application of internal models to calculate SCR. The PFSA Office also continued work on the carrying out of stress tests by insurance and reinsurance companies.

The PFSA Office delivered two trainings in 2010 under the CEDUR educational project for representatives of insurance

and reinsurance companies, where the topics included requirements of the Solvency II system, as well as three seminars under the project funded by the Norwegian Financial Mechanism. Subsequent seminars will be held in 2011.

In 2010, representatives of the Office, participated, as members of supervisory colleges, in the pre-application processes of European insurance groups which are of key importance from the Polish market perspective. As part of the process, workshops on internal models were organised, as well as inspections of the selected risk modules. The work also included the examination of the available documentation and working out a common position within the supervisory college.

10.2. Cooperation with international organisations

Cooperation with international organisations is an important part of the PFSA Office's activities. Involvement in international projects is an opportunity to exchange information, which is then effectively used to perform analytical and supervisory

tasks. Long-standing presence on the international arena also enables the PFSA to take part in the discussion on new regulatory and supervisory concepts.

10.2.1. Banking Supervisors from Central and Eastern Europe (BSCEE)

Since January 1st 2006, the PFSA Office has run the BSCEE Secretariat. BSCEE is a body associating banking supervisors from 21 countries of Central and Eastern Europe to share information and experiences.

In 2010, the BSCEE Secretariat focused its efforts on organising and coordinating the 23rd BSCEE Annual Conference, held in Ohrid, Republic of Macedonia, on June 15th–17th. The subjects covered included *Lessons Learned from the Crisis and Policies Aimed at Strengthening the Resilience of the Banking Sector* and *Liquidity Risk Standards and Measurement - Overview on the National Measures during and after the Crisis*. The Secretariat prepared and presented at the Conference a report on BSCEE's and the Secretariat's activities.

Because the present term of office of the BSCEE Secretariat in Poland came to an end on December 31st 2010, the PFSA Office officially applied for re-election and submitted its offer to run the Secretariat for the next five-year term. The

member states accepted that candidature by acclamation. As a consequence, the BSCEE Secretariat will remain in Poland until December 2015.

The Secretariat was also involved, through organisational and technical support, in the organisation of a BSCEE regional seminar in cooperation with the Financial Stability Institute. The seminar, held in Ljubljana, the capital city of Slovenia, from June 1st to June 3rd 2010, was devoted to *Stress Testing and Risk Management Techniques*.

In addition, the Secretariat was also involved in the organisation and acted as a co-host of the BSCEE Regional Meeting at the 16th International Conference of Banking Supervisors (ICBS), held in Singapore on September 20th–24th. The Regional Meeting took place on September 21st and covered the main topics of the ICBS, i.e. *Towards a More Resilient Banking Sector* and *A Stable Financial Environment for Sustained Economic Growth*.

10.3. Activities within European institutions

Engagement in the work of European institutions represents an important aspect of the PFSA Office's activities. Active presence at the EU forum and initiatives designed to ensure that the PFSA'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 Level 3 Committee expert and working groups, as well as contributing to the final shape of European Commission's legislative proposals – all these efforts help promote solutions favourable from the perspective of the Polish supervisor. It should be noted that the PFSA 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 supervisory authorities and central banks in Europe.

The PFSA Office's commitment to the activities on the EU arena was reflected in the appearance of Chairperson Stanisław Kluza at a public hearing on the forum of the Economic and Monetary Affairs Committee of the European Parliament, where he spoke on the issues of cross-border crisis management in the banking sector. The meeting was also attended by:

- Mr Eddy Wymeersch, Chairman of the Committee of European Securities Regulators (CESR),
- Mr Jacques de Larosière, Chairman of the EU's High Level Group on Financial Supervision,
- Mr Carmine Lamanda, Senior Executive Vice-President, Member of the UniCredit Management Committee and Head of Institutional and Regulatory Strategic Advisory,
- Prof. Dirk Schoenmaker, Dean of the Duisenberg School of Finance,
- Ms Rym Ayadi, Forum of user experts in the area of financial services - FIN USE.

During his presentation, Chairperson Kluza pointed to the need to limit the size of financial institutions and stated that the risk related to the size of a given institution should not preclude its declaration of bankruptcy in the event of insolvency. He also indicated that deposits should be better

protected, in particular through the involvement of parent companies in the guarantee fund schemes of local institutions.

As a form of contribution to the debate on the reform of the financial supervision in the EU, the PFSA Office organised a panel devoted to risks and challenges related to the new architecture of the financial supervision in the EU. The panel was held at the 20th Economic Forum in Krynica, and its participants included:

- Mr Miroslav Singer, President of the National Bank of the Czech Republic,
- Mr Gabriel Bernardino, Chairman of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS),
- Mr Vladimír Dvořáček, Director of the Financial Market Supervision Department of the National Bank of Slovakia,
- Prof. Anna Maria Jurkowska-Zeidler of the University of Gdańsk,
- Prof. Rainer Masera of Guglielmo Marconi University in Rome (member of the de Larosiere group).

The participants presented their views concerning the desired shape of relationships between the European supervisory agencies and the national supervisors, the major challenges standing before the European Supervisory Authorities during the initial period of their operation, and the advisability of other changes to be made in the EU financial supervision system. The discussion during the panel was moderated by the Chairperson of the PFSA.

10.4. Cooperation in level 3 committees

10.4.1. Committee of European Banking Supervisors (CEBS)

In 2010, CEBS focused its activities mainly on issues resulting from the regulatory and supervisory consequences of the financial crisis, the analysis of the proposed changes to the CRD (CRD IV) and amendments to Basel II (Basel III), work related to the preparation of the Committee to its transformation into a new European supervisor (European Banking Authority - EBA), and the assumption of new powers vested in it by virtue of Regulation (UE) No. 1093/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority).

In addition, CEBS published rules relating to risk management as part of the supervisory review process and rules relating to disclosures by financial institutions during a crisis.

In connection with the legislative proposals of the European Commission relating to the banking sector, presented at the end of 2009 and during 2010, CEBS prepared, inter alia, a

response to the EC consultation document *An EU Framework for Cross-Border Crisis Management in the Banking Sector*, and performed an analysis of the proposed changes to the CRD, in particular with respect to the full harmonisation of its provisions. Moreover, considering the changes proposed by the Basel Committee on Banking Supervision (BCBS) to the Basel II standards, CEBS published the results of a quantitative impact study (QIS) measuring the impact of the new Basel III requirements on the European banking market.

In 2010, CEBS also performed an EU-wide stress testing exercise designed to assess the overall resilience of the banking sector to crisis situations. 91 banks from 20 EU member states, including one Polish bank, PKO BP, took part in the exercise.

In 2010, the staff of the PFSA Office organised a seminar as part of the CEBS training programme *Operational Risk Management and Supervision*. The seminar was attended by members of supervisory authorities from over ten EU

countries and representatives of the Polish banking sector. The purpose of the seminar was to provide theoretical and practical knowledge on the validation of requests to use the Advanced

Measurement Approach to calculate the capital requirement for operational risk.

10.4.2. Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

In its last year of operation in the existing form, CEIOPS was involved in two large projects which engaged different groups within the Committee: its transformation into EIOPA (see previous chapters), and preparation of supervisory authorities and insurance undertakings to the implementation of the Solvency II regime. Relevant work was carried out within the

working groups dedicated to the Solvency II project (FinReq, IntMod, IGSRR, IGSC). In addition, other CEIOPS working groups continued their work. A representative of the PFSA Office sat on the management board of the Committee.

10.4.3. Committee of European Securities Regulators (CESR)

In 2010, representatives of the PFSA Office took part in the discussion on the internal organisation and rules of operation of ESMA - a new European supervisory agency replacing CESR. The PFSA Office consistently supported the fully democratic nature of that structure, which is ensured by:

- ▶ the key role of expert committees in the decision-making process,
- ▶ qualified majority voting on all important matters,
- ▶ maintenance of member fees at the lowest possible level.

The fact that ESMA is taking over, by virtue of a decision of EU authorities, the direct supervision over rating agencies operating in the EU is considered by the PFSA Office a matter of particular importance. The high priority of that matter is determined by two factors. Firstly, the quality of work of rating agencies is important for the proper functioning of the entire financial market and, despite the common view that the market depends too much on ratings, global regulators have so far found no alternative mechanism for an objective assessment of the creditworthiness of issuers, institutions and financial instruments. Secondly, the plan to submit rating agencies to

the European supervision is the first instance in the European financial market when national supervisors yield their powers to a EU institution (the project will therefore serve as a test of the new structure). Consequently, representatives of the PFSA Office took part in the debate on the future operation of such supervision in practice, i.e. development of a more detailed structure on the basis of the general framework defined in the relevant EU regulation, and agreed to head a special Task Force on Transition of CRA Supervision to ESMA.

At the same time, intensive work was carried out in standing committees, i.e. expert working groups created following the reorganisation and simplification of the CESR's structure. Representatives of the PFSA Office were involved in the work of most of the standing committees as this is the only way the Office may directly influence the shape of the EU laws regulating the capital market. Such laws are ever more often drafted in the form of a regulation (of the European Parliament and of the Council), which means in practice that the provisions of such acts are directly applied in the member states - with no need for their implementation in each country.

10.5. Cooperation in supervisory colleges

10.5.1. Banking sector

In 2010, the PFSA Office participated in 31 meetings of supervisory colleges established by home-country regulators of banking groups operating 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 PFSA 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 being subject to supervision in Poland,

- ▶ obtain information on the already implemented 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

10.5.2. Insurance sector

In 2010, representatives of the PFSA Office attended 22 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 of insurance companies belonging to insurance groups and of evaluating the financial standing of groups and the manner in which they conduct their activities. At the supervisory college meetings, the staff of the PFSA Office presented overviews of the financial standing and manner of operation of the Polish members of the insurance groups to which the meetings

10.5.3. Rating agencies

In 2010, representatives of the PFSA Office took part in supervisory colleges for four rating agency groups which filed registration applications pursuant to Regulation No. 1060/2009. The work of the individual colleges involved an analysis of the application documentation and an on-going supervisory

undertakings operating in Poland. It is especially important in the context of intervention measures undertaken by the PFSA 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.

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 PFSA Office to deepen its understanding of the processes taking place at domestic insurance 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.

dialogue. The PFSA Office's staff focused on the review of the activities of companies incorporated in Poland and belonging to particular rating agency groups in terms of their compliance with the provisions of Regulation No. 1060/2009.

10.6. Cooperation with foreign regulators

In 2010, the PFSA cooperated with banks and consolidating supervisors with respect to:

- ▶ analysis of already submitted and planned applications for issuance of a decision 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.

In 2010, representatives of the PFSA Office also participated in three informal meetings of European supervisors, which were organised to share experiences (gained during pre-application processes) and standardise the approach to the assessment of internal models of insurance undertakings.

PFSA Office



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II. PFSA Office

II.I. Budget of the PFSA Office

The PFSA Office is a publicly financed entity. Expenditure of the Office is covered directly from the state budget. The Office's revenue is the budget revenue transferred to the state budget account. As a public sector entity, the Office manages its finances in accordance with applicable laws, in particular the Act on Public Finance of August 27th 2009 (Dz.U. of 2009, No. 157, item 1240, 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.

Like in many other European countries, in Poland the costs of state supervision over individual markets are borne by those markets.

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 PFSA 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 PFSA Office in 2010 measured on an accrual basis and cash basis amounted to PLN 236,975,957 and PLN 201,365,830, 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 5,386,779.

The expenditure allocated in the 2010 state budget for the PFSA's operations amounted to PLN 197,974,000, which was 0.5% more than in the preceding year. The actual spending was PLN 178,184,765, i.e. 10% below the planned amount. The lower spending is attributable mainly to a delay in the extension and modernisation of the building at ul. Jasna 12. No payment was made to the external contractor performing the work. In addition, in 2010 the PFSA Office continued Project PL0435, named *Strengthening of Administrative and Institutional Capacities of the Office of the Polish Financial Supervision Authority 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 1,618,203 allocated in the 2010 Budget Act was PLN 1,527,142.

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 2010, dated May 20th 2009, the PFSA 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 31 and 32 show the PFSA's budget expenditure and revenue for 2010 – actual and planned in the Budget Act, with a specification of key expenditure and revenue items versus the corresponding amounts for 2009.

■ TABLE 31. EXECUTION OF THE PFSA'S 2010 BUDGET REVENUE PLAN

BUDGET REVENUE	2009 PLANNED (PLN '000)	2009 ACTUAL		2010 PLANNED (PLN '000)	2010 ACTUAL (ACCRUAL BASIS)		PLANNED - 2010 VS. 2009 (%)	ACTUAL - 2010 VS. 2009 (%)
		(PLN '000)	(%)		(PLN '000)	(%)		
I	2	3	4	5	6	7	8	9
Fees towards the costs of supervision over insurance and brokerage activities paid by insurance companies	21,664.0	23,281.0	107	19,797.0	21,087.3	107	91	91
Fees towards the costs of supervision over open-end pension funds paid by pension fund management companies	13,786.0	14,963.9	109	13,858.0	14,675.7	106	101	98
Fees towards the costs of supervision paid by the capital market	23,633.0	24,329.2	103	31,676.0	33,124.3	105	134	136
Fees towards the costs of supervision paid by supervised banks	137,859.0	156,737.7	114	132,643.0	162,598.1	123	96	104
Fees for official duties connected with examinations for brokers, actuaries and insurance agents	204.0	378.8	186	360.0	502.1	139	176	133
Fines imposed on the industry	1,810.0	3,204.2	177	2,500.0	3,656.3	146	138	114
Other	510.0	1,497.4	294	45.0	1,332.3	2,961	9	89
Fees towards the costs of supervision made by cooperative savings and loan associations (SKOK)*	250.0	0	0	-	-	-	-	-
Total	199,716.0	224,392.1	112	200,879.0	236,976.0	118	101	106

* In accordance with the government's amendment to the 2009 Budget Act.

■ TABLE 32. EXECUTION OF THE PFSA'S 2010 EXPENDITURE PLAN

BUDGET EXPENDITURE	2009 PLANNED (PLN '000)	2009 ACTUAL		2010 PLANNED* (PLN '000)	2010 ACTUAL*		PLANNED - 2010 VS. 2009 (%)	ACTUAL - 2010 VS. 2009 (%)
		(PLN '000)	(%)		(PLN '000)	(%)		
Payroll, including overheads	113,451.0	93,314.5	82	113,536.0	110,118.7	97	100	118
Non-payroll expenditure	83,491.0	90,259.6	108	84,438.0	68,066.1	81	101	75
including:								
out-of-pocket expenses	54,395.0	44,342.4	82	48,438.0	44,113.5	91	89	99
spending on assets	29,096.0	45,917.2	158	36,000.0	23,952.5	67	124	52
Total	196,942.0	183,574.1	93	197,974.0	178,184.8	90	101	97

*Excluding expenditure on the Norwegian Financial Mechanism.

Table 33 shows costs of supervision over particular markets in 2010 vs. 2009.

■ TABLE 33. COSTS OF SUPERVISION OVER PARTICULAR MARKETS IN 2010 VS. 2009.

MARKET	2009		2010		RELATIVE TO PREVIOUS YEAR	
	PLANNED (PLN '000)	ACTUAL (PLN '000)	PLANNED (PLN '000)	ACTUAL (PLN '000)	PLANNED (2009=100)	ACTUAL (2009=100)
Capital market	23,633	32,768	31,676	34,315	134.0	104.7
Insurance market	21,664	20,933	19,797	21,742	91.4	103.9
Pension market	13,786	13,026	13,858	14,713	100.5	112.9
Banking market	137,859	116,325	132,643	107,415	96.2	92.3
Total	196,942	183,052	197,974	178,185	100.5	97.3

Pursuant to Art. 2.1 of the Act on the Supreme Audit Office, dated December 23rd 1994, performance of the state budget in part 70 – the PFSA 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 PFSA 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 PFSA 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 PFSA 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 PFSA'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 PFSA 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 management 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 five tasks, to which for 2010 it allocated PLN 178,185 thousand out of the planned amount of PLN 197,974 thousand. The PFSA Office's budget by activity is presented in Table 34.

■ TABLE 34. STATE BUDGET EXPENDITURE BY ACTIVITY (PART 70 – THE POLISH FINANCIAL SUPERVISION AUTHORITY) IN 2010 (PLN '000)

NO.	FUNCTION/ACTIVITY/SUB-ACTIVITY	PLANNED	PLANNED	ACTUAL
		2010, AS PER THE BUDGET ACT	AS AMENDED	
4.	Management of public finances	120,432	109,326	102,659
4.11.	Supervision over the capital, insurance, pension and banking markets	86,375	81,223	78,531
4.11.1.	Supervision over capital market entities	17,608	15,250	14,732
4.11.2.	Supervision over insurance companies	10,940	9,711	9,379
4.11.3.	Supervision over the pension market	7,614	6,995	6,742
4.11.4.	Banking supervision	50,213	49,267	47,678
4.13	Computerisation and development of information society	34,057	28,103	24,129
22.	Policy development and coordination	77,542	88,648	75,525
22.1.	Coordination of statutory activities, as well as strategic and operational planning	28,823	27,676	26,628
22.2.	Back-office support	16,019	23,087	21,640
22.3	Technical support	32,700	37,885	27,257
	Total:	197,974	197,974	178,185

II.2. Introduction of management control at the PFSA Office

To ensure cost-effective, efficient and effective performance of the tasks and goals of the PFSA, the PFSA has been assigned a mission to support stable functioning and secure development of the financial market. To ensure that the goals and tasks are performed in accordance with applicable laws, and in a cost-effective, efficient, competent and timely manner, the PFSA Office, by virtue of Decision No. 85/2010 issued by the PFSA's Chairperson on December 28th 2010, introduced management control policies at the PFSA Office.

The management control policies developed at the Office define, inter alia, the goal, scope and tasks, manner of assessment as well as the components of the management control system.

The management control serves in particular to ensure:

- compliance of operations with the law and internal procedures,

- cost-effectiveness, efficiency and effectiveness of operations,
- reliability of statements and reports,
- protection of resources,
- compliance with and promotion of the principles of ethical conduct,
- effective information flow,
- risk management.

The management control system at the PFSA Office is founded on the management control standards applicable to the public finance sector. The system relies on five areas and the corresponding components of management control:

- control environment,
- goals and risk management,
- control mechanisms,
- information and communication,
- monitoring and assessment.

II.3. Human resources management

The average staffing level at the PFSA Office in 2010 was 902 FTEs. The PFSA Office recruited staff for 64 FTEs, while the number of FTEs left as a result of termination of employment with the PFSA Office was 65. In most cases, the PFSA employees terminated their employment with the PFSA because they were offered more attractive financial terms of employment. Some

of the staff left as they reached the retirement age and some resigned in consequence of reorganisation processes involving change of the workplace. The employee turnover rate at the PFSA Office in 2010 was 7.1%.

Table 35 shows the staffing levels at the PFSA Office in 2008-2010.

■ TABLE 35. STAFFING LEVEL AT THE PFSA OFFICE IN 2008-2010

	2008	2009*	2010
Average staffing level throughout the year	812	891	902
Staffing level at year end	827	918	898

*In the employment plan provided for in the 2009 Budget Act, the number of FTEs at the PFSA was increased by 60.

In performance of the Human Resources Management Department's principal duties related to the provision of training, a series of highly specialised training sessions was organised in response to the requirements voiced by the particular organisational units of the Office. To meet the staff expectations as fully as possible, all training programmes were consulted or prepared based on relevant guidelines and detailed descriptions of programme assumptions, and approved by the management of the organisational units which proposed subjects for the training programmes.

The training courses had a total of 2,784 participants, including 262 employees participating in training held in Poland and 127 employees participating in training held abroad. This translates into an average of 3.1 training courses per employee. The intensity of 2010 training is illustrated by the ratio of approximately six training man-days per employee. The number of training courses in 2010 was lower than in 2009. This resulted from the parallel execution of training courses as part of the Norwegian Financial Mechanism, covering mainly training related to the insurance market.

II.4. Code of ethical conduct for PFSA Office 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 PFSA Office has consistently striven to maintain high professional standards, and to exercise its supervision over the financial market in a rigorous and transparent manner. One of the key efforts made in pursuit of that objective was the commencement in 2010 of work on the *Code of Ethical Conduct for PFSA Office Employees*.

The preparation of an internal code of ethics was justified in the light of the fact that the PFSA Office staff are not part of the civil service corps, who are bound by the rules of ethical

conduct laid down in a special regulation of the Prime Minister. A lack of such rules with respect to the employees of the PFSA 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 PFSA Office's organisational culture ever since its inception.

A draft *Code of Ethical Conduct* was drawn up by a dedicated team appointed by the Chairperson of the PFSA. The draft was then circulated for consultation among the employees of the PFSA Office. Based on the feedback received, all doubtful provisions were further clarified, the layout was modified, and the provisions which might potentially conflict with the work regulations were removed.

II.5. Inspections by external bodies

In the years 2007-2010, a total of 22 inspections were carried out at the PFSA Office by external bodies, including the Supreme Audit Office Inspector General for Personal Data Protection (GIODO), the Chancellery of the Prime Minister, the Social Insurance Institution (ZUS), the Tax Office (US) and the Archives of New Records. In 2010, three inspections at the PFSA Office were started by the Supreme Audit Office. One of the inspections, intended to examine the execution of the state budget in 2010, is still ongoing. The other two inspections are described below.

Between June 22nd and September 6th 2010, the Supreme Audit Office carried out an inspection to assess whether the expenditure on training at the PFSA Office was reasonably and properly incurred. In the Supreme Audit Office's opinion, the expenditure on training in the period under review was properly planned and duly documented. All financial transactions related to purchase of training services were properly documented and accounted for.

The Supreme Audit Office concluded that all training courses in the period under review were delivered in accordance with their intended purpose and served to further the PFSA Office's statutory functions. All group training courses were assessed positively by their participants, particularly in terms of the usefulness of topics covered by the courses for the work duties assigned to their positions.

In the period covered by this report, the Supreme Audit Office also carried out an inspection designed to assess the PFSA Office's performance against its tasks related to the protection of clients of insurance companies and pension funds in the period from January 1st 2008 to September 30th 2010. The post-inspection statement issued on December 27th 2010 contained the Supreme Audit Office's positive opinion, qualified for minor irregularities, on the PFSA Office's performance against the tasks defined above.

The Supreme Audit Office satisfied itself that all the 5,760 complaints against insurance companies and 5,767 complaints against open-end pension funds filed with the PFSA Office in the period under review were properly registered. In the Supreme Audit Office's opinion, the PFSA Office reviewed all the complaints with due care and took them into consideration when exercising supervision over the insurance and pension fund market.

The Supreme Audit Office also focused on the issue of the PFSA Office's task of reviewing general conditions of insurance agreements ("GCI") and eliminating provisions which compromise the interests of clients of insurance companies. The number of GCI registered in the PFSA Office's database is 1,202. However, seeing that after Poland's accession to the EU insurance undertakings are under no obligation to submit their GCI to the PFSA Office, there is no assurance that the database is complete. In the reviewed period, the PFSA Office

reviewed 462 GCI which were found to contain provisions compromising the interests of clients of insurance companies. The Supreme Audit Office issued a positive opinion on the results of the PFSA Office's review of GCI.

The Supreme Audit Office also examined the performance of the cooperation agreements with the Insurance Ombudsman and the President of the Office of Competition and Consumer Protection. The Supreme Audit Office discovered that the requirement to conduct annual joint reviews of the performance of the agreements with the President of the Office of Competition and Consumer Protection and the Insurance Ombudsman was not observed. However, the Supreme Audit Office established that all matters referred to the PFSA Office by the Insurance Ombudsman were properly investigated and used as a basis for reviewing the solutions adopted by other insurance undertakings.

In the Supreme Audit Office's opinion, the PFSA Office was conscientious in fulfilling its mission to educate and inform the public about the operations of insurance companies and pension funds. Also the fulfilment of its role to monitor the advertising messages of insurance companies and open-end pension funds was assessed as adequate.

In addition, the Supreme Audit Office examined the PFSA Office's performance of the task which consists in creating conditions for amicable and conciliatory settlement of disputes arising under agreements between insurance undertakings and their clients. The Supreme Audit Office established that in over 70% of all requests, insurers refused to refer a dispute to the Conciliatory Court of the PFSA. In the Supreme Audit Office's opinion, the Conciliatory Court's caseload could increase if the existing legislation was amended so as to assume implied consent of insurers for referral of disputes with consumers for settlement before the conciliatory court.

Annex

12



Annex

Publications and studies prepared by the PFSA Office in 2010

NO.	TITLE	DATE
BANKING SECTOR		
1.	Information on Risk Associated with Foreign-Currency Loans	January 14th 2010
2.	Myths Surrounding Recommendation T	March 4th 2010
3.	Information on Cooperative Banks Placed under Recovery Proceedings in 2009	March 10th 2010
4.	List of Questions to the National Cooperative Savings and Loan Association	June 14th 2010
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