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Narodowy Bank Polski



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# Information on Activities of the Financial Stability Committee in the Area of Macroprudential Supervision in 2016

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# **Information on Activities of the Financial Stability Committee**

**in the Area of Macroprudential Supervision  
in 2016**



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## Foreword of the Chairperson of the Committee

Dear Sirs,

Hereby I present the report describing the activity of the Financial Stability Committee in the area of macroprudential supervision (FSC-M) in 2016. This document fulfils the obligation of annual presentation to Sejm RP (the Polish Parliament) of information concerning the implementation of the tasks related to macroprudential supervision, imposed on the Committee under the Act of 5 August 2015 on macroprudential supervision of the financial system and crisis management. Under this Act, the Financial Stability Committee was designated as the authority responsible for macroprudential supervision in Poland. Its objective is to strengthen the resilience of the financial system, and in consequence, to support long-term and sustainable economic growth.

2016 was the first whole year of the Committee's work when many important initiatives were implemented, with the aim of supporting the stability of the financial system in our country. In the first half of 2016, the Committee adopted and published the strategic document describing legal and institutional framework of its activity and defined intermediate objectives of macroprudential supervision. The document explains the principles of FSC-M activities to the public and market participants. I recognise this as an important element of information policy, in particular, due to the fact that the Committee is a new participant of the financial safety net in our country and positive effects of its activity may become apparent only in a long-term perspective. Increased transparency of the macroprudential policy pursued by the Committee should facilitate its understanding and undertaking desired action by market participants.

Throughout the year, the Committee analysed risk sources for the financial system and communicated such information regularly in press releases after meetings. The Committee positively assessed the stability of the Polish financial system. Taking into account the uncertainty in the external macroeconomic environment, the Committee highlighted the importance of maintaining high resilience of the national financial system to disturbances. In this context, the Committee has found that its statutory obligation is to take a stance on FX housing loans. In the Committee's opinion, solutions discussed in the public debate, assuming the obligatory conversion of loans into zloty, in particular, at the loan origination exchange rates, generated direct threat to the stability of the financial system in our country. At the same time, FX risk to which borrowers are exposed and the associated social aspects could not be disregarded. In connection with the foregoing, following my initiative, the Committee established a special purpose working group whose target was to develop a concept of creating conditions and incentives for voluntary restructuring of the portfolio of such loans. As a result of the work carried out in the second half of 2016, in January 2017 the Committee adopted a package of recommendations addressed to institutions represented in the FSC, aiming at creating the appropriate regulatory environment which will constitute a significant incentive for concluding voluntary agreements between banks and borrowers, without posing a threat to the financial stability of the country. The recommendations issued will be implemented in the current year.

An important element of the activity of the Financial Stability Committee in the area of macroprudential supervision is communication with the public and financial market participants. The

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*Committee intends to continue the development of this form of its activity, which is demonstrated in the report presented below for your information. In 2016, the NBP website was extended where FSC-M documents are uploaded. Many analytical materials based on which the Committee pursues the macroprudential policy were published.*

*International cooperation was also an important aspect of the FSC-M work. As domestic financial systems in the European Union are closely interlinked, the autonomous macroprudential policy should also take the European aspects into account. In this context, the Committee made many important decisions related to the implementation of recommendations of the European Systemic Risk Board related to coordination of the macroprudential policy at the EU level. The documents published by the ESRB last year indicate that Poland is in the group of countries accurately implementing macroprudential supervision rules, in compliance with the applicable schedule.*

*Summarizing the Committee's activity in 2016, I can state with satisfaction that despite a short period of its operation, it successfully fulfilled the obligations arising from the Act. In the coming years, the Committee will endeavour to strengthen its position within the financial safety net and continue its contribution to maintaining financial system stability.*

*Adam Glapiński  
President of Narodowy Bank Polski  
Chairperson of the Financial Stability Committee  
for macroprudential supervision*

## 1. Work of the Financial Stability Committee acting as macroprudential supervision

### 1.1. Composition of the Committee

In accordance with the Act of 5 August 2015 on macroprudential supervision of the financial system and crisis management (Journal of Laws 2015, item 1513 as amended)<sup>1</sup>, the Financial Stability Committee is a collegial body competent for macroprudential supervision (FSC-M), comprising:

- President of Narodowy Bank Polski – as the Chairperson<sup>2</sup>,
- Minister of Finance,
- Chairman of the Polish Financial Supervision Authority (KNF),
- President of the Management Board Bank Guarantee Fund (BFG).

In case if personal participation of the Chairperson or other member of the Committee in the meeting is impossible, designating a representative to take over the powers of a person represented is permitted.

In 2016, due to changes in positions of heads of institutions comprising the Committee, arising mainly from the lapse of the term of office, FSC-M held its meetings in changing composition:

1) 2<sup>nd</sup> meeting on 22 February 2016<sup>3</sup>:

- Marek Belka – President of Narodowy Bank Polski – Chairperson of the Committee,
- Paweł Szalamacha – Minister of Finance,
- Andrzej Jakubiak – Chairman of the Polish Financial Supervision Authority,
- Jerzy Pruski – President of the Management Board Bank Guarantee Fund;

2) 3<sup>rd</sup> meeting on 13 May 2016:

- Marek Belka – President of Narodowy Bank Polski – Chairperson of the Committee,
- Paweł Szalamacha – Minister of Finance,
- Andrzej Jakubiak – Chairman of the Polish Financial Supervision Authority,
- Zdzisław Sokal – President of the Management Board Bank Guarantee Fund;

3) 4<sup>th</sup> meeting on 10 August 2016:

- Adam Glapiński – President of Narodowy Bank Polski – Chairperson of the Committee,
- Paweł Szalamacha – Minister of Finance,

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<sup>1</sup> Hereinafter: Act on macroprudential supervision.

<sup>2</sup> Pursuant to the Act on macroprudential supervision, the Financial Stability Committee has a dual mandate for action. Under the first mandate discussed in this document, the Committee performs macroprudential supervision tasks. The Committee performing this function has been designated by the FSC-M abbreviation. On the other hand, the Committee performing functions in the area of crisis management is defined by the FSC-C abbreviation. The Chairperson of the FSC-c is the Minister of Finance.

<sup>3</sup> Counting consecutively as of the moment of establishment of FSC-M it was the second meeting. The first meeting was held on 23 December 2015.

- Andrzej Jakubiak – Chairman of the Polish Financial Supervision Authority,
- Zdzisław Sokal – President of the Management Board Bank Guarantee Fund;

4) 5<sup>th</sup> meeting on 5 December 2016:

- Adam Glapiński – President of Narodowy Bank Polski – Chairperson of the Committee,
- Piotr Nowak<sup>4</sup> – Undersecretary of State at the Ministry of Finance (MF),
- Marek Chrzanowski – Chairman of the Polish Financial Supervision Authority,
- Zdzisław Sokal – President of the Management Board Bank Guarantee Fund.

**Table 1. Changes in the composition of FSC-M in 2016**

	2 <sup>nd</sup> meeting	3 <sup>rd</sup> meeting	4 <sup>th</sup> meeting	5 <sup>th</sup> meeting
<b>NBP</b>	Marek Belka		Adam Glapiński	
<b>MF</b>	Paweł Szałamacha			Mateusz Morawiecki
<b>PFSA</b>	Andrzej Jakubiak			Marek Chrzanowski
<b>BGF</b>	Jerzy Pruski	Zdzisław Sokal		

Source: NBP study.

## 1.2. FSC tasks related to macroprudential supervision

The basic tasks of the FSC-M specified in the Act on macroprudential supervision are to:

- apply macroprudential instruments, including statements and recommendations issuing;
- identify financial institutions that pose a significant risk for the financial system;
- cooperate with the European Systemic Risk Board, other European Union authorities and institutions, macroprudential supervision authorities as well as with other international institutions;
- ensure an adequate flow of information between the members of the Committee enabling it to carry out its tasks.

The Financial Stability Committee affects the financial sector indirectly through issuing recommendations addressed to specific institutions represented in the Committee and presenting its statements. The FSC is not authorised to issue binding acts of law regulating the activity of entities in the financial market. In the performance of its tasks, FSC-M analyses phenomena and events occurring or likely to appear both in the domestic and in the world economy in terms of identification of threats to financial stability and assessment of the likelihood of systemic risk materialisation. Conclusions of the analyses provide basis for undertaking macroprudential supervision measures.

<sup>4</sup> Representative of the Ministry of Finance appointed by Minister of Economic Development and Finance Mateusz Morawiecki.

**Statements** of the Committee are presented when a significant increase or a high level of risk is identified and the Committee finds it necessary to inform market participants of its sources and potential consequences for the financial system and the economy. Warnings expressed in the form of a statement are addressed to a broad group of recipients and may serve as a stimulus triggering corrective or adjustment actions in the financial system.

**Recommendations** are issued when the FSC-M finds it necessary to take measures aimed at mitigating systemic risk. The recommendations can be addressed to institutions represented in the FSC, i.e. Narodowy Bank Polski, the Minister of Finance, the Polish Financial Supervision Authority and the Bank Guarantee Fund. Recommendations are not legally binding, however, the “comply or explain” principle shall be applicable in their case.<sup>5</sup>

The implementation of macroprudential policy tasks<sup>6</sup> requires the application of instruments whose goal (not always the only one) is to mitigate systemic risk. The list of macroprudential instruments is not closed. Many tools are available to institutions of the financial safety net which, besides their standard application, may be used for macroprudential purposes. These instruments can be divided into two groups: 1) harmonised, i.e. regulated at the European level<sup>7</sup> and 2) non-harmonised. The first group includes capital buffers and national measures provided for in Article 458 of the CRR. Thus, the Financial Stability Committee may respond to systemic risk through recommending a wide range of instruments.

### 1.3. Meetings and adopted resolutions

In accordance with the adopted schedule reflecting the requirements of the Act on macroprudential supervision, in 2016 the FSC-M held four meetings.

In each quarter of 2016, the Committee fulfilled its statutory obligation to define the value of the countercyclical buffer guide. It also issued recommendations addressed to the Minister of Finance, decided to publish relevant information and fulfilled the obligation to submit it to the ESRB. During each meeting of the Committee, the Minister of Finance (or its representative) adopted the recommendations concerning the level of the countercyclical buffer. In 2016 the countercyclical buffer did not change and it is maintained at a level of 0%.<sup>8</sup>

Information associated with the countercyclical buffer, subject to publication under the FSC-M resolution, includes the level of the recommended countercyclical buffer rate and:

- 1) the applicable countercyclical buffer rate,

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<sup>5</sup> The “comply or explain” principle means that addressees of the recommendations are obliged to inform FSC-M of measures undertaken or explain the reasons for non-compliance.

<sup>6</sup> The terms “macroprudential policy” and “macroprudential supervision” are used interchangeably.

<sup>7</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms amending Regulation (EU) No 648/2012 (hereinafter CRR).

<sup>8</sup> At a level introduced in Article 83 of the Act on macroprudential supervision.

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- 2) the buffer guide,
  - 3) the credit-to-GDP ratio,
  - 4) indicator of deviation of the ratio of credit to GDP from its long-term trend.

Those values are published on the website of Narodowy Bank Polski under the “Macroprudential supervision” tab.

At its 2<sup>nd</sup> meeting (first in 2016), the Committee adopted the FSC by-laws which defined the manner and procedures of its operation, both under the macroprudential formula and in the area of crisis management. The by-laws determined, among others, the specific procedures related to replacement of members of the Committee, rules of convening the meetings, standard deadlines for submission of documents, regulations concerning the manner of adopting resolutions and details regarding the appointment of working groups. At the same meeting, the Committee appointed the Permanent Working Group.

In fulfilment of its statutory obligations<sup>9</sup>, at the 3<sup>rd</sup> meeting held on 13 May 2016, the Committee adopted the statement in which it approved the draft document of the Polish Financial Supervision Authority entitled: *Procedura określająca metodę identyfikacji globalnych instytucji o znaczeniu systemowym oraz definiowania podkategorii globalnych instytucji o znaczeniu systemowym* (the procedure determining the methodology for the identification of global systemically important institutions (G-SII) and for the definition of subcategories of global systemically important institutions), recognising it as compliant with the EU regulations<sup>10</sup> and relevant for the identification of global systemically important institutions in Poland.

At the same meeting, the Committee also adopted the resolution concerning the recommendation regarding the systemic importance of other systemically important institutions (O-SII).<sup>11</sup> In the resolution, the Committee recommended the application of the guidelines of the European Banking Authority<sup>12</sup> defining the assessment criteria, for the purpose of identification of institutions and imposing capital buffers.<sup>13</sup> It also recommended taking into account additional elements arising from the specific features of the Polish banking sector.

At the 4<sup>th</sup> meeting of FSC-M (in August 2016) under the administrative proceedings conducted by the Polish Financial Supervision Authority with the aim of identification O-SII and imposing buffer on them, the Committee examined the requests submitted by the KNF. As a result of

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<sup>9</sup> Obligations arising from Article 36(2) of the Act on macroprudential supervision.

<sup>10</sup> The PFSA draft is compliant with the procedure of identification of global systemically important institutions defined in Commission Delegated Regulation (EU) 1222/2014 of 8 October 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for the specification of the methodology for the identification of global systemically important institutions.

<sup>11</sup> In fulfilment of the obligations arising from Article 39(6) of the Act on macroprudential supervision.

<sup>12</sup> In accordance with Article 39(1) of the aforementioned Act, the Polish Financial Supervision Authority identifies other systemically important institutions (OSII) and imposes Other Systemically Important Institutions buffer on them. As part of the identification process (i.e. the assessment of systemic importance of other systemically important institutions), the PFSA takes into consideration, among others, the FSC-M recommendation regarding the systemic importance of other systemically important institutions.

<sup>13</sup> EBA Guidelines of 16 December 2014 on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (EBA/GL/2014/10)

proceedings, the Committee issued 12 decisions in which it contained positive opinions concerning identification indicated domestic banks as O-SII s and proposed capital buffers.

Recognising the need to resolve the issue of FX housing loans, the Financial Stability Committee deemed it advisable for financial safety net institutions and the macroprudential authority to be actively involved in this process. The objective was to develop proposals of systemic solutions which would be safe in terms of financial stability. Following the initiative of the President of NBP, in August 2016 the Committee appointed the Working Group on the Risk of FX Housing Loans (GRKW), with the task of developing such solutions which would address the problem and would not pose risk to financial stability. The engagement of the Committee stems directly from the statutory objective of macroprudential supervision, in particular, to strengthen the resilience of the financial system in the event of the materialisation of systemic risk.

Work of the Group concentrated in the fourth quarter of 2016 and it was concluded on 13 January 2017 at the 6<sup>th</sup> FSC-M special meeting, convened on initiative of the President of NBP. The Committee adopted the resolution concerning the recommendations regarding the restructuring of the portfolio of FX housing loans. The recommendations were addressed to individual institutions of the financial safety net with aim to introduce regulatory solutions and use available financial supervision instruments, in order to encourage banks and borrowers to taking voluntary restructuring decisions. Such measures should lead to limiting of the problem from the borrowers' perspective and ensure that banks demonstrate an adequate resilience in the event of materialisation of risk associated with foreign currency loans. In principle, they would stimulate the process of voluntary restructuring of FX housing loans, while maintaining financial system stability.

At the same meeting, the Committee also decided to extend the mandate of the GRKW for another 6 months and assign it new tasks associated with the implementation of the Recommendation.

**Table 2. Resolutions of the Financial Stability Committee**

RESOLUTION NO	CONTENT
<b>2<sup>nd</sup> meeting/ 22 February 2016</b>	
2/2016	on the by-laws of Financial Stability Committee
3/2016	on the appointment of the Permanent Working Group
4/2016	on the level of the countercyclical buffer rate
5/2016	on the submission of information concerning the countercyclical buffer to the European Systemic Risk Board
<b>3<sup>rd</sup> meeting/ 13 May 2016</b>	
6/2016	on the level of the countercyclical buffer rate
7/2016	on the submission of information concerning the countercyclical buffer to the European Systemic Risk Board

8/2016	on the recommendation regarding the systemic importance of other systemically important institutions
9/2016	on the statement regarding the draft procedure of the Polish Financial Supervision Authority for the purpose of global systemically important institutions identification
<b>4<sup>th</sup> meeting/ 10 August 2016</b>	
10/2016	on the appointment of the Working Group on the Risk of FX Housing Loans
11/2016	on the level of the countercyclical buffer rate
12/2016	on the submission of information concerning the countercyclical buffer to the European Systemic Risk Board
<b>5<sup>th</sup> meeting/ 5 October 2016</b>	
13/2016	on the level of the countercyclical buffer rate and submission of information concerning the countercyclical buffer to the European Systemic Risk Board
<b>6<sup>th</sup> meeting/ 13 January 2017</b>	
14/2017	on the recommendation regarding the restructuring of the portfolio of FX housing loans
15/2017	amending the resolution on the appointment of the Working Group on the Risk of FX Housing Loans

Source: NBP.

#### 1.4. Working groups

**Permanent Working Group (SGR)** was established for an indefinite period as the basic body supporting the work of the FSC-M, enabling close and ongoing cooperation between institutions of the financial safety net gathered in the Committee.

The SGR plays an auxiliary function to FSC-M, and the tasks assigned to it include, among others:

- exchanging opinions concerning systemic risk assessments,
- developing proposals of macroprudential measures,
- presenting proposed macroprudential instruments.

The composition of the Permanent Working Group reflects the collegial nature of the FSC, which fosters active inclusion of all institutions represented in the Committee in work oriented towards the accomplishment of the macroprudential target. The Group enables the use of the competence of representatives of institutions included in the FSC and creates conditions for cooperation at all stages of the work. Such design of the Group helps to diagnose systemic risk, which takes into account diverse perspectives and fosters the *ex-ante* coordination of macroprudential policy. The Group is chaired by a representative of NBP and it comprises two representatives of each of the institutions present in the FSC.

The frequency of SGR meetings arises from the schedule of FSC-M work. In accordance with the defined rules, each meeting of the Committee is preceded by at least one meeting of the SGR. In

2016, the Group held 5 meetings. At the first stage of its operation, the SGR laid down internal organisation rules, including the principles of cooperation between its members and the frequency of meetings. Subsequently, taking into account the recommendations of the European Systemic Risk Board, it undertook measures resulting in the elaboration of the strategic document called: *Macroprudential supervision in Poland - institutional and functional framework*. On the next stages, analytical tools supporting systemic risk diagnosis were developed and key issues were discussed, later becoming the subject of discussions and decisions taken by the Financial Stability Committee. During SGR meetings, among others, content-related and formal issues associated with resolutions adopted by FSC-M were considered, the assessment methodology, identification method and systemic risk sources were discussed.

**Working Group on the Risk of FX Housing Loans** was established by the Financial Stability Committee in August 2016, initially for a period of 6 months, in order to develop recommendations on solutions aiming at safe – in terms of financial stability – restructuring of FX housing loans. The Group is chaired by a representative of NBP.

In line with the Committee's expectations, the draft recommendation was to take into account, in particular, the phased implementation of the restructuring process, which would spread over time banks' costs of this operation and foster maintaining of domestic financial system stability. Due to the complexity of the restructuring process of foreign currency loans, the Group assumed that the solutions recommended should refer to a broad range of instruments available to institutions represented in the Financial Stability Committee. On the other hand, use of those instruments should take into account risk parameters associated with individual borrowers or loans, as well as other important criteria, including those qualitative ones. According to the assumptions, burdens associated with the loan restructuring process – as a rule – should be borne by both- banks and borrowers. Another desirable feature of the recommendations developed was the reliance of the draft on the principle of voluntary agreement between banks and their clients.

At the Financial Stability Committee meeting in January 2017, the Group, exercising its mandate, presented the draft package of recommendations of a macroprudential nature<sup>14</sup>, which included the use of the catalogue of instruments available within the competence of institutions represented in the FSC. Parallel to adopting the Recommendation, the Committee extended the period of the Group's activity and its mandate to include tasks related to cooperation with institutions on the calibration of selected instruments, coordination of cooperation among financial safety net institutions as well as monitoring of the implementation process of individual recommendations.

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<sup>14</sup> More on this FSC-M Recommendation in Chapter 5.5.

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## 2. The Role of Narodowy Bank Polski

The formula of the organisation of macroprudential supervision in Poland is based on the assumption of close cooperation among institutions of financial safety net. At the same time, the Act on macroprudential supervision imposed on Narodowy Bank Polski specific tasks aimed at supporting the work of the Financial Stability Committee in the area of macroprudential supervision. In particular, the Act assigned the role of chairperson of the FCS-M to the President of Narodowy Bank Polski with the casting vote. The President of Narodowy Bank Polski also represents the Committee before external institutions.

Narodowy Bank Polski was assigned the task of providing services to FSC-M in two areas: analytical and research support and organisational and administrative services. It resulted from international practice as well as from the NBP's long-lasting engagement and experience in conducting analyses of the financial system and its relationship with the real economy. Narodowy Bank Polski acts as the analytical back office of the Financial Stability Committee in its macroprudential responsibility. Resources, experience, knowledge base and the analytical instruments developed at NBP serve the Committee in fulfilling its tasks.

The main documents which NBP has to submit to the FSC in compliance with its statutory obligations and which were discussed in 2016 by the macroprudential supervision authority include: the *Financial Stability Report* (published twice a year) and the *Report on Macroeconomic Stability of the Polish Economy* (annual). The Committee has also been provided with access to results of studies, analyses, reports and other documents prepared at NBP which may potentially influence the assessment of systemic risk and, at the same time, the macroprudential policy pursued. Some analytical and research tasks implemented by Narodowy Bank Polski are carried out, in particular, for the needs of the FSC-M, such as the questionnaire survey concerning systemic risk assessment or study on the credit cycle and the macroeconomic stability of the Polish economy. While performing the assigned task, Narodowy Bank Polski organises the Committee's work, i.e. provides legal service, arranges flow of information and materials, makes a meeting room available, provides technical facilities. Narodowy Bank Polski fulfils the same functions in relation to bodies appointed by the Financial Stability Committee, i.e. provides analytical materials and administrative service to the Permanent Working Group and the Working Group on the Risk of FX Housing Loans.

Narodowy Bank Polski is also responsible for the implementation of the Committee's communication policy which, is aimed, in particular, at informing of identified threats to financial stability, explaining of decisions taken and dissemination of knowledge concerning macroprudential supervision and its importance. Accordingly, NBP operates the Committee's website and cares for the provision of relevant information to interested parties as well as fulfils disclosure obligations towards European Union institutions and authorities.

### 3. Macroprudential supervision strategy

#### 3.1. Ultimate objective of macroprudential supervision

In accordance with the definition presented in the Act, macroprudential supervision comprises identification, assessment and monitoring of systemic risk arising in the financial system or its environment as well as undertaking measures aimed at eliminating or reducing this risk. The proper performance of macroprudential supervision requires the specification of objectives to determine measures undertaken by the relevant bodies.

In 2011, the European Systemic Risk Board indicated in its Recommendation on the macroprudential mandate of national authorities<sup>15</sup> that the ultimate goal of macroprudential supervision is to contribute to the safeguard of the stability of the financial system as a whole, in particular, by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable participation of the financial sector in economic growth. The objective specified in a similar way is reflected in the Polish Act on macroprudential supervision.<sup>16</sup>

Intermediate objectives constitute a more specific expression of the ultimate objective of the macroprudential policy pursued. Specifying intermediate objectives facilitates risk analyses in the context of the overall financial system (instead of its individual sectors) and facilitates communication. In Poland, intermediate objectives of macroprudential supervision are precisely defined in the strategic document on *Macroprudential supervision in Poland – institutional and functional framework*, adopted at the 3<sup>rd</sup> FSC-M meeting on 13 May 2016 and published on the NBP website.

#### 3.2. Intermediate objectives of macroprudential supervision

Respecting ESRB recommendations and also having regard to the specific nature of the Polish financial system, while defining the framework for pursuing an effective macroprudential policy, the FSC-M has adopted the following intermediate objectives of macroprudential supervision:

- mitigation of risk arising from excessive indebtedness or leverage,
- mitigation of risk arising from excessive balance-sheet mismatch of financial institutions or of the risk of illiquidity of financial markets,
- mitigation of risk arising from excessive concentration of exposures,
- mitigation of risk arising from misaligned incentives influencing the behaviour of financial institutions or their clients,
- ensuring the adequate resilience of the financial infrastructure.

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<sup>15</sup> Recommendation on the macroprudential mandate of national authorities of 22 December 2011 (ESRB/2011/3).

<sup>16</sup> Article 1(2) of the Act on macroprudential supervision.

**Table 3. Intermediate objectives of macroprudential supervision and the major elements of risk covered**

	INTERMEDIATE OBJECTIVES	RISK DESCRIPTION <sup>17</sup>
1	Mitigation of risk arising from excessive indebtedness or leverage	Risk arising from the pro-cyclical behaviour of financial institutions reflected in the credit debt cycle; manifested in high leverage or lending growth.
2	Mitigation of risk arising from excessive balance-sheet mismatch or the risk of financial markets illiquidity	Risk of unstable funding arising from the structure and sources of funding and excessive funding costs. Liquidity risk as a result of excessive maturity mismatch of assets and liabilities. Risk of financial markets illiquidity as a result of structural changes in financial markets.
3	Mitigation of risk arising from excessive exposure concentration	Risk arising from large exposures to individual entities or homogenous exposure groups. Risk of contagion in the network of mutual exposures or interdependencies of asset prices.
4	Mitigation of risk arising from misaligned incentives influencing the behaviour of financial institutions or their clients	Excessive risk-taking by managers of financial institutions, in particular, risks related to the excessive size and complexity of financial institutions. Risk of misaligned incentives leading to increased moral hazard among depositors or investors as a result e.g. of legal regulations concerning the protection of depositors, the inadequate resolution system for financial institutions or the lack of supervision over certain sectors.
5	Ensuring the adequate resilience of the financial infrastructure	Risk of instability of the financial market infrastructure entities: risk of cessation of key services (e.g. payment and settlement systems and clearing houses), inappropriate institutional solutions or inadequate resilience to risk materialisation.

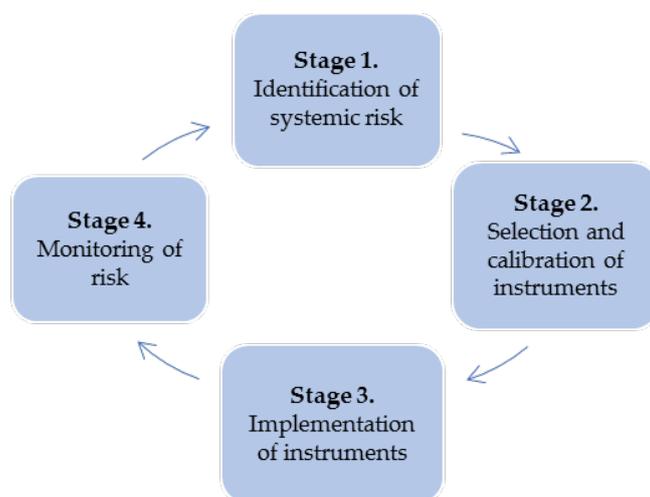
Source: Own study based on *Macroprudential supervision in Poland – institutional and functional framework*.

### 3.3. Cycle of measures

In the *Macroprudential supervision in Poland – institutional and functional framework*, the Committee also presented the macroprudential supervision cycle. The model of pursuing macroprudential policy comprises actions undertaken by the Financial Stability Committee in close cooperation with individual institutions that are represented in it.

<sup>17</sup> In this material, a synthetic description of the risk is presented, whereas details concerning intermediate objectives and the FSC-M macroprudential policy strategy are contained in *Macroprudential supervision in Poland (...)*, [http://www.nbp.pl/nadzormakroostroznowosciowy/publikacje/Ramy\\_inst-funkc.pdf](http://www.nbp.pl/nadzormakroostroznowosciowy/publikacje/Ramy_inst-funkc.pdf).

Diagram 1. Cycle of macroprudential supervision measures



In simple terms, a macroprudential supervision cycle can be described as a sequence of the following stages:

**Stage 1.** Covers **the identification of systemic risk in the financial system** on the basis of the analyses prepared by Narodowy Bank Polski and other institutions represented in FSC-M. The subject of analysis is the whole financial system and its relations with the real economy as well as the international environment.

**Stage 2.** Means **the selection of a specific macroprudential instrument** which will mitigate the identified systemic risk adequately. If the need to implement a macroprudential instrument arises, the Financial Stability Committee shall issue a recommendation addressed to a specific institution, which is obliged to comply with the recommendation and inform the FSC-M what measures aimed at mitigating systemic risk have been undertaken or explain the reasons for non-compliance.

**Stage 3.** Provides for the **application of measures mitigating systemic risk** through the implementation of FSC-M's recommendations.

**Stage 4.** Covers the **risk monitoring, including the effectiveness of the measures** undertaken in Stage 3. The analysis can form the basis for the Committee to recommend the maintenance, withdrawal or modification of the parameters of a given macroprudential instrument.

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## 4. Systemic risk – monitoring and identification

### 4.1. Methodology of systemic risk assessment and identification

#### **Risk monitoring in the financial system and coordination of work of financial safety net institutions**

All financial safety net institutions are responsible for continuous process of systemic risk monitoring. Their systematic analyses are coordinated and ideas are confronted within SGR. During discussions at the expert level, a common risk assessment project is developed, later presented at each FSC-M regular meeting. The main tool used for structuring the debate concerning the systemic risk is the questionnaire survey on the *Systemic risk assessment by institutions of the financial safety network*, prepared and developed by NBP (Box 1).

#### **Common conceptual framework used for the identification and assessment of systemic risk**

In order to facilitate the discussions within the FSC-M, a set of standardised basic terms, used in the process of systemic risk assessment has been developed. In accordance with the conceptual framework, the description of a risk source consists of three key elements:

- ***Vulnerability***

The category of *vulnerability* indicates the location and nature of risk source. Vulnerability may be of both external and internal nature in relation to the financial system. It often assumes the nature of imbalance (e.g. excessive involvement of financial institutions in a certain activity type) which may occur and build up in the system over a longer period, without materialisation until the emergence of a triggering factor.

- ***Risk trigger***

A *trigger* is defined as an event or phenomenon resulting in risk materialisation. This factor may assume a form of a shock originating from the same financial system or its environment (e.g. from real economy).

- ***Amplifiers or mitigators of risk materialisation effects***

Such factors may include, in particular

- links between the risk sources (e.g. materialisation of one of the sources is a trigger for another risk source),
- the capacity of economic entities to absorb shocks (e.g. a sound capital position of a financial institution increases the capacity to absorb losses), or
- institutional solutions (e.g. existence of effectively operating institutional security systems or the deposit guarantee schemes).

**Box 1.****Questionnaire Survey *Systemic risk assessment by institutions of the financial safety net***

This survey, conducted among institutions represented in the Committee on a quarterly basis, is a tool supporting the process of systemic risk assessment performed by the FSC-M. The objective of the survey is to collect the opinion concerning risk sources in the Polish financial system. Results of the survey contribute to discussions concerning systemic risk assessment during the SGR meetings and FSC-M sessions.

In the questionnaire, each of the institutions presents its own assessment of risk sources in the Polish financial system. Questions contained in the document (related to each of risk sources analysed) can be divided into three parts (see below).

**Diagram of the structure of the questionnaire survey *Systemic risk assessment (...)***

Description of risk sources			Nature and intensity of risk				Counteraction
Vulnerability	Potential triggers	Potential risk amplifiers or mitigators	Intermediate objective of macroprudential policy	Time horizon	Risk intensity assessment	Change in risk intensity assessment since the last survey	Proposed macroprudential measures

Part 1 is the description of risk sources, comprising the description of a vulnerability defining identified risk source, including the qualitative description of triggers and potential amplifiers or mitigators of this risk intensity. Part 2 comprises four elements (intermediate objective, time horizon, risk intensity and its change) and refers to the assessment of the current nature of described risk source. Standardisation of the response method enables harmonisation of the approach to the assessment and visualisation of results, facilitating discussions at meetings. The last part focuses on potentially feasible measures which may limit possible materialisation of a given risk source.

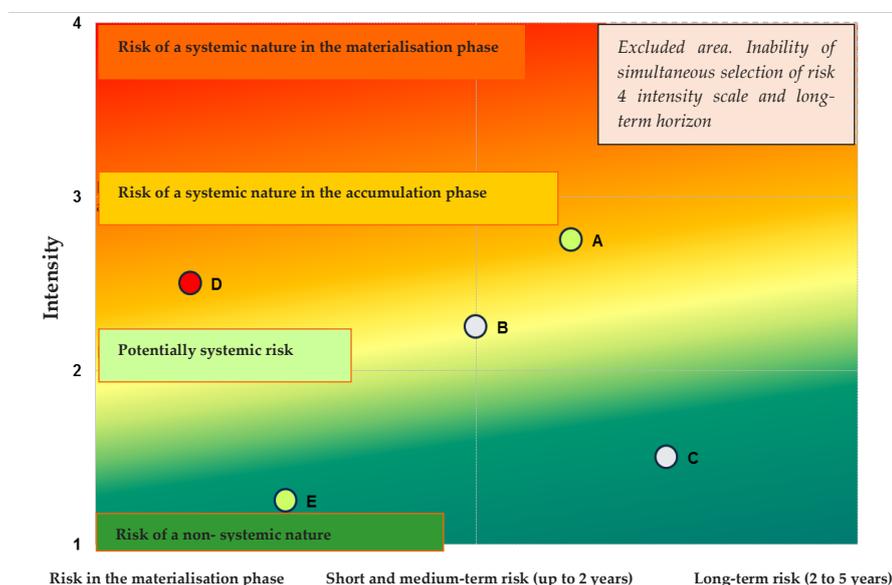
The questionnaire survey is conducted quarterly.

First, a list of main risk sources (vulnerabilities) occurring in the Polish financial system is defined. This list is developed based on previous FSC-M work as well as NBP analytical documents: the *Financial Stability Report* and the *Report on Macroeconomic Stability of the Polish Economy*.

Subsequently, the list is sent to institutions represented in FSC-M (through the Permanent Working Group) which separately prepare the assessment of each defined vulnerability, in accordance with the adopted questionnaire template. At this stage, institutions have a possibility to propose additions to the description of risk sources and indicate new additional risk sources.

The summary of the questionnaire survey prepared by NBP on the basis of those responses is the subject of SGR discussions. Then, based on comments and conclusions of the discussions within the SGR, Narodowy Bank Polski performs a collective summary which is finally presented to FSC-M members. Results of the questionnaire survey represent one of the background documents for discussions on risk whose effects are reflected in the Committee's recommendations related to the level of the countercyclical buffer and other macroprudential instruments. The assessment of systemic risk is also included in FSC-M's press releases.

## Graphical presentation of questionnaire survey results



Note to the diagram:

The diagram shows the significance of five hypothetical risk sources. The horizontal axis presents the averaged time horizon, the vertical axis – the averaged assessment of risk intensity.

The closer the risk source to the top left-hand corner of the diagram, the more significant the risk is in the assessment. The top right-hand corner of the diagram has been excluded from the analysis since the risk of long-term nature cannot simultaneously be in the materialisation phase.

In addition, colours of the points indicate the change in the risk intensity assessment since the last questionnaire survey, where green indicates a decline in intensity, red – a growth and grey – no change in the assessment.

Source: NBP report

## Systemic risk identification

In the majority of cases, identification of systemic risk sources starts from the identification of vulnerabilities in the system. At the next stage, triggers are assigned to vulnerabilities and the existence of potential links between entities in the financial system is analysed, the institutional environment is assessed as well as the capacity to absorb shocks, which allows for indicating potential amplifiers and mitigating factors of a given risk source. The identification of systemic risk sources may also start with indicating a trigger, when it is a significant event of an external nature in relation to the financial system in Poland.

While searching for vulnerabilities in the financial system, the catalogue of intermediate objectives of macroprudential policy described in Chapter 3 is useful. A detailed description of intermediate objectives indicating risks counteracted by macroprudential policy simultaneously creates the description of vulnerabilities in the financial system. Moreover, for the purpose of

determining monitoring priorities, the financial system structure is important as well as the binding institutional and legal solutions.

For macroeconomic policy purposes, the identification of all risk sources occurring in the financial system is not as important as the answer to the question which of them have systemic importance in the light of the definition contained in the Act on macroprudential supervision. Two aspects are crucial for the assessment of intensity of a given risk source:

- assessment of consequences for the economy (whereas the assessment of consequences should consider previously analysed amplifiers/ mitigators of a risk source, e.g. the capacity to absorb shocks – capital buffers, liquidity buffers, institutional barriers);
- assessment of materialisation probability.

Taking into account both aspects of a risk source enables to assess whether the risk is of a systemic nature.

In the systemic risk assessment performed by the FSC-M, a broad scope of information is used, comprising analyses based on econometric models and simulations, indicators and oversight information acquired by the PFSA. In relation to the risk to the financial sector, simulations and stress tests make an important tool.<sup>18</sup> The assessment of vulnerabilities in the remaining segments of the financial sector relies, to a larger extent, on the analysis of financial indicators for individual types of institutions as well as on the assessment of significance of functions fulfilled by those institutions in the financial system and in the economy as a whole.

#### **4.2. Results of analyses – systemic risk assessment in 2016**

The most important risk source which was the subject of discussions by the FSC-M in 2016 was the issue of potential systemic consequences of the restructuring of the portfolio of FX housing loans. According to the FSC-M opinion, portfolios of FX housing loans denominated do not generate significant systemic risk to the stability of the financial system in economic terms. On the other hand, systemic risk may emerge in the context of potential consequences of legal solutions proposed in the public debate and in the context of potential operating risk, particularly legal risk. In 2016, in its announcements the FSC-M stressed that legislative initiatives related to this issue should be constructed and implemented carefully, so that they neither affect financial system stability nor significantly reduce its resilience nor restrict the capacity of banks to provide lending to the economy.

Among other risk sources in the Polish financial system – although demonstrating lower intensity – the following factors were indicated:

- the decreasing banks' resilience associated with the declining profitability – in the environment of low interest rates and the accompanying higher tax burdens for the

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<sup>18</sup> The aim of the stress test is the assessment of banking sector's response to the extremely unfavourable and highly unlikely economic scenario. Due to this type of analyses, it is possible to examine the resilience of the banking sector. For the needs of the *Financial Stability Report*, stress tests are conducted by NBP twice a year and their results are presented to the FSC-M and on an ad-hoc basis, should the probability of negative shocks in the banking sector significantly increase.

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financial sector, the reduced profitability of banks limits the possibilities of internal generation of capital and may also hamper raising capital externally due to the ROE decline below the cost of capital. It reduces banks' resilience to macroeconomic shocks.

- the portfolio of zloty housing loans in the context of banks' lending policy and the all-time low level of interest rates - in the environment of low interest rates and the downward trend in interest rates in zloty over the last four years, both borrowers and lenders could have underestimated a possibility of interest rate growth in the future. Consequently, borrowers may hold inadequate income buffers and, in the event of a growth in interest rates, their loan repayment capacity may deteriorate;
- a difficult situation of the credit union (SKOK) sector and some cooperative banks, arising from ineffective and inefficient business model demonstrating low effectiveness, high concentration of risk exposure (in some cooperative banks) or increased moral hazard (credit union sector), increases the potential of contagion effect through increased burdens in favour of BGF.
- imbalance on the commercial real estate market – a significant oversupply, in particular, in the office real estate segment. The adjustment of imbalances may affect banks through credit risk in the portfolio of loans for the purchase and construction of commercial real estate (the size of this portfolio is currently limited), as well as in the portfolio of loans to construction firms with revenue strongly dependent on the construction of commercial real estate.

## 5. Macroprudential instruments

The Financial Stability Committee, as the macroprudential supervision authority in Poland, has a right to influence the financial system indirectly. In accordance with the provisions of the Act on macroprudential supervision, the Committee may present statements and issue recommendations; it is also bound to co-participate in the process of introducing macroprudential instruments by the Polish Financial Supervision Authority and the Minister of Finance.<sup>19</sup>

In 2016, the Committee did not issue any statement, however, it formulated a number of recommendations related to the application of macroprudential instruments by authorised institutions.

The catalogue of macroprudential instruments whose application is regulated in the Act on macroprudential supervision comprises capital buffers, i.e.:

- conservation buffer,
- countercyclical buffer,
- systemic risk buffer,
- global systemically important institutions buffer,
- other systemically important institutions buffer

and measures provided in the European Union regulations.<sup>20</sup>

Out of instruments listed above, the conservation buffer, the countercyclical buffer and the Other Systemically Important Institutions buffer were used in Poland in 2016.

### 5.1. Conservation buffer

Credit institutions (more precisely, banks) are bound to maintain the conservation buffer at a level of 2.5% of the total risk exposure amount, calculated in accordance with Article 92(3) of the CRR.<sup>21</sup> The buffer is binding for all banks and the purpose of its introduction is the protection of capital.

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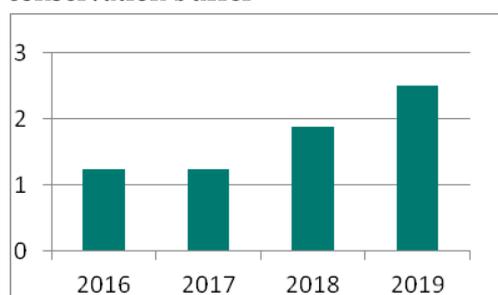
<sup>19</sup> More on this issue, in the document on *Macroprudential supervision in Poland (...)*.

<sup>20</sup> Article 458 of Regulation of the European Parliament and of the Council (EU) no 575/2013 of 26 June 2013 on *prudential requirements for credit institutions and investment firms* amending Regulation (EU) No 648/2012 (CRR).

<sup>21</sup> Article 19 of the Act on macroprudential supervision.

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**Figure 1. Required level of conservation buffer**



Source: NBP.

At the same time, the Act introduced a transitional period in the application of this buffer, in accordance with which its level amounted to 1.25% in 2016. The same level shall apply in the consecutive year whereas in 2018 it shall increase to the level of 1.875% to reach its target level of 2.5% in 2019.

## 5.2. Countercyclical buffer

The aim of the countercyclical capital buffer is, first of all, to increase the resilience of the banking system to cyclical fluctuations of systemic risk. Cyclical changes in systemic risk are associated both with a periodical easing of lending conditions and increasing the scale of risk taken, as well as with the underestimation of risk due to problems related to its measurement. The working of the countercyclical buffer is based on increasing the level of banks' capital in the upswing phase of the credit cycle and (gradual or full) release of this capital in the downturn phase of the cycle, so that banks have funds to cover losses and the capital requirements do not force pro-cyclical behaviour and do not lead to excessive credit availability constraints in the economy.

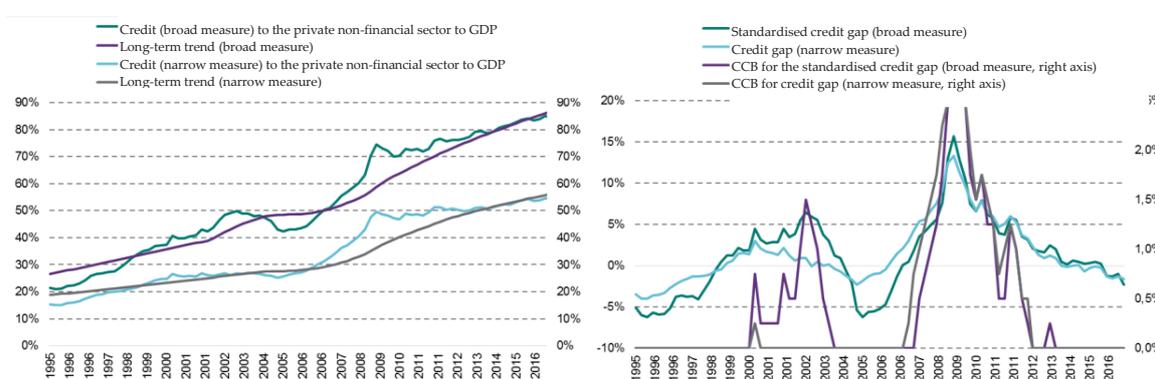
The Financial Stability Committee is obliged to calculate on a quarterly basis the buffer guide<sup>22</sup>, which is a base of recommended level of the countercyclical buffer rate to the minister competent for financial institutions. Issuing of the recommendation on the level of the countercyclical buffer rate is associated with another requirement providing that the minister competent for financial institutions, taking into consideration the Committee's recommendation, assesses the level of the countercyclical buffer rate on a quarterly basis. Throughout 2016, the Committee adopted resolutions on recommending the countercyclical buffer rate at a level of 0%. This meant the lack of changes in relation to the level determined in the Act. Having reviewed the results of analyses concerning setting the countercyclical buffer level, the Committee recognised that the risk associated with excessive lending was low and no premises existed to set the countercyclical buffer rate at a higher level.

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<sup>22</sup> Pursuant to Article 23 of the Act on macroprudential supervision, the buffer guide is a variable reflecting the credit cycle and the risk associated with excessive credit growth in the national economy, taking into account the specific nature of the Polish economy and its financial system.

During its meetings, the Committee reviewed analytical materials<sup>23</sup> which presented information concerning the developments in the credit cycle indicators. Taking decisions on the recommended value of the countercyclical buffer, the Committee considered, among others: the credit gap – a deviation of the private non-financial sector debt to GDP ratio from its long-term trend, the financial cycle phase in Poland, results of models used for early warning against a banking crisis, as well as other indicators reflecting systemic threat stemming from excessive growth of non-financial sector debt in Poland.

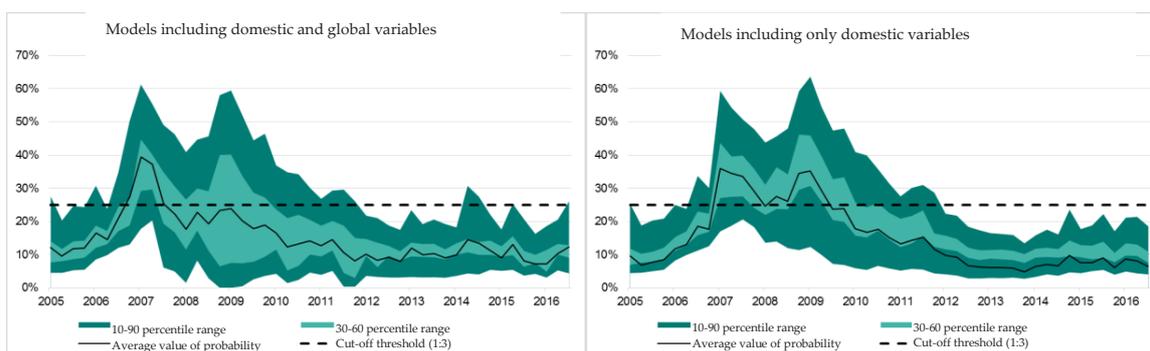
Figure 2. Standardised credit gap and the corresponding buffer rate



Source: NBP calculations.

Notes: The last observation for the 3<sup>rd</sup> quarter of 2016.

Figure 3. Probability of a banking crisis in Poland



Source: NBP calculations.

Note: The last observation for the 3<sup>rd</sup> quarter of 2016

<sup>23</sup> The analytical materials discussed at FSC-M meetings are available on the NBP website: <http://www.nbp.pl/nadzormakroostroznowsciowy/publikacje.aspx>

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The figures present the average value of probability derived on the basis of 237 models taking domestic and global variables into account (left-hand panel) and 176 models taking only domestic variables into account (right-hand panel) and the cut-off threshold, which when exceeded, signals the threat of a banking crisis. For details, see the analytical material published on the website.<sup>24</sup>

The credit cycle indicators analysed by the Committee indicated that in the examined period Poland was in the final phase of recovery, which meant that the threat associated with credit expansion was low.<sup>25</sup> The credit gap remained negative and close to zero, which also implied that there was no threat associated with excessive credit growth<sup>26</sup> (Figure 2). Both the total debt of the private non-financial sector to GDP and the debt to domestic credit institutions (banks and credit unions) were growing at a rate consistent with the long-term trend. Early warning models also indicated that in the horizon of one to four years, the threat of a banking crisis remained low (Figure 3).

### 5.3. Global systemically important institutions buffer

The application of the global systemically important institutions (G-SII) buffer remains within the competence of the Polish Financial Supervision Authority (i.e. the obligation to identify global systemically important institutions and classify them in categories defining the importance of those institutions, simultaneously determining the level of the suitable buffer). In this process, the Financial Stability Committee issues statements regarding the KNF procedure related to the identification of such institutions and the opinion concerning the identification and classification of institutions into categories determining the level of applied G-SII buffer.

In 2016, the Polish Financial Supervision Authority provided the Financial Stability Committee with the draft *Procedure determining the methodology for the identification of global systemically important institutions and for the definition of subcategories of global systemically important institutions*, asking it to present its position. Following a detailed analysis of the proposal, at its meeting on 13 May 2016, the Committee recognised the draft KNF procedure as compliant with the statutory requirements and the procedure for the identification of global systemically important institutions defined in the EU regulations<sup>27</sup> and adequate for identification of Polish global systemically important institutions.

Following the adopted procedure, the Polish Financial Supervision Authority did not identify G-SIIs on the Polish market, consequently, it did not impose the global systemically important institutions buffer.

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<sup>24</sup> <http://www.nbp.pl/nadzormakroostroznosciowy/publikacje.aspx>

<sup>25</sup> The threat would be high mainly if the country remained in the expansion phase over a long period.

<sup>26</sup> In accordance with the recommendations of the Basel Committee on Banking Supervision and the European Systemic Risk Board, the countercyclical capital buffer should be created whenever the value of credit gap is positive and exceeds 2%; however, it should not be the only factor taken into consideration.

<sup>27</sup> Commission Delegated Regulation (EU) 1222/2014 of 8 October 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for the specification of the methodology for the identification of global systemically important institutions.

#### **5.4. Other systemically important institutions buffer**

The application of the other (i.e. domestic) systemically important institutions (O-SII) buffer remains within the competence of the Polish Financial Supervision Authority. It identifies other systemically important institutions and imposes O-SIIs buffers on them. Under this process, the KNF, while performing such assessment, should consider the FSC-M recommendation regarding the importance of other systemically important institutions.

At the same time, the Act on macroprudential supervision imposes the obligation on the KNF to notify, through the Financial Stability Committee, relevant institutions and authorities of the European Union as well as the domestic macroprudential supervision institutions concerned of the intention to impose the other systemically important institutions buffer and the level of such a buffer rate.

##### **Committee's Recommendation regarding the systemic importance of Other Systemically Important Institutions**

At its meeting on 13 May 2016, the Financial Stability Committee in its macroprudential capacity passed a resolution recommending the KNF the application of the relevant guidelines of the European Banking Authority<sup>28</sup> for the assessment of systemic importance of O-SIIs, and indicated that due to the specific nature of the Polish banking sector, the following additional aspects should be taken into account in the process of identification of other systemically important institutions:

- considering all banks and branches of credit institutions when calculating the reference values for individual mandatory indicators;
- applying the threshold of 350 basis points for the identification of other systemically important institutions based on mandatory indicators;
- using an optional indicator of the importance of an institution for the institutional protection scheme.

The Committee recommended annual identification of other systemically important institutions.

##### **Opinion on the identification of other systemically important institutions**

Having considered the recommendation, on 1 August 2016, the KNF requested the FSC-M to issue the opinion on the identification of 12 banks as other systemically important institutions and imposition of the relevant capital buffers on them.

Having assessed the KNF's proposal and agreed on the draft statement, at its meeting on 10 August 2016 the Committee issued, based on the KNF's request, twelve separate opinions on the recognition of banks indicated by the Commission as other systemically important institutions

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<sup>28</sup> Guidelines of the European Banking Authority of 16 December 2014 on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (EBA/GL/2014/10).

and imposition of the proposed buffers on them. The opinions of the Committee were submitted to the Polish Financial Supervision Authority as well as to the banks concerned. The Polish Financial Supervision Authority, under administrative decisions adopted on 4 October 2016, identified banks presented in Table 4 as other systemically important institutions and imposed the relevant buffers on them.<sup>29</sup>

**Table 4. Banks identified as other systemically important institutions**

BANK	PROPOSED O-SII BUFFER
Powszechna Kasa Oszczędności Bank Polski S.A.	0.75%
Bank Polska Kasa Opieki S.A.	0.75%
mBank S.A.	0.5%
Bank Zachodni WBK S.A.	0.5%
ING Bank Śląski S.A.	0.5%
Bank Handlowy w Warszawie S.A.	0.25%
Bank Millennium S.A.	0.25%
Bank BGŻ BNP Paribas S.A.	0.25%
Raiffeisen Bank Polska S.A.	0.25%
Getin Noble Bank S.A.	0.25%
Bank Polskiej Spółdzielczości S.A.	0%
SGB-Bank S.A.	0%

Source: NBP study.

#### **Information on the intention to impose the other systemically important institutions buffer and the level of such buffer's rate**

In order to fulfil the notification duty, on 8 July 2016, the Polish Financial Supervision Authority requested the Financial Stability Committee to notify the intention to impose the other systemically important institutions buffer to the European Commission, the European Systemic Risk Board, the European Banking Authority and the competent authorities responsible for macroprudential supervision in the Member States concerned, i.e.: Bundesanstalt für Finanzdienstleistungsaufsicht, Banco de Portugal, Banco de España, Banca d'Italia, De Nederlandsche Bank, Finanzmarktaufsicht Österreich and L'Autorité de contrôle prudentiel et de résolution. On 20 July 2016, the Chairperson of the FSC-M issued the relevant notifications.

On 7 October 2016 the Polish Financial Supervision Authority informed the Financial Stability Committee of the adoption of administrative decisions concerning the identification of other systemically important institutions and imposition of relevant buffers. At the same time, the KNF requested the FSC-M to notify this fact to the European Commission, the European Systemic Risk Board, the European Banking Authority. On 19 October 2016, the Chairperson of the FSC-M sent the required information.

<sup>29</sup> [https://www.knf.gov.pl/Images/institucje\\_o\\_znaczeniu\\_systemowym\\_OSII\\_14\\_11\\_2016\\_tcm75-48623.pdf](https://www.knf.gov.pl/Images/institucje_o_znaczeniu_systemowym_OSII_14_11_2016_tcm75-48623.pdf)

## 5.5. Recommendation on the restructuring of the portfolio of FX housing loans

One of significant subjects related to the stability of the domestic financial system dealt with by the FSC-M in 2016 was the issue of the portfolio of FX housing loans.

In the Committee's opinion, in economic terms, the portfolio of FX housing loans does not generate a significant risk to financial system stability.<sup>30</sup> The situation of the vast majority of households which had taken FX loans is good and their resilience to further currency exchange shocks – high. This is associated with higher initial income buffers, a high rise in nominal wages in the period following loan origination as well as lower interest rates in foreign currencies. Consequently, FX housing loans are repaid well and the impaired loans ratio as of the end of 2016 is only slightly higher than for zloty loans.

At the same time, the FSC-M recognised that systemic risk generated by such portfolios must not be disregarded in the context of potential effects of statutory solutions raised in the public debate, assuming mandatory currency conversion of loans to the zloty, in particular, at a rate significantly deviating from the current market rate.

Due to identified conditions and risk factors, the FSC-M considered necessity of the restructuring of FX housing loans on the basis of voluntary agreement between banks and borrowers, in particular, in the case of those who have to cope with a difficult financial situation due to circumstances beyond their will.

On the basis of a comprehensive assessment of the risk associated with the portfolio of FX housing loans, on 13 January 2017 the FSC-M passed the resolution on the recommendation regarding the restructuring of this portfolio.<sup>31</sup>

The recommended instruments were adjusted so that, on the one hand, they should impose an adequately high burden prompting banks to undertake restructuring measures and, on the other hand, they should not result in the decline of banks' resilience and the stability of the entire banking sector. The Committee mainly recommended a significant increase in effective burden of the capital requirements on the portfolio of FX housing loans as well as introduction of other measures supporting the process of voluntary restructuring of those loans.

The implementation of the complex recommendation of the FSC-M should create incentives prompting banks and their clients to undertake individual measures aimed at restructuring of FX housing loans. Due to the voluntary nature of the restructuring, this process will be implemented gradually and, consequently, it will not disrupt the financial stability of the country. The

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<sup>30</sup> Detailed arguments are presented in the justification to Resolution No 14/2017 of the FSC of 13 January 2017 on the Recommendation regarding the restructuring of the portfolio of FX housing loans.

<sup>31</sup> Resolution No 14/2017 of the Financial Stability Committee of 13 January 2017 on the Recommendation regarding the restructuring of the portfolio of FX housing loans.

prerequisite for the success of the voluntary restructuring process is also a lowering of expectations about the potential mandatory conversion of loans, which currently discourage borrowers and creditors from entering into voluntary agreements.

**Table 5. FSC-M recommendations broken down according to addressees**

ADDRESSEE	RECOMMENDATION
<p style="text-align: center;">MINISTER OF FINANCE</p>	<ul style="list-style-type: none"> <li>• Raising to 150% the risk weight for FX housing loans at banks using the standardised approach for estimation of the capital requirement</li> <li>• Increasing the minimum LGD parameter for banks using the internal ratings-based approach for estimation of the capital requirement</li> <li>• Introducing changes in the rules of operation of the Borrowers' Support Fund leading to an increased use of funds for the support of financially distressed borrowers and also their additional allocation to support the process of voluntary restructuring of the portfolio of FX housing loans</li> <li>• Development of adequate solutions neutralising potential excessive tax burdens which may occur as a result of the restructuring of FX housing loans</li> <li>• Imposing the systemic risk buffer of 3% applicable to all exposures on the territory of the Republic of Poland</li> </ul>
<p style="text-align: center;">POLISH FINANCIAL SUPERVISION AUTHORITY</p>	<ul style="list-style-type: none"> <li>• Updating of the Methodology of Supervisory Review and Evaluation Process of Commercial, Associating and Cooperative Banks (BION methodology) and its extension so as to enable imposing additional capital requirements due to risk factors associated with the portfolio of residential mortgage loans in foreign currency, not considered so far (operating risk, market risk and risk of collective default of borrowers)</li> <li>• Supplementing additional capital requirements currently used under Pillar II, associated with operating risk, market risk and risk of collective default of borrowers</li> <li>• Issuing the supervisory recommendation on good practices with regard to restructuring of the portfolios of FX housing loans</li> </ul>
<p style="text-align: center;">BANK GUARANTEE FUND</p>	<ul style="list-style-type: none"> <li>• Taking into consideration the risk associated with FX housing loans in the method of determining contributions to the bank guarantee fund</li> </ul>

Source: NBP study.

## 6. International cooperation

International cooperation is an essential aspect of the Committee's work. As domestic financial systems in the European Union are closely interlinked, the autonomous macroprudential policy should also take the European aspects into account.

As part of international cooperation, the Financial Stability Committee, being the macroprudential supervision authority in Poland, maintains relations and cooperates with external institutions, mainly with the European Systemic Risk Board (ESRB) which is responsible for pursuing the macroprudential oversight at the EU level. The ESRB monitors the state of play on the implementation of recommendations issued by it and measures related to the application of macroprudential instruments undertaken in the European Union Member States. Through its website, the ESRB provides access to such information to all stakeholders. In addition, the Committee usually addresses notifications similar to those submitted to the ESRB, the European Commission, the European Central Bank and the European Banking Authority.

In 2016 the Financial Stability Committee implemented the following three significant recommendations issued by the European Systemic Risk Board<sup>32</sup>:

### 6.1. ESRB recommendation on intermediate objectives

The ESRB recommendation on intermediate objectives and instruments of macroprudential policy<sup>33</sup> issued in 2013 imposes, among others, the following duties on national macroprudential supervision authorities:

- the obligation to define and achieve operational objectives supervisory authorities shall pursue to achieve the ultimate objective- financial stability (Recommendation A);
- selection of macroprudential instruments (Recommendation B);
- developing the macroprudential policy strategy under which the macroprudential authority intends to act (Recommendation C);

In accordance with the schedule, the recommendation should have been implemented by 31 December 2014 in parts A and B and by 31 December 2015 in part C. For reasons beyond control of the Committee<sup>34</sup> the recommendation was implemented in 2016.

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<sup>32</sup> ESRB recommendations are addressed to specific entities, including national banking supervision bodies. Prior to the establishment of the Financial Stability Committee in the area of macroprudential supervision, responses to the recommendations were provided by individual institutions currently associated within the FSC-M. In 2016, it became possible to submit to the ESRB the assessment concerning the implementation of the recommendation (ESRB/2012/2) on funding of credit institutions addressed to: national supervisory authorities with responsibility for banking supervision, EBA, national supervisory authorities and other authorities with a macroprudential mandate). At the beginning of 2017, the ESRB evaluated the fulfilment of this recommendation by Poland as *largely compliant*. The PFSA was responsible for delivering to the ESRB a report on the application of part A, B, C and E of the recommendation, excluding part A.3 of the recommendation addressed jointly to: supervisory authorities and other authorities with a macroprudential mandate, i.e. PFSA and FSC-M.

<sup>33</sup> Recommendation of the European Systemic Risk Board of 4 April 2013 *on intermediate objectives and instruments of macroprudential policy* (ESRB/2013/1).

At its meeting in May, the FSC-M defined its intermediate objectives, indicated the directions of their operational implementation, covered all required systemic risk areas and adjusted them to the specific nature of the Polish economy. The macroprudential policy strategy was developed and published on the website in *Macroprudential supervision in Poland - institutional and functional framework*. Information on the undertaking of the relevant measures aimed at implementing the recommendations on intermediate objectives was submitted to the ESRB.

**Box 2.**

**Compliance report on ESRB Recommendation on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1)**

In February 2017, the ESRB published a report that provided an assessment of the level of implementation of the Recommendation on intermediate objectives and instruments of macroprudential policy.

**Assessment of the level of implementation of Recommendation ESRB/2013/1 by selected Member States**

Country	Overall grade	Recommendation A	Recommendation B	Recommendation C
Bulgaria	FC	FC	FC	LC
Croatia	FC	FC	FC	LC
Czech Republic	LC	LC	LC	PC
Estonia	FC	FC	FC	FC
Lithuania	FC	FC	FC	FC
Latvia	FC	FC	FC	FC
Poland	FC	FC	FC	FC
Romania	FC	FC	FC	FC
Slovakia	FC	FC	FC	FC
Slovenia	FC	FC	FC	FC
Hungary	FC	FC	FC	FC

The degree of compliance with the recommendation

FC	Fully Compliant
LC	Largely Compliant
PC	Partially Compliant
MN	Materially Non-compliant
NC	Non-compliant

Source: NBP study.

The evaluation was based on information submitted to the ESRB by the EU Member States. The results of the implementation are very good. None of the countries received a negative evaluation of undertaken measures (*Non-Compliant*). The majority of recommendation addressees obtained the

<sup>34</sup> The FSC became a macroprudential authority upon entry into force of the Act on macroprudential supervision on 1 November 2015.

highest grade for the implementation of each of the sub-recommendations (*Fully Compliant*). Only three of the evaluated states have not yet regulated the institutional issues associated with macroprudential policy – Romania, Italy and Spain, accordingly in those cases the ESRB conducted an evaluation of measures undertaken by authorities temporarily performing the macroprudential mandate. **Poland obtained the highest grade for each of the sub-recommendations.**

## 6.2. ESRB recommendation on the principle of reciprocity

At the beginning of 2016, the ESRB published the Recommendation on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/2), regulating the method of application of the mechanism of reciprocity for macroprudential instruments. The recommendation commits all EU Member States to adopt, on a voluntary basis, macroprudential instruments which are introduced by other Member States. The symmetric application of those instruments and reducing regulatory arbitrage is to ensure the effectiveness of measures mitigating systemic risk. During the year, Belgium and Estonia submitted requests to the ESRB on the application of the principle of reciprocity in relation to macroprudential instruments introduced in those countries. It resulted in supplementing the applicable general recommendation by introducing additional elements related directly to Belgium<sup>35</sup> and Estonia<sup>36</sup>.

By implementing the recommendation in the case of **Belgium**, the Financial Stability Committee performed the analysis of exposures of Polish credit institutions secured by residential property on the territory of the country (in accordance with the recommendation), and subsequently, due to the lack of such exposures, it decided not to take action. The relevant information was sent to the ESRB.

In the case of **Estonia**, the analyses were also performed and due to the lack of significant exposures of the Polish banking sector in Estonia, the Committee found that also in that case it is not necessary to reciprocity the macroprudential measure introduced and informed the ESRB of this fact.

## 6.3. ESRB recommendation on the identification of third countries

At the beginning of 2016, the ESRB published the Recommendation on recognising and setting countercyclical buffer rates for exposures to third countries (ESRB/2015/1). The aim of the recommendation is to harmonise the principles of recognising and setting countercyclical buffer rates in relation to non-EU states – third countries. One of the sub-recommendations refers to the setting of countercyclical buffer rates for exposures to third countries (Recommendation B) and

<sup>35</sup> Recommendation of the European Systemic Risk Board of 24 March 2016 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2016/3).

<sup>36</sup> Recommendation of the European Systemic Risk Board of 24 June 2016 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2016/4).

includes the obligation to identify material third countries on an annual basis and submit a list of such material third countries to the ESRB. Moreover, national macroprudential authorities should monitor risks from excessive credit growth in material third countries (at least on an annual basis), except for countries which are already monitored directly by the ESRB.<sup>37</sup>

For the purpose of the materiality assessment of third countries, the Financial Stability Committee adopted a formula based on the rules proposed by the ESRB, according to which exposure is material if the average share of a given country in the total exposure of the Polish banking sector over 8 quarters exceeds 1% and, at the same time, the share of this country in each of the last 2 quarters exceeds 1%. The analysis of the data, based on the adopted methodology, indicates that no third country is material in terms of exposures of the Polish banking sector. The information was submitted to the ESRB. The monitoring of third countries is conducted by Narodowy Bank Polski.

**Table 6. The highest exposures of Polish banks**

COUNTRY	Average share in 8 quarters	Exposure > 1% in the last 2 quarters	Exposure qualification
United Kingdom	1.10%	no	immaterial
France	0.91%	no	immaterial
Germany	0.48%	no	immaterial
United States	0.22%	no	immaterial
Czech Republic	0.19%	no	immaterial

Source: NBP.

## 7. Communication – domestic and foreign

The communication policy has a significant impact on the expectations and behaviour of entities operating on the financial market. The FSC-M pursues its tasks in this area based on the principle of transparency, demonstrated by publishing decisions significant for the implementation of the macroprudential supervision objective. Moreover, the FSC-M publishes analytical materials based on which it takes decisions and which allow market participants to independently assess the developments in the financial system. In FSC-M's opinion, informing of identified systemic risk is one of the major tasks aimed at protecting financial stability. It results from the fact that the

<sup>37</sup> In accordance with the ESRB decision of 11 December 2015 on the assessment of materiality of third countries for the Union's banking system in relation to the recognition and setting of countercyclical buffer rates (ESRB/2015/3), the states recognised as material and, at the same time, monitored by the ESRB include: Brazil, China, Hong Kong, Russia, Turkey and United States.

awareness of risk incidence among market participants may reduce the scale of risk-taking and, additionally, it usually makes consequences of its materialisation less severe. To increase access to information, the Committee uses the website as a channel for communication with the public and financial market participants.

The legal solutions adopted in the Act on macroprudential supervision, based on which the Financial Stability Committee pursues its communication policy in its macroprudential activity, and the standards used by the FSC-M are compliant with the recommendations of the European Systemic Risk Board.<sup>38</sup>

### **7.1. Press releases of the Committee**

The press release is the basic tool for informing the public of activities of the Committee. After each meeting, the FSC-M publishes a press release delivering information on the subjects discussed at the meeting and the decisions taken. In press releases, the FSC-M provides its assessment of discussed macroprudential developments in the context of their impact on financial system stability.

Immediately after concluding of the meeting, a press release adopted by the FSC-M is posted on the main page of Narodowy Bank Polski website and under the “Macroprudential supervision” tab.

### **7.2. Website – extension and materials posted**

In fulfilment of its obligations to provide services to the FSC-M, NBP created a tab devoted to macroprudential supervision on its website.<sup>39</sup>

Under this tab, basic information concerning the FSC-M is published, among others, the composition and tasks of the Committee. It also comprises the most significant legal issues and definitions arising from the Act on macroprudential supervision, information on macroprudential instruments currently used in Poland (including a special area devoted to the countercyclical buffer) as well as materials and documents of an educational nature concerning systemic risk and macroprudential supervision considered as important by the Financial Stability Committee in terms of its policy.

Parallel to the development of its activity, FSC-M expands the scope of its communication with the environment, perceiving it as a significant instrument shaping the conditions for financial system stability. As part of the activity, the tab related to the *Countercyclical buffer* was expanded,

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<sup>38</sup> Recommendation of the European Systemic Risk Board of 22 December 2011 *on the macro-prudential mandate of national authorities* (ESRB/2011/3).

<sup>39</sup> <http://www.nbp.pl/nadzormakroostroznosciowy/index.aspx>

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a new tab on *Macroprudential instruments* was added, containing information on the *Conservation buffer* and on *Other systemically important institutions buffer*.

In order to enhance the transparency of its activities, the FSC-M decided to publish analytical materials based on which it takes decisions concerning macroprudential instruments on the website. It refers, in particular, to materials providing basis for findings relating to the level of the countercyclical buffer rate. Document *Countercyclical capital buffer and models of early warning against the banking crisis. Application for Poland* contains a description of the methodology used for determining the countercyclical buffer. Moreover, information on the level of the buffer and background for its calculation is published on a quarterly basis.

### **7.3. Notifications addressed to EU institutions and authorities**

The tasks of the Financial Stability Committee in its macroprudential activity include notification of the European Systemic Risk Board, the European Commission, the European Banking Authority or macroprudential authorities from the Member States concerned, on the introduction of a specific macroprudential instrument, the intention to introduce it, or the change of its level.

On a quarterly basis, the FSC-M fulfils the statutory obligation to notify the European Systemic Risk Board of the level of the applicable countercyclical buffer rate. This obligation is performed through the application of the ESRB Epsilon IT system, accessible by Narodowy Bank Polski. Information provided is published on the ESRB website.

**Table 7. Notifications by the FSC-M**

	SUBJECT OF NOTIFICATION	ADDRESSEE	NOTIFICATION DATE
1.	Quarterly information on the level of the countercyclical buffer rate	ESRB	February, May, August, December 2016
2.	Report on measures undertaken to implement the recommendation on the guidelines for determining the countercyclical buffer rates	ESRB	June 2016
3.	Intention to impose the Other Systemically Important Institutions buffer	EC, ESRB, EBA, macroprudential authorities concerned	July 2016
4.	List of third countries to which material exposures of Polish financial institutions occurs	ESRB	August 2016
5.	Report on the impact assessment of credit institutions' financing plans on the flow of credit to the real economy	ESRB	September 2016
6.	The principle of reciprocity in relation to the instrument used in Estonia – no exposures	ESRB	September 2016
7.	Information on identified other systemically important institutions and imposition of the relevant buffer on such institutions	EC, ESRB, EBA	October 2016
8.	The principle of reciprocity in relation to the instrument used in Belgium – no exposures	ESRB	October 2016
9.	Report on measures undertaken to implement the recommendation on intermediate objectives and instruments of macroprudential policy	ESRB	November 2016
10.	List of criteria set for the identification of countries to which material exposures occur	ESRB	December 2016
11.	Report on the methodology for monitoring of risk associated with excessive lending in third countries to which significant exposures occur	ESRB	December 2016
12.	Information on the implementation of changes in the strategy and communication rules taking into account decisions on countercyclical buffer rates in relation to third country exposure	ESRB	December 2016
13.	Information on the intention to impose a systemic risk buffer up to 3% and implementation of other macroprudential instruments	EC, ESRB, EBA	January 2017

Source: NBP.

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## Glossary

BFG	Bank Guarantee Fund (Bankowy Fundusz Gwarancyjny – BFG)
Countercyclical capital buffer	A countercyclical capital buffer is an additional capital requirement imposed on institutions (banks) in order to increase the resilience of the banking system to cyclical fluctuations of systemic risk. Pursuant to Article 83 of the Act of 5 August 2015 on macroprudential supervision of the financial system, the countercyclical buffer in Poland amounts to 0% as long as it is changed by the minister competent for financial institutions by means of the regulation.
Global Systemically Important Institutions buffer	An additional capital requirement maintained by global systemically important institutions.
Other Systemically Important Institutions buffer	An additional capital requirement maintained by other systemically important institutions.
Systemic risk buffer	An additional capital requirement maintained by institutions, which serves to prevent and mitigate of long-term non-cyclical risk or macroprudential risk which may result in strong adverse consequences for the financial system and for the economy of a given country.
Conservation buffer	An additional capital requirement aimed at increasing the resilience of institutions. Pursuant to Article 19 of the Act on macroprudential supervision, institutions are obliged to maintain a conservation buffer amounting to 2.5% of the total risk exposure. The Act introduced a transitional period in the application of this buffer, in accordance with which its level amounted to 1.25% in 2016.
Intermediate objectives	Intermediate objectives include, among others: mitigation of risk arising from excessive growth or size of debt or leverage, excessive maturity mismatch of assets and liabilities of financial institutions or of the risk of illiquidity of financial markets, excessive concentration of exposures to entities or risk factors and the related interconnectedness between financial system entities, misaligned incentives influencing the behaviour of financial institutions or their clients and ensuring the adequate resilience of the financial infrastructure; Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1). Compliance Report on Recommendation ESRB/2013/1 on intermediate objectives and instruments of macroprudential policy.
CRR	Capital Requirements Regulation; Regulation of the European Parliament and of the Council (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (OJ L 176, 2013, p. 1).
CRD IV	Capital Requirements Directive IV; Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (OJ L 176, 2013, p. 338).
ECB	European Central Bank
EPSILON	<i>ESRB CCB Notification System</i> . The system was launched by the ESRB Secretariat on 1 January 2016.

## Glossary

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ESRB	European Systemic Risk Board
EBA	European Banking Authority
GRKW	Working Group on the Risk of FX Housing Loans (Grupa Robocza ds. Ryzyka Walutowych Kredytów Mieszkaniowych – GRKW)
G-SII	Global Systemically Important Institution
KNF	Polish Financial Supervision Authority
Third countries	Material third country – a third country to which institutions operating under the licence granted in a given country has material exposures.
FSC	Financial Stability Committee
FSC-M	Financial Stability Committee as a macroprudential authority
FSC-C	Financial Stability Committee for crisis management
MF	Minister of Finance
NBP	Narodowy Bank Polski
O-SII	Other Systemically Important Institution, in accordance with Article 39(1) of the Act on macroprudential supervision, the Polish Financial Supervision Authority identifies other systemically important institutions and imposes Other Systemically Important Institutions buffer on them. Within the identification process (i.e. the assessment of systemic importance of other systemically important institutions), the FSA takes into consideration, among others, the FSC-M recommendation regarding the systemic importance of other systemically important institutions.
SGR	Permanent Working Group
Stress tests	The aim of these tests is the assessment of banking sector response to the extremely unfavourable and highly unlikely economic scenario. Due to this type of analyses, examining of banking sector resilience is possible.
EU	European Union