Polish Financial Supervision Authority

2 December 2014

PFSA position on the dividend policy of financial institutions

In a meeting on 2 December 2014 the Polish Financial Supervision Authority (PFSA) adopted its position on:

- **the dividend policy** of banks, insurance and reinsurance undertakings, general pension fund management companies, investment fund management companies and brokerage houses in 2015 for 2014.

The dividend policy pursued in recent years by financial institutions in accordance with the recommendations of the PFSA has allowed to strengthen their capital base and improve the ability to absorb potential losses. This situation has a positive effect on maintaining the stability of the financial system in Poland, allowing its further development. However, due to the continued elevated risk in the external environment of the Polish economy and the most common level of capital endowment of other banking systems of EU countries, the maintenance of a strong capital base and, in some cases its further strengthening, is recommended. This will contribute to the stability and security of the financial system and the Polish economy.

Each sector will receive a recommendation in the form of a letter from the Chairman of the Polish Financial Supervision Authority.

Banks

The PFSA, similarly to the regulators of other EU countries, attaches a particular importance to an adequately high level of capital of banks which have a systemically important share in the deposit market in Poland.

Banks with a significant market share in the non-financial sector deposits (deposits of the non-financial sector in the bank's balance sheet exceed 5% of the aggregate sum of these deposits in the banking sector)

It is recommended that banks with a significant market share in non-financial sector deposits, satisfying **jointly** all of the following criteria be able to pay out a dividend of **up to 100%** of the profit generated in 2014:

- the bank is not subject to reorganisation proceedings,
- the common equity Tier 1 ratio (CET1) greater than 12% (9% + 3% systemic risk buffer);
- total capital ratio (TCR) greater than 15.5% (12.5% + 3% systemic risk buffer);
- the final Supervisory Review and Evaluation Process (SREP) rating is 1 (good) or 2 (satisfactory);
- SREP rating for the level of capital risk is not worse than 2 (satisfactory).

Banks with a significant market share in non-financial sector deposits which have a total capital ratio (TCR) **in the range of 12.5% to 15.5%, may pay out up to 50% of the profit generated in 2014 if they meet the other criteria.**

Other banks

It is recommended that other banks satisfying jointly all of the following criteria be able to pay out a dividend of up to 100% of the profit generated in 2014:

- the bank is not subject to reorganisation proceedings,
- the common equity Tier 1 ratio (CET1) greater than 9%;
- total capital ratio (TCR) greater than 12.5%;
- the final Supervisory Review and Evaluation Process (SREP) rating is 1 (good) or 2 (satisfactory);
- SREP rating for the level of capital risk is not worse than 2 (satisfactory).

Banks that do not meet the criteria for the dividend payout are recommended to allocate the entire profit earned in 2014 to equity.

As far as *cooperative banks* are concerned, due to the different nature of their operations, the ownership structure, and the need for gradual amortisation of the share fund resulting from Article 484 and 486 of CRR, it is assumed that the abovementioned systemic approach be supplemented with the individual approach. Similarly to the previous year, cooperative banks that do not meet the criteria set out by the PFSA will receive letters containing recommendations issued pursuant to Article 138(1) of the *Banking Law* concerning the allocation of the entire net profit for 2014 for the purpose of increasing own funds. Cooperative banks which applied in 2014 for permission to decrease own funds due to the payment of members' shares declared for reimbursement will be analysed thoroughly because pursuant to the provisions of CRR these banks must supplement their funds from other sources adequately to the scale of the decrease. In addition, due to the nature of current and future relationships within the associations operating in the banking cooperative sector, in the case of associated cooperative banks the capital adequacy of associating banks and the level of equity interest of a cooperative bank in the associating bank should be also taken into account in relation to the principles of equity involvement adopted in internal regulations of the individual associations.

Insurance and reinsurance undertakings

It is recommended that only insurance/reinsurance undertakings which meet all the following criteria pay out dividends:

I. they received the risk rating of 1 (good) or 2 (satisfactory) as part of the SREP for 2013;

II. in 2014 they did not report a shortfall of own funds to cover their solvency margin or guarantee capital or a shortfall of assets to cover their technical provisions (in monthly or quarterly periods);

III. in 2014 they were not subject to a reorganisation plan or programme as referred to in Article 187 clauses 1–3 and 8 of the Insurance Activity Act;

IV. as at 31 December 2014 they have a capital requirements coverage ratio (understood to mean the minimum of own funds to the solvency margin and own funds to guarantee capital) of at least 160% for section I undertakings or 200% for section II undertakings;

V. as a result of stress tests conducted as at 31 December 2014 for all the examined types of risk the capital requirements coverage ratio was at least 110% and the ratio of the coverage of technical provisions with relevant assets was at least 100%;

VI. in the quantitative impact study conducted as at 31 December 2013 they reported eligible own funds in the amount at least equal to the minimum capital requirement and the capital solvency requirement.

Insurance/reinsurance undertakings meeting the above criteria should limit the dividend payout to a maximum of 75% of the profit generated in 2014, save that the capital requirements coverage ratio after the dividend payout should remain at the level of at least 110%.

At the same time, it is permissible to make a dividend payment of all the profit generated in 2014 (which means that the payment from the profit generated in previous years is not permitted) if the capital requirements coverage ratio after dividend payout remains at a higher level than the one specified under criterion IV, and if the fulfilment of criterion V and VI is maintained taking into consideration the balance as at 31 December 2014 adjusted by the dividend amount.

When making the decision on the dividend amount insurance/reinsurance undertakings fulfilling the abovementioned criteria should take into account their additional capital requirements in the time horizon of twelve months from the date of the approval of 2014 financial statements, resulting from, inter alia, an increase in costs caused by changes in the market and legal environment (e.g. court judgements) as well as capital requirements arising from the preparation for Solvency II.

General pension fund management companies

It is a prerequisite recommended by the PFSA that a general pension fund management company which will make a decision on dividend payout in 2015 meet jointly all of the following criteria:

criterion I — the company received the final SREP rating of 1 (good) or 2 (satisfactory) for 2013;

criterion II — in 2014 the company did not report a failure to comply with statutory capital requirements;

criterion III — as at 31 December 2014 the equity of the company, plus the value of the Guarantee Fund attributable to the company, represented at least 1.25% of net assets of the open-end pension fund managed by the company;

criterion IV — as at 31 December 2014 the value of liquid assets of the company[1], plus the value of the Guarantee Fund attributable to the company, represented at least 1.25% of net assets of the open-end pension fund managed by the company;

criterion V — the company received a partial SREP rating of 1 (good) or 2 (satisfactory) in the "capital adequacy" area for 2013.

In connection with a material change in the legal environment affecting the functioning of general pension fund management companies and limiting the risk of their operations, a company that meets the abovementioned criteria is allowed to pay the dividend from profit for 2014 and the previous years, save that the total value of the dividend paid out in 2015 should not exceed 150% of the profit earned in 2014. In addition, the dividend payout should not

[1] The following assets may be regarded as liquid assets: securities issued by the State Treasury or the National Bank of Poland, receivables from open-end pension funds: as a fee on the contribution and the management fee, cash and cash equivalents and other short-term financial assets.

cause a decrease in equity and respectively liquid assets, increased by the value of funds under the Guarantee Fund attributable to the company, below the level specified in criterion III and criterion IV. Moreover, when making a decision on dividend payout the company should take into account the additional capital needs projected for one year from the date of approval of the company's 2014 financial statements by the general meeting of shareholders. The company which manages a voluntary pension fund should also take into account the risk associated with this part of its business and its potential impact on the financial result.

Brokerage houses

It is recommended that only brokerage houses which meet all of the following criteria be allowed to pay the dividend for 2014 in 2015:

I. in 2014 the brokerage house did not breach capital adequacy standards, including regulations on large exposure limits;

II. the common equity Tier 1 ratio as at 31 December 2014 amounted to at least 6% (for brokerage houses subject to capital requirements);

III. the equity Tier 1 ratio as at 31 December 2014 amounted to at least 9% (for brokerage houses subject to capital requirements);

IV. the total capital ratio as at 31 December 2014 amounted to at least 12% (for brokerage houses subject to capital requirements);

V. the ratio equal to the share of equity in total assets as at 31 December 2014 amounted to at least 50% (for brokerage houses not being subject to capital requirements);

VI. the Supervisory Review and Evaluation Process (SREP) rating valid as at 31 December 2014 is 1 (good) or 2 (satisfactory);

VII. in addition, when making a decision on the amount of the dividend, brokerage houses should take into account additional capital needs in the perspective of twelve months from the date of approval of the 2014 financial statements.

At the same time, it is recommended that brokerage houses retain undistributed profits from previous years, including in the form of supplementary and reserve capital so that the payment of the dividend in 2015 does not exceed 100% of the value of the net result for 2014.

When deciding on the payment of the dividend the brokerage house should take into account the values of the ratios referred to in clauses II–V calculated on the basis of the audited financial statements for 2014.

Investment fund management companies

When making a decision on the distribution of profit for 2014 and the payment of the dividend in 2015 the following criteria should be followed:

I. in 2014 and in the period from the beginning of 2015 until the adoption of the resolution on dividend payout, there was no situation where statutory capital requirements were not satisfied;

II. when making a decision on the amount of the dividend, the company should take into account additional capital needs in the horizon of twelve months from the date of the approval of the 2014 financial statements so that the payment of the dividend does not affect the ability to satisfy capital requirements in subsequent months;

III. the decision on the payment and amount of the dividend should take account whether in the period of 6 months prior to adopting the resolution on dividend payout any claims of unit-holders were lodged in connection with the improper management of investment funds;

IV. investment fund management companies satisfying the conditions referred to in clauses I–III which simultaneously received a final SREP rating of 1 (good) or 2 (satisfactory) in the last SREP of investment fund management companies may pay out the dividend in 2015:

   1. in the total amount of a maximum of 75% of the profit generated in 2014 if the payment of the dividend does not result in a decrease of the capital requirements coverage ratio below 1.5;

   2. in the total amount of more than 75% but not more than 100% of the profit generated in 2014 if the payment of the dividend does not result in a decrease of the capital requirements coverage ratio below 2;

   - where the capital requirements coverage ratio is calculated as the quotient of the value of the company's equity and the applicable level of capital requirement.