

The Role of a Central Bank in Maintaining Financial Stability: Case of Poland

National Bank of Poland
First Deputy President
Jerzy Pruski

NBP

National Bank of Poland

Overview

- History in brief
- Current institutional arrangements
- Macro-prudential analysis: financial sector analysis & risk assessment
- Micro-prudential supervision
- Payment system analysis & oversight
- Communication with the public
- Future challenges

History in brief:
Evolution of the NBP's role
in safeguarding the financial sector stability

Banking system transformation in 1989-1990

- The mono-bank system replaced by two-tier banking system on the basis of new banking legislation
- NBP was ascribed functions typical for the central bank in a market economy – preserving the value of the *zloty* as a goal
- NBP became responsible for supervision of commercial & co-operative banks
- State Treasury extended explicit guarantee for deposit at *state banks*

The NBP`s role at that stage

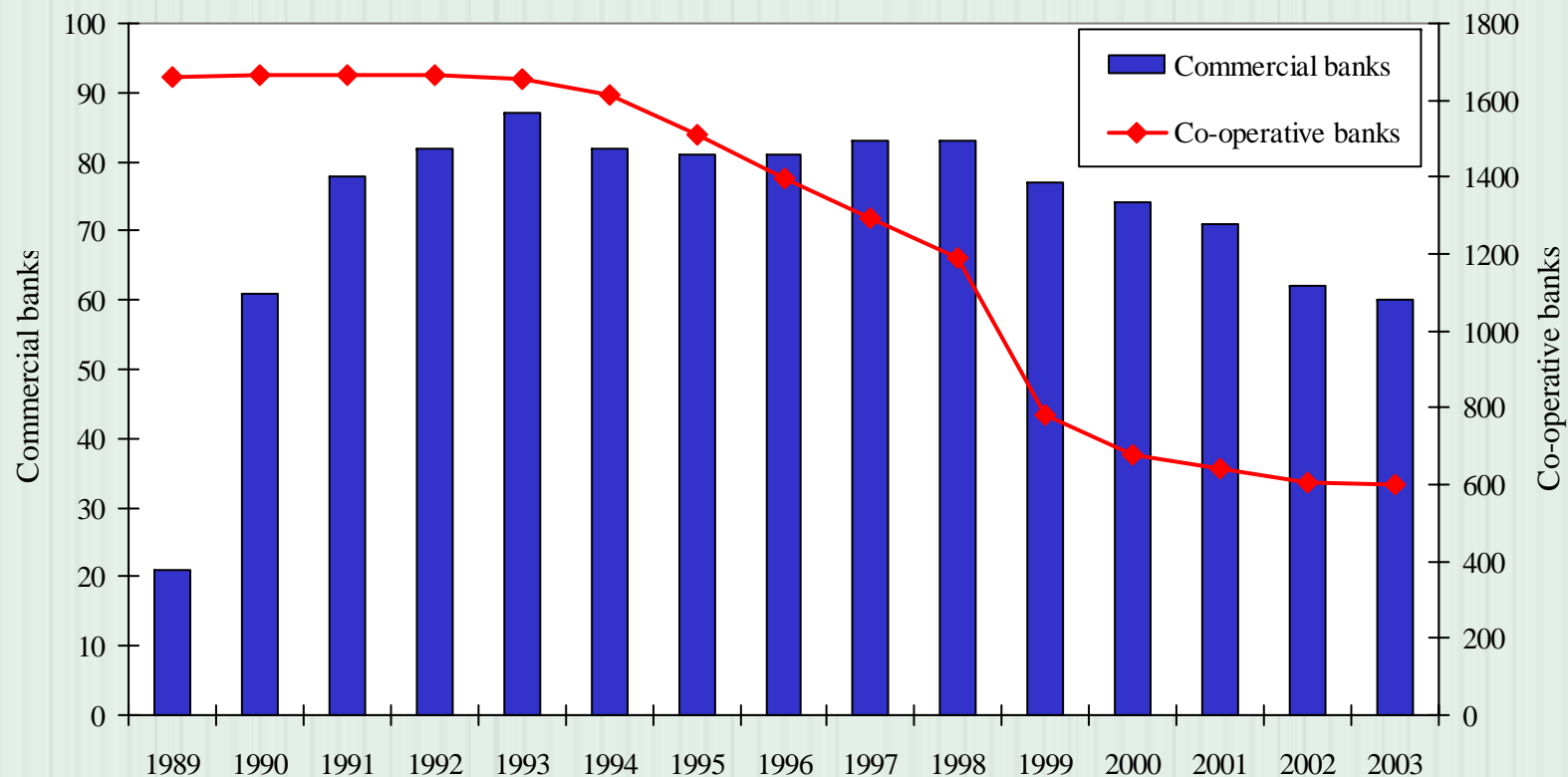
- NBP received extensive competencies in the supervisory function
 - Licensing banks
 - Setting up prudential norms
 - Monitoring banks` compliance with the law & NBP regulations
 - Collecting & analysing banks` financial data
 - Initiating corrective actions against banks in poor financial condition

The NBP`s role at that stage, cont.

- Developments in banking industry
 - Emergence of a number of banks - mostly weak, undercapitalized and poorly managed
 - Banks` clients and banks themselves adversely hit by unfavorable economic conditions
 - Risk management skills in many banks proved to be inadequate
 - Severe erosion of banking capital base as a consequence of high inflation and NPLs

NBP's role at that stage, cont.

Number of banks 1989-2003



NBP's role at that stage, cont.

- Key danger perceived: immature banking sector
 - Accumulation of non-performing assets
 - Likelihood of liquidity problems leading to bank runs and a domino effect, potentially resulting in public confidence loss
- The need to protect the depositors of *private banks* left without any coverage
 - Equal treatment
 - Stability issues
- The NBP involvement in banks restructuring and in providing the financial assistance

The NBP`s role at that stage, cont.

- NBP involvement in bank restructuring
 - Direct participation – taking over of a regional (e.g. PKBL) or a local bank (e.g. Prosper Bank)
 - Indirect participation – granting the financial, conditional assistance to banks taking over the other banks or to stand alone banks

The NBP`s role at that stage, cont.

- NBP`s financial assistance to *private* banks
 - Forms
 - acquisition of bills and/or bonds issued by the bank undertaking the rehabilitation (low yielding, below the market rates)
 - temporary suspension of reserve requirements
 - Amount: PLN 534 Million in 1993-1994
- The government`s assistance to *state-owned* banks in that period: PLN 2 Billion (*in the form of restructurisation bonds*)

History in brief:

Change in the NBP policy - consequence of a growing number of banks in distress as well of realizing of emergence of moral hazard problem

Adopted policy

- Temporary and partial suspension of granting new banking licenses in the period 1992-1994
- Cleaning up the system from inefficient institutions - decision to file for bankruptcy or to liquidate many small banks in 1993-1994 (7 banks in 1994 alone)

History in brief:

Replacement of the blanket guarantees of
the Treasury & NBP and establishing
the Bank Guarantee Fund

Development of the *Safety Net*

- Up to 1994, bank deposit guarantee function performed by:
 - State Treasury
 - NBP
- Bank Guarantee Fund established in 1994
 - Deposit guarantee function taken over from the NBP
 - Guarantee responsibility of the Treasury considerably reduced and eventually abandoned (in 1999)

Current institutional arrangements

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Current institutional arrangements

Institutions involved in promoting financial stability in Poland:

- National Bank of Poland
- Supervisory agencies:
 - Commission for Banking Supervision (since 1998)
 - Securities and Exchange Commission (since 1991)
 - Insurance and Pension Funds Commission (1996, 1999)
- Bank Deposit Guarantee Fund (since 1995)

The legal basis for the NBP`s role

- Responsibility for financial stability not explicitly stated in the law – but increasingly perceived by the NBP as an important task
- The Act on NBP (1997) „The responsibilities of the NBP shall also include:
 - organising monetary settlements,
 - regulating the liquidity of the banks and providing them with refinancing facilities,
 - establishing the necessary conditions for the development of the banking system

Arrangements within the organisational structure of the NBP

- General Inspectorate of Banking Supervision (operational arm of the CBS)
 - Micro-prudential analysis, inspections
- Financial System Department (since June 2002)
 - Macro-prudential analysis
- Payment System Department
 - Payment and settlement system analysis & oversight
- Domestic Operations Department
 - Liquidity assistance

Macro-prudential analysis: financial sector analysis & risk assessment

Main areas of financial sector analysis

- Focus on the banking sector
(80% of Polish financial system assets)
- Other financial institutions
 - Pension funds
 - Insurance companies

Macroeconomic environment analysis

Household sector

- Financial situation – wages and unemployment rate monitoring
- Net debt and debt burden analysis

Corporate sector

- Credit demand, financial situation and debt level monitoring
- Analysis of debt and interest payment burden

Banking sector surveillance

- Credit risk
- Market risks
- Asset price risk
- Liquidity risk
- Banks' earnings analysis
- Capital position & risk-absorption capacity

Banking sector surveillance, cont.

- Credit risk
 - Monitoring portfolio quality
 - Stress tests using both aggregate and individual (large exposures) data: assessment of the impact of unfavorable macroeconomic scenarios on banks' loan losses and portfolio quality

Banking sector surveillance, cont.

- Market risk
 - Monitoring FX and interest rate markets
 - Value at Risk analysis
- Asset price risk
 - Monitoring equity-related exposures
 - Analysis of exposures to the housing market
 - Monitoring housing prices
- Liquidity risk
 - Analysis of funding sources, liquidity gap and market liquidity

Banking sector surveillance, cont.

- Banks' earnings analysis
 - Current and prospective profitability
 - Structure of income and costs
- Capital position & risk-absorption capacity
 - Monitoring capital adequacy & capital structure
 - Analysis of loan losses absorption capacity under assumed scenarios of loan quality deterioration

Micro-prudential supervision

Micro-prudential supervision

- On-going on-site and off-site examinations
- Consolidated supervision
- Supervisory profile of individual banks (quarterly)
- Special surveys – according to market developments
- Quarterly bank rating and rating panel
- Overall executive summary of the key warning signals and outlook for banks

Payment system analysis & oversight

Payment & settlement system

- System of analysis & oversight
 - Assessing functioning of payment systems
 - Co-operation with payment system providers and customers
 - Collecting statistical data and information
 - Initiating actions towards development of safe and efficient payment systems

Communication with the public

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Communication with the public

- Financial Stability Report/Review
(annually since 2002, now semi-annually)
- Report on Development of Financial System
(annually)
- Banking Sector Performance - A Synthesis
(quarterly)
- Payment System in Poland (periodically)

Future challenges

Challenges for the future

- Banking sector structure after EU accession
 - Potential risk of transformation of systematically important banks - mostly owned by foreign capital - into branches
 - Entrance of new branches (*single passport* principle – *Directive 2000/12/EC of the European Parliament*)
 - Limited authority of national supervisors over these branches
 - *Home country control* but *host country responsibility* for systemic stability

Challenges for the future, cont.

- Crisis management concerns – the EU level
 - Use of host taxpayers' money to bail out foreign banks as they are systematically important
 - Potential conflict of interests between a home country and a host country in the resolution of banking problems

Challenges for the future, cont.

- Possibly greater role of financial conglomerates
 - Consolidated supervision issues
- Implementation of new regulations
 - New Basel Capital Accord (CAD III)
 - International Financial Reporting Standards

Other financial stability implications

- Potential increase in capital flows into Polish markets with effects on market risks and vulnerability of economy and financial markets to potential shocks
- Impact of the possible change of classification of capital-based pension funds on their ability to diversify their investments, but also on current macroeconomic risks