Polish
Financial
Supervision
Authority

December 6, 2016

The Financial Supervision Authority position concerning the dividend policy of banks, insurance companies, universal pension fund companies, brokerage firms and investment fund companies

The Financial Supervision Authority (KNF), during its session of December 6, 2016, adopted a position concerning:

- the **dividend policy** of banks, insurance and reinsurance companies, universal pension fund companies, brokerage firms and investment fund companies in the year 2017.

The situation of the Polish economy in terms of its external conditions is still characterized by an increased level of risk. This is due, among others, to the results of the June referendum concerning the further participation of the Great Britain in the European Union, and the result of the December constitutional referendum in Italy. Therefore, KNF recommends the financial institutions to maintain a strong capital base, and, in some cases, to further reinforce it.

The dividend policy operated in the last years by the financial institutions in line with the KNF recommendations has allowed them to strengthen their capital base, and to improve the ability to absorb potential losses. This has a positive impact on maintaining the stability and security of the Polish economy, as well as the financial system, allowing for its continued growth.

Each of the sectors will receive recommendations in the form of a letter from the KNF President.

Banks

Assessing the supervisory actions taken concerning the banks in the dividend policy area from several years' perspective it may be concluded that, along with other prudential initiatives, they allowed for a continued and stable development of the sector. Among the benefits of assessing the Polish banking sector as stable and actively supervised is the possibility of obtaining financing of these banks on beneficial terms. Aiming at further stable growth of the sector, the Financial Supervision Authority is presenting its expectations concerning the dividend policy of banks in the upcoming year.

The material risk related with the potential, statutory solution to the problem of mortgage-secured foreign currency loans, in case of implementing the act, will have a detrimental effect on the financial results of banks, and will negatively impact their capitals and adequacy. As part of the dividend policy towards banks engaged in foreign-currency housing loans for households, additional criteria adjusting the maximum level of the dividend rate were introduced. The earning retained by those banks will allow to prepare better for the potential additional burden.

- **Dividend payment criteria for commercial banks**

It is recommended that dividend can be paid only by banks fulfilling all of the below criteria:

- not carrying out a repair program;
- positively assessed in process of supervisory evaluation and assessment (BION) - the BION final score not lower than 2.5 (master scale - grade 1 or 2);
- having a financial leverage at a level higher than 5%;
- having T1 capital ratio at a level higher than the minimum value of this indicator, increased by the security capital, i.e.:
  - OSII banks - with Tier I (T1) capital ratio higher than 13.25% + 75%*add-on + OSII buffer;
  - other commercial banks - having a Tier I (T1) capital ratio higher than 11.25% + 75%*add-on;
- having a total capital ratio at a level higher than: 13.25% + add-on + OSII buffer.

It is recommended that the banks fulfilling all of the above criteria can pay up to 50% of the achieved profit.

It is additionally recommended that up to 100% of the profit generated may be paid by banks fulfilling the supervisory expectations concerning the minimum level of total capital ratio, in consideration of the security capital, i.e.:

- OSII banks - having a total capital ratio higher than 16.25% + add-on + OSII buffer;
- other commercial banks - having a total capital ratio higher than 14.25% + add-on.

Additionally, banks significantly engaged in foreign-currency housing loans for households[1] adjust their dividend payment rate based on the two additional criteria:

[1] Banks having in their portfolio of receivables from the non-financial sector at least a 5% share of foreign-currency housing loans for households.

Criterion 1 (K1) - based on the share of the foreign-currency housing loans for households in the entire portfolio of receivables from the non-financial sector.

Criterion 2 (K2) - based on the share of the foreign-currency housing loans granted in years 2007 and 2008 (loans decisive for the amount of banks' losses in case of implementing the potential statutory solutions) in the portfolio of foreign-currency housing loans for households.

Appropriate adjustments are applied, depending on the size of the portfolio held by the bank.

Criterion 1

- Banks with a share of over 10% - adjustment of the dividend rate by 20%
- Banks with a share of over 20% - adjustment of the dividend rate by 30%
- Banks with a share of over 30% - adjustment of the dividend rate by 50%

Criterion 2

- Banks with a share of over 20% - adjustment of the dividend rate by 30%
- Banks with a share of over 50% - adjustment of the dividend rate by 50%

It must be stressed that a bank holding a non-appropriated profit from the preceding years is obliged at all times to notify the intent of payment of dividend to KNF, which will assess such intent on individual terms. Such consent can be applied for by banks fulfilling the dividend payment criteria.

- **Dividend payment criteria for associating banks and cooperative banks**

Associating banks are recommended to apply the general dividend policy principles - the same as for other banks operating in the form of a joint stock company.

Cooperative banks not fulfilling the criteria for dividend payment from net profit for year 2016 will be subjects of individual representations of UKNF, the same as in the preceding years.

Apart from the general criteria, the position of KNF concerning the dividend payment possibility of individual cooperative banks will also take into consideration the rule of proportionality, that will most of all be dependent on the legal and organizational specifics of said banks, and also their relation towards the functioning associations and institutional protection systems.

In the case of cooperative banks, their dividend policy should take into account the possibility of recognizing the equity fund as own funds, which the possibility will appear after effective notification of the membership shares in the European Banking Authority, as well as the factor limiting the material capital risk, i.e. functioning under the protection system Functioning under protection systems created based on associations, which - according to the Act on the Functioning of Cooperative Banks, their associations and associating banks - will replace them within a maximum time of three years from the creation of said systems, provides the cooperative banks significant protection of capital adequacy and (liquidity) assistance. The funds from the assistance fund may, pursuant to the provisions of art. 5b of the Act, be credited to CET1 capital. Functioning within protection systems, thanks to the mutual control and solidary support of their participants, reduces the risk of occurrence of losses, amortizes any potential effects of business failures of cooperative banks, and also - through the use of sanction mechanisms of the protection system - can impose changing the way of operating of a bank exposing itself to excessive risk.

On the other hand, the dividend payment possibility (varied depending on the bank's situation) will allow to limit the outflow of shareholders in the definite majority of cooperative banks. Moreover, in view of the necessity of building an adequate market image, a possibility is granted of spending part of the net gains for year 2016 for charity goals defined in the articles of association of the given cooperative banks.

Due to the above, **the possibility of payment of a non-material part of the profit in the form of dividend is granted to cooperative banks with capital adequacy ratios below 13.25% for TCR and/or below 10.25% for T1.** Within this entitlement, the banks will be able to decide on the relation of the amount of dividend to the amount of funds for financing the goals defined in the articles of association.

Those cooperative banks that would be entitled to pay part of the net gains for 2016 are divided into 3 groups.

1. The first group includes banks that fulfill the recommended general criteria for commercial banks, and that have capital adequacy ratios at levels above 13.25% for TCR, and 10.25% for T1. In such banks, no limitation is imposed on the payment of dividend from profit generated in 2016.
2. The second group are independent banks, or banks that did not decide on joining a protection system, i.e. banks that are, or within a maximum of 2 years will be deprived of support from an associating bank. Provided that these banks fulfill the general criteria, then, despite the failure to fulfill one or two capital adequacy indicators (13.25 for TCR and 10.25% for T1), they may appropriate no more than 5% of their net gains for year 2016 for paying the dividend. Considering the experiences from the previous years, this level should be deemed sufficient for preventing the outflow of shareholders.
3. The third group are cooperative banks operating under SGB and BPS protection systems, which are entitled, pursuant to art. 113 item 7 of CRR (subject to the agreement of KNF), to apply a 0% credit risk weight to mutual exposures.

These banks, provided that they fulfill the general criteria, will be entitled to pay dividend equivalent to no more than 10% of their net gains for 2016, despite their failure to fulfill one or two capital adequacy indicators (13.25% for TCR and 10.25% for T1).

Insurance and reinsurance companies

It is recommended that dividend is paid only by those insurance/reinsurance companies that fulfill all of the below criteria:

I. they received a good (1.00) or satisfactory (2.00) risk score from BION for year 2015;
II. in the individual quarters of 2016 did not exhibit deficiency of own funds for covering the capital requirement (defined as the maximum from the minimum capital requirement and the solvency capital requirement);
III. in 2016 were not subject to a short-term financial plan or recovery plan, as mentioned in art. 312 and 313 of the Act on Insurance and Reinsurance Companies;
IV. as on December 31, 2016, the value of own funds, without deducting the projected dividends, was at a level of at least 175% of the capital requirement value for companies performing economic activity in sector I, and at least 150% of the capital requirement value for companies performing economic activity in sector II.

Insurance/reinsurance companies fulfilling the above criteria should limit the payment of dividend to 75% of the value of profit generated in 2016, and the coverage of the capital requirement for the quarter in which the dividend was paid should be maintained at a level of minimum 110%.

At the same time, payment of dividend equivalent to the entire profit generated in 2016 is permitted (which means that no payment from the remaining elements of equity is allowed), provided that the capital requirement coverage (after deducting the projected dividends from own funds) as on the end of December 31, 2016, and for the quarter in which the dividend was paid, will be at a level of at least 175% for companies performing economic activity in sector I, and at least 150% for companies performing economic activity in sector II.

When deciding on the amount of dividend, the insurance/reinsurance companies meeting the above criteria should take into account the additional capital needs for the twelve months' perspective following approval of the financial statement for year 2016, resulting, among others, from changes to the market and economic circumstances.

Universal pension fund companies

The precondition necessary and recommended by the supervisory authority is that a universal pension fund company that will be deciding on the payment of dividend in year 2017 fulfills all of the below mentioned criteria:

criterion I	the company was graded as 1 (good) or 2 (satisfactory) after BION final assessment for year 2015;
criterion II	in 2016, the company did not exhibit failure to fulfill the statutory capital requirements;
criterion III	as on December 31, 2016, the value of the company equity, increased by the value of the Guarantee Fund to which the company is entitled constituted at least 1.25% of the value of net assets of the open pension fund managed by the company;
criterion IV	as on December 31, 2016, the value of liquid assets of the company[2], increased by the value of the Guarantee Fund to which the company is entitled constituted at least 1.25% of the value of net assets of the open pension fund managed by the company;
criterion V	the company received a partial grade in the "capital adequacy" area of 1 (good) or 2 (satisfactory) after BION final assessment for year 2015;

A universal pension fund company fulfilling the above criteria should limit the value of the dividend paid from profit generated in 2016 and in the preceding years to a level not exceeding 150% of the value of profit generated in 2016. The dividend payment may also not cause a decrease of the value of equity and, accordingly, the value of liquid assets, increased by the value of funds of the Guarantee Fund that the company is entitled to, below the level specified in criterion III and criterion IV. Moreover, when deciding on the payment of dividend, the company should take into account the additional capital requirements in the perspective of one year following approval by the general meeting of shareholders of the company's financial statement for year 2016. A company that manages its voluntary pension fund should also take into account the risk related to this sphere of its economic activity, and its potential impact on the financial performance.

Brokerage companies

It is recommended that dividend is paid in 2017 only by those brokerage companies that fulfill all of the below criteria:

A. Dividend in an amount not exceeding 75% of net gains for 2016:

I. for entities subject to capital adequacy standards pursuant to regulation 575/2013 as for December 31, 2016:

[2] Liquid assets are defined as, among others: securities issued by the State Treasury or the National Bank of Poland, receivables from the Open Pension Fund: on account of premium fee and management fee, cash and cash equivalents, as well as other short-term financial assets.

- **Tier I core capital ratio** was at least **6%**;
- **Tier I capital ratio** was at least **9%**;
- **total capital ratio** was at least **14%**;

II. for entities not subject to the capital adequacy standards, pursuant to regulation 575/2013, as for December 31,2016, the indicator being the **share of the equities amount in the total assets** is at least **50%**;

III. **the supervisory grade** given as part of the BION process carried out in year 2016 is **1** or **2**;

IV. in 2016, the entity **did not violate any regulations concerning capital requirements, provided in regulation 575/2013 and in the Act** on Trading Financial Instruments (Journal of Laws of 2016, item 174, as amended), as well as regulations concerning the limits of large exposures.

B. Dividend in an amount not exceeding 100% of net gains for 2016:

I. fulfills all the criteria mentioned in item A;

II. for entities subject to capital adequacy standards pursuant to resolution 575/2013, the criteria mentioned in item A, point I, are fulfilled at the end of each quarter in year 2016;

III. for entities not subject to capital adequacy standards pursuant to resolution 575/2013, the criterion mentioned in item A, point II, is fulfilled at the end of each quarter in year 2016;

Additionally, brokerage companies, when deciding on the amount of dividend to be paid, should take into account any additional capital requirements in the perspective of twelve months following the moment of approving the financial statement for year 2016.

Also, those brokerage companies that are obliged, pursuant to applicable regulations, to maintain additional capital requirements, should increase the ratios mentioned in item A.I by the value of the additional capital requirements.

Investment fund companies

The criteria that investment fund companies should take into consideration when deciding on the appropriation of profit for year 2016 and on payment of dividend in year 2017:

I. in 2016, and in the period from the beginning of 2017 until adopting a resolution on the payment of dividend, no situation of failing to meet the statutory capital requirements took place;

II. when making the decision concerning the value of dividend, the company should take into account the additional capital needs in the perspective of twelve months following the moment of approving the financial statement for year 2016, so that the payment of dividend by the company has no impact on the fulfillment of capital requirements in the following months, and so that the decisions made by the company concerning the lowering of equity do not cause a decrease of the capital requirement coverage ratio below the level indicated in point IV;

III. when deciding on the payment and the amount of the dividend it should be taken into consideration whether any claims of the investment fund participants were raised against the company due to unduly management of the investment fund;

IV. those investment fund companies that fulfill the conditions mentioned in point I - III, that were graded BION 1 or 2 in the course of the final process of the investment fund companies Supervisory Assessment and Evaluation, may pay a dividend in year 2017:
   1. in the total maximum amount of 75% of profit generated in 2016 (which means that no payments from the remaining elements of equity are allowed), provided that the payment of dividend will not effect in decreasing the capital requirement coverage ratio below **1,5**;
   2. in a total amount higher than 75%, but not higher than 100% of the profit generated in 2016 (which means that no payments from the remaining elements of equity are allowed), provided that the payment of the dividend will not effect in a decrease of the capital requirement coverage ratio below **2**; said capital requirement coverage ratio is calculated as a quotient of the company's equity and the applicable capital requirement level.