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

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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 złoty 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
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)
• 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
Communication with the public

- 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
  – 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