Polish Financial Supervision Authority

15 December 2015

KNF stand on banks' dividend policy

On 15 December 2015 the Polish Financial Supervision Authority (KNF) took a stand on:

- 2015 **dividend policy** of banks in 2016.

When analyzing the measures taken by KNF with regard to banks' dividend policy over the past few years, it can be concluded that, combined with other prudential initiatives, they ensured the continuous growth of banks' own funds. Between 2010 and 2014, own funds of the bank sector increased by PLN 37.8 billion or 38.1%. Strong capital base provided for continuous, stable development and lending growth, which was reflected in the banks' financial performance. A positive assessment of the Polish banking sector as stable and actively supervised is reflected in the quality of its external ratings, including those issued by rating agencies. This ensures the banks more opportunities to obtain financing for their activities on favourable conditions.

In order to ensure further operational stability of Polish banks, KNF recommends adopting a dividend policy which will strengthen the banks' capital base and bring it to the level recorded at other EU states.[1]

Based on their financial results as at 31 December 2015, each bank will receive individual recommendations for dividend policy in a letter from the Chairman of the Polish Financial Supervision Authority.

Irrespective of the above, KNF will request the Financial Stability Committee (KSF), as the authority responsible for macroprudential oversight within the meaning of the Act of 5 August 2015 on macroprudential oversight over the financial system and crisis management in the financial system, to express its opinion on the capital position and dividend policy of banks with a share in the market for non-financial sector deposits in excess of 5%.

I. Dividend payment criteria for commercial banks

1. It is recommended that dividends are paid out only by banks which:
   - are not implementing a recovery programme,
   - received a positive score in the Supervisory Review and Evaluation Process (SREP, Polish: BION) – final SREP score of no less than 2.5,

[1] Information on the capital adequacy of banks from other European countries and Poland are presented in Item III and IV below.

- ➢ have a Leverage Ratio (LR)[2] above 5%, Tier 1 capital ratio increased by security capital:[3]
- ➢ banks with a share in the market for non-financial sector deposits in excess of 5% with Tier 1 capital ratio increased by security capital above 13.25% plus 75% of possible capital surcharge for foreign currency loan risk imposed individually by KNF on 23 October 2015[4].
- ➢ other commercial banks – with Tier 1 capital ratio increased by security capital above 11.25% plus 75% of possible capital surcharge for foreign currency loan risk, imposed individually by KNF on 23 October 2015[5].

2. It is recommended that up to 50% of generated profit be paid out by banks which comply with regulatory expectations regarding the level of total capital ratio, i.e. with total capital ratio above 13.25% plus 100% of possible capital surcharge for foreign currency loan risk, imposed individually by KNF on 23 October 2015.
3. It is recommended **that up to 100% of generated profit** be paid out by banks which comply with regulatory expectations regarding the level of total capital ratio increased by security capital:
   - ➢ banks with a share in the market for non-financial sector deposits in excess of 5% with total capital ratio above 16.25% plus 100% of possible capital surcharge for foreign currency loan risk imposed individually by KNF on 23 October 2015,
   - ➢ other commercial banks with total capital ratio above 14.25% plus 100% of possible capital surcharge for foreign currency loan risk, imposed individually by KNF on 23 October 2015.

II. Dividend payment criteria for affiliating and cooperative banks

Affiliating banks are subject to general terms of the dividend policy, applicable to other banks operating as joint-stock companies.

Just as in previous years, individual regulatory measures will be taken with regard to cooperative banks which do not meet the criteria of dividend payout from net profit for 2015.

Apart from the general criteria, the regulator's stand on dividend payout by specific cooperative banks will also take into account the proportionality rule, based mainly on the specific legal and

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[2] Pursuant to Article 429 CRR the Leverage Ratio (LR) is defined as the relation of Tier 1 capital to total exposure. Unlike the solvency ratio, LR does not differentiate between risk weights depending on the asset type.

[3] For the purposes of dividend policy, security capital is defined as 3 percentage points above the Tier 1 capital ratio recommended by KNF and the level of total capital ratio for banks with a share in the market for non-financial sector deposits in excess of 5% and 1 percentage point for other banks. According to the letter of KNF to banks dated 22 October 2015 in connection with the introduction of security capital as of 1 January 2016, the required level recommended by KNF is 10.25% for Tier 1 capital ratio and 13.25% for total capital ratio, so these values are increased by 3 percentage points or 1 percentage point on account of security capital.

[4] For example, for a bank with a share in the market for non-financial sector deposits in excess of 5% which received 1 percentage point of capital surcharge for foreign currency loans from KNF, the Tier 1 capital ratio above which the bank will be able to pay out dividends equals 10.25% + 3 percentage points + (1 percentage point x 0.75) = 14.00%.

[5] For example, for a bank with a share in the market for non-financial sector deposits below 5% which received 1 percentage point of capital surcharge for foreign currency loans from KNF, the Tier 1 capital ratio above which the bank will be able to pay out dividends equals 10.25% + 1 percentage point + (1 percentage point x 0.75) = 12.00%.

organizational conditions of those banks, as well as their relationship with the existing affiliations and Institutional Protection Schemes (IPS).

The dividend policy of cooperative banks should take into account both the factor which increases capital risk, i.e. no possibility of classifying the share fund under equity, and the factor limiting capital risk, i.e. being part of a protection scheme. Operation under the existing protection scheme affiliations, which – pursuant to the Act on the functioning of cooperative banks, their affiliation and affiliating banks – will replace the banks in up to three years, secures their capital adequacy and (liquidity) support. The aid fund may, according to Article 5b of the Act, be used to increase CET1, to compensate for the inability of bank owners to offer capital support to their banks in the current formal and legal environment. Membership in a protection scheme, with mutual control and solidarity of the participants, will limit the risk of losses, compensate for the possible effects of business failures of cooperative banks and, through the internal sanction mechanisms, force banks with excessive risk exposures to change their operational model.

On the other hand, the possibility of limited dividend payout (depending on the bank's condition) at the majority of cooperative banks will limit shareholder exits and stimulate interest of cooperative members in the bank's activities (corporate oversight). Moreover, taking into account the needs related to reputation building, it will be possible to allocate a part of the 2014 net profit to social purposes defined in the articles of association of such cooperative banks.

Due to the above circumstances, there will be a possibility of limited profit distribution through dividend payout by cooperative banks with capital adequacy ratios below 13.25%, for total capital ratio, and/or below 10.25%, for Tier 1 capital ratio. Within the amount available for payment, banks will be able to decide on the ratio of the dividend amount to the funds designated for statutory purposes.

The cooperative banks which could pay out some of their net profit for 2015 can be divided into three groups:

1. The first group comprises banks which meet the recommended general criteria for commercial banks and have adequacy ratios above 13.25% for total capital requirement and above 10.25% for Tier 1 capital ratio. Such banks are not subject to any restrictions as to dividend payout for 2015.
2. The second group comprises independent banks or banks which have not joined the protection scheme, i.e. banks which have lost or will lose the support of the affiliating bank in no more than 3 years. Provided that those banks meet the general criteria, but do not meet either or both of the required adequacy ratios (13.25% for total capital requirement and 10.25% for Tier 1 capital ratio), they may designate no more than 5% of their 2015 net profit for dividend payout. Based on past-year experience, this level should be sufficient to prevent shareholder exits.
3. The third group comprises cooperative banks operating as part of the protection scheme of the Cooperative Bank Group (SGB), and in the case of the BPS Affiliation, those declaring their will to participate in the protection scheme, which will be authorized to apply a 0% loan risk weight to mutual exposures under Article 113 Section 7 CRR, subject to KNF approval.

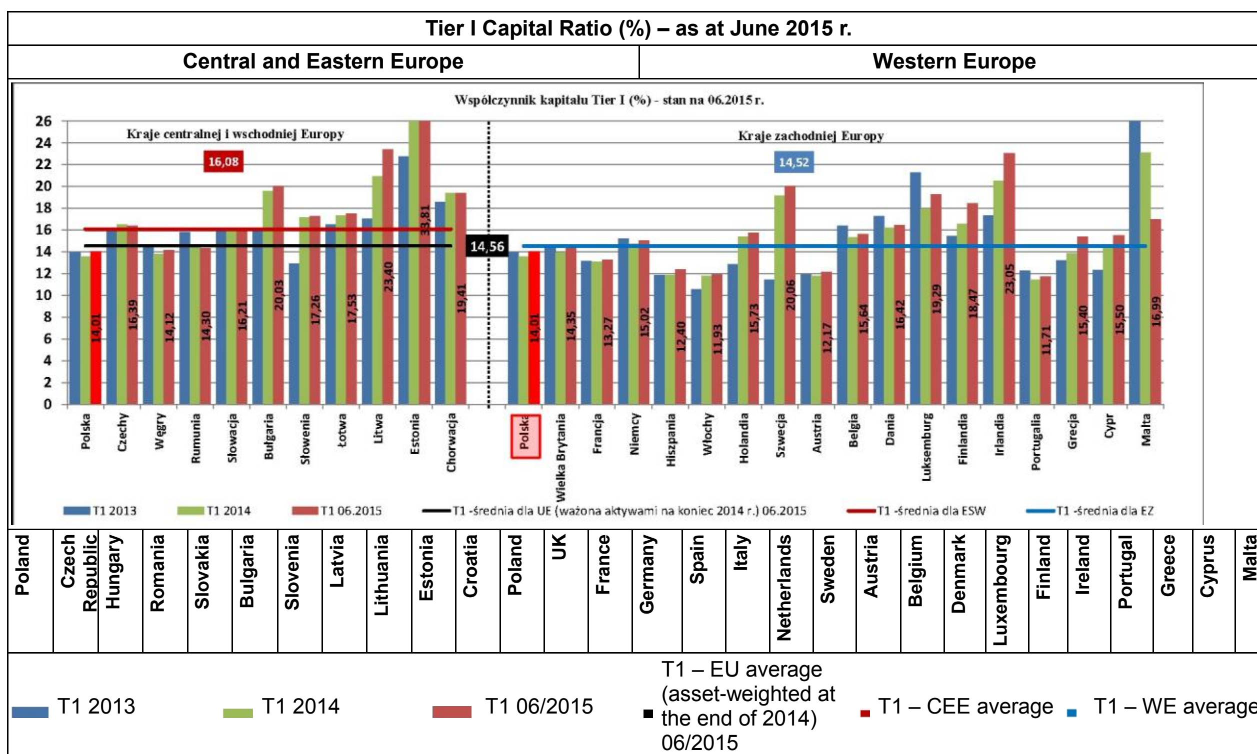
Provided that those banks meet the general criteria but do not meet either or both of the required adequacy ratios (13.25% for total capital requirement and 10.25% for Tier 1 capital ratio), they may designate no more than 10% of their 2015 net profit for dividend payout.

III. Current capital levels in European countries

In Europe, capital adequacy expressed as Tier 1 capital ratio significantly exceeds regulatory requirements; its average value was 14.56% at the end of June 2015 and total capital ratio amounted to 16.49% at the end of 2014.[6][7] In many countries, regulatory requirements concerning capital ratios are increased with buffers.

Tier I Capital Ratio (%) – as at June 2015 r.

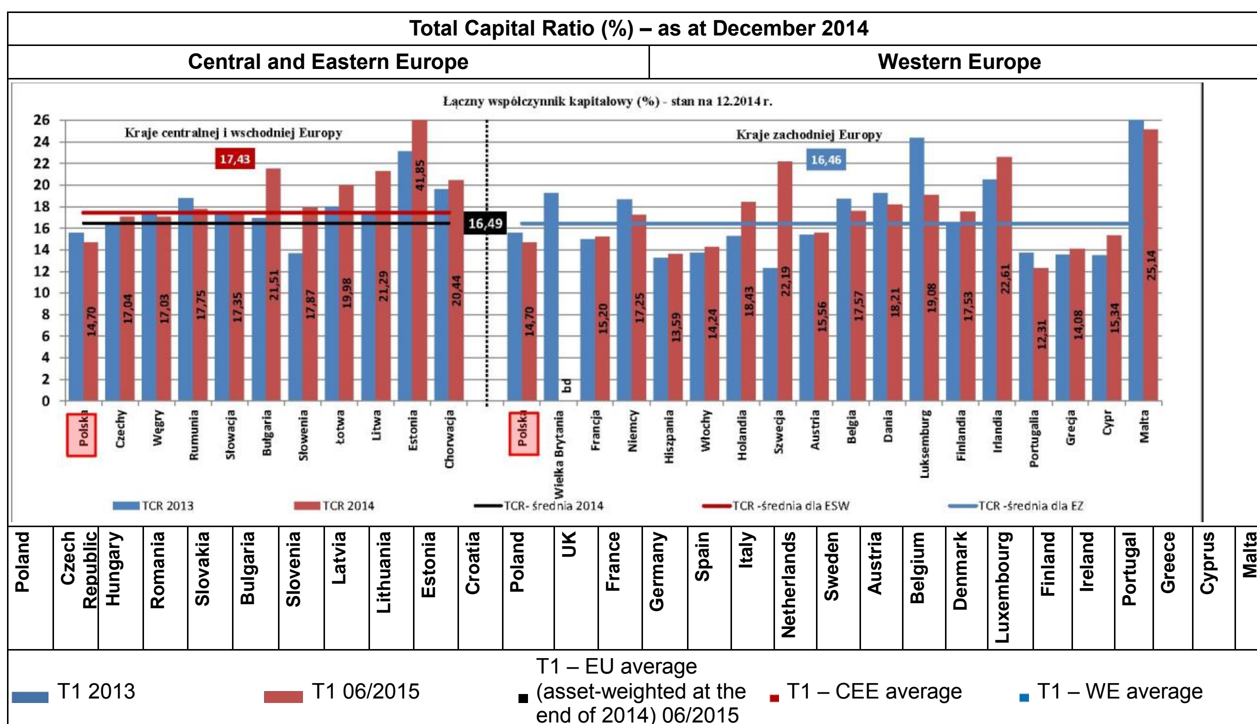
Central and Eastern Europe	Western Europe



Poland	Czech Republic	Hungary	Romania	Slovakia	Bulgaria	Slovenia	Latvia	Lithuania	Estonia	Croatia	Poland	UK	France	Germany	Spain	Italy	Netherlands	Sweden	Austria	Belgium	Denmark	Luxembourg	Finland	Ireland	Portugal	Greece	Cyprus	Malta

T1 2013	T1 2014	T1 06/2015	T1 – EU average (asset-weighted at the end of 2014) 06/2015	T1 – CEE average	T1 – WE average

[6] Sector's asset-weighted average at the end of 2014.
[7] Sector's asset-weighted average at the end of 2014.



Total Capital Ratio (%) – as at December 2014	
Central and Eastern Europe	Western Europe

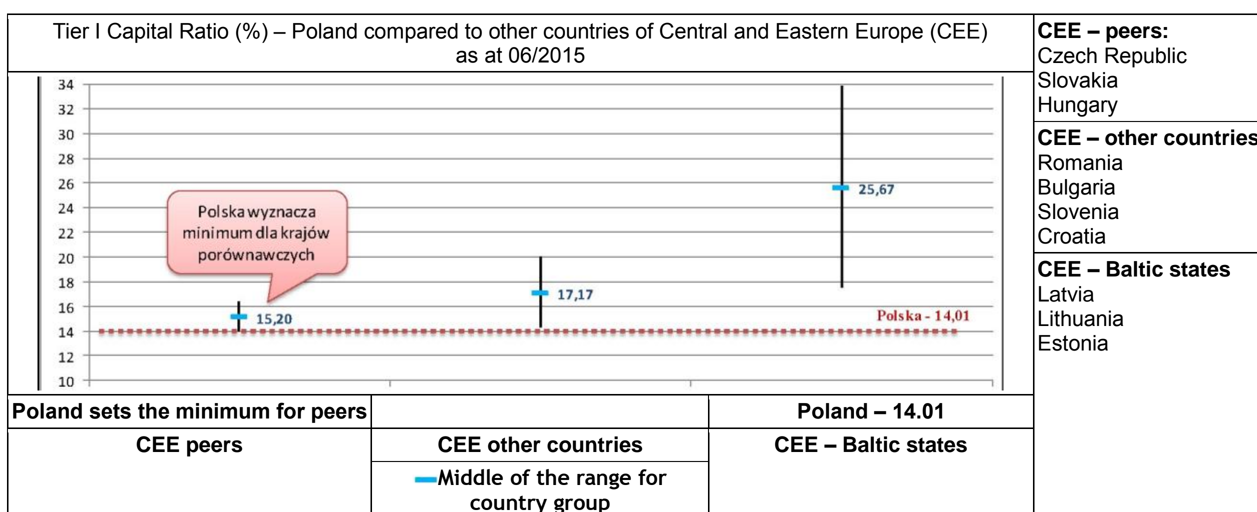
Poland	Czech Republic	Hungary	Romania	Slovakia	Bulgaria	Slovenia	Latvia	Lithuania	Estonia	Croatia	Poland	UK	France	Germany	Spain	Italy	Netherlands	Sweden	Austria	Belgium	Denmark	Luxembourg	Finland	Ireland	Portugal	Greece	Cyprus	Malta

T1 2013 | T1 06/2015 | T1 – EU average (asset-weighted at the end of 2014) 06/2015 | T1 – CEE average | T1 – WE average

Having analysed the capitalization of the Polish banking sector as compared to other CEE countries (analysed peers: Hungary, Czech Republic and Slovakia), the regulator considers it justified to recommend increasing Poland's capital base to the mid-level of the peer range:

- Tier 1 capital ratio (T1) – 15.20%;
- Total capital ratio (TCR) – 16.02%.

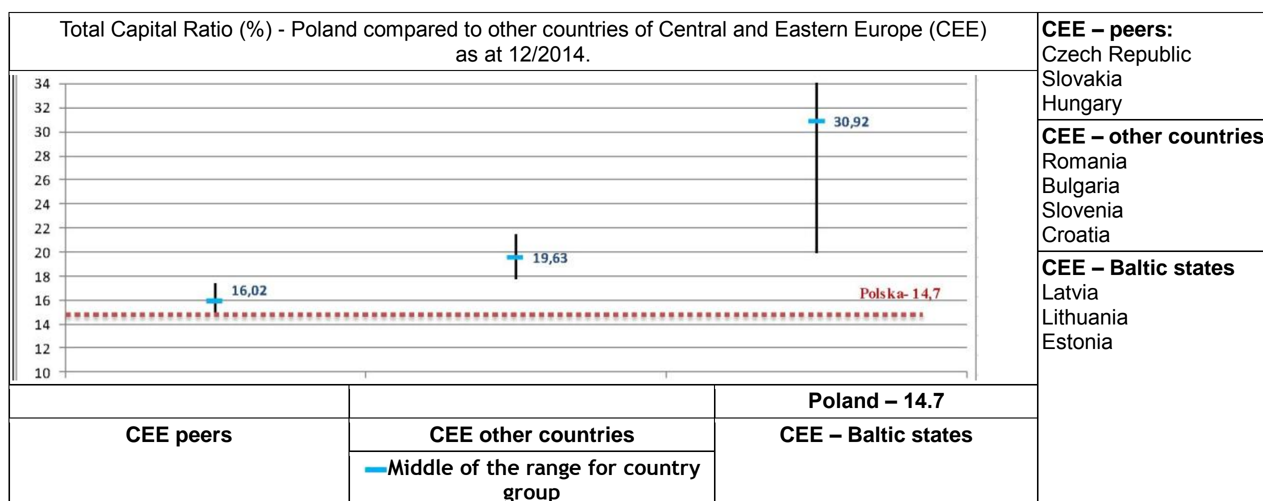
The adequacy for CCE countries for the banking sector in Poland is presented below.[8]



Tier I Capital Ratio (%) – Poland compared to other countries of Central and Eastern Europe (CEE) as at 06/2015			
			CEE – peers: Czech Republic, Slovakia, Hungary; **CEE – other countries:** Romania, Bulgaria, Slovenia, Croatia; **CEE – Baltic states** Latvia, Lithuania, Estonia
Poland sets the minimum for peers		**Poland – 14.01**	
CEE peers	**CEE other countries**	**CEE – Baltic states**	
	Middle of the range for country group		

[8] Without BGK.

Total Capital Ratio (%) - Poland compared to other countries of Central and Eastern Europe (CEE) as at 12/2014.



		Poland – 14.7
CEE peers	**CEE other countries**	**CEE – Baltic states**
	Middle of the range for country group	

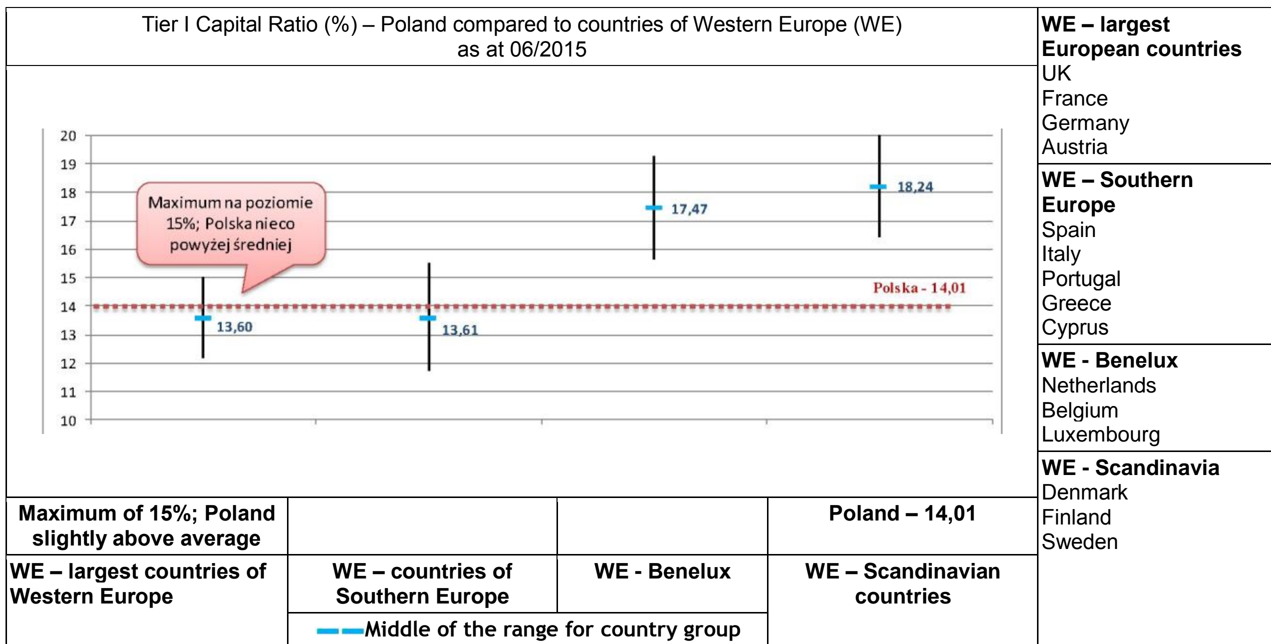
CEE – peers:	**CEE – other countries:**	**CEE – Baltic states**
Czech Republic Slovakia Hungary	Romania Bulgaria Slovenia Croatia	Latvia Lithuania Estonia

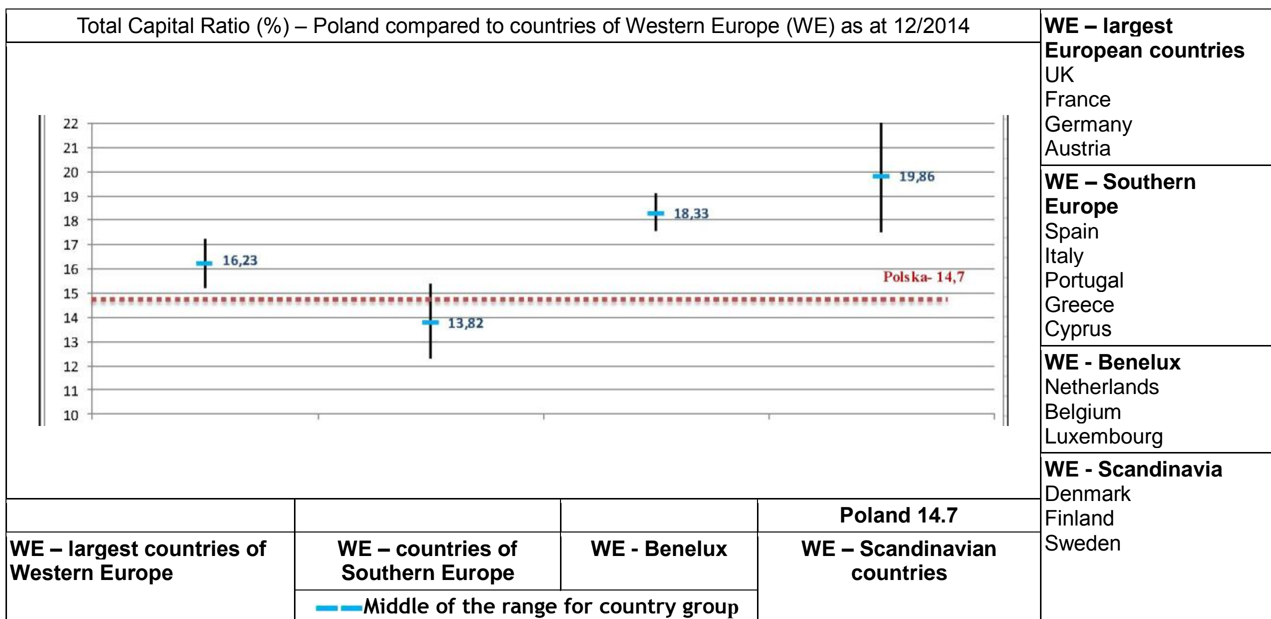
In terms of adequacy of the banking sector measured with Tier 1 capital ratio, compared to Western Europe, Poland ranks slightly above the average calculated for the largest European countries (UK, France, Germany, Austria) and Southern Europe (i.e. Western Europe excluding Benelux and Scandinavia). Total capital ratio (as at December 2014) for the biggest European countries indicates a higher value than the figures for Poland. On the one hand, this proves that the capital base is strong, but on the other, it shows that it is necessary to strengthen the capital of Polish banks to achieve a total capital ratio which is closer to the middle of the range for the largest countries in Western Europe, so to have total capital ratio around 16.23%.

The choice of the largest countries of Western and Southern Europe as the benchmark for Poland is justified by the fact that the development of the Polish banking sector is modelled on those economies, which are more comparable in size than the Benelux or Scandinavian market. What is also important is the fact that the ownership structure of Polish banks controlled by foreign capital is dominated by investors from those regions (48.3% of sector out of 61.9% controlled by foreign investors; Benelux and Scandinavia have a share of 7.2%).

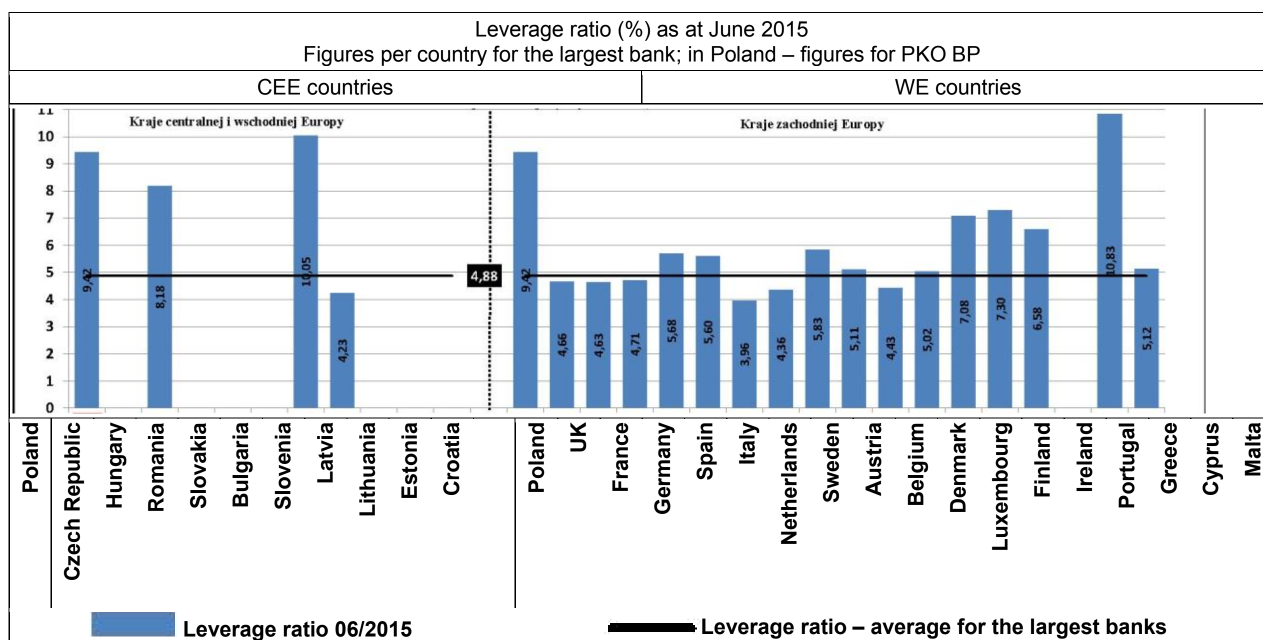
Exclusion of Benelux and Scandinavia from the benchmark results from the specific characteristics of those countries; these are rich, small countries with highly developed banking sectors, institutions using advanced methods for calculating RWA and capital requirements, so their ratios are not fully comparable with those for Poland or many other European countries. In particular, they report high T1 and TCR levels by low LR.

Lack of adequate capital base as compared with other counties may result in a weaker assessment of Polish banks.





The leverage ratio (LR) is an additional measure of capital level. This ratio reflects the relation of the institution's capital (defined as Tier 1 capital) to total exposure of that institution (defined as the sum total of exposures from all assets and off-balance-sheet items with the exception of items reducing Tier 1). The ratio is the average value of this relation in the last three months expressed in percentages.



The data obtained by EBA as part of the transparency exercise for major European banks reveals that the average value of this ratio at selected banks is 4.88%.

IV. Current capital levels at commercial banks in Poland

Analysis of the Polish sector in comparison to other EU states reveals that it is necessary to strengthen the capital of the Polish banking sector. At present, commercial banks in Poland have an average Tier 1 capital ratio of 14.25% (as at September 2015) and a total capital ratio of 15.56%.[9] Among those banks, much higher levels are maintained by small banks, and medium-sized banks have ratios below the indicated average. Large banks have an average ratio similar to the average for commercial banks. Capital strengthening of medium-sized banks will improve the ratios for the entire sector, but it is also important that large banks (which are systemically relevant for the banking and financial sector in Poland) maintain and strengthen their capital, especially those with substantial portfolios of non-financial client deposits. Maintenance of security capital by those banks will be an important prudential base for stable growth, securing the banks' operation in the changing legal environment and difficult global market conditions.

Due to its structure, the leverage ratio is correlated with the level of the capital ratios; banks with higher capital ratios also have higher solvency ratios. The significant gap between the leverage ratio and the Tier 1 capital ratio is due to the specific characteristics of the bank (assets with low risk weights and/or guarantees reducing the asset's risk weights), or to the advanced methods of RWA calculation applied by the bank (IRB approach).

[9] Average ratio values for the sector and specific bank groups calculated as the sum total of nominators divided by the sum total of denominators.

The leverage ratio is an indicator of the bank's capital position, but, unlike the solvency ratio, it does not differentiate risk weights depending on the asset type. At the end of September 2015, the average leverage ratio for commercial banks was 8.64%.