REPORT ON THE CONDITION OF POLISH BANKS IN 2010

POLISH FINANCIAL SUPERVISION AUTHORITY
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POLISH FINANCIAL SUPERVISION AUTHORITY

MOST IMPORTANT OBSERVATIONS AND CONCLUSIONS

In the first half of 2010, the situation of the **banking sector remained stable.** Assessing of particular areas justifies stating that:

- The current **situation regarding the capital base is good.**
- The current **situation regarding short-term liquidity is good. The situation regarding medium- and long-term liquidity is, however, unsatisfactory.** as is shown by the absence both of proper functioning of the interbank market in respect of transactions with maturities longer than one day and of an adequate level of medium and long-term funding.
- The **level of new lending remains limited. The main area in which lending is growing is housing finance, loans to the budget sector** and to a lesser extent **loans to individual entrepreneurs. In other areas lending is stagnant,** which is related both to the reduced demand for credit from some entities and to some banks' limiting their lending activity. This is a result of uncertainty as to future developments (on the part of both banks and their clients) and of a serious deterioration in the quality of loan portfolios, which is causing a tightening of lending policy in some sectors together with modification of strategies for growth.
- The **growth of the deposit base continues to be restrained** (significant growth in deposits took place only in the fourth quarter), which is related to a reduction in interest rates paid on deposits, improvement in conditions in capital markets and the still difficult situation in the labour market.
- **Improvement in financial results** arose from a **reduction in interest costs, an increase in fees and charges and maintenance of discipline over costs.**

  The main factor depressing results has been write-offs of consumer loans (more than 60% of all write-offs), which have been concentrated mainly in smaller institutions. A growth has been noted in write-offs of housing-related loans, but these remain an insignificant proportion of the total of write-offs. On the other hand, a reduction has been noted in write-offs in the enterprise sector, and in the fourth quarter in total write-offs, which may be a signal of a weakening of negative factors.
- **The main area of risk remains the loan portfolio, the quality of which worsened** as a result of excessive loosening of the standards of lending policy and of the economic slowdown in late 2008 and early 2009, which with a certain time-lag had an impact on the financial condition of some lenders. 2010 saw **a further increase in the value of impaired loans**, but the **second half of the year saw a slowing in the development of negative phenomena in certain sectors**.

  It was the consumer loans portfolio that was marked by the lowest quality. The marked worsening in the quality of these loans resulted from their growth in small and medium-sized lenders, whose earlier expansion in this sector had been based on the acceptance of excessive risk (leading in these banks to a serious deterioration in their results). At the regulatory level the answer to identified weaknesses in risk management was the **promulgation of Recommendation T.**

  Excessive loosening in housing-related lending must be judged negatively. It was displayed in a very large rise in the proportion of loans with a high LTV (a record high in the share of loans with an LTV over 80%), the very long term of loans granted and the renewal by certain banks of offers of foreign currency mortgages. Furthermore 2004-2010 saw a **very large increase in the share of housing-related loans in the assets** of most of the banks that had a leading position in the market for such loans. These banks thus made their future financial condition depend on the quality of the portfolio of housing loans, on the situation in the property market and, in view of the very high share of foreign currency-denominated loans, also on conditions in the foreign exchange market and the interest rates applying to foreign currency-denominated instruments (set in response to decisions of the SNB and ECB rather than the NBP).

  The quality of the portfolio of loans extended to small and medium-sized enterprises has shown a marked deceleration in the growth of unfavourable phenomena and **in the case of loans to large enterprises one can speak of a stabilisation** of the quality of the loan portfolio.

Despite the observable revival of and improvement in the functioning of financial markets an **elevated level of risk continues to exist in the external environment** and banks must recognise the possibility of disorders occurring, for the most part outside the sector, which can negatively affect their condition. Therefore **it is necessary for banks to take potential threats into account when formulating their strategies.**

CONTENTS

1 THE ENVIRONMENT IN WHICH BANKS OPERATE [1]

1.1 Macroeconomic situation

After the marked weakening that occurred in late 2008 and early 2009 as a result of escalation of the financial crisis, a **recovery has been visible in the global economy** with the strength of this recovery differing between particular regions and countries. Growth in activity in Poland's principal economic partners has been conducive to an **increase in the rate of growth of the Polish economy.**

According to initial estimates the rate of growth in GNP in 2010 amounted to 3.8% (as against 1.7% in 2009) and was among the highest in the EU, with growth accelerating from quarter to quarter (3.0%; 3.5%; 4.2%; 4.5%). The improvement in the rate of growth was influence by strengthening in domestic demand (by 4.3%), which resulted primarily from growth in individual consumption (of 3.2%) supplemented by growth in public consumption and an increase in stock-building. On the other hand, however, a further reduction (of 1.2%) was noted in gross investment in fixed assets, with an insignificant increase in investment been seen in the second half of the year. Attention should be paid to:

- growth in industrial production sold (of 9.7% over the whole of the year), in construction and assembly output (of 3.0%) despite the sharp fall noted at the start of the year, and in retail sales (of 1.5%);
- buoyancy in foreign trade (exports increased from 2009 by 10.9% in zlotys and by 19.5% in euros and imports were up, respectively, by 12.9% i 21.7%), with the current account deficit increasing to about 3.3% of GDP;

Figure 1.
Year-on-year increase in GDP (%)

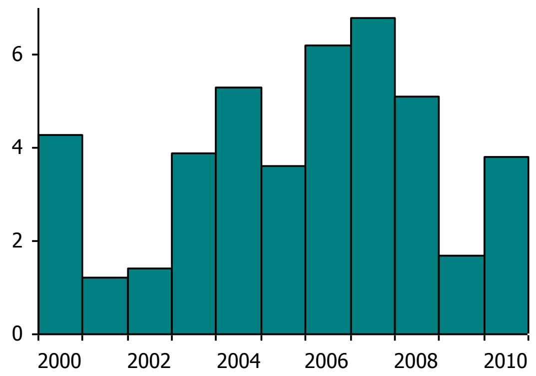


Figure 2.
Rate of GDP growth in selected countries and regions (%)

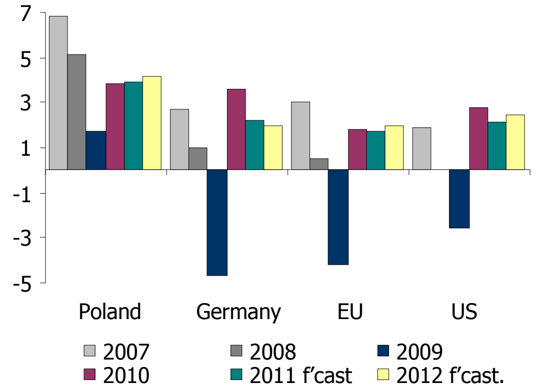


Figure 3.
Increase in foreign trade 2010/2009 (%)

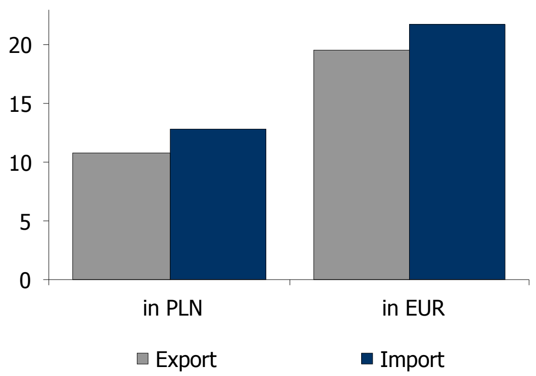
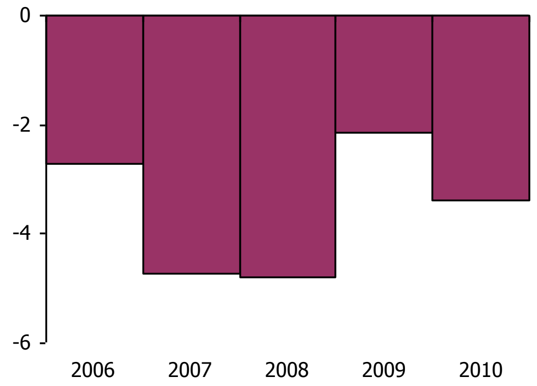


Figure 4.
Current account deficit as proportion of GDP (%)



[1] For further information see "Information on socio-economic situation of the country", GUS; "Financial results of non-financial enterprises in 2010", GUS; "Inflation Report", NBP; "World Economic Outlook", IMF; "Global Financial Stability Report" IMF; "Report on Financial Stability", NBP.

Figure 5.
Year-on-year growth in production and retail sales (%)

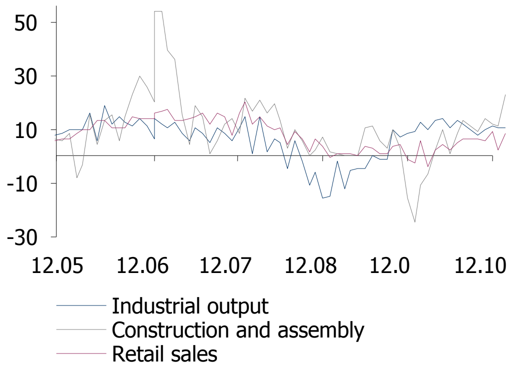


Figure 6.
Financial results of the enterprise sector (PLN bn)

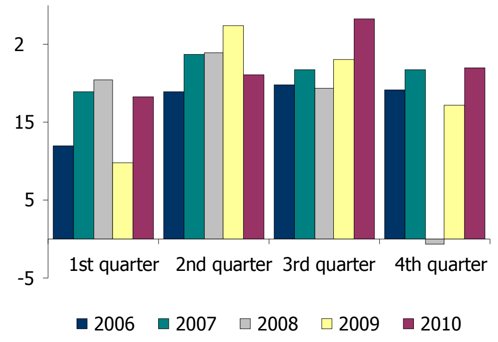


Figure 7.
Unemployment rate (%)

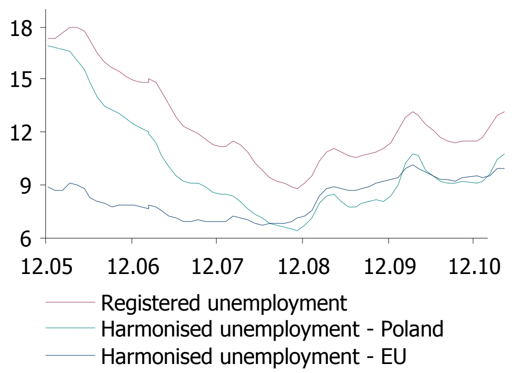


Figure 8.
Year-on-year growth in earnings and emp't in the ent. sector (%) (%)

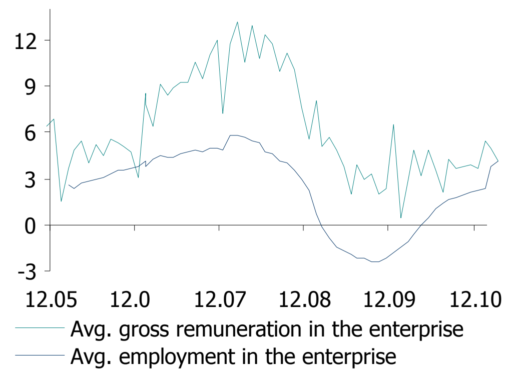


Figure 9.
Year-on-year increases in CPI and PPI (%)

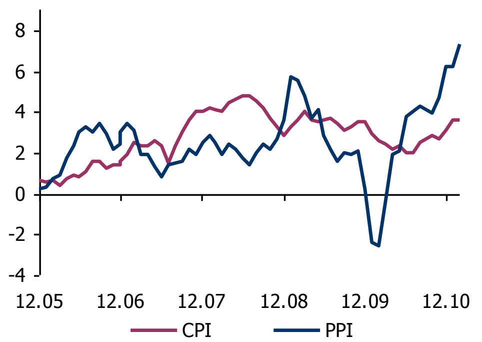


Figure 10.
Outlook and confidence indicators

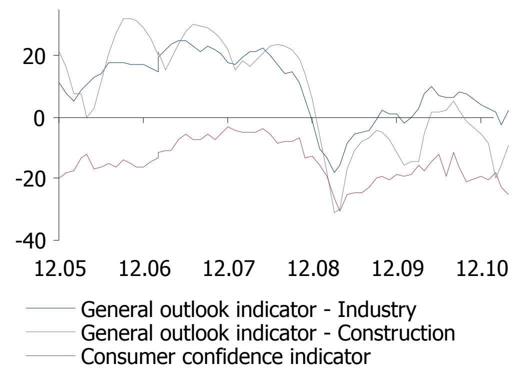


Figure 11.
Developers' activity ('000s)

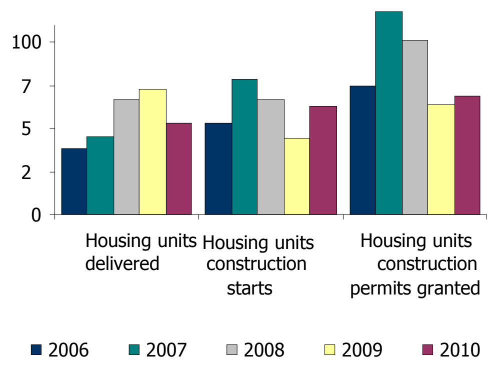


Figure 12.
Average price paid per sq. m. in the fourth quarter (PLN '000s)

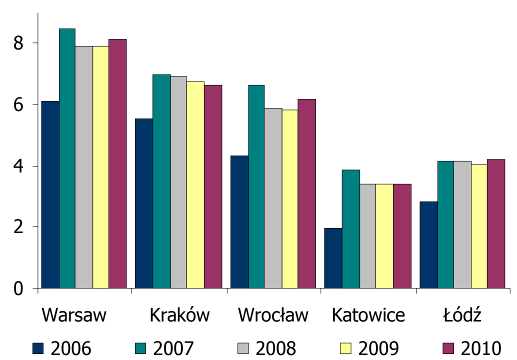


Figure 13.
Cumulative state budget deficit (PLN bn)

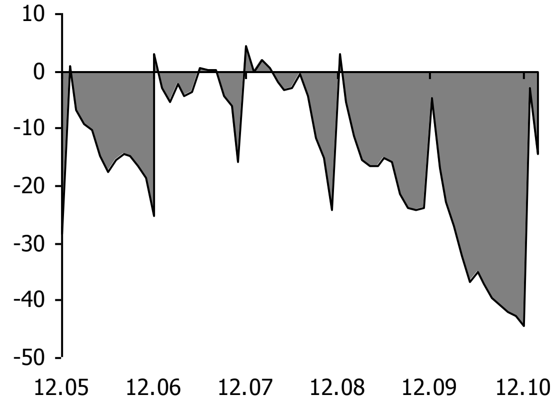
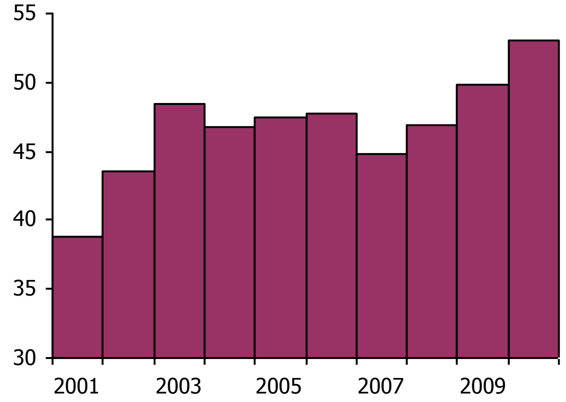


Figure 14.
Public sector debt as a proportion of GDP (%)



Source: GUS, Eurostat, NBP, AMRON, own calculations

- improvement in the financial results of the enterprise sector (net financial profits grew from PLN 78.9 bn in 2009 to PLN 89.4 bn in 2010, i.e. by 13.4%, and the proportion of enterprises reporting profits increased from 77.3% to 78.4%)., The indicator of cost levels fell while those of profitability and liquidity rose;
- gradual improvement in labour market conditions, shown by a small increase in employment and a rise in earnings. However, the rate of growth of earnings in the enterprise sector remained low (3.3% as against 4.4% in 2009 r.; in real terms growth amounted to 0.8% as against 1.1% in 2009 r.). At the same time the rate of registered unemployment was higher than in 2009 (at the end of 2010 it stood at 12.3%, as against 12.1% at the end of 2009);
- a gradual increase in inflationary pressure. It is true that the rate of growth of the prices of consumer goods and services was close to the MPC's inflation target but a significant increase in inflation was visible in the closing months of 2010 (in December the year-on-year CPI increase was 3.1%). This resulted from strong growth in commodity prices in world markets, which was reflected among other things in growth in fuel and food prices. Strong growth in the prices of industrial production sold was also recorded (in December the PPI was up by 6.2% year-on-year)[2];
- stabilisation of prices in the housing market. A substantial fall (of 26.4%) was recorded in the number of housing units delivered by developers but this was accompanied by a strong rise in the number of housing units construction of which was begun and by growth in the number of construction permits issued;
- the low or negative position of indicators of the overall outlook for industry and construction and of consumer confidence.

Despite the real revival of the economy it remains under strong pressure from the external environment, and in particular from uncertainty as to prospective developments in Poland's major trading partners and from the significant volatility of moods in financial markets.

Rapidly growing public sector debt may become an important constraint on the economy's development. State public debt increased from about PLN 669.9 bn at the end of 2009 to PLN 748.5 bn at the end of 2010. As a consequence **public debt rose** from 49.9% **of GDP to 53.0%.** This means that the first prudential threshold provided for in the Act on Public Finances has been crossed[3].

According to the EU's methodology the relationship of public debt (that of central and local government institutions in line with ESA 95) to GDP increased from 50.9% in 2009 to 55.1% in 2010.

[2] Adverse phenomena continued at the beginning of 2011 (the increase in VAT rates contributed to this), forcing the MPC to respond (see below).

[3] In accordance with the provisions of Article 86 of the Act on Public Finances, this means that, in the case of the budget for 2012, "The Council of Ministers is to approve a draft budget bill in which the relationship of the state budget deficit and state budget revenues cannot be higher than the relationship between the state budget deficit and state budget revenues in the current year".

1.2 The situation in financial markets

The situation in financial markets continued to be characterised by increased volatility but was more stable than in 2009 (and particularly in the first quarter of 2009). The greatest influence on moods and on the attitudes of market participants was exerted by the flow of macroeconomic data from the US, from the EU and from China, whose economy has become the second largest in the world.

Investors' greatest concerns related to the strength and durability of the recovery seen in crucial regions and countries, the fiscal situation of particular countries, the consequences of gradual tightening of Chinese economic policy and further loosening of monetary policy in the US. Particular worries among investors was created by the condition of public finances in so-called peripheral countries of the euro zone (Greece, Ireland, and this year also Portugal, sought international financial assistance and the European Stabilisation Mechanism was established). This was reflected in periodic worsening of conditions in equity and commodity markets and in weakening of local currencies vis-à-vis major currencies. It also led to weakening of the euro against the dollar and the Swiss franc.

Figure 15.
Central bank reference rates (%)

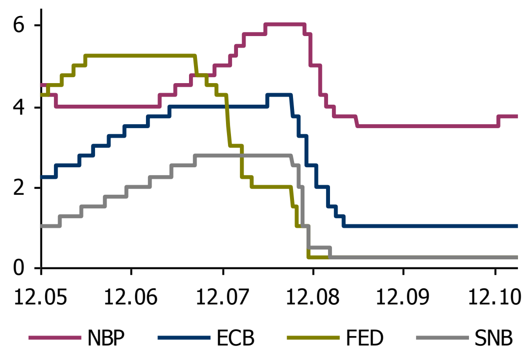


Figure 16.
Money market rates (%)

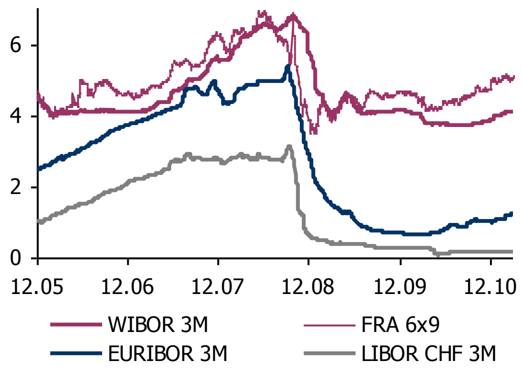


Figure 17.
Major currencies' exchange rates against the zloty

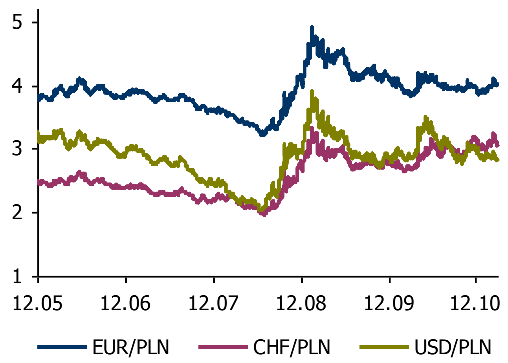


Figure 18.
Yields on Polish Treasury bonds (%)

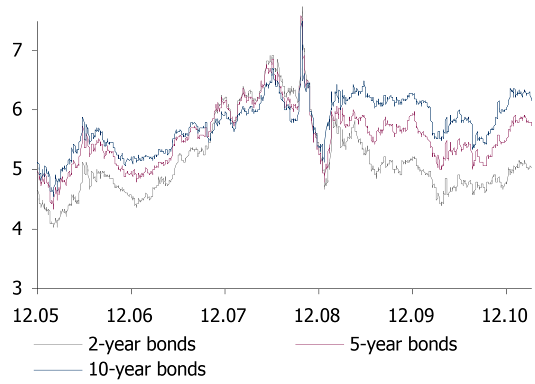


Figure 19.
Yields on 10-year Treasury bonds (%)

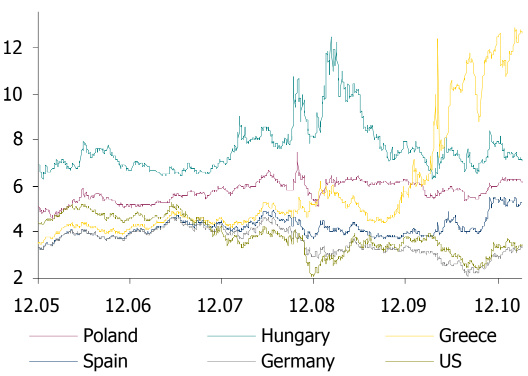


Figure 20.
5-year credit default swap rates (basis points)

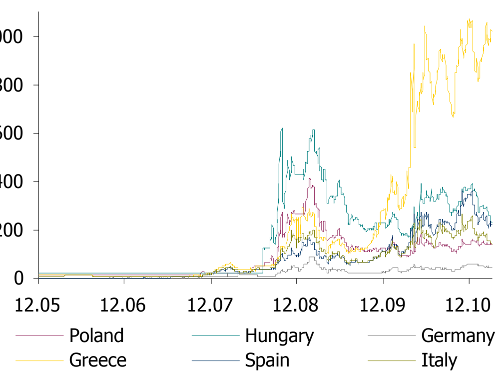


Figure 21.
Changes in market indices since end 2005 (%)

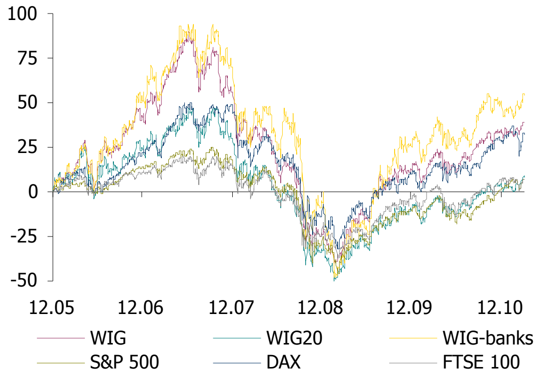


Figure 22.
Changes in commodity prices since end 2005 (%)

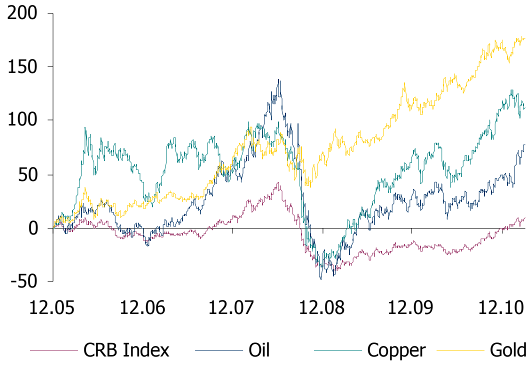


Figure 23.
Market capitalisation of selected banks (PLN bn)

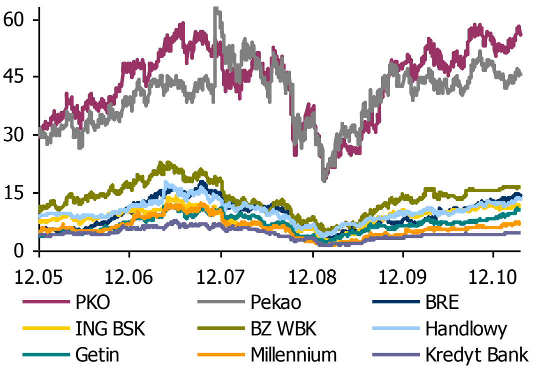
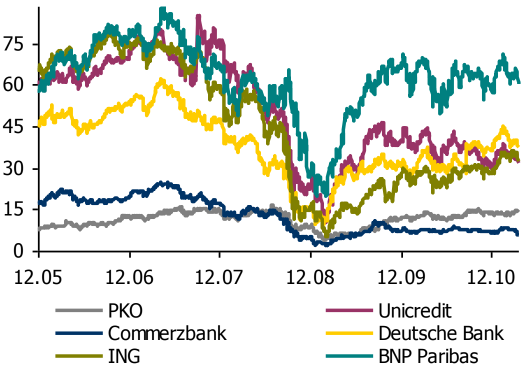


Figure 24.
Market cap. of PKO BP and selected EU banks (EUR bn)



Source: Bloomberg, own calculations

Attention should be paid to the following developments in domestic markets:

- **the MRC's leaving central bank rates unchanged**[4] while in October last year it raised the compulsory reserve ratio by half a percentage point from 3.00% to 3.50% (returning to the level before 30 June 2009);
- **the reduction of interest rates in the interbank market** (the average rate of 3m WIBOR fell from 4.1% in December 2009 to 3.8% in December 2010) **and of yields on Treasury bonds** (the average secondary market yield on 5-year Treasury bonds fell from 5.8% to 5.5% and that on 10-year bonds from 6.2% do 6.0%). From the fourth quarter of last year a gradual increase in Treasury bond yields and in interbank interest rates was perceptible, which is to be related to investors' expectations of tightening of monetary policy by the MRC.

  It should be noted here that **foreign investors' involvement in purchases of Polish Treasury securities increased greatly** (from PLN 81.8 bn at the end of 2009 to PLN 128.3 bn at the end of 2010), which "financed" almost all of the increase in their issuance (the quantity of Treasury securities in the hands of domestic entities fell from PLN 380.5 bn to PLN 378.7 bn). On the one hand this is a positive phenomenon but on the other it does give rise to an increase in systemic risk (given the present scale of the market withdrawal of a substantial part of these funds would certainly cause a rise in yields and weakening of the zloty); **investors' expectations of a rise in interest rates** (in December 2010 the average quote for 6 x 9 FRAs pointed to expectations that 3m WIBOR would rise to about 4.7%);
- **improvement in the functioning of the interbank market, although this market has continued to be less efficient than before the crisis.** This is manifested *inter alia* by low reciprocal credit limits and the reluctance of banks to accept risks. As a result banks have managed liquidity primarily by using overnight transactions, the share of which in total interbank turnover exceeded 90% while in the "pre-crisis" period it was about 80% of turnover;

[4] The ever more pronounced increase in inflationary pressure led, however, to the MPC's beginning a gradual tightening of monetary policy in 2011 (the reference rate was raised to 3.75% in January and to 4.00% in April).

- **continued increased volatility in the zloty's external value** (at end December 2009 and at the end of March, July, September and December 2010 the average NBP PLN/EUR rate was 4.1082; 3.8622; 4.1458; 3.9870 and 3.9603, the average NBP PLN/CHF rate 2.7661; 2.7000; 3.1345; 2.9955 and 3.1639, and the average NBP PLN/USD rate 2.8503; 2.8720; 3.3946; 2.9250 and 2.9641);
- **continuation of the price rises in the equity market** that began in the spring of 2009. The "increasingly selective nature of rises" should, however, be noted (in 2009 rises related to the "broad market"), as should some companies' capitalisation reaching a level close to or in excess of their value at the peak of the previous bull market (in some cases this gave rise to concerns about how justified valuations were)[5].

Figure 25.
Average interest rates on deposits and loans in place (%)

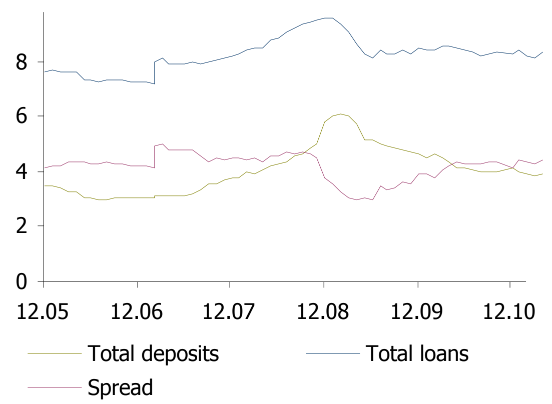
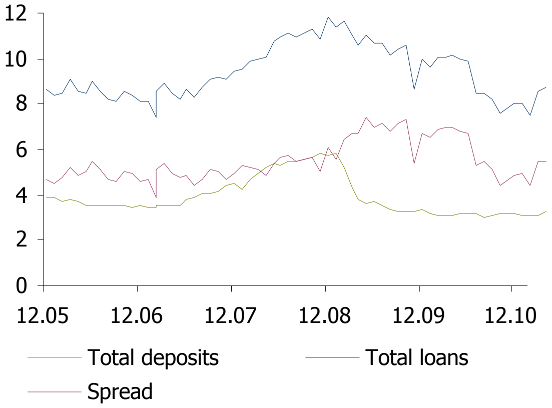


Figure 26.
Average interest rates on new deposits and loans (%)



Source: NBP, own calculations

In 2010 banks made an adjustment to their deposit-lending policy[6]. On the basis of changes in the interest rates applying to new agreements one can state that the **banks did not in essence alter what they offered depositors** and kept the interest rate paid on deposits at a level only a little above 3%. On the other hand there was an appreciable **reduction in the interest rate applied to newly arranged loans** from about 9-10% at the end of 2009 go about 8% at the end of 2010, which reflected a reduction in margin.

What was crucial in determining banks' results in this regard was, however, the interest rates applied during the year to all agreements in place. In relation to this it can be asserted that average interest rate applied to all deposits during the whole of 2010 was about 4.1% and was significantly lower than in 2009, when it was 5.1%. In turn the average interest rate applied to all loans during the whole of 2010 was about 8.4%, as against 8.5% in 2009. This explains the strong growth in profits on deposit-taking and lending activity by the banking sector that was seen in 2010 (see below).

[5] This latter phenomenon is probably related, *inter alia*, to the very large number of companies that have entered the market in recent years and to the rapid development of the New Connect market. In regard to this, it appears necessary to think further about the strategy for development of the capital market, since the current situation may lead to negative consequences manifested, among other things, in declining interest on the part of small and medium-sized investors in capital market, the lack of trustworthy market valuation or manipulation of share prices. The size of the market (including the number of listed companies) and the length of the trading session should be adjusted to match the scale of the entire economy.

[6] Caution should be used when interpreting these data because of changes in NBP reporting (data since June 2010 are not fully comparable with those for previous periods) and because of significant fluctuations in certain items (this relates above all to the interest rate on total new lending).

To summarise, **2010 saw a rise in the rate of growth of the Polish economy. However, it continued to be subject to strong pressure from the external environment. An important restraint has been the rapidly rising indebtedness of the public sector,** which may lead to successive precautionary thresholds being passed, which would force the government to cut expenditure radically and to do so quickly, which would have negative effects on economic growth.

The situation in financial markets improved further but markets remained uncertain and volatility high (investors' principal fears related to the strength and durability of the recovery seen in crucial regions and countries, the fiscal situation of particular countries, and especially that of peripheral countries of the Euro zone, and the consequences of gradual tightening in Chinese economic policy). This was reflected in periodic weakness in equity and commodity markets, in weakening of local currencies vis-à-vis major currencies and in weakening of the euro vis-à-vis the dollar and the Swiss franc.

Despite the improvement in the functioning of the domestic interbank market it continues to be less than fully efficient, which is manifested *inter alia* in low reciprocal credit limits and the limitation of transactions principally to overnight transactions.

Thus, despite the decided improvement in the functioning of financial markets in recent quarters together with the global economy's entering a growth path, **a heightened level of risk continues to affect the business of the banking sector.** As a consequence banks must face up to the possibility of disturbances of an external nature, which may affect negatively their situation. Therefore **it is necessary for banks to take potential threats into account when formulating their strategies.**

2 PRINCIPAL DIRECTIONS OF THE DEVELOPMENT OF THE BANKING SECTOR'S BUSINESS[7]

In the first half of 2010, the situation of the banking sector remained stable. However the substantial worsening in the quality of the loan portfolio and the uncertainty as to development of the macroeconomic situation seen in 2009-2010 gave rise to tightening of lending policy in some areas (and above all in consumer loans). Together with reduced demand for loans from certain entities (particularly some enterprises) this led to a further **slowdown in new lending.** The main areas of development were housing lending, loans to individual entrepreneurs and loans to the budget sector. On the other hand banks increased their portfolio of NBP bills and Treasury bonds, which promised high liquidity and a safe income. At the same time banks **increased their deposit base** (most of the growth took place in the fourth quarter).

Despite still difficult external conditions and **worsening of the quality of the loans portfolio the banks succeeded in significantly improving their financial results.** This resulted from higher profits on deposit-taking and lending activity and a reduction in the negative balance of write-offs (this last factor appeared only in the fourth quarter). Further **increase in the capital base** must also be viewed as a positive phenomenon.

Table 1. Selected data on the banking sector – changes in relation to the end of 2009

	Growth or Positive change	Stabilisation or lack of significant change	Decrease or negative change
Employment	**1,700**		
Number of branches and sub-branches	**260**		
Balance sheet total	**9.5%** (adj.[8] - approx. 7.5%)		
Financial result	**41.0%**		
New loans			
Households	**14.2%** (adj. - Approx. 9.1%)		
Housing loans	**22.8%** (adj. - approx. 13.0%)		
Consumer loans		**1.4%**	
Enterprises		**-1.1%**	
Small and medium-sized ents.		**-0.2%**	
Large enterprises			**-2.3%**
Budget sector	**31.9%**		
Debt instruments portfolio	**15.4%**		
Deposits of non-financial sector	**9.4%**		
Households	**8.9%**		
Enterprises	**10.7%**		
Proportion of impaired loans			
Households			**7.2% (from 6.0%)**
Housing loans			**1.8% (from 1.5%)**
Consumer loans			**17.3% (from 13.0%)**
Enterprises			**12.4% (from 11.6%)**
Small and medium-sized ents.			**14.5% (from 13.4%)**
Large enterprises		**9.5% (from 9.2%)**	
Budget sector		**0.2% (from 0.2%)**	
Capital adequacy			
Own funds	**11.6%**		
Solvency ratio	**13.8% (from 13.3%)**		

The balance sheet totals of the banking sector **rose by 9.5%** from PLN 1,057.4 bn at the end of 2009 to PLN 1,158.0 bn at the end of 2010, with this in part arising from the weakness of the zloty vis-à-vis the Swiss franc and dollar (strengthening vis-à-vis the euro acted in the contrary direction). If the effects of foreign exchange fluctuations were eliminated then growth in balance sheet totals would be **7.5%.** Attention is drawn here to the relative low level of activity of some large and medium-sized banks, which arose from their more conservative strategies, changes to previously-pursued strategies, changes in strategic investor, "subordination" of banks as a result of mergers, or "cleansing" of the loan portfolio.

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[7] Note: Unless otherwise stated, the source of all data presented below is the database of the Office of the PFSA. The data come from the database of as it stood at 12 March 11 and do not take into account subsequent corrections.

[8] Growth rate adjusted for the impact of exchange rate fluctuations (if the impact was negligible it is omitted from the presentation). To determine the growth rate adjusted for changes in exchange rates, rates are assumed to remain stable at their levels at the end of 2010, but additional assumptions were used in calculations because of the limitations of the reporting system. The adjusted growth rates presented in different parts of this material should therefore be treated as estimates.

2.1 Structure of the sector, employment, sales network, concentration, role in the economy

The structure of the banking sector did not undergo significant change.

Table 2. Selected data on the structure of the banking sector

	2006	2007	2008	2009	2010
Number of banks and branches of credit institutions					
Total, of which:	647	645	649	643	646
- commercial banks	51	50	52	49	49
- branches of credit institutions	12	14	18	18	21
- cooperative banks	584	581	579	576	576
Ownership structure proportion of assets (%)					
Domestic investors:	30.3	29.1	27.7	31.9	33.8
- Banks controlled by the State Treasury	19.8	18.3	17.3	20.8	21.5
- other commercial banks	4.3	4.6	5.0	5.3	6.2
- cooperative banks	6.2	6.2	5.4	5.8	6.1
Foreign investors:	69.7	70.9	72.3	68.1	66.2
- commercial banks	66.6	66.6	66.9	62.8	61.5
- branches of credit institutions	3.1	4.3	5.4	5.3	4.7
Employment					
Total, of which:	157,931	167,127	181,114	175,249	176,915
- commercial banks	127,201	133,724	145,839	138,094	139,042
- branches of credit institutions	1,826	3,300	4,608	5,433	5,742
- cooperative banks	28,904	30,103	30,667	31,722	32,131
Number of branches and sub-branches					
Total, of which:	11,927	12,847	13,655	13,910	14,170
- commercial banks	8,541	9,230	9,902	9,780	9,953
- branches of credit institutions	171	184	212	354	353
- cooperative banks	3,215	3,433	3,541	3,776	3,864

At the end of 2010 **646 banks and branches of credit institutions were engaged in business:**

- the number of commercial banks remained unchanged at 49, with 2010 seeing the merger of Getin Bank with Noble Bank and the start of business by FM Bank;
- the number of branches of credit institutions increased from 18 to 21 (Aareal Bank Aktiengesellschaft, Citibank Europe, Ikano Bank and Nordea Bank began operations and Commerzbank's branch was merged into BRE);
- the number of cooperative banks remained unchanged at 576.Cooperative banks are grouped into three structures: Bank Polskiej Spółdzielczości (359), Gospodarczy Bank Wielkopolski (150) and Mazowiecki Bank Regionalny (66), and during the year 11 banks changed association. Krakowski Bank Spółdzielczy, which functions independently, constitutes an exception.

In the ownership structure of the banking sector the second year in a row saw an **increase in domestic banks' share in the sector's assets:**

- **domestic investors controlled ten commercial banks and all the cooperative banks (**the **State Treasury** controlled **four commercial banks -** PKO Bank Polski, Bank Gospodarstwa Krajowego, Bank Pocztowy and Bank Ochrony Środowiska). Measured by assets, their **share in the market** increased from 31.9% to **33.8%.**
- foreign investors controlled 39 commercial banks and all the branches of credit institutions. At the end of 2010 **investors from 18 countries** were present in the banking sector, with the leading role being played by Italian investors (controlling 12.4% of the sector's assets), who are followed by German (10.4%), Dutch (8.6%), American (6.9%) and French (5.8%) investors. In this regard it should be noted that the sale of BZ WBK by Allied Irish Banks (from Ireland) to Banco Santander (Spain) took place in 2010 with the PFSA giving consent to the exercise of rights arising from shares by Santander in 2011.

Additionally, as a consequence of the 2007-2009 crisis, changes of strategic investors in other banks cannot be excluded.

2010 saw **growth in employment** and **growth of the sales network:**

- at the end of 2010 176,900 people were employed in the banking sector, a rise of 1,700 from the end of 2009, though the two largest banks were continuing to reduce employment.
- at the end of 2010 the sales network of the banking sector consisted of 14,170 locations, an increase of 260 from the end of 2009. This growth occurred, however, primarily in smaller banks and in the cooperative bank sector.

Banks' financial plans indicate that a **reduction of employment can be expected in 2011.** On the other hand banks plan to **expand their sales network.**

The level of concentration of the Polish banking sector remained unchanged. The share of the five largest banks in the system **amounted to 43.9%** (and that of the ten largest to 63.1%) and was at the **average level to be found in EU countries** (44.3%).

The unquestioned **leading position is occupied by PKO BP** (with balance sheet totals close to PLN 170 bn), followed by Pekao (approximately PLN 130 bn) and BRE (close to PLN 85 bn). Following them are ING BSK and BGK with assets of over PLN 60 bn and a group of banks with assets above PLN 35 bn. It is notable that Getin Noble has appeared among the ten largest banks.

The assets of most cooperative banks are under PLN 100 m and only 15 of them have balance sheet totals over PLN 500 m. The leaders in this sector remain Krakowski Bank Spółdzielczości and Podkarpacki Bank Spółdzielczy, whose assets are now close to PLN 2 bn, and Wielkopolski Bank Spółdzielczy, which has balance sheet totals of more than PLN 1 bn.

Figure 27.
Structure of the financial system (%)

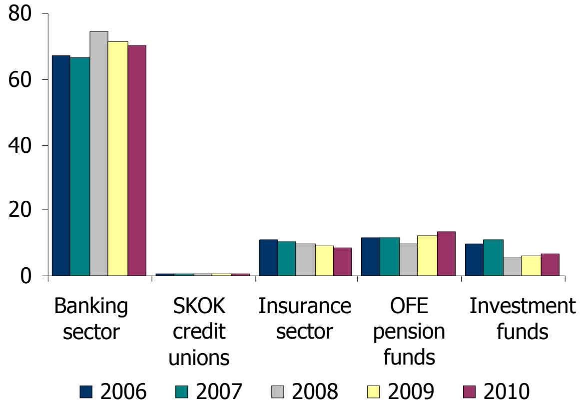
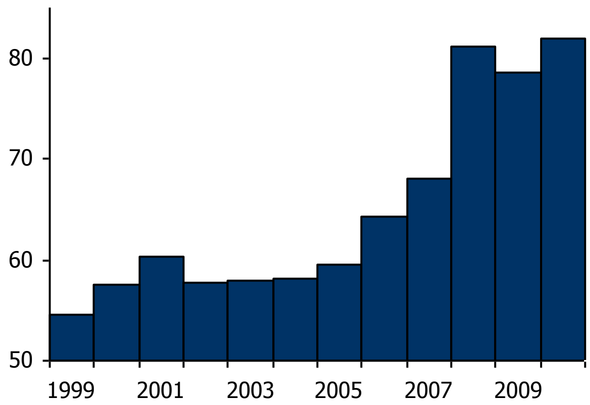


Figure 28.
Assets of the banking sector as a proportion of GDP (%)



At the end of 2010 the **assets of the banking sector accounted for about 70% of the entire financial system** (excluding the NBP), with the assets of the largest bank being comparable to the total assets of other parts of the financial system. The **stability of the banking sector is** therefore **of crucial importance for the stability of the financial system as a whole**.

Assets of the banking sector amount to about **82% of GDP.**

Figure 29.
Assets of the banking sector as a proportion of GDP (%) - 2009

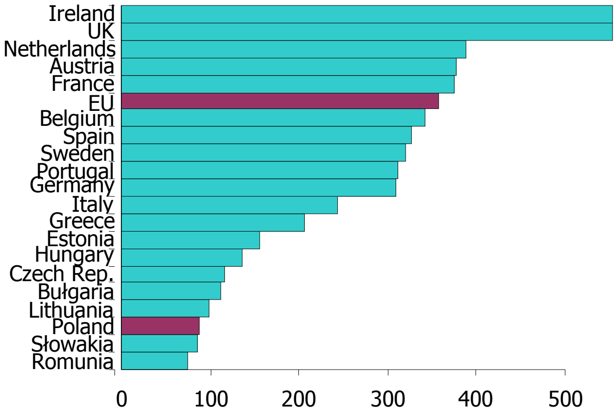


Figure 30.
Total non-bank deposits as a proportion of GDP - 2009

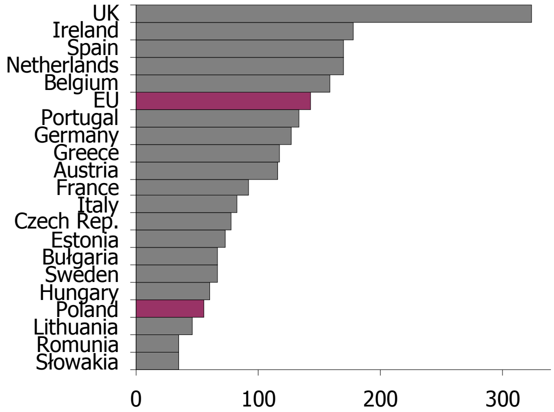


Figure 31.
Loans to enterprises as a proportion of GDP (%) - 2009

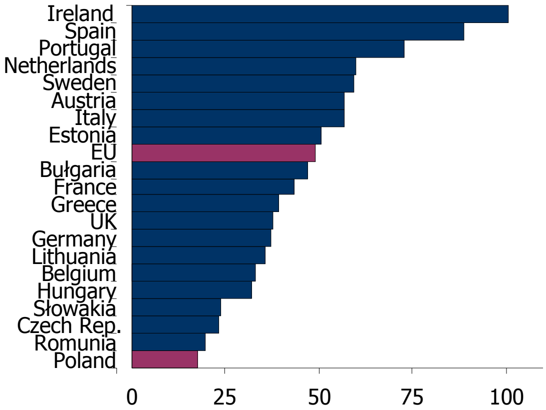


Figure 32.
Loans to households as a proportion of GDP (%) - 2009

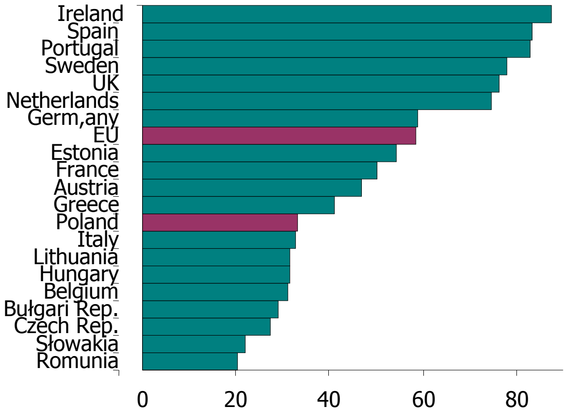


Figure 33.
Housing loans as a proportion of GDP (%) - 2009

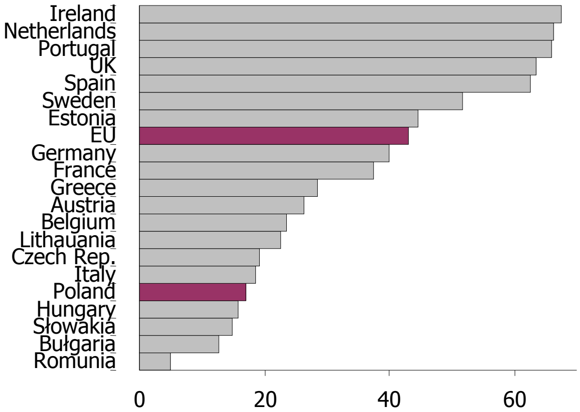
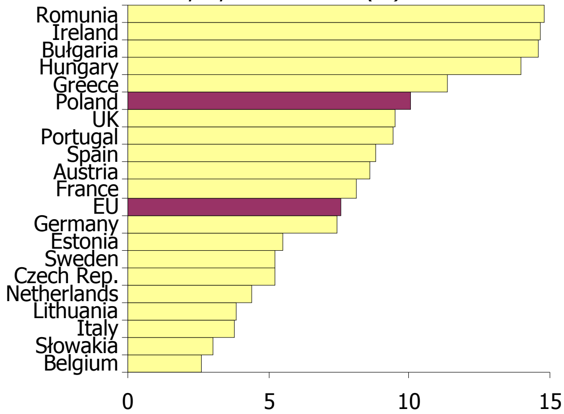


Figure 34.
Consumer loans as a proportion of GDP (%) - 2009



Source: "Report on EU banking structures", ECB 2010, own calculations

Comparison of selected data on the banking sector in Poland and in other EU countries makes clear the **low level of banking penetration** of the Polish economy. It is true that the second half of the last decade saw rapid development of the banking sector but to a large degree this was the result solely of the very rapid growth in housing loans. The low level of banking penetration bears witness to the significant **potential for development of the Polish banking system.** However it is **necessary for this to be balanced**, so that on the one hand it favours economic development and on the other it does not lead to the appearance of or increase in "tension" and imbalance in the banking system and in the economy as a whole. It is important to note here the **major limitation that is constituted by the relatively low level of savings accumulated in banks**, and as a result it is desirable to create systemic incentives to increase savings in banks (and particularly long-term savings) and development of the market for medium- and long-term instruments.

2.2 Lending and investment activity

In 2010 the volume of **new lending continued to grow only slowly.** The value of total lending[9] (by gross balance sheet value) grew by **10.2%** from PLN 713.9 bn at the end of 2009 to PLN 786.8 bn at the end of 2010 (growth in the fourth quarter of the year amounted to 3.2%). However part of this growth was due to the zloty's weakening against the Swiss franc and dollar, which affected the value expressed in zlotys of loans extended in or denominated in those currencies (the strengthening of the zloty vis-à-vis the euro acted in the contrary direction. After elimination of the effect of exchange rate fluctuations the growth over the year of loans was about PLN 55 bn and the rate of growth about **7.5%** (in the fourth quarter it was about 2.2%).

Table 3. Structure of the loan portfolio (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total lending, of which:	653.6	713.9	711.3	752.6	762.1	786.8	10.2%	3.2%
1/ Financial sector	19.1	24.6	24.1	23.3	23.4	24.9	1.2%	6.4%
2/ Non-financial sector	608.0	641.2	641.6	681.0	683.7	698.5	8.9%	2.2%
- households	372.4	416.4	420.7	455.3	459.1	475.4	14.2%	3.6%
private individuals	318.0	356.9	359.7	391.5	394.2	410.8	15.1%	4.2%
individual entrepreneurs[10]	35.8	40.2	41.6	43.6	44.4	44.6	11.0%	0.5%
individual farmers	18.6	19.3	19.4	20.2	20.4	20.0	3.5%	-2.0%
- enterprises	233.3	222.1	218.1	222.8	221.5	219.7	-1.1%	-0.8%
small and medium-sized ents.	125.3	127.2	125.6	129.0	128.3	127.0	-0.2%	-1.0%
large enterprises	108.0	94.9	92.5	93.8	93.2	92.7	-2.3%	-0.6%
- non-profit institutions	2.3	2.7	2.8	2.9	3.1	3.4	25.2%	10.2%
3/ Budget sector	26.5	48.1	45.6	48.3	55.0	63.4	31.9%	15.2%
- government institutions	8.8	19.0	19.9	21.9	25.2	28.4	49.4%	12.7%
- local government institutions	17.7	25.2	24.1	24.9	28.3	35.0	38.5%	23.7%
- social insurance funds	0.0	3.8	1.6	1.5	1.5	0.0	-100.0%	-100.0%
Loan structure by currency								
- zloty	433.1	488.2	492.8	502.3	522.2	534.1	9.4%	2.3%
- foreign currency	220.5	225.7	218.5	250.3	239.9	252.7	12.0%	5.3%
of which households	152.0	157.4	154.4	180.3	174.8	184.6	17.3%	5.6%

Figure 35.
Loans to selected groups of customers (PLN bn)

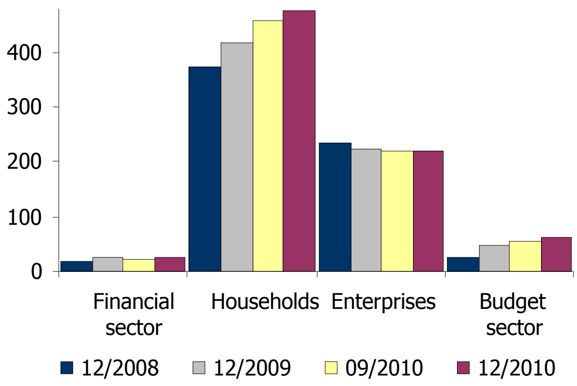
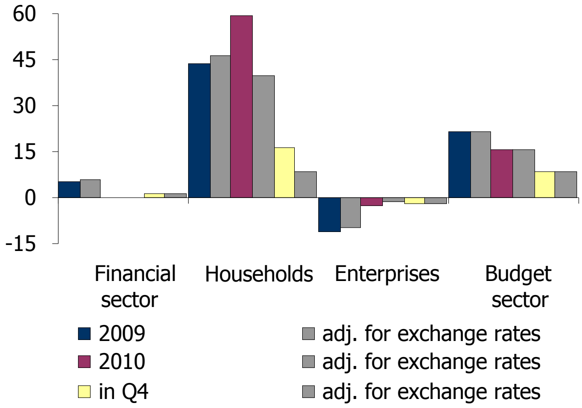


Figure 36.
Change in loans outstanding in 2009 and 2010 (PLN bn)



[9] Starting from the report for 2010, the Office of the PFSA is changing the way in which the loan portfolio is presented. First, the concept of total loan portfolio, which was previously identified with non-financial sector loans, has been expanded to include loans to the financial sector (other than banks) and loans to the budget sector, which were previously considered separately. Secondly, the meaning of the term loan portfolio has been expanded to include so-called other receivables, which were not previously treated as loans (they were considered together with loans in the category of total receivables).

[10] Natural persons conducting economic activity on their own account in which no more than nine people were working at the end of the fiscal year last completed.

After a large increase in 2009 the value of loans to the **financial sector** stabilised (growth amounted to 1.2% after 28.9% in 2009). The proportion of these loans in the total loan portfolio remained marginal at barely 3.2%.

The value of loans to the **non-financial sector** increased in 2010 by **8.9%** (after 5.5% in 2009). After adjustment for the effect of exchange rate fluctuations, the rate of growth was close to that seen in 2009 at about **5.9%.** It should be noted, though, that the portfolio of these loans was characterised by rates of growth that varied widely according to the sector and nature of loans. On the one hand rapid growth was seen in housing loans to households and individual entrepreneurs while on the other the value of outstanding consumer loans and loans to the enterprise sector stagnated or fell (see below). The slowing in the rate of growth of new loans has been the result of several interrelated factors. A crucial role has undoubtedly been played by the effects of the financial crisis, which led to limitation of activity by some entities and at the same time to increased uncertainty as to the economic outlook and to a greater awareness of risk on the part of both banks and borrowers. As a consequence some enterprises and households reduced their demand for credit. Meanwhile, experience gained during the crisis and the sharp deterioration of the quality of the loan portfolio (in part as a result of the crisis and in part the product of inappropriate business models and risk-assessment systems) led to an adjustment in banks' lending policies. This consisted *inter alia* in the tightening of standards for loans, which gave rise to limitation of the financing of more risky customers.

Last year witnessed the continuation of strong growth in loans to the **budget sector,** the value of which rose by **31.9%** and the share of which in the lending portfolio increased to 8.1% (from 6.7%).

Table 4. Structure of loans to households (PLN bn, %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total loans	372.4	416.4	420.7	455.3	459.1	475.4	14.2%	3.6%
Structure of loans by product								
1/ Housing loans	195.1	217.8	219.7	249.3	251.1	267.5	22.8%	6.5%
2/ Consumer loans	116.6	132.2	132.4	134.1	134.5	134.0	1.4%	-0.4%
3/ Other	60.7	66.5	68.6	71.9	73.5	73.9	11.1%	0.6%
Structure of loans by currency								
- zloty	220.4	259.0	266.4	275.0	284.2	290.8	12.3%	2.3%
- foreign currency	152.0	157.4	154.4	180.3	174.8	184.6	17.3%	5.6%
- EUR	4.2	9.9	11.3	15.6	18.4	22.0	121.5%	19.7%
- CHF	132.8	134.0	129.8	149.7	142.5	148.6	10.9%	4.3%
- other currencies	15.0	13.4	13.2	15.0	13.9	14.0	3.9%	0.2%

Figure 37.
Product structure of loans to households (PLN bn)

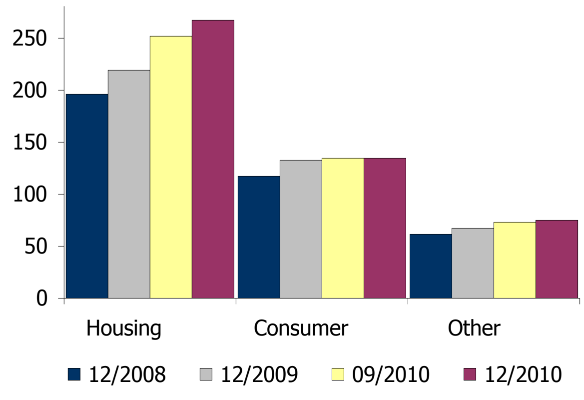
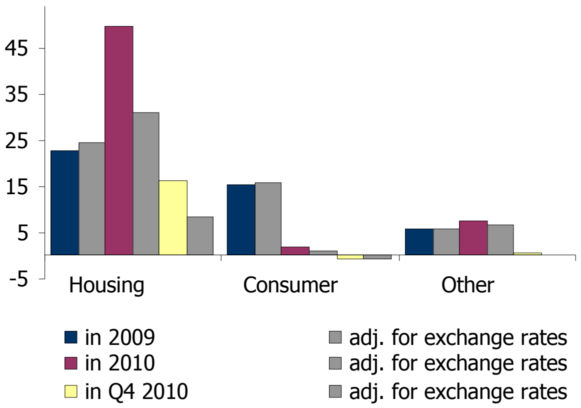


Figure 38.
Change in loans outstanding in 2009 and 2010 (PLN bn)



The value of the portfolio of **loans to households** increased by **14.2%** (growth in the fourth quarter of last year amounted to 3.6%) and their share in the total lending increased to 60.4% (from 58.3% at the end of 2009). After elimination of the effect of exchange rate fluctuations the growth in lending over the year was about PLN 40 bn and the rate of growth about **9.1%** (in the fourth quarter it was about 1.8%) and was a little lower than in 2009 as a whole (about 11.9%).

Growth in the portfolio of housing loans was of crucial importance in determining the rate of growth of lending to households, while lending to individual entrepreneurs had less impact and the portfolio of consumer loans remained at a level close to that of 2009.

Table 5. Structure of housing loans (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total housing loans, of which:	195.1	217.8	219.7	249.3	251.1	267.5	22.8%	6.5%
- zloty	59.1	75.6	79.7	85.2	91.4	98.2	29.9%	7.5%
- foreign currency	136.0	142.1	140.0	164.1	159.7	169.3	19.1%	6.0%
- EUR	2.6	7.6	9.5	13.5	16.2	19.7	161.2%	21.5%
- CHF	131.9	132.9	128.8	148.5	141.4	147.4	10.9%	4.3%
- other currencies	1.5	1.7	1.7	2.1	2.1	2.1	27.8%	2.6%

Figure 39.
Currency structure of housing loans (PLN bn

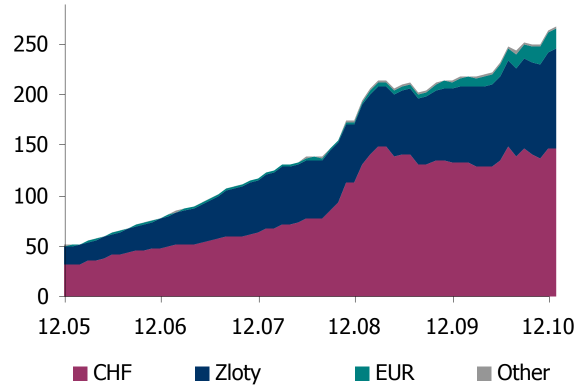


Figure 40.
Annual rate of growth in housing loans (%)

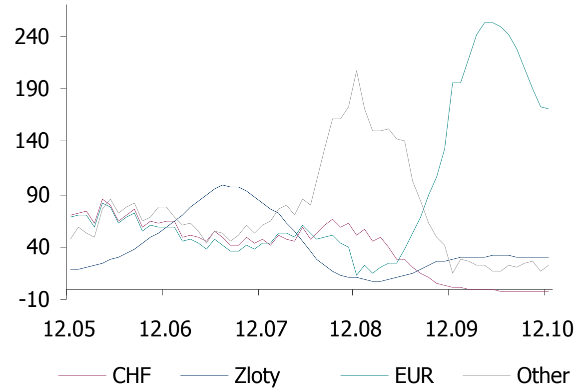


Figure 41.
Quarterly growth in housing loans (PLN bn)

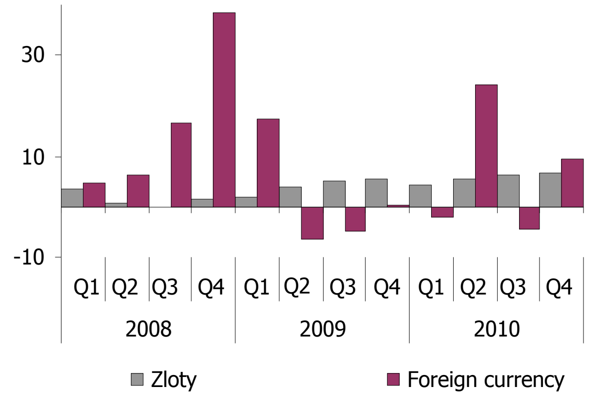
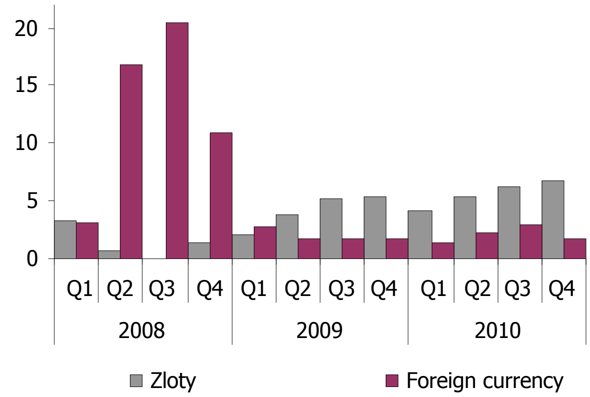


Figure 42.
Growth corrected for exchange rate fluctuations (PLN bn)



The increase in the portfolio of housing loans, which were the largest item both among loans to households and in the overall loan portfolio, **had a decisive effect on the growth of loans** to households and on that of the **total loan portfolio.**

The value of the portfolio of housing loans increased by 22.8% (and in the fourth quarter of last year by 6.5%), from PLN 217.8 bn at the end of 2009 to PLN 267.5 bn at the end of 2010, and their **share in the loan portfolio increased to 34.0%** (from 30.5% at the end of 2009). However, a strong influence on the growth of loans was exerted by the weakness of the zloty vis-à-vis the Swiss franc. After elimination of the effect of exchange rate fluctuations the growth over the year of credits was about PLN 31 bn and the rate of growth about **13.0%** (in the fourth quarter it was about 3.3%) and was a little higher than in 2009 as a whole (about 11.6%).

Notable here is the strong rise in the housing loans portfolio in several medium-sized and small banks, which may give rise to concern as to whether a strategy directed at rapidly expanding their share in the market may have been accompanied by acceptance of excessive risk, which may materialise in the future. It should, however, be noted that this observation relates to all the banks that expanded their business in the housing loans market in 2005-2008. On the other hand the year saw stagnation or a fall in new lending in two banks, which previously had a strong position in the market for housing loans, which should be attributed to a change in their strategy.

The clear dominance of zloty loans in the structure of new housing loans should be regarded as a positive phenomenon. The value of **zloty** loans increased by PLN 22.6 bn, i.e. by **29.9%** (and in 2009 by PLN 16.5 bn, i.e. by 28.0%). In consequence the share of zloty loans in the housing loans portfolio increased to 36.7% (from 34.7% at the end of 2009). The value of the portfolio of **foreign currency** loans, it is true, increased by PLN 27.2 bn, i.e. by **19.1%,** but after elimination of the effect of exchange rate fluctuations the growth in foreign currency loans was about PLN 8 bn and the rate of growth about **5.1%** (after about 5.3% in 2009). It should be noted here that a fundamental change took place in the structure of newly extended foreign currency loans consisting of displacement of the Swiss franc by the euro.

Analysis of the structure of foreign currency loans extended by particular banks shows that only one bank continued to engage in widespread **financing in Swiss franc.** In the other banks the level of financing in that currency stabilised or fell, and the nominal growth in the portfolio of these loans derived only from the weakening of the zloty vis-à-vis the Swiss franc. In turn in the case of **euro**-denominated loans it is notable that the market for such loans has been **developed primarily by smaller entities. Large banks** (with one exception) have made a fundamental alteration to their lending policy in regard to foreign currency lending and in recent periods have concentrated on development of new lending in zlotys.

Figure 43.
Number of loans extended under the RnS programme ('000s)

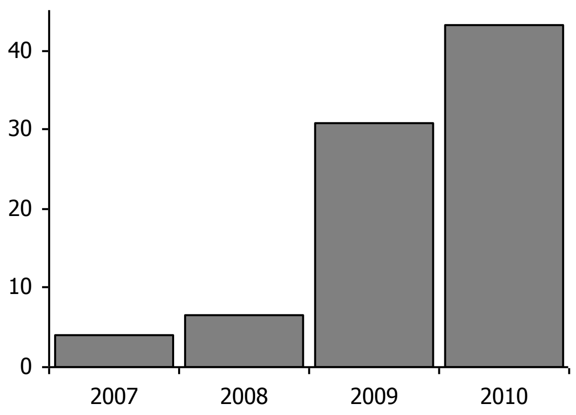
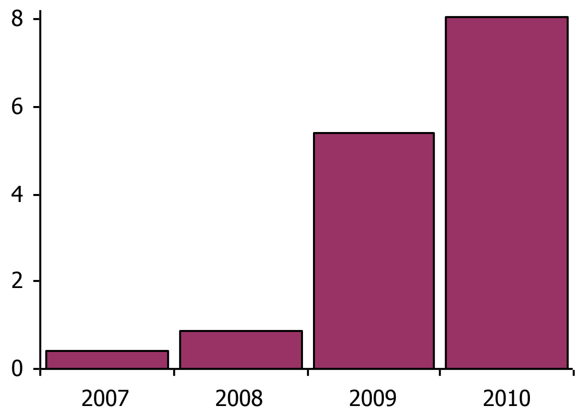


Figure 44.
Value of loans extended under the RnS programme (PLN bn)



Source: BGK

Favourable changes in the currency structure of the housing loans portfolio must also be related to the actions of the banking supervisor and to growing awareness of currency risk on the part of customers and banks, resulting in reduced demand for foreign currency loans and in tightening of conditions for their extension by banks. One factor that has favoured the growth of zloty-denominated credits has been the "Rodzina na Swoim" [Family in its Own] programme, which despite a whole series of reservations as to how this functioned and the risk it generated for the banking system (arising from the step increase in payments by customers after eight years) caused growth in the zloty loan portfolio, since only such loans could be covered by the programme (in 2010 43,100 loans with a total value of more than PLN 8 bn were extended under this programme).

Figure 45.
Number of loans extended ('000s)

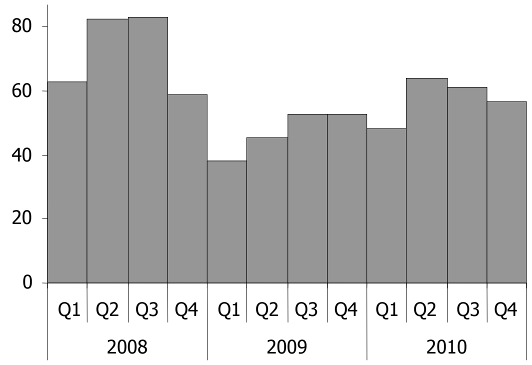


Figure 46.
Number of loans outstanding at end year ('000s)

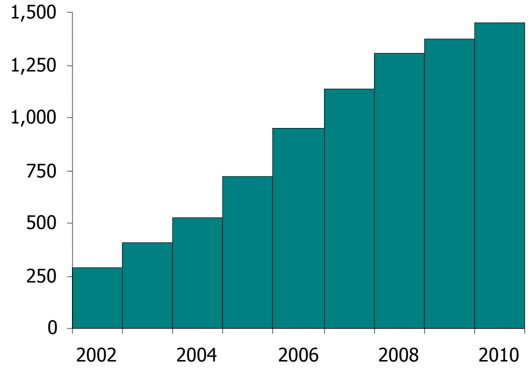


Figure 47.
Value of loans extended (PLN bn)

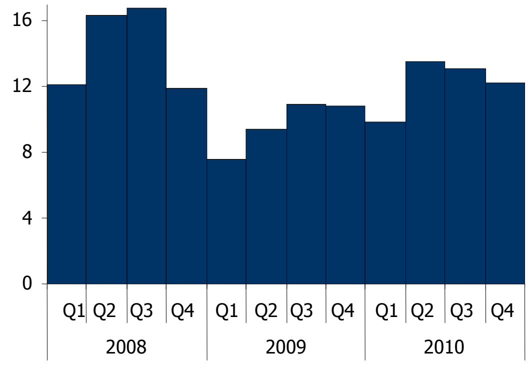


Figure 48.
Size of newly-extended loans (%)

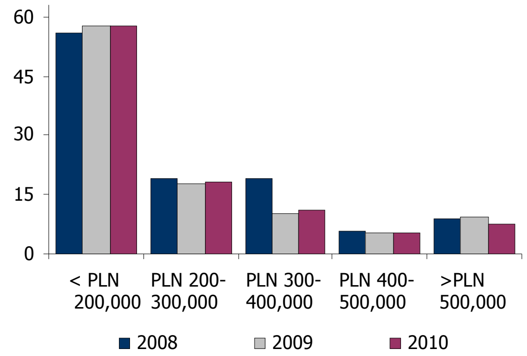


Figure 49.
Currency structure of newly-extended housing loans (%)

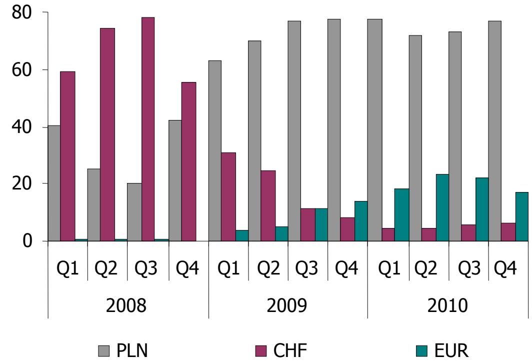


Figure 50.
Share of loans with LTV>80% in newly-extended loans (%)

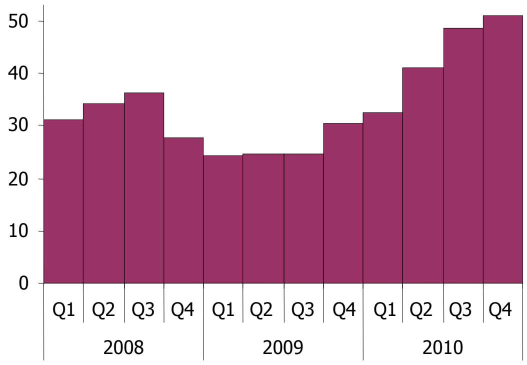


Figure 51.
Average value of newly-extended loans (PLN '000s)

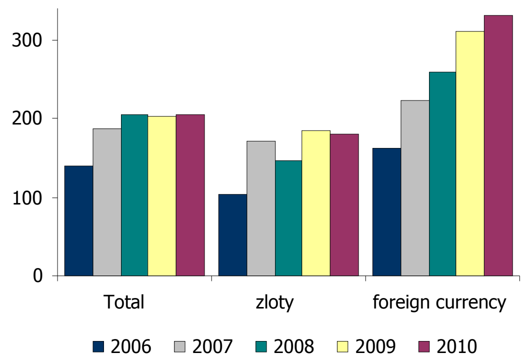
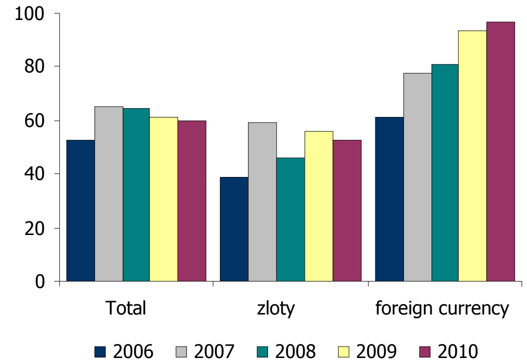


Figure 52.
Average value of loan /average monthly earnings



Source: ZBP, AMRON-SARFiN, GUS, own calculations

According to ZBP [Związek Banków Polskich – Polish Bank Union][11] data, at the end of 2010 1,448,800 loan agreements were in force, an increase from the end of 2009 of 74,100. It is true that the annual growth of loan agreements was decidedly lower than during the credit boom (in 2005-2007 annual growth was of the order of 200,000) but it was slightly higher than in 2009 (and one should bear in mind the gradual "saturation of the market").

Starting from the second half of 2009, the **banks have eased lending policy** in relation to the margin on loans, maximum LTV, maximum term of loans and currency denomination of loans. **Some phenomena should, however, be judged to be negative:**

- **the marked easing in requirements regarding maximum LTV - in the first quarter of last year loans with LTV greater than 80% accounted for less than one third of newly granted loans but in the fourth quarter they accounted for more than half[12].** Starting from the second quarter last year the share of loans with LTV above 80% was **much higher than at the peak of growth in new lending in 2008.** In the year as a whole loans with LTV above 80% accounted for 43% of newly-extended loans, while in 2009 their share in them was 26% and in 2008 it was 32%. The **very high share of loans with LTV above 100%** is additionally disturbing; **in the fourth quarter of last year these accounted for 17%** of newly granted loans;
- **excessive extension of the term of loans** - in the first quarter of last year the proportion of loans with a term of more than 25 years was 56% and in the fourth quarter it was 68%[13];
- **renewed expansion by some banks of new lending in foreign currencies** (see below), although in the fourth quarter of last year the share of foreign currency loans in newly-extended loans decreased again (in the four quarters of last year the share of foreign currency loans in the newly-extended loans was 23%, 28%, 27% and 23%[14]);
- further **growth in the average size of newly-extended foreign currency loans**, which in the whole of 2010 averaged PLN 332,000 (after PLN 310,000 in 2009 and PLN 259,000 in 2008)[15]. Consequently, there has been a further deterioration in the relationship of the average loan amount to average gross earnings in the enterprise sector, which in 2010 amounted to 96.6 (after 93.3 in 2009).This means that the average loan was equal to 8.1 years of gross annual earnings (for comparison in 2006 it was equal to 5.1 years of gross annual earnings). In the case of zloty-denominated loans the average value of loans extended in 2010 was PLN 180,000 (after PLN 185,000 in 2009 and PLN 146,000 in 2008) and was equal to 4.4 years of gross earnings (in 2006 it had been equal to 3.3 years of gross earnings). It should be noted that no data exist that unambiguously confirm the thesis that customers taking out foreign currency loans have higher incomes (and especially not that they are twice higher than those of customers taking out zloty-denominated loans). That is particularly questionable in the case of borrowers from the years of the credit boom and the peak of the bull market in real estate, many of whom decided to take a foreign currency loan so as to be able to demonstrate the higher creditworthiness that was needed to obtain a loan for the purchase of expensive housing units.

On the basis of banks' financial plans, **growth in housing loans of about 9% is to be expected in 2011.**

As for assessment of the longer-term prospects for the development of new lending, it seems that stabilisation of property prices (or a decline in prices in the market for certain kinds of housing and the undertaking by developers of new lower-cost projects) together with the likelihood of improvement in the labour market should be conducive to growth in demand for housing loans. This does, however, raise concerns that some banks may be taking excessive risks so as to increase or maintain their market shares and also that this may lead to their future financial positions becoming excessively dependent on the volume and quality of their portfolios of housing loans (see section 4).

[11] See "Ogólnopolski raport o kredytach mieszkaniowych i cenach transakcyjnych nieruchomości" ["National report on housing loans and real estate transaction prices"] AMRON-SARFiN.
[12] Ibid.
[13] Ibid.
[14] Ibid.
[15] Ibid.

Table 6. Structure of consumer loans (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total consumer loans, of which:	116.6	132.2	132.4	134.1	134.5	134.0	1.4%	-0.4%
- credit cards	12.9	15.2	15.0	15.1	14.9	14.7	-2.9%	-1.0%
- vehicle	8.3	7.9	7.8	7.9	7.8	7.7	-2.6%	-0.6%
- instalment	39.8	44.5	44.8	45.2	46.0	46.3	4.0%	0.7%
- other[16]	55.7	64.6	64.7	66.0	65.9	65.3	1.1%	-0.9%

Figure 53.
Year-on-year growth in consumer loans (%)

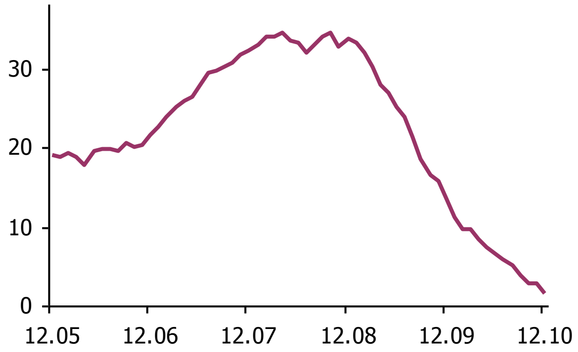


Figure 54.
Quarterly growth in consumer loans (PLN bn)

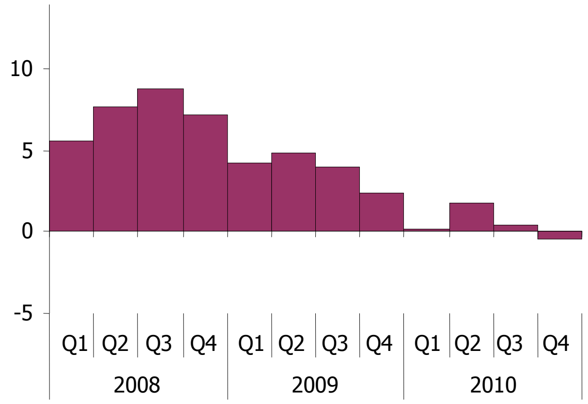


Figure 55.
Structure of consumer loans (PLN bn)

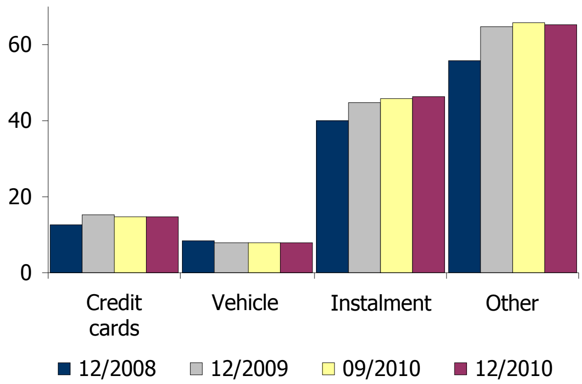
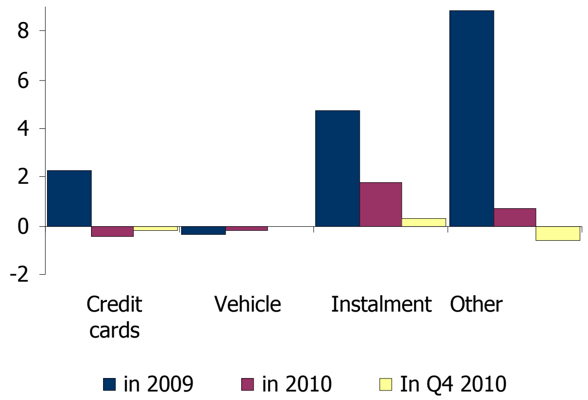


Figure 56.
Change in loans outstanding in 2009 and 2010 (PLN bn)



Substantial deterioration in the consumer loan portfolio gave rise to a tightening of lending policies in this area, which caused *inter alia* a marked deceleration in the rate of growth of these loans. As a consequence, the **value of the portfolio of consumer loans**[17] **increased by only 1.4%** (in the fourth quarter of last year it declined by 0.4%) from PLN 132.2 bn in late 2009 to PLN 134.0 bn at the end of 2010.[18]

Stagnation affected almost every product in the area of consumer loans. The outstanding value of credit card debt decreased by 2.9%, the value of vehicle loans decreased by 2.6% and the value of debt on current accounts and of loans repaid as lump sums grew by only 1.1%. The only area in which one can see signs of recovery is instalment loans, the value of which increased by 4.0%.

[16] This category includes overdrafts and loans repayable in a single payment.

[17] Starting from the report for 2010, the **category of consumer loans** includes only loans that are given to private persons, i.e. natural persons excluding those who run their own businesses or are engaged in agriculture. In previous publications, this category included all those that were classified as households.

[18] Since more than 90% of these loans are loans in zloty data adjusted for changes in exchange rates have been omitted from this presentation (if such an adjustment were made credit growth would be slightly lower, since most consumer loans in foreign currencies are loans in Swiss francs).

Banks' financial plans for 2011 suggest there will be a slight recovery in lending in the area of consumer finance; PFSA information and NBP surveys show, however, that banks still intend to continue tightening credit policy in this area.

Table 7. Structure of other loans to households (PLN bn, %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Other loans to households, of which:	60.7	66.5	68.6	71.9	73.5	73.9	11.1%	0.6%
- operating	21.0	21.7	23.0	24.0	24.4	23.3	7.0%	-4.9%
- investment	21.2	22.7	23.0	24.1	24.6	25.1	10.4%	2.0%
- for property	5.4	6.9	7.1	7.6	7.8	8.1	17.5%	3.7%
- other	13.2	15.1	15.6	16.2	16.6	17.4	15.4%	5.1%

Figure 57.
Year-on-year growth rate in other loans to households (%)

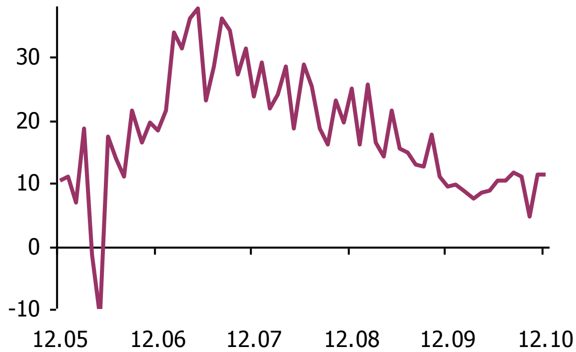


Figure 58.
Quarterly growth in other loans to households. (PLN bn)

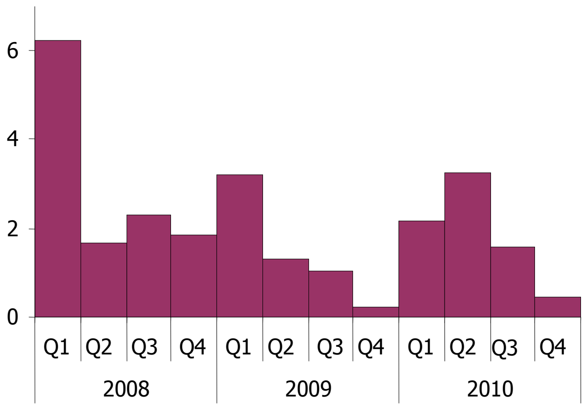


Figure 59.
The structure of other loans to households (PLN bn)

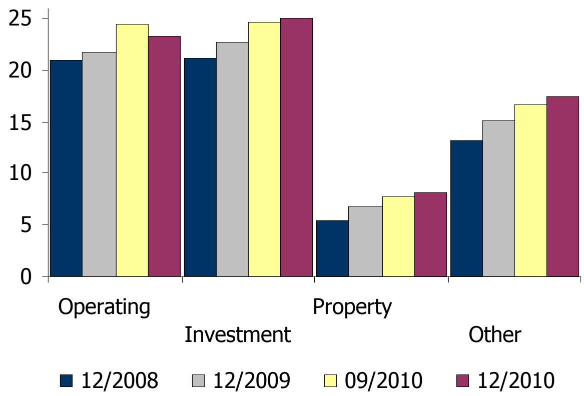
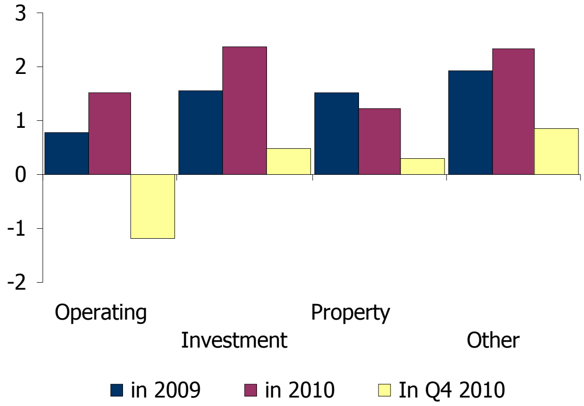


Figure 60.
Change in loans outstanding in 2009 and 2010 (PLN bn)



The portfolio of **other loans to households**, which consists mainly of operating and investment loans for individual entrepreneurs and farmers, increased by 11.1% from PLN 66.5 bn at the end of 2009 to PLN 73.9 bn at the end of 2010 [19] (and in the fourth quarter of last year by 0.6%).

The relatively high rate of growth of operating (7.0%) and investment (10.4%) loans and of property finance (17.5%) may be a signal confirming continuation of economic recovery.

It is worth noting that these loans predominate in cooperative banks portfolios (they account for over 45% of their total loan portfolio, in which the share of housing loans is less than 10% and that of consumer loans less than 13%[20]), as a result of the fact that some of these loans are loans to individual farmers.

[19] Given that over 90% of these loans are loans in zloty adjusted data are omitted from this presentation.
[20] See Annex 1d.

Table 8. Structure of loans to enterprises (PLN bn;%)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total loans	233.3	222.1	218.1	222.8	221.5	219.7	-1.1%	-0.8%
Structure of loans by type of enterprise and product								
1/ small and medium-sized enterprises	125.3	127.2	125.6	129.0	128.3	127.0	-0.2%	-1.0%
- operating	47.2	46.0	47.0	48.8	48.2	46.2	0.4%	-4.2%
- investment	32.2	34.1	33.5	34.4	34.5	35.2	3.0%	1.9%
- for property	37.8	37.0	35.4	35.5	35.1	35.0	-5.5%	-0.4%
- other	8.0	10.0	9.8	10.3	10.4	10.7	6.0%	2.3%
2/ large enterprises	108.0	94.9	92.5	93.8	93.2	92.7	-2.3%	-0.6%
- operating	59.2	48.4	46.8	47.0	45.7	44.2	-8.6%	-3.3%
- investment	33.2	30.3	29.2	30.2	30.1	30.1	-0.8%	0.1%
- for property	9.7	10.3	10.2	9.9	9.5	9.2	-10.6%	-3.0%
- other	6.0	5.8	6.2	6.8	7.9	9.1	56.2%	15.3%
Structure of loans by currency								
- zloty	173.2	163.8	164.0	164.0	166.7	165.1	0.8%	-1.0%
- foreign currency	60.1	58.3	54.1	58.8	54.8	54.6	-6.4%	-0.4%
- EUR	46.9	46.0	42.5	45.4	42.5	42.0	-8.6%	-1.1%
- CHF	0.8	0.8	0.8	0.8	0.8	0.9	10.2%	4.1%
- other currencies	12.4	11.5	10.9	12.6	11.5	11.6	1.5%	1.7%

Figure 61.
Structure of loans to enterprises (PLN bn)

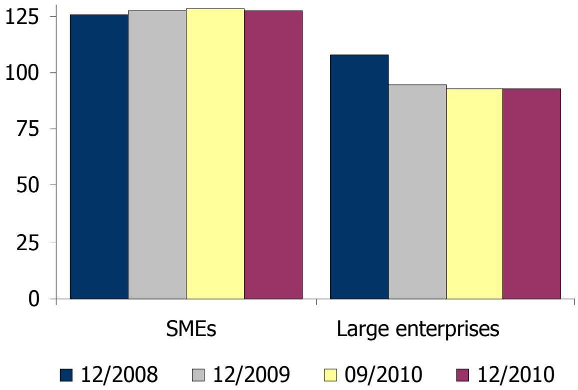


Figure 62.
Change in loans outstanding in 2009 and 2010 (PLN bn)

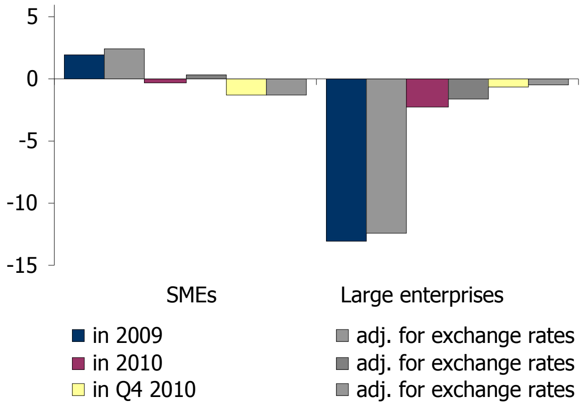


Figure 63.
Quarterly increase in loans to SMEs (PLN bn)

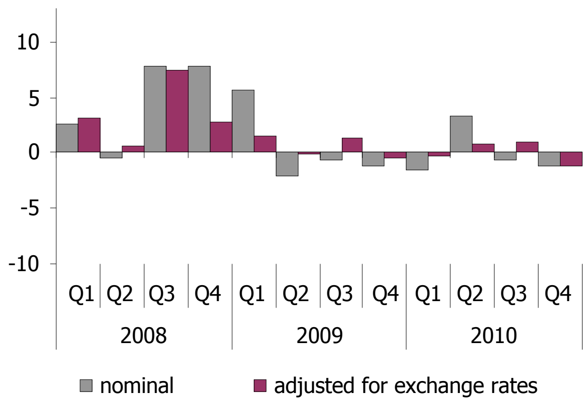
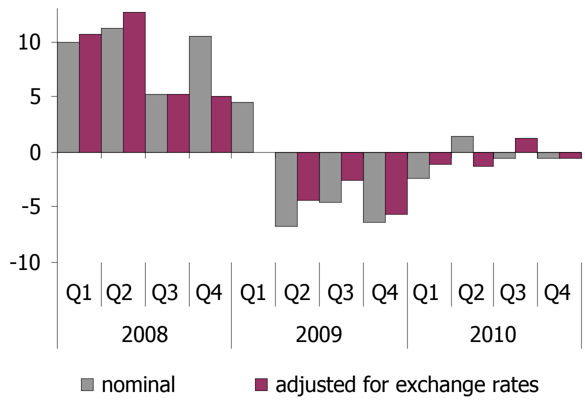


Figure 64.
Quarterly increase in loans to large enterprises (PLN bn)



In 2010 the **portfolio of loans to the enterprise sector decreased by 1.1%** (and in the fourth quarter of last year by 0.8%) from PLN 222.1 bn at the end of 2009 to PLN 219.7 bn at the end of 2010, with its **share in**

the loan portfolio decreasing to 27.9% (from 31.1% at the end of 2009). After eliminating the impact of exchange rate fluctuations, the decline in the value of these loans would be about PLN 1 bn, i.e. about **0.6%**[21].

Figure 65.
Structure of loans to SMEs (PLN bn)

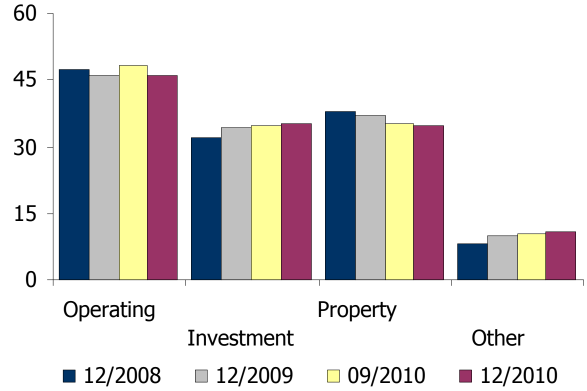


Figure 66.
Change in loans outstanding in 2009 and 2010 (PLN bn)

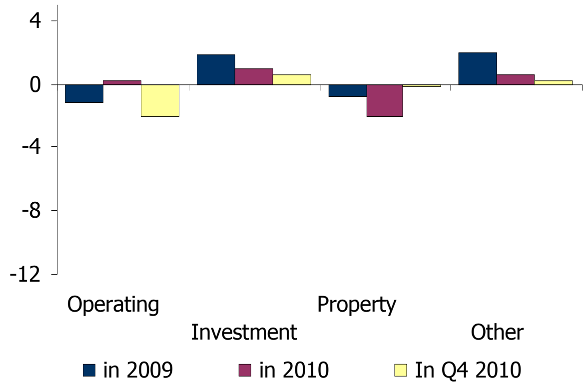


Figure 67.
Structure of loans to large enterprises (PLN bn)

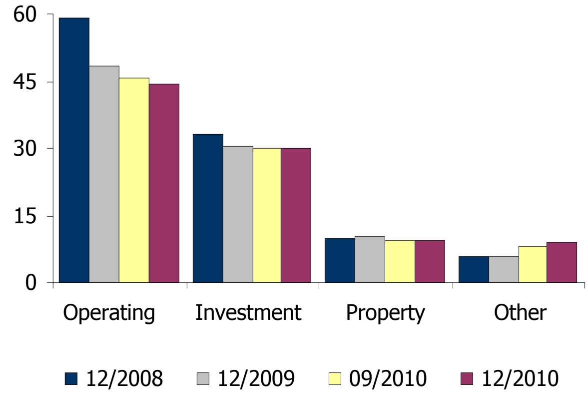
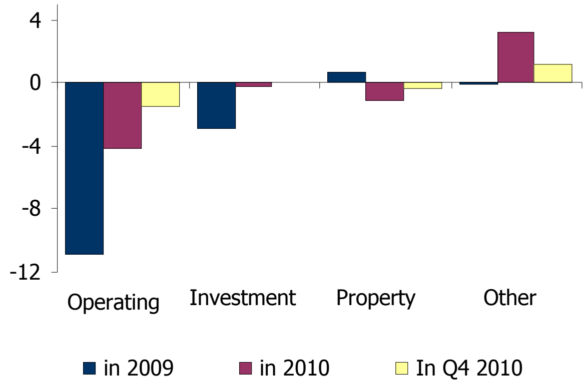


Figure 68.
Change in loans outstanding in 2009 and 2010 (PLN bn)



The reduction in new lending was primarily of loans to large enterprises, while in the case of loans to SMEs one should speak rather of stagnation:

- the value of the portfolio of loans to **SMEs decreased by 0.2%** (and in the fourth quarter of last year by 1.0%), but eliminating the impact of exchange rate fluctuations leaves a minimal increase of **0.2%.** Low growth in lending arose from the continued low rate of growth of operating loans (0.4%) and the reduction in debt related to property loans (-5.5%). Growth was experienced in investment loans (3.0%) and in other loans and receivables (6.0%). It should be noted that new lending to SMEs developed most strongly in the cases of small and medium-sized banks and of cooperative banks;
- the value of the portfolio of loans to large enterprises decreased by 2.3% (and in the fourth quarter of last year by 0.6%); eliminating the impact of exchange rate fluctuations leaves a decrease of 1.7%. The value of operating loans fell by 8.6%, that of investment loans by 0.8%, and that of property financing loans by 10.6%. Other loans and receivables rose by 56.2% but they constituted only a small part of the portfolio. It is notable that the value of outstanding loans fell in the case of most types of borrowers that have a high share in the market for corporate loans.

The low rate of growth of loans to the enterprise sector seen in recent periods is related to the ending of the boom in the Polish economy (2007) and to the escalation of the global financial crisis in the second half of 2008 and early 2009. This led on the one hand to reduced activity on the part of some enterprises (and thus to a **reduction** in their **demand for loans**) and on the other hand to tightening of banks' lending policies. In particular, consideration of the condition in 2009-2010 of the portfolios of loans extended to enterprises by particular banks may point to a **limitation of new lending by some banks** (this is indicated by stagnation or an outright reduction in enterprise financing coupled with a simultaneous increase in the value of liquid assets). A

[21] The decrease was lower than in the nominal amount because of the dominant share of euro-denominated loans in those extended to the enterprise sector (in 2010 the euro weakening slightly against the zloty.)

fundamental factor is a **change in financing strategy by some enterprises**, consisting of making greater use of own funds or issuing debt or equity[22]. Moreover the improvement now being seen in the financial situation of enterprises may be reducing to some extent their need for external financing. It appears, however, that maintenance of the economic recovery now being seen should lead to a gradual increase in demand from enterprises for loans. It should at the same time improve their financial situation while stabilisation of the quality of the loan portfolio should lead to easing of banks' lending policies.

Table 9. Structure of loans to the budget sector (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total loans	26.5	48.1	45.6	48.3	55.0	63.4	31.9%	15.2%
Structure of loans by type of borrower and product								
1 / Central government institutions	8.8	19.0	19.9	21.9	25.2	28.4	49.4%	12.7%
2/ Local government institutions	17.7	25.2	24.1	24.9	28.3	35.0	38.5%	23.7%
3/ Social insurance funds	0.0	3.8	1.6	1.5	1.5	0.0	-100.0%	-100.0%
Structure of loans by currency								
- zloty	22.0	41.0	38.9	40.9	47.8	53.7	31.1%	12.2%
- foreign currency	4.5	7.1	6.7	7.4	7.2	9.7	36.6%	35.3%

Figure 69.
Structure of loans to the budget sector (PLN bn)

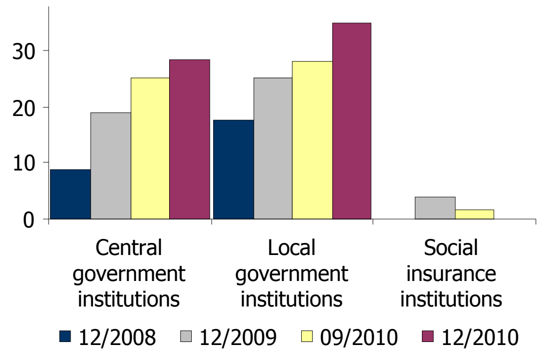
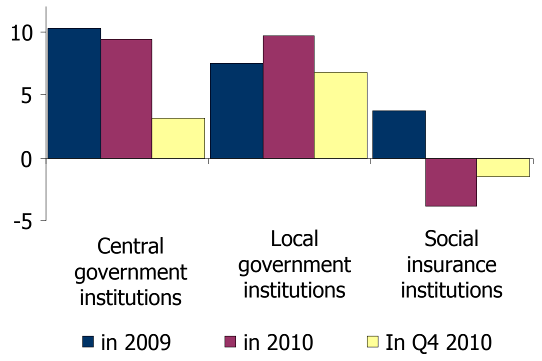


Figure 70.
Change in loans outstanding in 2009 and 2010 (PLN bn)



The **value of loans to the budget sector increased by 31.9%** (and in the fourth quarter of last year by 15.2%) from PLN 48.1 bn at the end of 2009 to PLN 63.4 bn at the end of 2010, with its share in the loan portfolio increasing to 8.1% (from 6.7%). After eliminating the impact of exchange rate fluctuations, growth would be around 32.6%.

Loans to central government increased by 49.4%, and loans to local governments by 38.5%. Despite the significant increase in public sector funding, its importance in the business of banks is still small (with a few exceptions, where the share of these receivables in assets exceed 10%).

[22] See "Podsumowanie IV kwartału 2010 na rynku nieskarbowych papierów dłużnych w Polsce" ["Non-Treasury debt market in Poland - summary for the fourth quarter of 2010"], FITCH (the value of corporate bonds outstanding increased from PLN 12.2 bn in late 2009 to PLN 17.6 bn at the end of 2010, and that of short-term debt securities from PLN 10.0 bn to PLN 14.8 bn).

Table 10. Cash, central banks, financial sector, debt and equity (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Cash and balances with central banks	39.6	50.5	28.6	34.1	34.6	50.4	-0.3%	45.5%
- cash	14.1	12.5	10.8	12.0	11.4	12.8	1.9%	11.9%
- balances with central banks	25.5	38.0	17.8	22.1	23.2	37.6	-1.0%	62.0%
Claims on banks	92.3	60.3	68.8	71.1	67.0	68.5	13.6%	2.2%
- resident	51.2	38.0	44.7	45.7	48.4	44.4	16.7%	-8.3%
loans	14.2	10.6	11.5	13.4	19.2	14.5	36.9%	-24.3%
deposits	36.9	27.4	33.2	32.3	29.2	29.8	8.9%	2.3%
- foreign	41.1	22.2	24.1	25.4	18.6	24.1	8.3%	29.4%
loans	6.7	4.0	3.7	7.1	3.4	5.2	30.7%	51.5%
deposits	34.4	18.3	20.4	18.3	15.2	18.9	3.4%	24.5%
Structure of deposits by currency[23]								
- zloty	56.1	38.8	47.3	45.8	47.2	42.1	8.5%	-10.7%
- foreign currency	36.1	21.5	21.5	25.3	19.8	26.4	22.8%	33.1%
Portfolio of debt and equity instruments	174.9	199.8	249.6	242.8	251.6	230.4	15.3%	-8.4%
1 / Debt securities	173.3	197.6	242.4	240.4	249.2	228.0	15.4%	-8.5%
- central banks	18.5	41.0	77.4	75.5	83.2	74.6	82.1%	-10.3%
- Treasury	147.7	149.0	157.5	157.1	157.1	142.8	-4.1%	-9.1%
bills	36.4	30.5	32.1	25.9	22.7	15.2	-50.1%	-32.8%
bonds	111.3	118.4	125.4	131.2	134.4	127.6	7.8%	-5.1%
- other	7.1	7.7	7.5	7.7	8.9	10.6	38.3%	18.9%
2 / Equity instruments	1.6	2.2	7.2	2.4	2.4	2.3	3.4%	-2.7%

Figure 71.
Selected categories of assets (PLN bn)

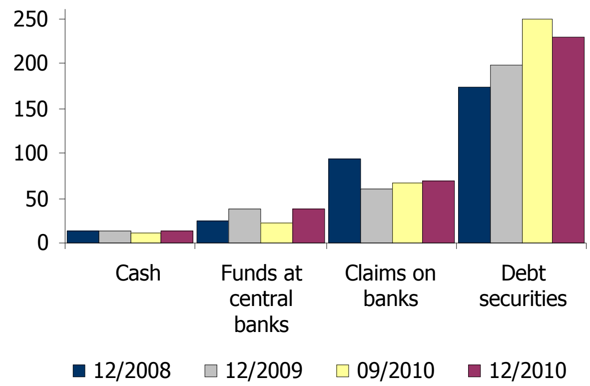
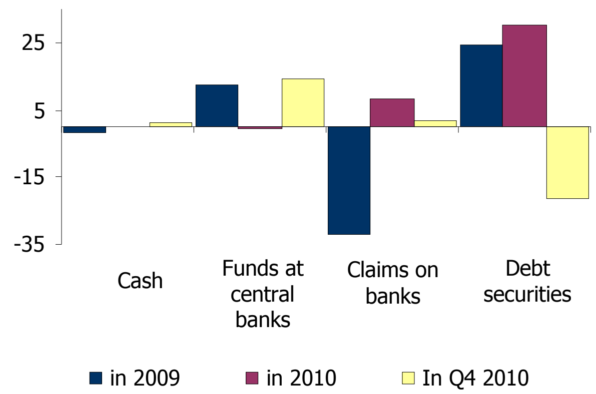


Figure 72.
Change in loans outstanding in 2009 and 2010 (PLN bn)



The experience of the financial crisis and the continuing uncertainty about future economic developments have contributed on the one hand to tightening of lending policies in some areas, and in consequence to a certain reduction in the supply of credit, and on the other hand to **heightened demand from banks for the most liquid assets.**

This relates in particular to NBP bills, which because of their short maturities have become a good "investment of excess liquidity". As a result, the **portfolio of NBP bills increased by 82.1%** from PLN 41.0 bn at the end of 2009 to PLN 74.6 bn at the end of 2010. The **portfolio of Treasury securities decreased by 4.1%** from PLN 149.0 bn to PLN 142.8 bn, with the portfolio of Treasury bills falling by 50.1% while the portfolio of Treasury bonds grew by 7.8%. The decrease of the Treasury bills portfolio reflects implementation of the Ministry of Finance's strategy for management of public debt, which has consisted *inter alia* of reducing issues of short-term Treasury bills in favour of medium- and long-term bonds. This strategy has also contributed to the growth seen in recent years in demand for NBP bills, which are in part a substitute for Treasury bills.

Claims on banks increased in 2010 **by 13.6%.** No significant increase was seen, however, in funds placed with non-residents and the share of these funds in total funds deposited in the interbank market declined from about 37% at the end of 2009 to about 35% at the end of 2010. Funds at the NBP remained at a level close to that of the end of 2009 (although their value fluctuated significantly during the year). It should be noted here

[23] Due to the limitations of the reporting system values shown are based on the estimated values of the gross carrying amount.

that over 30% of these claims on banks are those of cooperative banks, which deposit excess funds with apex (associating) banks and have small portfolios of debt securities.

Figure 73.
Claims on banks (PLN bn)

Figure 74.
Structure of the portfolio of debt securities (PLN bn)

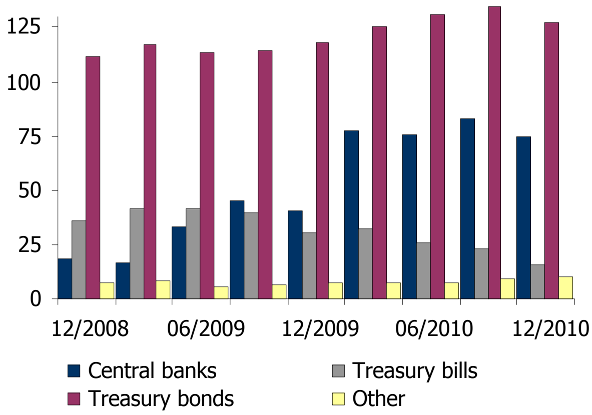


Figure 75.
Share of selected items in assets (%)

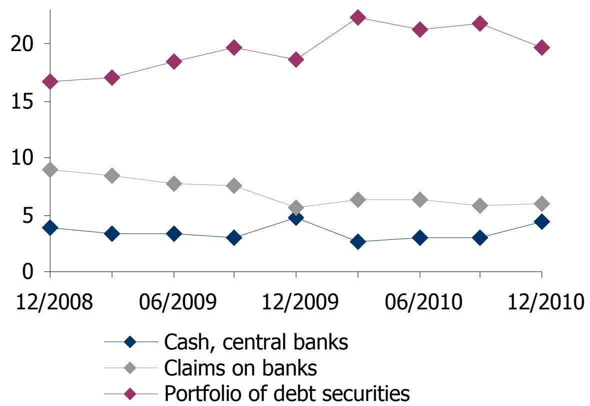


Figure 76.
Total share in assets (%)

In the context of the high value of the portfolio of NBP bills and Treasury securities it should be noted that there is only a limited possibility of these being used to expand new lending. First, the **"excess liquidity" is not distributed evenly across the whole sector** (a part is to be found *inter alia* in banks engaged to a large degree in investment banking or in banks which are not classic universal banks). Secondly, if one takes into account the **total of the cash to hand, funds in accounts with the NBP, funds deposited in financial markets and debt instruments** then it appears that their share in assets has **remained stable** (at the end of 2010 it was 30.0%, at the end of 2009 29.2% and at the end of 2008 29.5%, but at the beginning of the last credit boom it exceeded 40%). One can speak, therefore, of changes in the structure of the most liquid assets but not of a fundamental increase in them (an increase has occurred in the value of particular items but not in their share in total assets). It seems, therefore, that the **essential precondition for growth in new lending is an increase in the deposit base** and other long-term sources of funding and that a reduction in the share of liquid assets can only be a complement to this.

2.3 Sources of financing

2010 saw a **decrease in the rate of growth of the deposit base**, which is to be attributed, *inter alia*, to the reduced attractiveness of bank deposits and the still difficult situation in the labour market.

Table 11. Principal sources of financing (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total liabilities, of which:	947.2	954.1	974.3	1 017.8	1 026.5	1 041.8	9.2%	1.5%
1 / Deposits and loans of the financial sector	230.8	216.8	222.0	236.6	235.2	244.5	12.8%	4.0%
2/ Deposits of the non-financial sector	499.0	567.2	566.9	584.0	587.1	620.4	9.4%	5.7%
3 / Deposits of the public sector	52.7	52.0	62.1	62.9	69.0	53.0	1.9%	-23.3%
4 / Liabilities arising from issue of securities	12.5	19.4	19.9	25.6	25.4	24.4	25.5%	-3.9%
5 / Subordinated liabilities	7.6	8.9	8.7	9.3	9.1	9.7	9.5%	6.3%
Total capital	88.1	103.3	109.0	109.4	115.8	116.2	12.5%	0.4%

Figure 77..
Selected sources of funding (PLN bn)

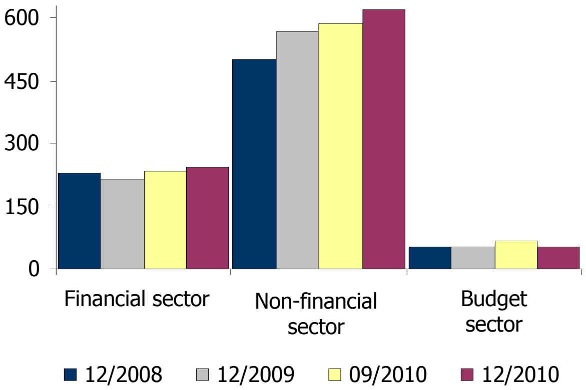
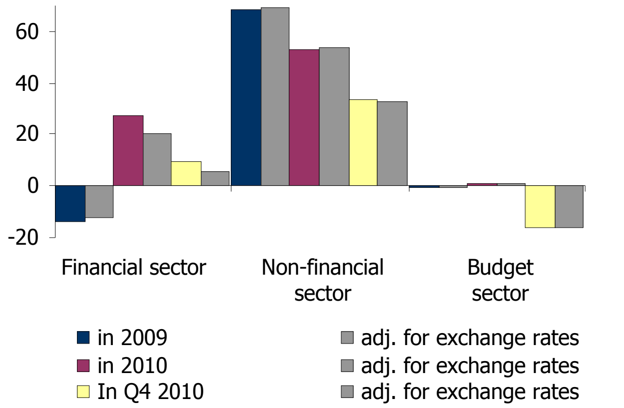


Figure 78.
Change in financing outstanding in 2009 and 2010 (PLN bn)



The value of total liabilities increased by 9.2% (and in the fourth quarter of last year by 1.5%) from PLN 954.1 bn at the end of 2009 to PLN 1,041.8 bn at the end of 2010, and after eliminating the effect of exchange rate fluctuations by about 8.2%. The largest item among liabilities was deposits of the non-financial sector (at the end of 2010 they accounted for 59.5% of liabilities), and this was followed by deposits and loans received from the financial sector (23.5%) and by budget sector deposits (5.1%).

Table 12. Deposits and loans of the financial sector (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Deposits and loans of the financial sector, of which	230.8	216.8	222.0	236.6	235.2	244.5	12.8%	4.0%
- banks	160.3	147.8	159.0	170.0	165.9	165.9	12.3%	0.0%
- other	70.5	69.0	63.0	66.5	69.3	78.6	14.0%	13.4%
Structure by country of origin								
- resident	80.2	67.1	71.1	72.1	73.3	74.5	11.0%	1.6%
- non-resident	150.6	149.6	150.9	164.5	161.9	170.0	13.6%	5.0%
Structure by currency								
- zloty	113.1	104.1	107.6	106.5	108.8	104.6	0.5%	-3.8%
- foreign currency	117.6	112.6	114.3	130.1	126.4	139.9	24.2%	10.7%

Figure 79.
Structure of fin. sector deposits[24] by type of entity (PLN bn)

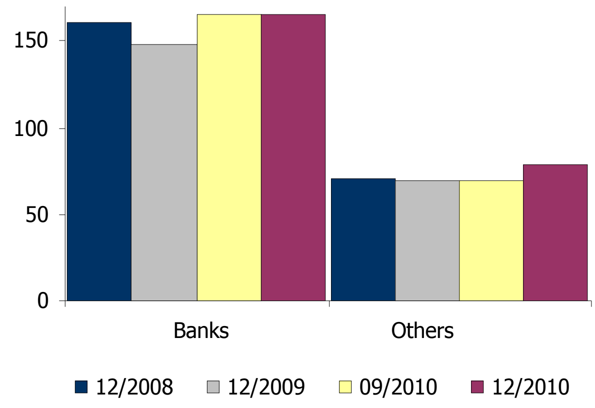
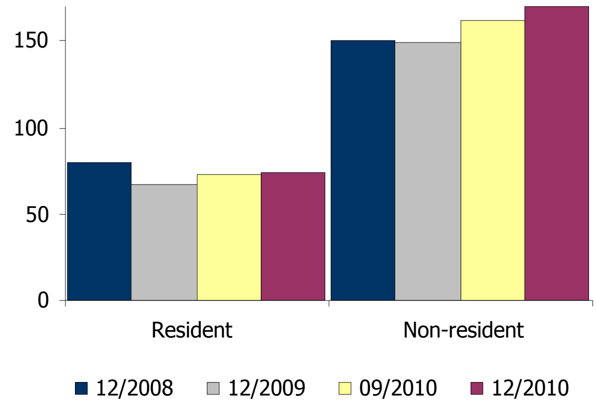


Figure 80.
Structure of fin. sector deposits[25] by country of origin (PLN bn)



Deposits and loans of the financial sector increased by 12.8% (and in the fourth quarter of last year by 4.0%). After adjustment for the effect of exchange rate fluctuations growth over the year was of about PLN 20 bn and the rate of growth was about **9.0%.**

Liabilities to banks (close to 70% of the total) accounted for most liabilities to the financial sector. By country of origin, in turn, a majority of liabilities were to non-residents. No significant growth was noted in these funds (which continue to account for about 70% of liabilities). Most of these funds came from parent entities, which contributed to the relatively greater stability of these funds. It does, however, also show a strong dependence on the financial situation of parent companies.

Given the share of deposits and loans from the financial sector in balance sheet totals one can state that the greatest degree of reliance on funds from the financial market is to be found in:

- the apex banks of associated cooperative banks, which results from the specific nature of their activity, which is to collect funds from those banks and invest them in financial markets;
- small banks and branches of credit institutions that operate in market niches (focusing, for example, on financial entities from their countries of origin), which will always operate to a large degree on the basis of funds derived from the parent company; and
- small and medium-sized banks and branches of credit institutions which have in recent times engaged aggressively in the areas of consumer finance or housing loans without having a deposit base or having one that is insufficiently developed (relative to the scale of lending activity).

In the case of the largest operators in the market, the share of funds coming from financial markets is limited (and usually less than 10%).

The exception is three banks which, in the second half of the past decade, rapidly expanded operations in the retail segment while making use, *inter alia*, of funds coming from companies belonging to the parent capital group.

[24] More strictly deposits and loans received from the financial sector.
[25] As above.

Table 13. Deposits of the non-financial sector (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Deposits of the non-financial sector, of which:	499.0	567.2	566.9	584.0	587.1	620.4	9.4%	5.7%
- households	336.9	387.7	394.8	401.3	404.6	422.4	8.9%	4.4%
- enterprises	148.0	165.1	157.4	167.5	166.8	182.8	10.7%	9.6%
- non-profit institutions	14.2	14.4	14.7	15.3	15.7	15.2	6.0%	-3.3%
Structure by currency								
- zloty	443.6	507.4	507.2	523.9	525.8	557.7	9.9%	6.1%
- foreign currency	55.4	59.7	59.8	60.1	61.3	62.7	4.9%	2.2%

Figure 81.
Deposits of the non-financial sector (PLN bn)

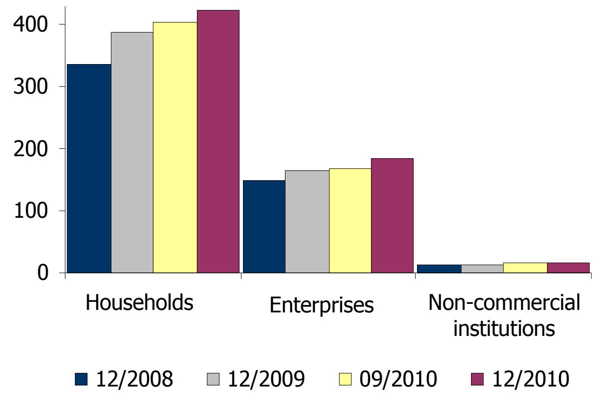


Figure 82.
Change in deposits outstanding in 2009 and 2010 (PLN bn)

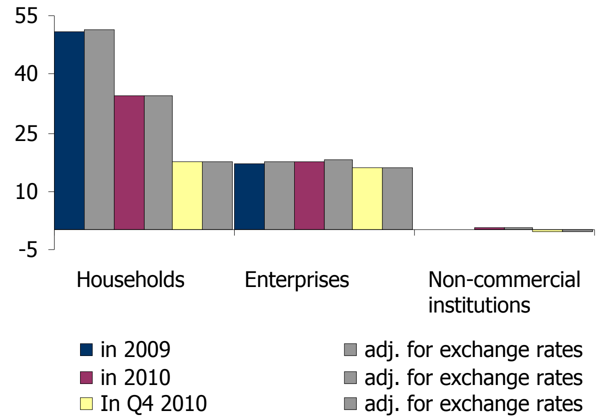


Figure 83.
Quarterly growth in household deposits (PLN bn)

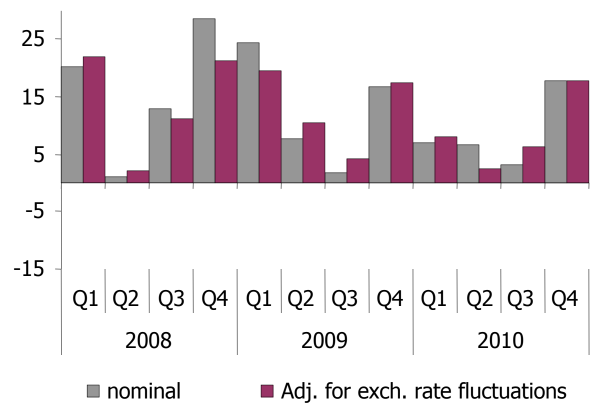
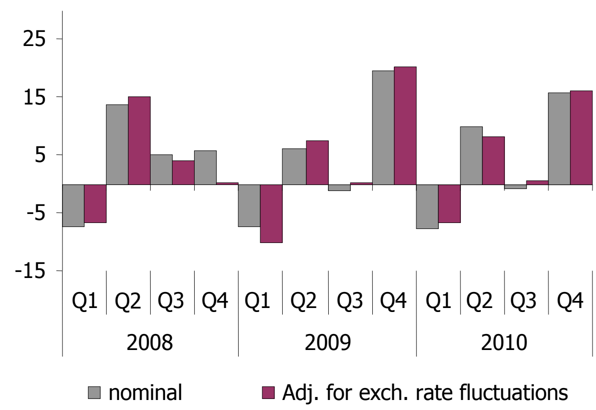


Figure 84.
Quarterly growth in deposits by enterprises (PLN bn)



Deposits by the non-financial sector grew by 9.4%, i.e. by PLN 53.2 bn, with, as in previous years, the largest increase being recorded in the fourth quarter (5.7%)[26].

- deposits by **households** increased by **8.9%** (and in the fourth quarter of last year by 4.4%), i.e. by PLN 34.7 bn;
- deposits by **enterprises** increased by **10.7%** (and in the fourth quarter of last year by 9.6%), i.e. by PLN 17.7 bn.

The causes of the weakening rate of growth in deposits that has been observed in recent periods are to be found (apart from the "statistical base effect") in a combination of a number of factors that often act in different directions on different participants in financial markets. The main reason is probably the reduced attractiveness of

[26] Because of the insignificant share of foreign currency deposits (approximately 10%) and the varied directions of currency fluctuations (weakening of the euro and strengthening of the dollar and Swiss francs), the increase in deposits after eliminating the impact of exchange rate fluctuations was similar.

bank deposits as a result of the reduction in their interest rates and the upturn in the equity market, which have led to a partial reallocation of assets. At the same time a gradual improvement in the macroeconomic situation has led some entities to increase spending or investment. On the other hand, the reduction in the income of some households and businesses as a result of the crisis may be reflected in a lower level of deposits made by them. Tightening of lending policy may act in the same direction, since it encourages greater self-financing by some enterprises at the expense of reduced deposits.

It is worth noting that, despite earlier concerns about strong competition from commercial banks, the rate of growth in deposits in 2010 was significantly higher in the case of cooperative banks (17.8%) than that of commercial banks (8.5%). As a consequence, the share of cooperative banks in the non-financial sector's deposits increased (from 8.1% at the end of 2009 to 8.7% at the end of 2010).

On the basis of banks' financial plans, it can be stated that **in 2011, banks expect an increase of about 8% in the level of household deposits** and one of more than **15% in enterprises' deposits**.

Table 14. Deposits of the budget sector (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Total deposits of the public sector, of which:	52.7	52.0	62.1	62.9	69.0	53.0	1.9%	-23.3%
- central government institutions	20.6	24.8	35.2	36.4	39.1	28.3	14.1%	-27.6%
- local government institutions	21.5	20.6	22.0	21.8	21.8	19.8	-3.8%	-9.2%
- social insurance funds	10.7	6.5	5.0	4.7	8.1	4.8	-26.7%	-40.8%

Figure 85.
Deposits of the budget sector (PLN bn)

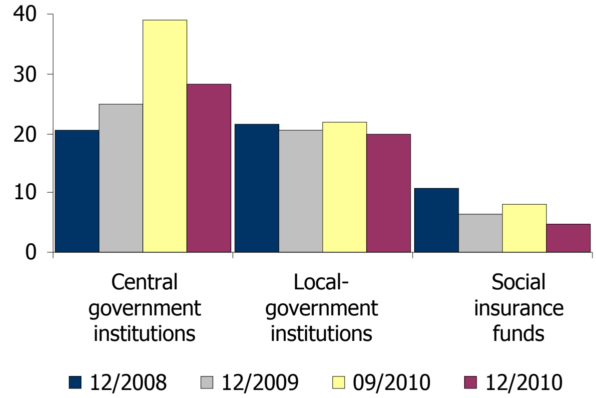
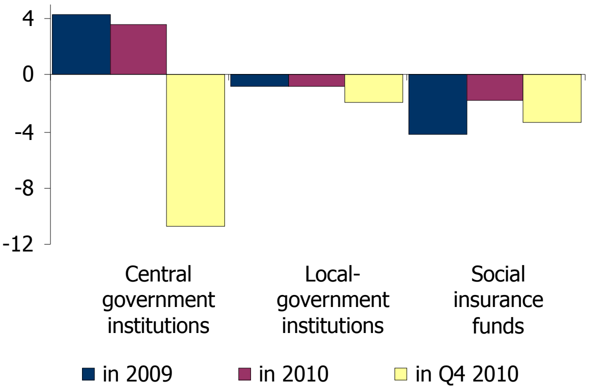


Figure 86.
Change in deposits outstanding in 2009 and 2010 (PLN bn)



For most of the year the value of funds held in bank accounts by central and local government bodies was significantly higher than at the end of 2009. However, as in 2009, due to large payments made at the end of the year (resulting from the bunching of spending at the end of calendar year that is characteristic of the public sector) the increase in this sector's deposits over the year amounted to only 1.9%. Outstanding deposits of central government institutions, despite a strong decline in December, increased (by 14.1%) over the year as a whole while the deposits of local government institutions and those of social insurance funds decreased (respectively, by 3.8% and 26.7%).

Among other sources of external funding attention it is worth noting the increase (of 25.5%) in liabilities arising from issue of banks' own securities. However, other than in the case of a few banks, their share in financing the activities of banks was small. The value of subordinated debt also increased (by 9.5%) but, as in the case of banks' issuing of securities, its share in financing activities remained marginal.

Table 15. Currency structure of balance sheet and mismatch of assets and sources of funding (PLN bn;%)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Balance sheet total	1,035.4	1,057.4	1,083.2	1,127.2	1,142.3	1,158.0	9.5%	1.4%
Zloty assets	741.2	786.3	816.8	825.5	850.0	844.3	7.4%	-0.7%
Foreign currency assets	294.1	271.0	266.4	301.8	292.3	313.8	15.8%	7.4%
- EUR	100.9	92.1	89.0	103.2	107.5	123.5	34.0%	14.9%
- CHF	156.4	151.5	145.9	166.4	157.3	164.5	8.6%	4.5%
- USD and other currencies[27]	36.8	27.4	31.6	32.1	27.5	25.8	-5.9%	-5.9%
Zloty liabilities	820.7	851.2	876.8	899.3	915.4	912.2	7.2%	-0.3%
Foreign currency liabilities	214.7	206.2	206.4	227.9	226.9	245.8	19.2%	8.3%
- EUR	106.6	98.7	95.7	103.8	106.4	118.5	20.1%	11.3%
- CHF	68.7	73.9	70.3	87.0	81.2	89.1	20.6%	9.7%
- USD and other currencies[28]	39.3	33.6	40.5	37.1	39.3	38.3	13.7%	-2.7%
Mismatch of assets to sources of finance								
1 / PLN bn								
Foreign currency assets	-79.4	-64.8	-60.0	-73.9	-65.3	-67.9	4.8%	4.0%
- EUR	5.8	6.5	6.7	0.6	-1.0	-5.0	-176.4%	377.1%
- CHF	-87.7	-77.6	-75.6	-79.4	-76.1	-75.3	-2.9%	-1.0%
- USD and other currencies	2.5	6.2	8.9	5.0	11.8	12.4	100.5%	4.8%
2 / as % of balance sheet total								
Foreign currency assets	-7.7%	-6.1%	-5.5%	-6.6%	-5.7%	-5.9%	x	x
- EUR	0.6%	0.6%	0.6%	0.1%	-0.1%	-0.4%	x	X
- CHF	-8.5%	-7.3%	-7.0%	-7.0%	-6.7%	-6.5%	x	X
- USD and other currencies	0.2%	0.6%	0.8%	0.4%	1.0%	1.1%	x	x

Figure 87.
Foreign currency assets (PLN bn)

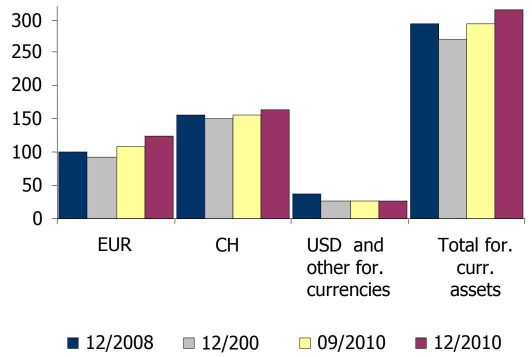


Figure 88.
Foreign currency liabilities (PLN bn)

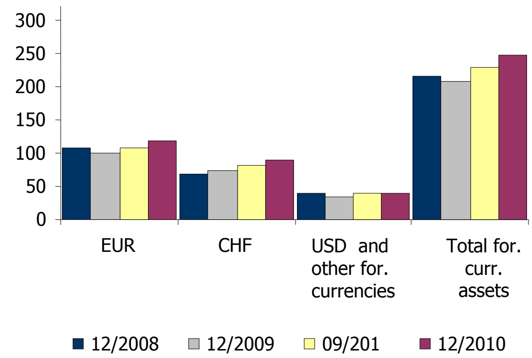


Figure 89.
Currency mismatch of assets and liabilities (PLN bn)

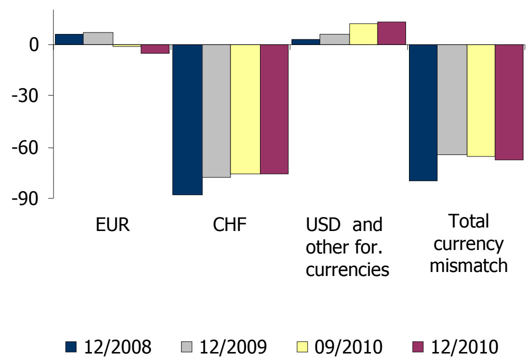
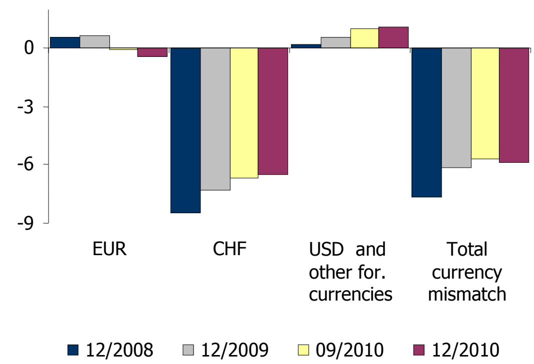


Figure 90.
Share of mismatches in total assets (%)



[27] The dollar accounted for about 75% and other currencies for a little over 25%.
[28] The dollar accounted for about 80% and other currencies for a little less than 20%.

In the context of the very high share of foreign currency loans attention must be drawn to the issue of currency mismatch of the sources of their financing.

At the end of 2010 the currency mismatch[29] in the sector as a whole amounted to PLN 67.9 bn and was equal to 5.9% of total assets (at the end of the previous year, respectively, PLN 64.8 bn and 6.1%). The mismatch related primarily to the Swiss franc and was due to the fact that not all banks granting loans in that currency have appropriate sources of financing.

The slowing in the rate of growth of foreign currency housing loans observed in 2009-2010 contributed to a **slowdown in adverse trends and the scale of mismatch remains relatively stable** with a slight tendency to decrease.

Table 16. Capital (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2010
Shareholder's funds, of which:	88.1	103.3	109.0	109.4	115.8	116.2	12.5%	0.4%
- share capital	16.1	21.1	22.2	22.3	22.7	23.0	8.7%	1.0%
- reserve capital	38.1	46.9	47.1	48.4	50.9	51.0	8.8%	0.2%
- other reserves	10.9	18.4	18.5	21.7	21.6	21.4	16.3%	-0.8%
- general risk fund	8.4	7.5	7.6	7.9	7.9	8.0	6.9%	1.5%
- revaluation reserve	0.3	0.5	2.2	1.2	1.4	1.0	78.7%	-30.9%
- profit/loss from previous years	0.0	-0.2	-0.3	-0.9	-0.6	-0.9	315.7%	36.3%
- net profit/loss of the current year	13.6	8.3	2.5	5.5	8.5	11.7	41.0%	37.1%
- Other items	0.8	0.8	9.3	3.4	3.4	1.1	35.4%	-68.8%

Figure 91.
Main items in shareholders' funds (PLN bn)

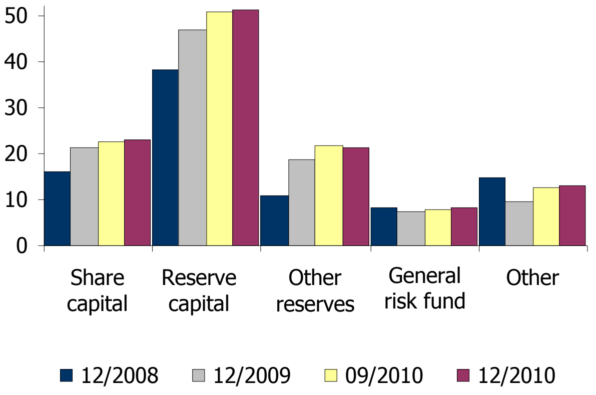
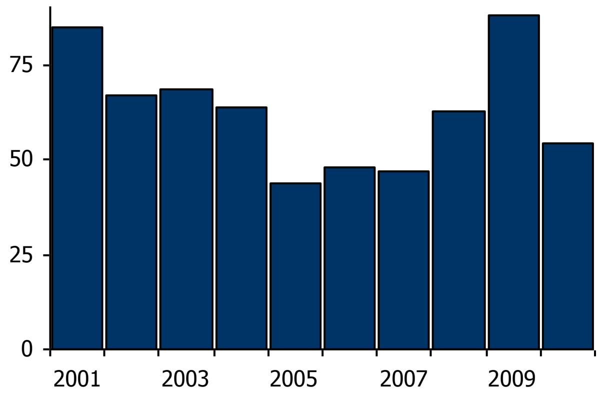


Figure 92.
Distribution of profits - share of earnings retained in banks (%)



In 2010 **own funds** of the banking sector **increased by 12.5%.** The increase in equity was a result of recapitalisation, retention of profits for 2009 and growth in earnings.

It should be noted that, after the record increase in own funds in 2009, banks returned to their usual practice, in which about half of profit is devoted to payment of dividends to shareholders (in the case of individual banks there were some deviations from the mean). It must be added here that in the case of cooperative banks, more than 90% of the profits were allocated to increasing their funds (It is characteristic of this group of banks that each year almost all their profit is devoted to increasing their capital base - this is the fundamental source of capital formation in this group of banks).

[29] Defined as the difference between foreign liabilities and foreign currency assets.

In summary, despite the acceleration in economic growth, the **activity of the banking sector** in 2010 **remained limited**. The moderate growth rate is connected with: continuing uncertainty about future economic developments and, associated with this, periodic disturbances in financial markets, deteriorating quality of loan portfolios (resulting in tightening of lending policies in some areas),reduced demand for loans from some customers (especially in the segment of large enterprises) together with adjustment processes at banks (resulting from a change in strategy, merger processes, a change of strategic investor or bringing order to the loan portfolio) aimed at strengthening risk management and improving performance.

The structure of the banking sector, its level of concentration and its role in the economy have not changed much but it is worth noting the increase in the share of domestic assets in the banking sector's assets and the increase in the share of the sector's assets in GDP (it is also worth noting the change of ownership of BZ WBK and the appearance of Getin Noble among the 10 largest banks).

There has been **growth in employment and in sales networks** (mainly in the case of smaller entities).

The level of new lending has remained limited. The main areas in which lending expanded were housing loans, loans for individual entrepreneurs and loans to the budget sector. On the other hand 2010 saw **stagnation** or a slight decrease in **consumer loans and loans to SMEs and large enterprises**, which was related both to a reduction in loan demand from some borrowers and to a reduction in new lending by some banks.

Expansion of lending in the area of housing loans should be regarded as beneficial, but some disquiet is caused by the marked easing in lending policy regarding maximum LTV (a record share of loans had LTV above 80%), lengthening of the term of loans and renewed expansion of financing in foreign currencies, which have taken place in some banks. These activities on the one hand lead to an increase in risk (both for the customer and the bank) and on the other hand restrict the possibility of effective restructuring in the future if the need for it arises. Most large and medium-sized banks have drawn the appropriate conclusions and reduced lending in foreign currencies; lending in foreign currencies is now being developed mainly by smaller entities.

Limited growth in new lending gave rise, *inter alia*, to an **increase in purchases of NBP bills and Treasury bonds**.

The **rate of growth of the non-financial sector's deposits has remained limited** (most of the growth over the year occurred in the fourth quarter, which is a cyclical phenomenon), which is to be attributed, *inter alia*, to the reduced attractiveness of bank deposits and the still difficult situation in the labour market.

In the context of the sources of financing for new loans, there has been a notable **stabilisation** (at the level of the sector) **of the scale of currency mismatching** as a result of limitation of growth in foreign currency housing loans.

A favourable phenomenon was the **substantial increase in bank's capital base** that arose through the retention of profits for 2009 (the banks have returned to their former practice, in which about half of the profit is devoted to payment of dividends), recapitalisation, and growth in profits in 2010.

3 THE BANKING SECTOR'S FINANCIAL RESULTS

In 2010 there was a significant **increase in the profits of the banking sector but banks' results still came under pressure from write-offs** as credit risks materialised, though they did so substantially less in the fourth quarter of the year.

Table 17. Selected items from the profit and loss account of the banking sector (PLN m;%)

	2008	2009	2010	Change 2010/2009		Profits in individual quarters of 2010			
				PLN m	%	Q1	Q2	Q3	Q4
Profit on banking activities	48,412	49,608	53,107	3,500	7.1%	12,611	13,467	13,357	13,673
- net interest income	28,012	26,376	30,841	4,464	16.9%	7,216	7,573	7,942	8,110
- net fee and commission income	11,439	12,459	13,732	1,273	10.2%	3,360	3,434	3,462	3,477
- other items	8,961	10,772	8,535	-2,237	-20.8%	2,035	2,461	1,953	2,086
Operating costs	24,713	24,814	25,534	720	2.9%	6,032	6,335	6,371	6,796
Depreciation	2,335	2,544	2,511	-34	-1.3%	643	710	673	484
Provisions and write-offs (negative)	4,140	11,749	11,284	-465	-4.0%	2,688	3,286	2,913	2,397
NET FINANCIAL PROFIT OR LOSS	13,556	8,282	11,674	3,392	41.0%	2,473	2,993	3,047	3,161

Figure 93.
Profit on banking activities (PLN m)

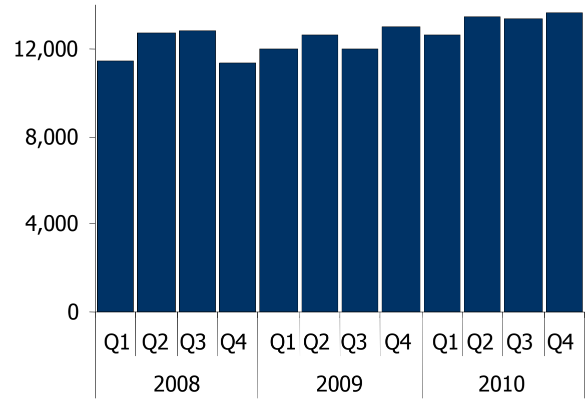


Figure 94.
Operating costs (PLN m)

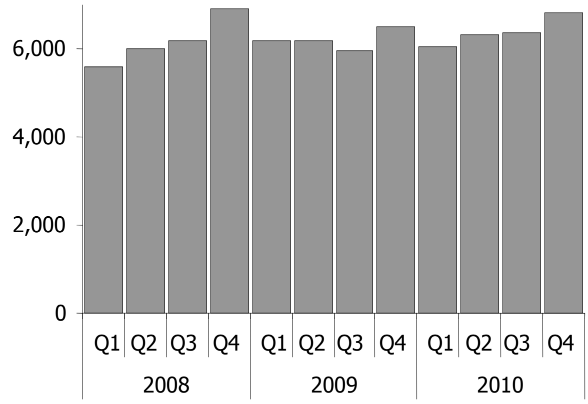


Figure 95.
Negative balance of write-offs/provisions (PLN m)

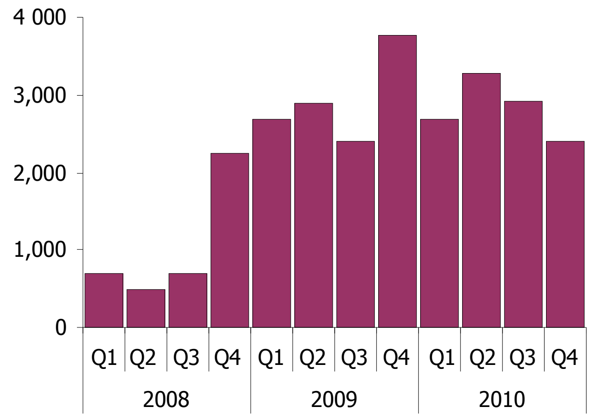
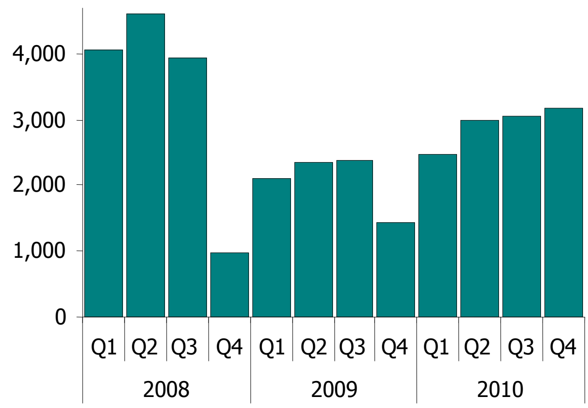


Figure 96.
Net financial profit or loss (PLN m)



Net earnings of the banking sector amounted to PLN 11.7 bn (PLN 2.5 bn in the first quarter, PLN 3.0 bn in the second, PLN 3.0 bn in the third and PLN 3.2 bn in the fourth) which means growth relative to 2009 of **about 41.0%.** Despite the significant improvement, the profits of the sector were lower than in 2007-2008 (by about 15%).

Improved results were recorded by 440 entities holding between them 80.1% of the sector's assets (and in the first three quarters by 437 entities holding 60.9% of assets). However:

- the results of the entire sector continue to be determined by the two largest banks, i.e. **PKO BP and Pekao**, which at the end of 2010 held a little more than 25% of the assets of the sector and were responsible for over 45% of the profits generated by all the banks that recorded a profit;
- several large and medium-sized banks reported a decline or an insignificant increase in profits, while the spectacular improvement in performance in some banks was due to their very poor results (or losses) in 2009; and
- **seven commercial banks, 11 branches of credit institutions, and two cooperative banks showed a net loss** totalling PLN 1,257 m; their total share in the sector's assets was 8.2%. In five entities losses exceeded PLN 100 m, in three they amounted to PLN 50-100 m, in two they were PLN 30-40 m, in four they were PLN 10-20 m and in the others they were under PLN 10 m.

The main sources of improvement were an increase in net interest income and in net fees and commissions and, in the fourth quarter, also a reduction in the negative balance of write-offs and provisions.

Table 18. Net interest income of the banking sector (PLN m; %)

	2008	2009	2010	Change 2010/2009		Profits in individual quarters of 2010			
				PLN m	%	Q1	Q2	Q3	Q4
INCOME	58,094	55,585	57,212	1,627	2.9%	13,849	14,121	14,484	14,758
1/ Financial sector	8,372	5,538	5,450	-88	-1.6%	1,286	1,376	1,387	1,401
2/ Non-financial sector	41,406	41,075	41,798	723	1.8%	10,213	10,281	10,552	10,752
Households	27,079	29,114	30,091	977	3.4%	7,374	7,425	7,621	7,671
Consumer loans	14,101	16,358	17,013	655	4.0%	4,291	4,238	4,300	4,185
- credit cards	1,652	2,041	1,983	-58	-2.8%	518	502	506	457
- vehicle	875	868	875	8	0.9%	234	194	219	229
- instalment	4,817	5,348	5,317	-31	-0.6%	1,343	1,327	1,321	1,327
- other	6,757	8,101	8,837	737	9.1%	2,195	2,215	2,254	2,173
Housing loans	8,266	7,560	8,131	570	7.5%	1,829	1,948	2,152	2,202
- zloty	4,418	4,356	5,256	900	20.7%	1,182	1,205	1,392	1,477
- foreign currency	3,847	3,205	2,875	-330	-10.3%	647	743	759	726
Other loans	4,712	5,195	4,947	-248	-4.8%	1,254	1,239	1,170	1,284
Enterprises	14,125	11,743	11,437	-306	-2.6%	2,797	2,773	2,860	3,007
- SMEs	8,300	6,866	7,329	463	6.7%	1,699	1,688	2,036	1,906
- large enterprises	5,825	4,877	4,108	-769	-15.8%	1,097	1,086	824	1,101
Non-profit institutions	202	218	270	52	24.1%	43	83	70	74
3/ Budget sector	1,835	1,793	2,063	270	15.1%	491	494	514	565
4/ Debt securities	6,481	7,179	7,900	721	10.0%	1,859	1,970	2,032	2,039
COSTS	30,082	29,209	26,371	-2,838	-9.7%	6,633	6,548	6,542	6,648
1/ Financial sector	11,392	8,926	7,056	-1,870	-21.0%	1,788	1,726	1,720	1,822
2/ Non-financial sector	16,116	18,206	17,221	-985	-5.4%	4,377	4,295	4,266	4,282
Households	9,856	13,534	12,634	-900	-6.6%	3,271	3,178	3,101	3,083
Enterprises	5,847	4,259	4,226	-33	-0.8%	1,012	1,033	1,071	1,110
Non-profit institutions	413	414	361	-52	-12.7%	94	85	94	89
3/ Budget sector	2,574	2,077	2,094	18	0.9%	468	527	556	544
NET INTEREST INCOME	28,012	26,376	30,841	4,464	16.9%	7,216	7,573	7,942	8,110
1/ Financial sector	-3,020	-3,388	-1,605	1,782	-52.6%	-501	-350	-333	-421
2/ Non-financial sector	25,290	22,869	24,577	1,708	7.5%	5,836	5,986	6,285	6,470
Households	17,223	15,580	17,457	1,877	12.0%	4,103	4,247	4,520	4,588
Enterprises	8,278	7,485	7,211	-274	-3.7%	1,784	1,740	1,789	1,897
Non-profit institutions	-211	-196	-91	105	-53.7%	-51	-2	-23	-15
3/ Budget sector	-739	-284	-31	253	-89.0%	22	-33	-42	21

Figure 97.
Interest income (PLN m)

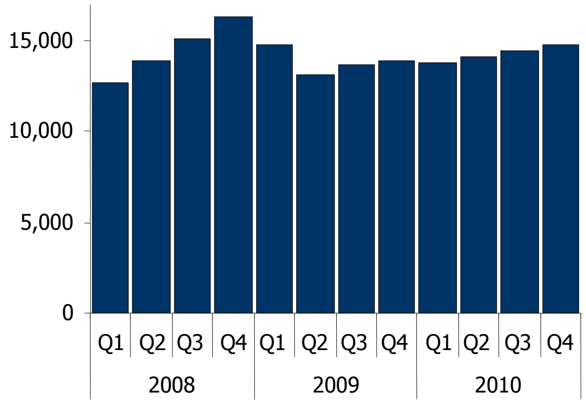


Figure 98.
Interest expense (PLN m)

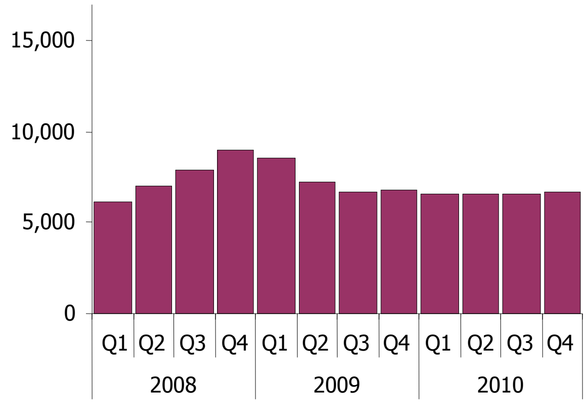


Figure 99.
Selected sources of interest income (PLN m)

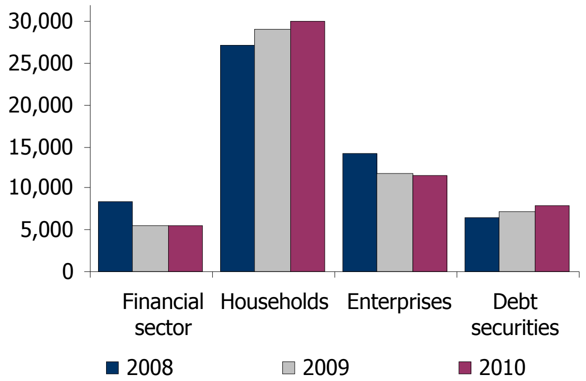
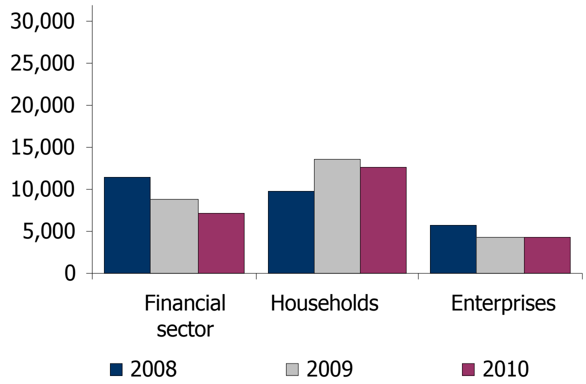


Figure 100.
Selected sources of interest expense (PLN m)



Net interest income increased by 16.9% (from PLN 26.4 bn in 2009 to PLN 30.8 bn in 2010).

The main factor in improving net interest income was the decline in interest expenses, which amounted to **9.7%** (from PLN 29.2 bn in 2010 to PLN 26.4 bn in 2010). Interest expense paid to the non-financial sector declined by 5.4%, the cost of funds obtained from the financial sector fell by 21.0% and the cost of budget sector deposits rose by only 0.9% (the high level of budget sector deposits during the year should be borne in mind).

It should be noted, however, that the decline in interest costs related mainly to comparison of the first half of 2010 with the first half of 2009[30] for in the second half of 2010, interest costs were similar to those incurred in the second half of 2009. This stemmed from the fact that in the first half of 2009, and especially in the first quarter of 2009, the high costs of financing were the result of the escalating financial crisis (which occurred in late 2008). This caused an increase in interest rates in financial markets and intensification of competition in the deposit market. Thanks to stabilisation measures taken on a global scale, the situation in financial markets calmed and this resulted, *inter alia*, in gradual reduction of the interest rates on deposits in the domestic market[31], thus reducing interest expense in subsequent periods (in relation to the first quarter of 2009).

[30] Interest expense in the second half of 2010 was similar to interest expense in the second half of 2009.

[31] Average 3M WIBOR in 2009 was 4.3% as against 3.9% in 2010, EURIBOR 3M 1.2% as against 0.9% 3M CHF LIBOR 0.4% as against 0.2% LIBOR USD 3M 1.2% as against 0.3% The average interest rate on all deposits in the whole of 2009 was about 5.1% and the equivalent in 2010 about 4.1%.

Despite falling interest rates and low growth in new lending **interest income rose by 2.9%** (from PLN 55.6 bn in 2009 to PLN 57.2 bn in 2010). Increased margins on newly extended loans positively influenced income. Since the end of 2009 the banks have gradually reduced margins but they are generally still higher than in the "pre-crisis" period. A positive influence was also exerted by a significant increase in the volume of zloty-denominated housing loans (revenue growth of 20.7%), loans to the budget sector (revenue growth of 15.1%) and portfolios of debt securities (revenue growth of 10.0%). One should also add that, despite the slowdown in consumer finance and a strong deterioration in the quality of the portfolio of consumer loans, an increase (of 4.0%) was recorded in interest income on these loans. This is to be explained on the one hand by the maintenance or increase of margins on newly extended loans and, on the other, by a higher average volume of loans outstanding (compared to the end of 2009, the level of consumer loans increased by only a little more than 1% but the average balance of these loans in 2010 was nearly 7% higher than in 2009). In turn, pressure was exerted on interest income by a reduction in borrowing by large enterprises and a fall in average interest rates in financial markets, giving rise, *inter alia*, to a decrease in interest income from the enterprise sector (of 2.6%) and in income from foreign currency loans (in the case of foreign currency housing loans the fall in interest income amounted to 10.3%). Another factor exerting downward pressure on interest income was the worsening financial situation of some borrowers, which resulted, *inter alia*, in cessation of, or irregularity in, servicing loans.

The increase in interest income was also affected to some degree by a change in banks' accounting policies, which resulted in the shift of some revenues to net interest income (notably PKO BP in the second quarter of 2009 introduced hedge accounting).

Net income from fees and commissions increased by 10.2% (from PLN 12.5 bn in 2009 to PLN 13.7 bn in 2010). The reasons for the improvement was increasing fees and commissions for the use of banking services and products, the gradual expansion of new lending, extending credit, increasing revenues from intermediation in insurance business, and the recovery of capital markets, which resulted in increasing income from sale of units in funds, from asset management and from brokerage.

It should be noted, though, that strong growth in net fee and commission income in the largest bank explains almost 50% of its increase in the sector as a whole.

The decline in income from other banking activities (from PLN 10.8 bn in 2009 to PLN 8.5 bn in 2010) is to be explained, *inter alia*, by the calming of moods in financial markets, which resulted in a decrease in income from foreign exchange activities (from the perspective of banking sector stability this is a positive phenomenon). In addition, the decline in income was caused by reduced revenues from dividends (down by nearly PLN 0.4 bn) and by the change in some banks' accounting policy referred to above, which caused displacement of some revenues to net interest income.

Improvement in banks' performance of banks was aided by the **maintenance of "discipline" over operating costs**, which were only **2.9%** higher (increasing by PLN 24.8 bn in 2009 to PLN 25.5 bn in 2010), with staff costs increasing by 6.3% and general and administrative expenses decreasing by 1.1%. Depreciation and amortisation decreased by 1.3%.

Table 19. Balance of write-offs/provisions (PLN m; %)

	2008	2009	2010	Change 2010/2009 PLN m	Change 2010/2009 %	Result in the individual quarters of 2010 Q1	Q2	Q3	Q4
Balance of write-downs and provisions, of which:	4,140	11,749	11,284	-465	-4.0%	2,688	3,286	2,913	2,397
1 / Write-offs in respect of financial assets	4,275	11,556	10,383	-1,173	-10.2%	2,713	2,890	2,707	2,072
Households	3,420	8,807	9,012	205	2.3%	2,519	2,468	2,144	1,881
Consumer loans	3,047	7,108	7,039	-69	-1.0%	1,909	2,037	1,568	1,524
- credit cards	342	888	931	43	4.8%	283	262	213	173
- vehicle	93	191	190	-1	-0.3%	45	73	52	20
- instalment	760	2,467	2,032	-435	-17.6%	572	526	674	260
- other	1,852	3,563	3,886	323	9.1%	1,008	1,176	630	1,071
Housing loans	247	562	867	305	54.3%	174	289	169	234
Other loans	125	1,137	1,106	-30	-2.7%	436	141	406	123
Enterprises	702	2,681	1,426	-1,255	-46.8%	198	393	574	261
- SMEs	358	842	882	40	4.7%	27	170	690	-5
- large enterprises	344	1,839	544	-1,295	-70.4%	171	223	-116	267
Other entities	153	68	-56	-123	-181.9%	-4	29	-11	-70
2/ Other items	-134	194	902	708	366.0%	-25	396	206	325
- provisions	398	525	668	143	27.2%	124	256	68	219
- write-offs in respect of nonfinancial assets	153	210	69	-140	-66.9%	-14	30	26	27
- IBNR/general risk provision	-685	-541	165	706	-130.5%	-135	110	111	80

Figure 101.
Write-offs in respect of financial assets (PLN m)

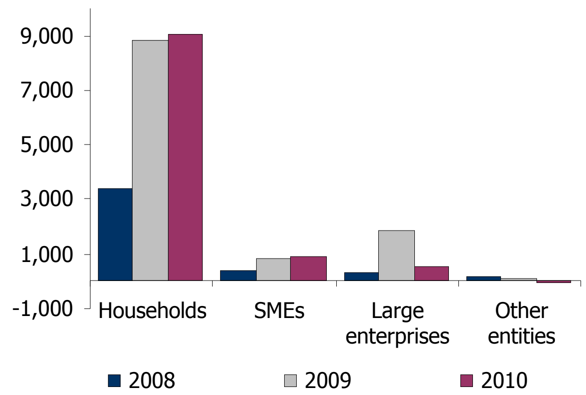


Figure 102.
Write-offs of loans to households (PLN m)

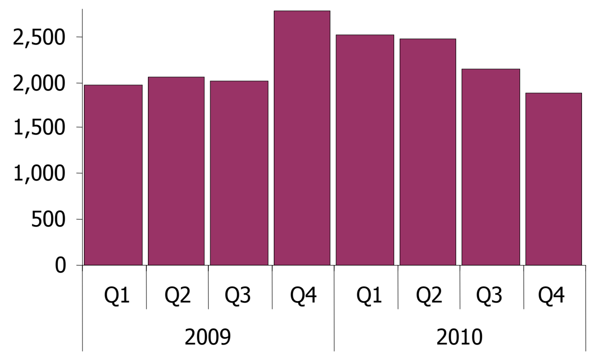


Figure 103.
Write-offs of consumer loans (PLN m)

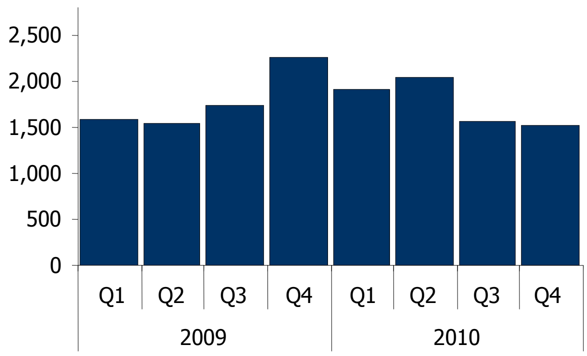
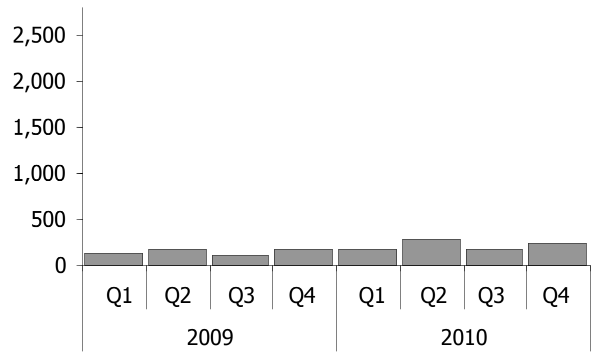


Figure 104.
Write-offs of housing loans (PLN m)



The main factor exerting negative pressure on banks' results was a negative balance of write-offs and provisions, which amounted to PLN 11.3 bn and was 4.0% (PLN 0.5 bn) lower than in 2009. It should, however, be noted that the decline compared to 2009 was due to the relatively low level of write-offs in the fourth quarter of last year, after being higher than in the corresponding periods of 2009 for most of the year (the negative balance of write-offs amounted to PLN 2.7 bn in the first quarter of 2010, PLN 3.3 bn in the second quarter, PLN 2.9 bn in the third quarter and 2.4 bn in the fourth quarter).

The negative balance of write-offs is primarily a consequence of the **materialisation of risks associated with the retail segment**, which accounted for **79.9% of total write-offs** made by banks in 2010 (they accounted for 75.0% in 2009). The total scale of write-offs made in 2010 and resulting from the impairment of financial assets related to households amounted to PLN 9.0 bn and was 2.3% (PLN 0.2 bn) higher than in 2009. The declining scale of write-offs in subsequent quarters (in each of the first and second quarters of 2010 they amounted to PLN 2.5 bn, as against PLN 2.1 bn in the third quarter and PLN 1.9 bn in the fourth quarter) must be viewed as positive.

The negative balance of write-offs and provisions related to consumer loans amounted to PLN 7.0 bn, a **decrease** from the previous year of 1.0% (PLN 0.1 bn), with write-offs made in the second half of last year significantly lower than in the first half. They constitute, however, a major burden on the banks (in 2010 these write-offs accounted for **62.4% of total write-offs**, as against 60.5% in 2009). Of the total amount of write-offs for consumer loans those relating to loans repayable in a single payment and overdrafts accounted for PLN 3.9 bn (an increase of 9.1%, or PLN 0.3 bn), to instalment loans PLN 2.0 bn (down by 17.6%, or PLN 0.4 bn), to credit cards PLN 0.9 bn (an increase of 4.8%, or PLN 0.0 bn), and to car loans PLN 0.2 bn (an increase of 0.3%, or PLN 0.0 bn).

In 2010, there was a significant **increase in write-offs due to the impairment of housing loans**, which amounted to PLN 0.9 bn and were 54.3% (PLN 0.3 bn) higher than in 2009. Despite the significant increase in the scale of these write-offs, their share in total write-offs remains relatively low (in 2010 it amounted to **7.7%**, as against 4.8% in 2009).

On the other hand it should be noted that the portfolio of these loans is "young" and one should therefore anticipate gradual growth in write-offs for these loans.

The share of other write-offs amounted to 21.1% (as against 25.0% in 2009). It is worth noting the **decrease in the negative balance of write-offs in the corporate segment**, which amounted to PLN 1.4 bn and was down by nearly half from 2009. This should be attributed to the general improvement in the enterprise sector’s financial situation and the limited impact of option transactions, which in the prior year constituted a considerable burden on banks' results.

Write-offs are concentrated in banks which in previous periods pursued an aggressive strategy in the area of consumer loans. Among the 21 entities in which the scale of net write-offs exceeded PLN 100 m nearly half were small and medium-sized institutions - their combined share in the assets of the banking sector was 12% and their share of write-offs 35% (the level of the negative balance in these entities ranged from PLN 0.1 bn to PLN1.0 bn).

The gradual decline in the level of write-offs (especially in the fourth quarter of last year) **may be a signal that the second half of 2010 saw a break in the growth of adverse trends and a gradual abating of negative pressure.** This is pointed to by further analysis of changes in the quality of loan portfolio (see section 4),analysis of changes taking place in the banks’ environment, the expected effects of actions taken by the PFSA (including the positive impact of Recommendations S and T in reducing individual and systemic risk) and the expectations of banks themselves.

This optimistic scenario requires, however, verification by auditors of the level of write-offs made by individual banks in 2010 and the tendency itself requires confirmation in subsequent periods.

Table 20. Selected measures of the efficiency of the banking sector (%; PLN m; PLN '000s)

	Banking sector			of which commercial banks			of which cooperative banks		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
ROA - Net profit / average assets	1.54	0.81	1.05	1.59	0.83	1.12	1.70	1.19	1.14
ROE - Net profit / average share capital	7.40	8.62	8.90	7.32	8.58	8.87	8.63	9.31	9.35
C /I - Expenses / income	54.44	54.21	52.30	53.28	52.87	50.70	65.99	71.53	69.18
Net income from banking operations / average assets	5.43	4.83	4.79	5.40	4.82	4.80	6.89	5.86	5.71
- net interest income / average assets	3.14	2.57	2.78	3.08	2.50	2.75	5.18	4.15	4.13
- net non-interest income / average assets	2.29	2.26	2.01	2.33	2.32	2.04	1.70	1.72	1.58
General and administrative expense / average assets	2.75	2.41	2.30	2.67	2.34	2.22	4.25	3.96	3.71
- employment / average assets	1.52	1.30	1.29	1.44	1.23	1.21	3.09	2.86	2.66
- general management / average assets	1.23	1.11	1.02	1.23	1.11	1.01	1.15	1.11	1.05
operating expense / profit/loss on banking activities	50.61	49.97	48.07	49.48	48.61	46.34	61.63	67.62	65.01
Operating expense / net interest income	87.54	93.97	82.77	86.97	93.71	80.71	81.90	95.61	89.85
Operating expense / net non-interest income	119.94	106.72	114.66	114.79	100.98	108.81	249.08	230.94	235.12
Balance of offsets and provisions / average assets	0.46	1.14	1.02	0.47	1.16	1.03	0.19	0.15	0.25
Assets per employee (in PLN m)	5.86	6.07	6.58	6.61	6.85	7.45	1.73	1.90	2.21
Personnel costs per employee (in PLN '000s)	76.89	76.99	81.06	82.53	82.21	86.47	50.01	51.23	54.73
Gross profit per employee (in PLN '000s)	97.45	70.01	90.23	112.67	78.37	103.52	34.87	26.87	30.26
Banks reporting a loss									
- number of banks reporting a loss	20	16	20	8	9	7	4	x	2
- share of sector assets	1.8%	7.9%	8.2%	1.2%	5.4%	5.6%	0.0%	x	0.0%
- total value of losses	-464	-1,716	-1 257	-364	-1,225	-644	-5	x	-15

The increase in profits and the maintenance of control over costs resulted in an **improvement in most measures of efficiency**. In particular, there has been:

- an increase in net interest margin from 2.57% in 2009 to 2.78% in 2010 (co-operative banks constituted an exception. Because of their substantial share of subsidized loans they are under pressure from the NBP's low interest rates and they must simultaneously face up to competition in the deposit market);
- reduction of the operating expenses indicator (C/I) from 54.2% to 52.3% and of the share of operating expenses in average assets from 2.41% to 2.30%. At the same time the ratio of operating expenses to profits generated from banking activity decreased;
- the ratio of the balance of write-offs and provisions to average assets fell from 1.14% to 1.02%; and
- ROA increased from 0.81% to 1.05% and ROE from 8.62% to 8.90%.

It is worth noting the significant differences between the efficiency of commercial banks and that of cooperative banks. In particular, cooperative banks are characterized by a dominant role of net interest income and commission income in generating profits from banking activity, a higher level of expenses (C/I) and a lower share of write-offs and provisions in assets. The lower efficiency of cooperative banks is, *inter alia*, an effect of the difference in scale of operations and scope of activities, the structure of customers served and the limited scalability of small banks due to the need to ensure the necessary division of tasks and control mechanisms.

On the basis of financial plans one can **expect net profit growth of about 25% in 2011**, which would be a record result. It should be noted, however, that nearly one-third of banks surveyed expect results to deteriorate.

To summarise, in 2010 saw a **significant improvement in the financial results of the banking sector**, but profits were still lower than in 2007 and 2008.

The main sources of improvement were an increase in net interest income and in net fees and commissions, and in the fourth quarter also a reduction in the negative balance of write-offs and provisions.

The increase in net interest income was driven mainly by a decrease in interest expenses, due to a decrease in interest rates in financial markets and the reduction by banks of interest rates on deposits. This is, however, mainly a comparison of the first half of 2010 and the first half of 2009, for in the second half of 2010, interest expenses were similar to those that banks incurred in the previous year.(High interest costs in the first half of 2009 resulted from the escalating financial crisis in late 2008, which caused an increase in interest rates in financial markets and increasing competition in the deposit market; thanks to action taken on a global scale the situation in financial markets has gradually stabilized, which has resulted, *inter alia*, in a decrease in interest rates paid for deposits in the domestic market). As a consequence, despite the increase in the deposit base, the cost of deposits by the nonfinancial and the financial sector have been reduced while the costs of deposits by the budget sector have increased marginally. **On the other hand, despite falling interest rates and low growth in new lending an increase was noted in interest income**. Positive influences on income have been played by increased margins on newly extended loans (they are generally higher than during the "pre-crisis" period) and by a significant increase in the volume of zloty-denominated housing loans, loans to the financial sector and portfolios of debt securities. Despite the negative phenomena observed in the portfolio of consumer loans this segment has also reported revenue growth, which resulted from high margins and a higher average balance outstanding of such loans. Pressure on incomes was caused meanwhile by a reduction in income from the corporate sector and from foreign currency housing loans. Another factor exerting downward pressure on interest income was the worsening financial situation of some borrowers, which resulted, *inter alia*, in cessation of, or irregularity in, servicing loans.

The increase in net fee and commission income was a consequence of the raising of fees and commissions, the gradual growth of new lending, increased revenues from insurance brokerage and the recovery of the capital market.

Improvement of banks’ performance was aided by the **maintenance of "discipline" over operating expenses**, which recorded a small increase.

The main factor exerting negative pressure on banks' profits, was a negative balance of write-offs and provisions. However, thanks to relatively low write-offs in the fourth quarter, this balance turned out to be lower than in 2009 over the year as a whole.

The negative balance of write-offs is primarily a consequence of the **materialisation of risks associated with consumer loans**, though the year as a whole saw a very small reduction in write-offs of such loans. Write-offs were concentrated in banks which in previous periods pursued an aggressive strategy in the area of consumer finance. A **gradual increase in write-offs related to impairment of the value of housing loans** is noteworthy. On the other hand a **fall in the negative balance of write-offs and provisions in the corporate segment** was seen. This should be attributed to the general improvement in the enterprise sector’s financial situation and the limited impact of option transactions, which in the prior year constituted a considerable burden on banks' results.

The increase in profits and the maintenance of control over costs resulted in an **improvement in most measures of efficiency**.

4 MAIN AREAS OF RISK AND CAPITAL ADEQUACY

4.1 Liquidity

The current **situation of banks in regard to liquidity can be considered satisfactory**.

Table 21. Number of banks and branches of credit institutions not meeting at end month the standards of Resolution 386/2008

	01/09	02/09	03/09	04/09	05/09	06/09	07/09	08/09	09/09	10/09	11/09	12/09
Commercial banks	3	2	4	2	2	1	1	3	3	4	2	1
Branches of credit institutions	1	1	1	1	1	1	1	1	1	1	1	0
Cooperative banks	7	5	5	12	9	11	6	9	10	10	6	10
Total share in the sector's assets (%)	2.7%	0.4%	4.7%	0.3%	0.7%	0.3%	0.2%	0.3%	0.4%	0.4%	0.3%	0.3%
	01/10	02/10	03/10	04/10	05/10	06/10	07/10	08/10	09/10	10/10	11/10	12/10
Commercial banks	-	1	-	1	-	-	-	-	-	-	-	-
Branches of credit institutions	-	-	-	-	-	-	-	1	-	-	1	1
Cooperative banks	5	6	7	7	5	10	6	6	6	4	4	4
Total share in the sector's assets (%)	0.2%	0.7%	0.2%	0.7%	0.1%	0.2%	0.1%	0.2%	0.2%	0.1%	0.1%	0.1%

Figure 105.
Selected assets[32] (bn)

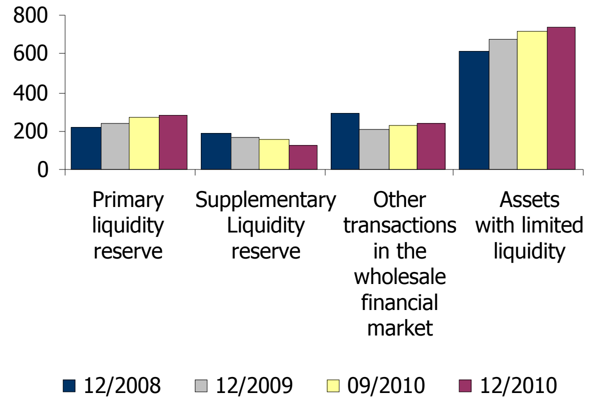


Figure 106.
Change in assets in 2009 and 2010 (PLN bn)

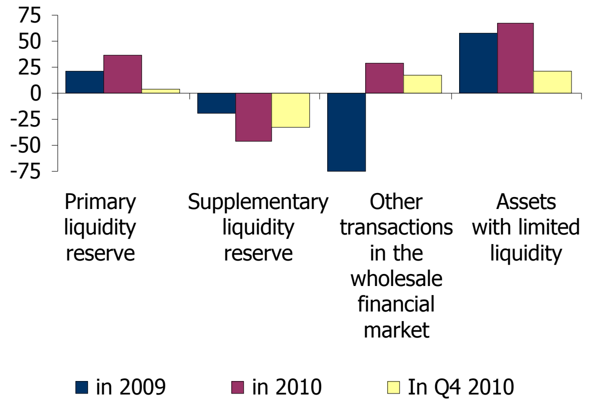


Figure 107.
Selected liabilities[33] (bn)

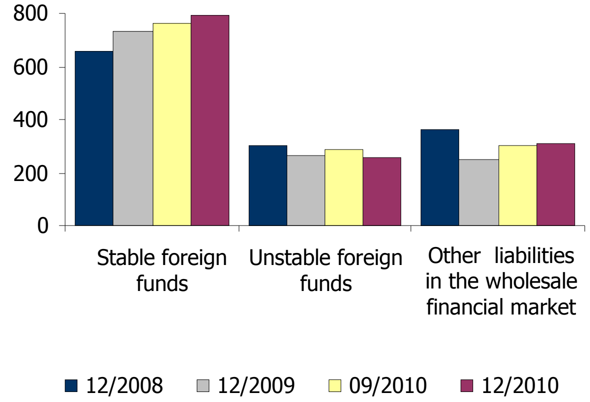
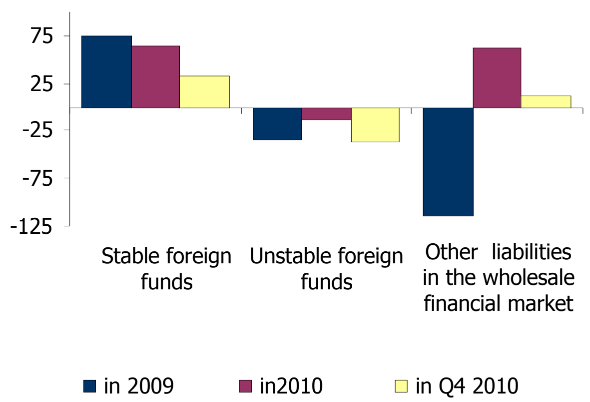


Figure 108.
Change in assets in 2009 and 2010 (PLN bn)



[32] For definitions see PFSA. Resolution 386/2008 on setting mandatory standards for bank liquidity.
[33] Ibid.

Figure 109.
Loans and deposits of non-financial sector (bn)

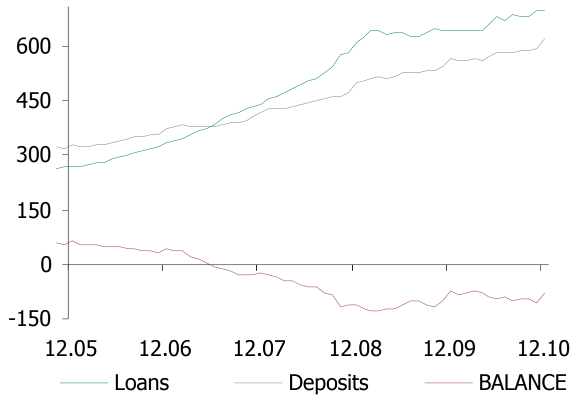
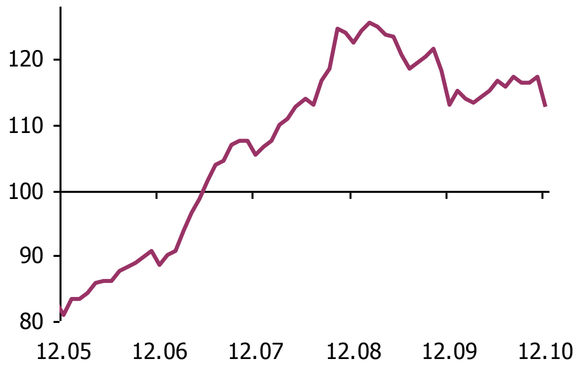


Figure 110.
Relationship of loans to non-financial sector deposits (%)



The main source of risk remains the continuing uncertainty in the market and the still limited level of mutual trust between participants in financial markets, which are results of the crisis of 2007-2009 and of the unfavourable events observable in some regions of the world economy. This relates, in particular, to the fiscal situation of some countries and to fears about the strength and durability of the recovery now visible in the global economy. The "inflow" of negative information is causing periodic disturbances to the functioning of some areas of financial markets (this is most apparent in the foreign exchange and equity markets) and is contributing to the unsatisfactory functioning of the interbank market for transactions with longer maturities.

Compliance with the provisions **of PFSA resolution No. 386/2008** on establishing binding norms for banks' liquidity **can be considered to have been satisfactory**. The number of breaches of the resolution has been low (and is noted to have improved compared to 2009) and they have related to entities of marginal importance in the scale of the system.

2010 saw, *inter alia*, an increase in the primary liquidity reserve of 15.2% (from PLN 239.8 bn in late 2009 to PLN 276.3 bn at the end of 2010), which largely resulted from the transfer of funds from the supplementary liquidity reserve. At the same time there was an increase of 8.7% in the level of stable foreign funds (from PLN 730.4 zł bn at the end of 2009 to PLN 794.3 bn at the end of 2010). The ratio of loans to deposits, which indirectly determines the scale of demand for funds from financial markets, remained stable and at the end of 2010 amounted to 112.6% (113.1% at the end of 2009).

Despite the observation of favourable phenomena and a satisfactory situation with regard to current liquidity, **measures are still needed to increase the stability of sources of funding** and strategies need to be developed that will sit well with difficult external conditions ("difficult" in terms of the reduced level of trust between market participants and periodic disturbances arising for the reasons referred to above).

4.2 Credit risk

Despite the improved financial results, 2010 saw a **further deterioration in the quality of the loan portfolio quality** as measured by the level and the proportion of impaired loans, but it does seem that **in the second half of last year there was a deceleration in the growth of unfavourable phenomena in some areas**.

Table 22. Impaired loans and their share in the portfolio (PLN bn; %)

	Value (PLN bn)					Share in portfolio (%)				
	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	03/2010	06/2010	09/2010	12/2010
Total lending, of which:	50.9	52.6	58.2	60.5	61.7	7.1%	7.4%	7.7%	7.9%	7.8%
1/ Financial sector	0.2	0.2	0.2	0.2	0.2	0.6%	0.8%	0.9%	0.8%	0.8%
2/ Non-financial sector	50.7	52.3	57.8	60.2	61.4	7.9%	8.2%	8.5%	8.8%	8.8%
- households	24.9	27.6	30.4	33.0	34.1	6.0%	6.6%	6.7%	7.2%	7.2%
individuals	20.8	23.3	25.7	27.8	28.8	5.8%	6.5%	6.6%	7.1%	7.0%
individual entrepreneurs	3.5	3.7	4.1	4.5	4.6	8.7%	9.0%	9.5%	10.1%	10.4%
individual farmers	0.6	0.6	0.6	0.7	0.7	3.0%	3.1%	3.1%	3.3%	3.3%
- enterprises	25.7	24.6	27.3	27.2	27.2	11.6%	11.3%	12.3%	12.3%	12.4%
SMEs	17.0	15.7	18.0	18.2	18.4	13.4%	12.5%	14.0%	14.2%	14.5%
large enterprises	8.7	8.9	9.3	9.0	8.8	9.2%	9.6%	9.9%	9.7%	9.5%
- non-profit institutions	0.0	0.1	0.1	0.1	0.1	1.5%	3.2%	3.6%	2.1%	2.0%
3/ Budget sector	0.1	0.1	0.1	0.1	0.1	0.2%	0.2%	0.2%	0.2%	0.2%
- government institutions	0.0	0.0	0.0	0.0	0.0	0.0%	0.1%	0.0%	0.0%	0.0%
- local government institutions	0.1	0.1	0.1	0.1	0.1	0.3%	0.3%	0.4%	0.4%	0.3%
- social insurance funds	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%	0.0%	0.0%

Figure 111.
Impaired loans of selected groups of customers (PLN bn)

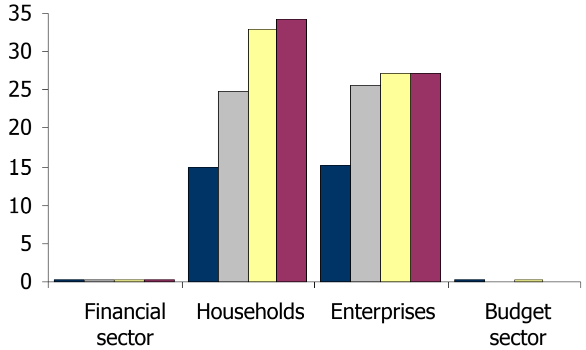
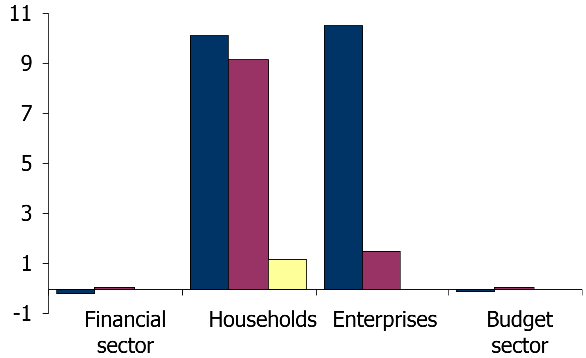


Figure 112.
Change in outstanding imp'd. lns. in 2009 and 2010 (PLN bn)



The value of loans with recognised loss of value (impaired loans) **increased** in 2010 **by PLN 10.7 bn,** i.e. by **21.1%**. At the same time the **share** of these loans in the entire loan portfolio increased from 7.1% at the end of 2009 to **7.8%** at the end of 2010. It is notable that the value of impaired loans grew by less than in 2009 (by PLN 20.3 bn; i.e. by 66.0%) and that the **growth of impaired loans decelerated** (the value of impaired loans increased by PLN 1.7 bn in the first quarter of 2010, by PLN 5.6 bn in the second quarter, by PLN 2.4 bn in the third and by PLN 1.1 bn).

The increase in impaired loans related mainly to the household sector and, to a much lesser extent, the enterprise sector.

The situation in the portfolio of loans to the financial sector and the budget sector remained stable and the quality of the portfolio remained high.

Table 23. Impaired loans to households and their share of the portfolio (PLN bn; %)

	Value (PLN bn)					Share in portfolio (%)				
	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	03/2010	06/2010	09/2010	12/2010
Impaired loans in total, of which:	24.9	27.6	30.4	33.0	34.1	6.0%	6.6%	6.7%	7.2%	7.2%
1/ Consumer loans	17.2	19.6	21.3	22.9	23.2	13.0%	14.8%	15.8%	17.0%	17.3%
- credit cards	1.9	2.2	2.5	2.6	2.7	12.6%	14.7%	16.3%	17.5%	18.2%
- vehicle	0.8	0.9	0.9	1.0	1.0	10.2%	11.1%	11.7%	12.4%	12.7%
- instalment	6.0	6.6	6.9	7.1	7.3	13.6%	14.8%	15.3%	15.5%	15.7%
- other	8.5	9.9	11.0	12.2	12.3	13.1%	15.3%	16.6%	18.5%	18.8%
2/ Housing loans	3.2	3.3	4.0	4.5	4.9	1.5%	1.5%	1.6%	1.8%	1.8%
- zloty	1.7	1.9	2.2	2.5	2.8	2.3%	2.4%	2.5%	2.8%	2.8%
- foreign currency	1.5	1.4	1.8	2.0	2.1	1.1%	1.0%	1.1%	1.2%	1.3%
3/ Other	4.5	4.7	5.2	5.6	6.0	6.7%	6.9%	7.3%	7.6%	8.1%
- operating	1.8	1.9	2.1	2.2	2.1	8.3%	8.3%	8.7%	9.1%	8.9%
- investment	1.1	1.1	1.2	1.3	1.4	4.7%	4.7%	4.9%	5.4%	5.6%
- property	0.4	0.4	0.4	0.4	0.5	5.2%	5.2%	5.1%	5.3%	5.7%
- other	1.2	1.4	1.6	1.6	2.1	8.3%	8.8%	9.6%	9.9%	11.9%

Figure 113.
Impaired loans to households (PLN bn)

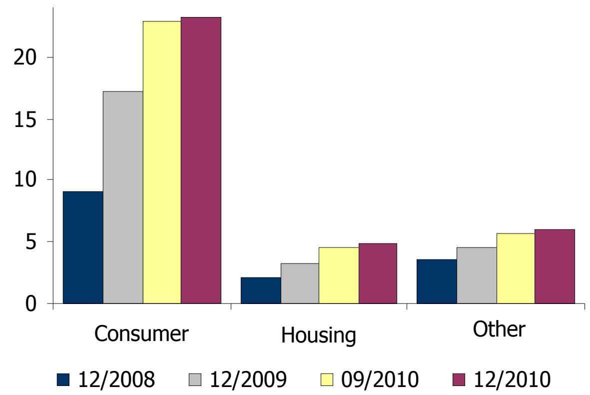


Figure 114.
Change in outstanding threat. loans in 2009 and 2010 (PLN bn)

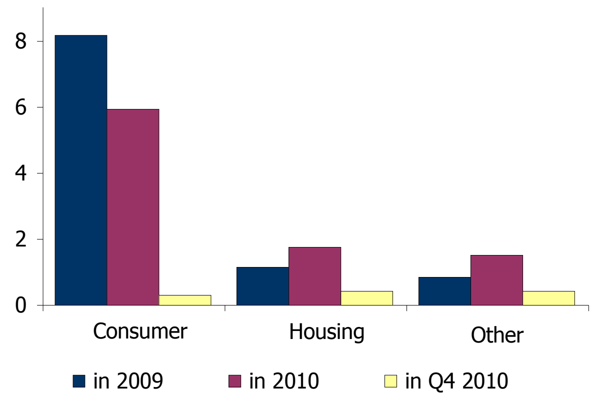


Figure 115.
Impaired consumer loans (PLN bn)

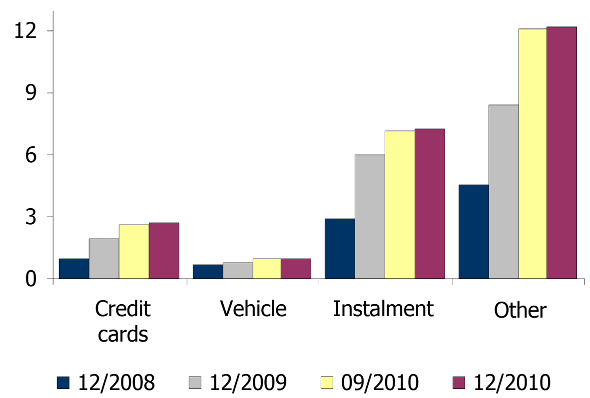
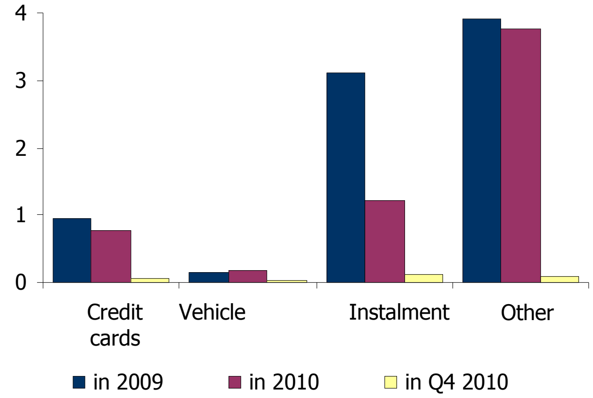


Figure 116.
Change in outstanding threat. loans in 2009 and 2010 (PLN bn)



Growth of impaired loans to households totalled about PLN 9.2 bn, i.e. **36.8%,** in 2010 (after PLN 10.1 bn in 2009). During the course of the year, however, growth in the value of impaired loans decelerated (it grew by PLN 2.7 bn in the first quarter of 2010, by PLN 2.8 bn in the second quarter, by PLN 2.5 bn in the third quarter and by only PLN 1.1 bn in the fourth quarter.).

The **share** of impaired loans in the portfolio of loans to households increased from 6.0% at the end of 2009 to **7.2%** at the end of 2010, and in the entire loan portfolio from 3.5% to **4.3%.**

The decisive influence on the growth of the portfolio loans was **further deterioration in the quality of the portfolio of consumer loans**. **Growth** of impaired loans to households in 2010 amounted to **PLN 5.9 bn,** i.e. 34.4%, and their **share** in the portfolio of such loans increased from 13.0% to **17.3%** (and in the entire portfolio from 2.4% to 2.9%). A positive feature is that the rate of growth of these loans decelerated in the fourth quarter of last year. (In the first quarter the increase in impaired consumer loans amounted to PLN 2.4 bn, in the second and the third to PLN 1.6 bn, and in the fourth to only PLN 0.3 bn). On the other hand, analysis of the degree to which these loans are being services in a timely manner indicates that further deterioration in the quality of these loans is possible (see below).

By product the **largest increase in impaired loans was of loans repayable in a lump sum and of overdrafts** (an increase of PLN 3.8 bn; their share in the total amount of such loans rose from 13.1% to 18.8%), followed by instalment loans (1.2 bn; from 13.6% to 15.7%), debt from credit cards (0.8 bn; from 12.6% to 18.2%) and car loans (0.2 bn; from 10.2% to 12.7%).

Growth in the portfolio of impaired loans in entities which in previous periods pursued aggressive strategies in the area of consumer finance (mainly small and medium-sized banks) was of crucial importance in determining the growth of impaired consumer loans in the sector as a whole. These banks were also characterized by the lowest quality of their portfolios of such loans and most of them saw their profits collapse or shrink substantially in 2009-2010.

A deceleration in negative tendencies in the portfolio of consumer loans is confirmed by data collected in BIK [Biuro Informacji Kredytowej - Credit Information Office][34] databases.

Figure 117.
Number of customers with more than 10 loans ('000s)

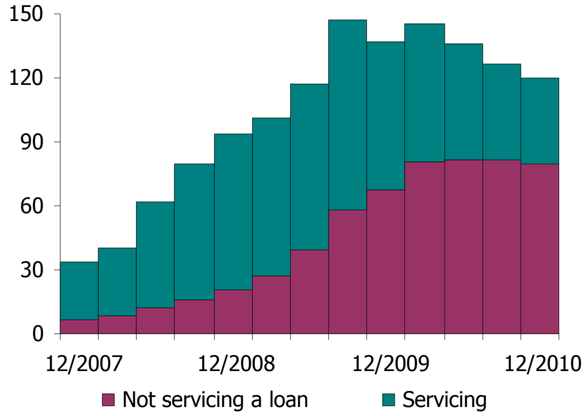
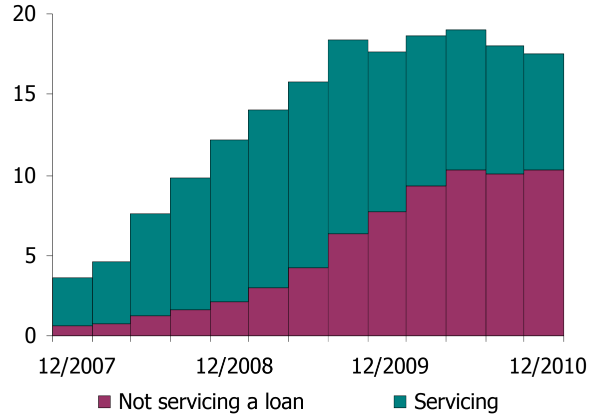


Figure 118.
Value of loans to customers with more than 10 loans (PLN bn)



Source: BIK

On the basis of the BIK data it can be stated that at the end of 2010 120,000 people had more than ten active loan agreements (there had been 147,000 at the end of 2009), whose total debt amounted to PLN 17.5 bn (after PLN 17.6 bn at the end of 2009)[35]. These people are conventionally defined as "overborrowed"[36] customers. In this group there were **80,000 customers** (67,600 a year earlier) **who were not servicing liabilities to banks** and their total debt not being serviced amounted to PLN 10.3 bn (PLN 7.3 bn)[37]. On the basis of changes over time in these amounts it can be said that:

- a sharp increase in the number of customers with more than ten credits occurred in 2008 and early 2009, which corresponds to observations by banking supervisors of a strong easing of banks' lending policies in 2007-2008,
- there was a **marked reduction in the total number of "overborrowed" customers in the second half of 2010** and the amount of their indebtedness together with **stabilisation of the number of**

[34] For further information see „Kredyt. Trendy" ['Loans.Trends], BIK March 2011.
[35] Their average level of debt amounted to PLN 146,200.
[36] This term should be treated conventionally. In particular, this group of "overborrowed" customers does not include people who took out a smaller number of credits and in practice are on the border of ability to meet their financial obligations or are unable to meet them.
[37] Their average level of debt amounted to PLN 128,200.

customers who were not servicing their liabilities at about 80,000 and the value of their outstanding debts at about PLN 10 bn. It is not possible to determine on the basis of BIK data whether the favourable trends are a result of repayment of a part of liabilities, the conclusion of agreements between banks and customers or the sale of loans (BIK's database does not record in full secondary movements in the loan portfolio, i.e. the processes of restructuring, consolidation or sale).

Figure 119.
Proportion of impaired loans[38] in consumer loans (%)[39]

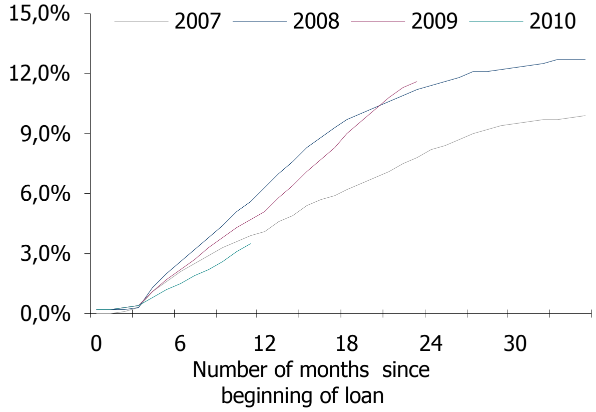
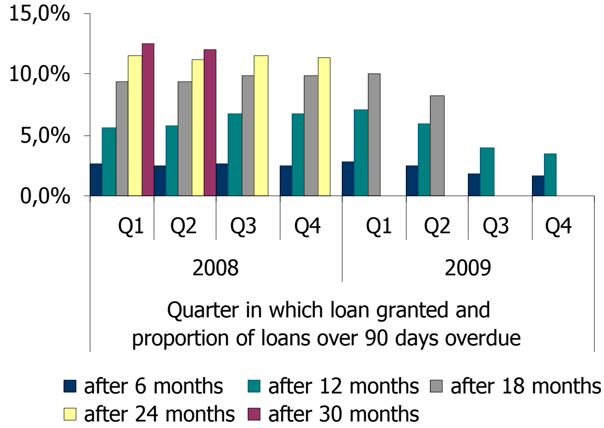


Figure 120.
Proportion of impaired loans by quarter of commencement (%)[40]



Source: BIK

Analysis of the age of the consumer loan portfolio indicates that:

- the period of time after which stabilisation of the share of impaired loans in the total of consumer loans extended in a given period occurs is approximately 30 months (after that, the lines showing impaired loans' share become horizontal). Taking into account the "lifespan" of these products, which by nature are short- or medium-term, one can say that the process of disclosure of the actual quality of the portfolio of these loans is a very long one;
- **the portfolio of consumer loans granted in 2008 and first half of 2009 is of the lowest quality**, with loans not being serviced for over 90 days accounting for around 12% of the total number of loan agreements for the period and for about 16% of the total value of loans. Due attention should be paid, however, to the complications referred to above, namely restructuring of some loans, sale of parts of the loan portfolio and prepayment of some loans. **Since the second and third quarters of 2009 a gradual improvement has taken place in the quality of consumer loans** - loans of successive generations appear to be better than their predecessors, which is to be attributed to the tightening of lending policies of banks in this area and also to the activities of the PFSA. In view of the period referred to above that is taken to reveal then actual quality of consumer credit, one should expect disclosure of losses in the loan portfolio from 2009 to continue;
- the lowest quality of loan portfolios from the boom years of 2007-2008 were generated by banks that specialised in the area of consumer finance (as a consequence of a rapid growth strategy combined with a lack of appropriate credit procedures and lack of adequate control over the sales network) and by the largest universal banks. The case of cooperative banks is interesting; before the escalation of the crisis

[38] **Impaired** loans here means loans with a delay in repayment of over 90 days.

[39] The graph shows the share of impaired consumer loans (with delay in repayment of more than 90 days) in total loans extended in each year of the period 2007-2010 (by quantity rather than value), at times elapsed since loans' extension. For example, after 18 months of the loan the share of impaired loans lost was 6.2% of total loans granted in 2007, 9.7% of those granted in 2008, and 9.1% of those granted in 2009 (There are no equivalent data for loans granted in 2010 since 18 months have not yet passed – this is why the curves are of differing lengths).

[40] The graph shows the share of impaired loans in generations of loans granted in various quarters of the years 2008-2009 (again by quantity rather than value). For example, the share of such loans in loans granted in the first quarter of 2008 was 2.7% after 6 months, 5.7% after 12 months, 9.4% after 18 months, 11.5% after 24 months and 12.5% after 30 months. Due to the very short period of time that has elapsed since granting the loan, it is not possible to show all these data for every quarter of 2008-2009 (which is shown in the lack of some bars in the graph).

these created better generations of consumer credit portfolios than the average in the system but at the turn of 2008/2009 they created a portfolio that was much worse than in the past. This should most probably be attributed to a belated response on the part of these banks as a result of which they "acquired" some of the "worst" customers who could no longer obtain loans from commercial banks.

Figure 121.
Impaired consumer loans (PLN bn)

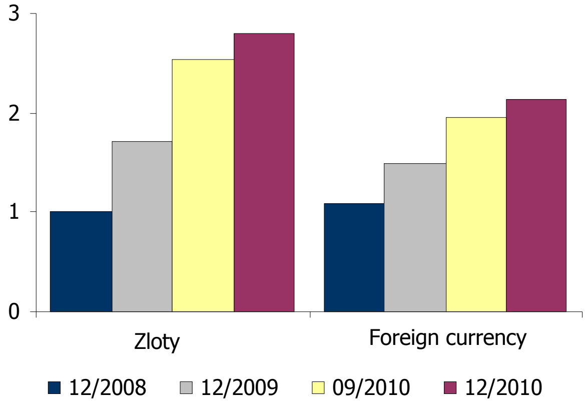
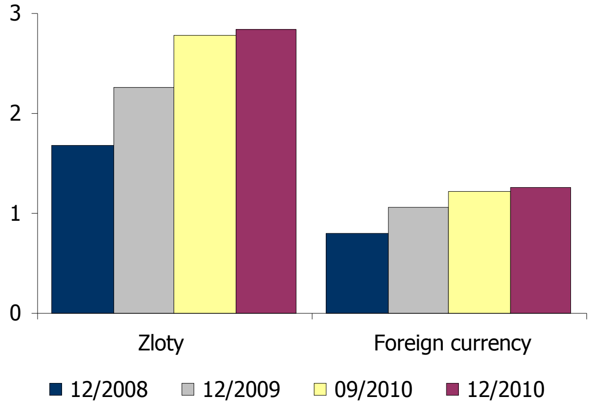


Figure 122.
Share of impaired housing loans in the hsg. loan portfolio (%)



Growth of impaired loans to households in 2010 amounted to **PLN 1.7 bn,** i.e. 53.7%(In 2009 the increase amounted to PLN 1.1 bn), and their **share** in the portfolio of housing loans increased from 1.5% to 1.8% (the share of these loans in the entire loan portfolio was still marginal - it increased from 0.4 % to 0.6%). Observation of quarterly growth in impaired loans in each (In the first quarter growth of impaired housing loans amounted to PLN0.1 bn, in the second to PLN 0.7 bn, in the third to PLN 0.5 billion and in the fourth to PLN 0.4 bn).

The increase in foreign currency impaired loans amounted to PLN 0.6 bn (after PLN 0.4 bn in 2009) and their share in the portfolio of foreign currency loans increased from 1.1% to 1.3%. The increase in zloty impaired loans amounted to PLN 1.1 bn (after PLN 0.7 bn in 2009) and their share in the portfolio of zloty loans increased from 2.3% to 2.8%.

One must be careful when interpreting data on the quality of housing loan portfolio by type of currency because of the **conversion** of some impaired foreign currency loans into zloty loans, which produces an "improvement" the quality of the portfolio of foreign currency loans and deterioration in the quality of zloty-denominated loans. In particular, this applies to foreign currency loans transferred to debt collectors, which are converted into zloty amounts (some banks also perform conversions into zloty in the event of delay in the payment of instalments of principal and interest, substantial weakening of the zloty or at customers' request). Additionally, one must bear in mind that **borrowers with debt in foreign currencies** benefited from the Swiss central bank (SNB)'s reduction of interest rates almost to zero, which compensated for the effects of zloty weakness. It should be noted, though, that zloty weakness led in their case to a substantial increase in outstanding indebtedness expressed in zloty (this has sometimes exceeded 50%). This means that the current **situation** of most of these borrowers is actually **worse than that of borrowers who chose to enter into zloty-denominated loans**. This is manifested in the need to keep up the foreign currency loan, because otherwise the borrower "would realise a loss" - the final cost of the loan (expressed in zloty), despite payment of lower monthly instalments, would be much higher than that of a similar zloty-denominated loan. Directly associated with this is the issue of ability to sell housing units (a significant portion of young borrowers bought their "first" housing unit with a view to selling it within a few years and buying a larger one), which as a result of substantial growth in indebtedness has (at current exchange rates) become very limited if not wholly unreal for most borrowers.

Figure 123.
Prop'n of for. curr. housing loans overdue by over 30 days (%)[41]

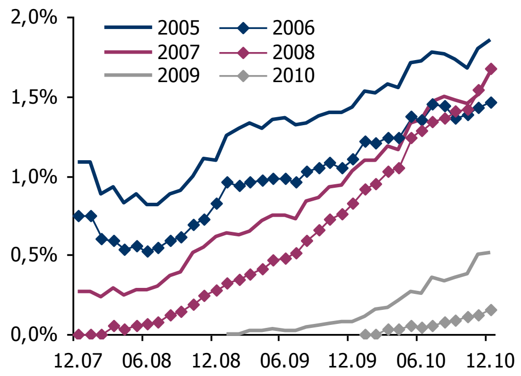


Figure 124.
Loans overdue by over 30 days 2007-2009[42] *(%)*

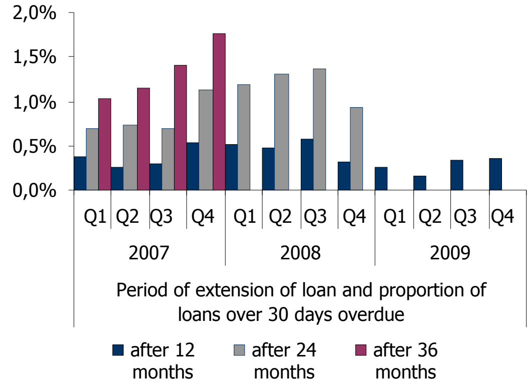


Figure 125.
Prop'n of zloty housing loans overdue by over 30 days (%)[43]

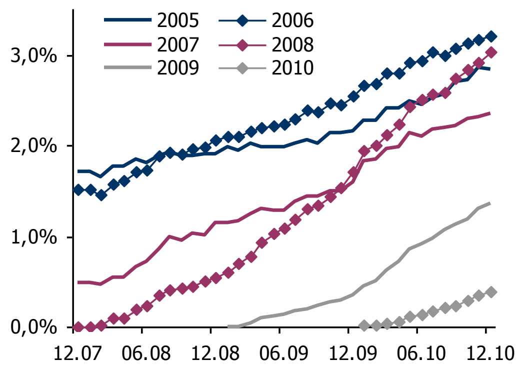
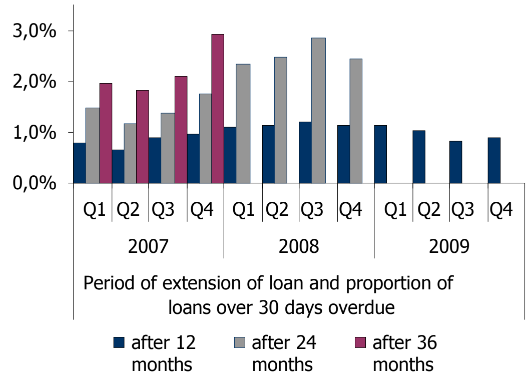


Figure 126.
Loans overdue by over 30 days 2007-2009[44] *(%)*



Source: BIK

Analysis of the age of the consumer loan portfolio shows:

- **"absence of stabilisation of quality" of housing loans** - the lines representing the proportion of loans payments on which are delayed by more than 30 days are continuing to rise. It is difficult to say how long the period is before you can determine the actual quality of the portfolio of housing loans (in the US this period is assumed to be about seven years, with that including the refinancing of loans after several years of debt service);
- **the lowest quality attaches to the portfolio of housing loans granted** at the peak of the boom in the property and housing loans markets, that is **in 2007-2008**, with the quality of loans extended in 2008 being particularly low. Despite their very short "history", they already have a lower quality than loans granted in 2006 and are rapidly "approaching" those of 2005 (for foreign currency loans this is

[41] The graph shows the share of foreign currency housing loans with a delay in payment of over 30 days in the total number of loans granted in the years 2005-2010 (again by quantity rather than value), at different times (from 12/2007 to 12/2010). For example: 1 / In December 2008, the share of these loans in total loans extended in 2005 was 1.1%, in loans extended in 2006 0.8%, in loans extended in 2007 0.6%, and in loans extended in 2008 0.3% (the high quality of loans from 2007 and 2008 observed in December 2008 is due to the very short history of these loans at this point of time) and the share in the loan portfolios from the years 2009-2010 is absent because these loans had not yet been awarded; 2 / In December 2010, the share of these loans in total loans from 2005, 2006, 2007, 2008, 2009 and 2010 were, respectively, 1.9%, 1.5%, 1.7%, .7%, 0.5% and 0.2%.

[42] The graph shows the share of foreign currency housing loans with delay in payment of over 30 days in the portfolio of loans in each quarter year from 2007 to 2009 (again by quantity rather than value). For example, the share of such loans in loans granted in the first quarter of 2007 was 0.47% 12 months after, 0.7% 24 months after and 1.0% 36 months after the granting of the loans (and for loans granted in the fourth quarter of 2007, respectively 0.5%, 1.1% and 1.8%. Naturally, since too short a period of time has elapsed from the extension of loans, in the case of loans granted in individual quarters of 2008 and 2009 is not possible to show the quality of the portfolio 36 months after the date of extension (or in the case of loans from 2009 also after 24 months).

[43] The interpretation is analogous to that in the case of foreign currency loans.

[44] The interpretation is analogous to that in the case of foreign currency loans.

manifested by the curves showing 2007 and 2008 loans breaking through the curve that shows 2006 loans; for zloty-denominated loans this is true only for loans extended in 2008);

- **in statistical terms the quality of the portfolio of foreign currency loans is higher** than that of zloty loans. **However** a number of complicating factors should be noted, namely: interest rates on foreign currency instruments falling to record lows, restructuring of some loans, conversion to zloty of loans handed over to debt collectors and the higher proportion of early repayment of zloty loans;
- it seems that the **easing of lending policy that has taken place since the second half of 2009 is leading to the renewed generation of "worse" loan portfolios** (this is clear to see in the case of foreign currency loans) but since only a short period has passed this phenomenon requires further observation and confirmation in subsequent periods.

The relatively high quality of housing loans should be attributed to several factors. First, lending procedures (including examination of creditworthiness) are sharper. Secondly, these loans have the highest priority for repayment by borrowers (because of fear of losing their housing). Thirdly, a very important factor has been the decline in interest rates to historically low levels that has been seen in the last two or three years. Finally, it should be kept in mind that most housing loans have a very short history, whereas the risk associated with them is generally evident only after several years have passed. In this context it should be noted that the level of the LTV of the average loan also increased, because the surge in housing prices in 2005-2008 led to a substantial increase in the average value of loans extended and in the relationship of the average amount lent to average income. Recent years have also seen changes in other parameters associated with housing loans, including in the level of risk accepted by banks. Therefore one cannot easily transfer experience with loans extended at the beginning of the decade to loans granted in 2007-2010.

Moreover, additional **risks may be generated** by the very strong growth in loans under the "**Rodzina na swoim"** ["Family in its Own"] **programme,** which entail a step increase in repayment instalments at the end of an eight-year period of assistance from the state (by the end of 2010 close to 90,000 of this loans had been granted, for a total amount in excess of PLN 15 bn[45]).

In the context of the quality of housing loans it should also be remembered that **the number of clients who meet their obligations under housing loans by incurring other liabilities or ceasing to meet other financial obligations** (e.g. payment of service charges) **is not known**.

Figure 127.
The share of housing loans in total assets (%)

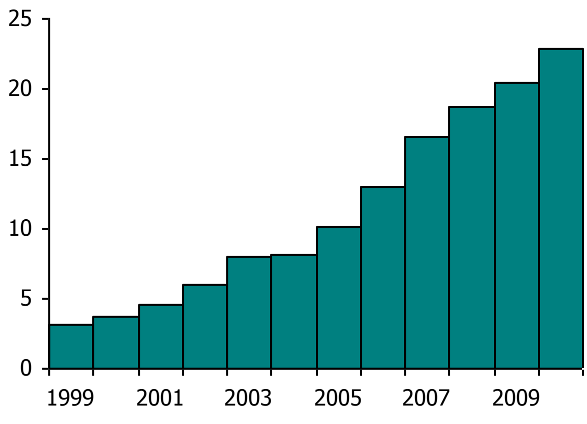
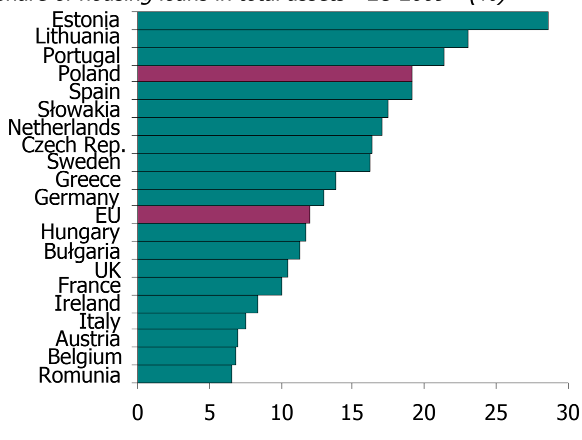


Figure 128.
Share of housing loans in total assets - EU 2009[46] (%)



In the context of the risks associated with the portfolio of housing loans attention should be paid to the growing role of housing loans in banks' balance sheets (giving rise to a risk of excessive product concentration).

Observing the changes that occurred between 2004 (i.e. at the beginning of the boom in the property and housing loans markets) and 2010, one can say that during this period there was a **strong increase in the**

[45] According to a BGK press release dated 18 April 2011, 100,500 loan agreements were open for a total amount of PLN 17.9 billion.
[46] Source: "Report on EU banking structures", ECB 2010, own calculations

share of housing loans in the banking sector's assets - from 8.1% at the end of 2004 to **22.9%** at the end of 2010.[47] Even greater changes have taken place **at the level of the banks** that hold a key position in the market for these loans. Many of them have **increased the percentage share of housing loans in their total loan portfolios from single figures to well over 20%** and one therefore can speak of a fundamental change in their business model (the very substantial changes in banks that had previously been associated with the corporate sector, consumer finance or with support for agriculture or environmental protection are particularly notable).

The changes that took place in 2004-2010 have specific consequences and give risk to specific risks. In particular, **many banks have rendered their future financial situation very much dependent on the future quality of their portfolios of housing loans and on future conditions in the property market**. **At the same time the situation in the foreign exchange market and the level of interest rates set under the influence of foreign monetary authorities** (mainly the SNB and the ECB) **will exert a strong influence on the quality of the housing loan portfolio** because of the very high share of foreign currency loans.

Table 24. Impaired loans to the enterprise sector and their share in the portfolio (PLN bn; %)

	Value (PLN bn)					Share in portfolio (%)				
	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	03/2010	06/2010	09/2010	12/2010
Total impaired loans, of which:	25.7	24.6	27.3	27.2	27.2	11.6%	11.3%	12.3%	12.3%	12.4%
1/ SMEs	17.0	15.7	18.0	18.2	18.4	13.4%	12.5%	14.0%	14.2%	14.5%
- operating	5.9	5.8	6.2	6.1	5.9	12.8%	12.4%	12.6%	12.7%	12.7%
- investment	4.0	3.9	4.2	4.5	4.6	11.7%	11.7%	12.3%	13.1%	13.0%
- property	5.9	4.7	6.3	6.2	6.3	16.0%	13.3%	17.6%	17.6%	18.2%
- other	1.2	1.2	1.4	1.3	1.6	11.6%	12.5%	13.4%	12.9%	14.8%
2/ Large enterprises	8.7	8.9	9.3	9.0	8.8	9.2%	9.6%	9.9%	9.7%	9.5%
- operating	4.6	4.4	4.6	4.4	4.1	9.5%	9.4%	9.7%	9.7%	9.2%
- investment	2.3	2.6	2.7	2.6	2.7	7.6%	8.9%	8.8%	8.8%	8.8%
- property	0.5	0.6	0.8	0.8	0.7	4.9%	6.3%	7.8%	8.0%	8.0%
- other	1.3	1.3	1.3	1.2	1.3	22.6%	20.4%	19.2%	15.1%	14.6%

Figure 129.
Impaired loans to the enterprise sector (PLN bn)

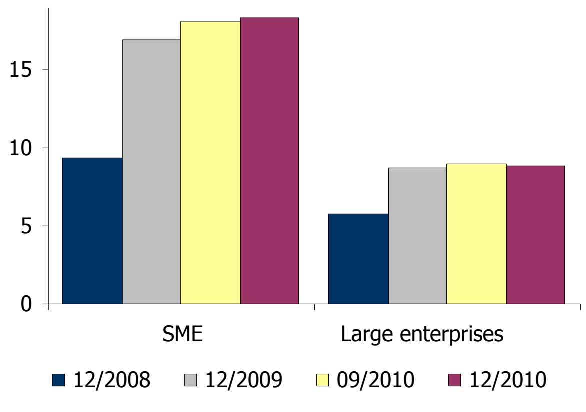
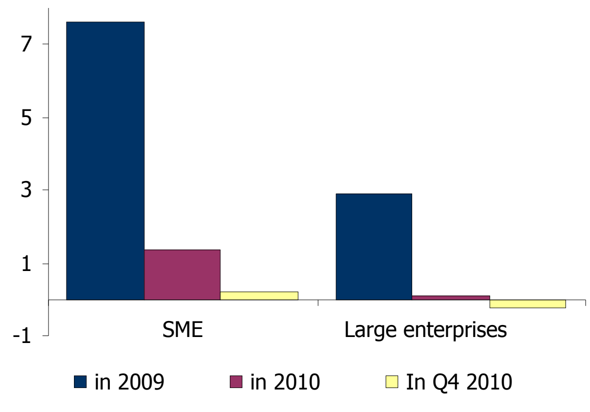


Figure 130.
Change in outstanding impaired loans in 2009 and 2010 (PLN bn)



Growth of impaired loans to households amounted to only **PLN 1.5 bn,** i.e. 5.7% in 2010(in 2009 growth amounted to PLN 10.6 bn). The **share** of impaired loans in the portfolio of loans to enterprises increased from 11.6% at the end of 2009 to **12.4%** at the end of 2010 but the share of these loans in the entire loan portfolio decreased from 3.6% to 3.5 % (this is linked to the fall in the share of loans to enterprises in the total loan portfolio).

Observation of the growth of loans by quarter shows a clear **process of stabilisation of the quality of the portfolio of loans to enterprises** (in the first quarter the level of impaired loans to enterprises decreased by

[47] In the years 2004-2010 there was also a **strong increase in the share of housing loans in GDP** - from about 4.7% in 2004 to about 18.7% in 2010

PLN 1.1 bn, in the second it increased by PLN 2.7 bn, in the third it decreased by PLN 0.1 bn and in the fourth it remained virtually unchanged).

A breakdown by type of business shows that the **increase in impaired loans occurred primarily in the area of loans to SMEs**, while the **quantity of impaired loans to large enterprises has remained practically unchanged**.

The level of impaired loans granted to SMEs increased in 2010 by PLN 1.4 bn, i.e. by 8.1% (in the first quarter the level of impaired loans decreased by PLN 1.3 bn, while the second, third and fourth quarters saw increases of PLN 2.2 bn, PLN 0.1 bn and PLN 0.2 bn) and their share in loans to SMEs increased to 14.5% (from 13.4% at the end of 2009).

By product breakdown, it was the portfolio of property loans that had the highest level of impaired loans (PLN 6.3 bn, 18.2% of such loans) and was of the lowest quality. This is related, however, to the acquisition by one of the banks of the assets of the National Housing Fund (the majority of its loans were to "TBS" social housing associations and to housing cooperatives). The low quality of other loans is to be attributed to the sharp deceleration of the economy at the turn of 2008 and 2009. As a result, some SMEs found themselves in financial difficulties, which led in 2009 to a substantial rise in the total of impaired loans extended to them. The economic recovery now under way should cause an improvement in the financial situation of SMEs and this has been manifested, *inter alia*, in the slowdown in the rate of growth of impaired loans observed in the second half of 2010.

The level of impaired loans extended to large enterprises has stabilised. The increase over the full year amounted to only PLN 0.1 bn and occurred in the first half (in the first quarter saw an increase of PLN 0.2 bn and the second one of PLN 0.4 bn); the second half saw a reduction in the level of impaired loans (in the third quarter to 0.3 bn and in the fourth PLN 0.2 bn). Although the share of impaired loans in loans to large enterprises rose from 9.2% at the end of 2009 to 9.5% at the end of 2010 but this was an effect of the general decrease in loans to large enterprises.

Table 25. Timeliness of servicing of loans to the non-financial sector (PLN bn; %)

	Total loans				Consumer loans[48]				Housing loans			
	03/2010	06/2010	09/2010	12/2010	03/2010	06/2010	09/2010	12/2010	03/2010	06/2010	09/2010	12/2010
VALUE												
Total	641.6	681.0	683.7	698.5	126.5	128.2	134.7	135.3	219.7	249.3	251.1	267.5
Non-delinquent	559.6	596.7	601.0	612.5	91.8	95.3	98.5	98.5	207.2	234.3	236.8	253.1
Delayed 1-30 days	37.5	35.8	32.2	33.7	15.4	12.0	11.9	11.7	8.3	10.4	9.3	9.0
Overdue > 30 days	44.6	48.5	50.5	52.3	19.2	20.9	24.3	25.1	4.2	4.6	5.0	5.4
- 31-90 days	10.0	8.7	8.1	8.6	3.9	3.5	3.4	3.3	2.1	1.9	1.9	2.1
- 91-180 days	5.4	6.5	6.2	5.7	3.0	3.1	2.8	2.5	0.6	0.8	0.8	0.9
- 181-365 days	10.3	9.7	10.0	9.7	5.1	5.1	5.4	5.0	0.5	0.7	0.8	0.9
- over 1 year	18.8	23.5	26.2	28.2	7.3	9.2	12.6	14.3	1.0	1.2	1.4	1.6
SHARE IN PORTFOLIO												
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Non-delinquent	87.2%	87.6%	87.9%	87.7%	72.6%	74.4%	73.2%	72.8%	94.3%	94.0%	94.3%	94.6%
Delayed 1-30 days	5.8%	5.3%	4.7%	4.8%	12.2%	9.4%	8.8%	8.7%	3.8%	4.2%	3.7%	3.4%
Overdue > 30 days	6.9%	7.1%	7.4%	7.5%	15.2%	16.3%	18.0%	18.6%	1.9%	1.8%	2.0%	2.0%
- 31-90 days	1.6%	1.3%	1.2%	1.2%	3.1%	2.7%	2.5%	2.4%	1.0%	0.8%	0.8%	0.8%
- 91-180 days	0.8%	1.0%	0.9%	0.8%	2.4%	2.5%	2.1%	1.9%	0.3%	0.3%	0.3%	0.3%
- 181-365 days	1.6%	1.4%	1.5%	1.4%	4.0%	4.0%	4.0%	3.7%	0.2%	0.3%	0.3%	0.3%
- over 1 year	2.9%	3.5%	3.8%	4.0%	5.8%	7.1%	9.4%	10.6%	0.5%	0.5%	0.6%	0.6%

Analysis of the timeliness with which loans are serviced[49] complements analysis of the quality of the loan portfolio based on the value of loans impairment of which has been recognised and their share in the portfolio. In view of the crucial importance of loans to non-financial sector this has been limited to presentation of the condition of this area.

[48] The difference between the value of consumer loans presented in this table and in earlier parts of this report arise because of the limitations of the reporting system. It does not change the essence of the matter.
[49] Analysis of the timeliness of payments as shown here has been possible only since March 2010.

Figure 131.
Delays in the repayment of consumer loans (PLN bn)

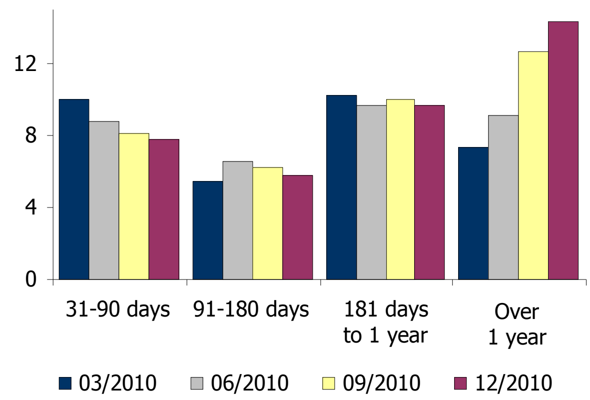
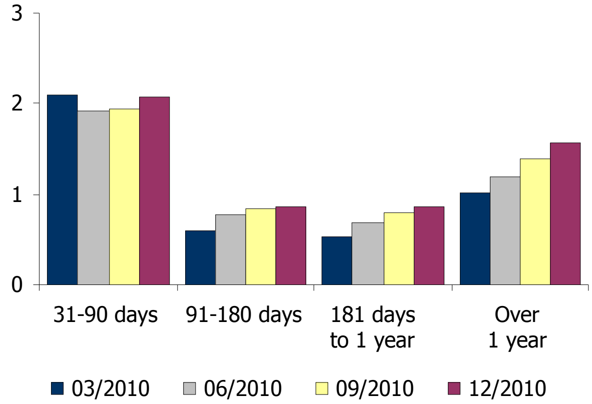


Figure 132.
Delays in the repayment of housing loans (PLN bn)



At the end of 2010, **loans to non-financial sector repayments of which were more than 30 days overdue had a value of PLN 52.3 bn and constituted 7.5%** of the portfolio of these loans (the share of loans with recognised loss of value in loans to non-financial sector amounted to 8.8%). On the basis of analysis of the timeliness of debt service one can state:

- **gradual deceleration is taking place in the growth in loans repayments on which are more than 30 days overdue** (in the second quarter they grew by PLN 3.9 bn, in the third by PLN 2.0 bn, and in the fourth by PLN 1.8 bn) and signs are appearing of stabilisation of their share in the entire portfolio of loans to the non-financial sector;
- **consumer loans are marked by the lowest proportion of loans that are being serviced on time.** At the end of 2010, the value of loans repayments on which are more than 30 days overdue amounted to PLN 25.1 bn (of which loans repayments on which are more than 90 days overdue accounted for PLN 21.9 bn) and their share in the portfolio of such loans to 18.6% (16.2%). It can be viewed as positive that the rate of growth of these loans slowed in the fourth quarter (to PLN 0.8 bn from PLN 3.4 bn in the third quarter and PLN 1.7 bn in the second quarter);
- the **housing loan portfolio** is showing signs of improvement, which are manifested in the decrease in the share in the total portfolio of loans repayments on which are more than 30 days overdue (at the end of 2010 this was 3.4%), although their value continues to increase. On the other hand the relatively stable level of loans repayments on which are up to 30 days overdue is a source of potential further deterioration in the quality of the portfolio.

Taking into account the entire portfolio of loans to the non-financial sector one can be state that the lowest level of timeliness in servicing of loans was to be found at those banks which have had aggressive business strategies in the segment of consumer finance.

In the context of credit risk one should note the high quality of the cooperative banks' loan portfolio (the share of impaired loans in cooperative banks' loans portfolio was 4.8%, while in that of commercial banks it was 8.0%). The objective justification for this difference may be the conduct of business in on the local, transparent market and the diversification of the loan portfolio that results from the structure of customers.

The financial plans of banks shows that they expect the quality of the loan portfolio to improve in 2011.

4.3 Capital adequacy

The banking sector's current situation as regards its capital base can be considered to be good.

Table 26. Capital adequacy (PLN bn; %)

	Value (PLN bn)						Change from (%)	
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	12/2009	09/2009
Own funds for calculation of CAR	76.9	90.1	95.8	95.7	99.9	100.5	11.6%	0.7%
Own funds account:								
1 / own funds	73.7	86.4	94.4	92.0	96.3	98.2	13.6%	1.9%
- core funds	54.1	67.8	69.1	70.5	73.5	73.9	8.9%	0.5%
- reserves	16.4	18.3	23.0	20.7	21.9	21.9	19.8%	-0.2%
- general risk fund	8.5	7.6	7.7	8.0	8.0	8.0	5.4%	0.1%
- other own funds	0.0	0.0	0.0	0.0	0.0	0.2	x	x
- negative items	-5.3	-7.4	-5.4	-7.2	-7.2	-5.8	-20.8%	-18.9%
2 / Supplementary own funds	8.5	9.9	10.9	10.4	10.8	11.4	14.9%	5.4%
3 / Reductions in funds for calculation of CAR	-5.8	-6.5	-9.7	-7.0	-7.6	-9.3	42.0%	22.6%
- core	-4.2	-5.2	-7.5	-5.6	-6.0	-7.7	47.4%	29.2%
- supplementary	-1.6	-1.3	-2.2	-1.4	-1.6	-1.6	20.3%	-2.0%
4 / Short term capital	0.4	0.3	0.2	0.2	0.3	0.3	-6.8%	3.1%
Total capital requirement, of which:	55.6	54.2	54.3	57.4	57.4	58.2	7.4%	1.4%
- credit risk	48.6	47.3	47.2	50.0	50.0	50.8	7.4%	1.6%
- operating risk	5.7	6.0	6.2	6.2	6.2	6.3	5.8%	1.3%
- general interest rate risk	0.7	0.6	0.5	0.6	0.6	0.5	-7.1%	-10.3%
- price risk	0.4	0.3	0.3	0.4	0.5	0.5	63.1%	1.2%
- settlement risk - deliveries	0.0	0.0	0.0	0.1	0.0	0.0	-0.9%	-3.9%
- other and transitional capital requirements	0.2	0.1	0.0	0.1	0.1	0.1	3.1%	4.4%
Surplus/deficit of own funds	21.2	35.8	41.6	38.3	42.5	42.3	18.1%	-0.3%
Solvency ratio	11.2	13.3	14.1	13.5	13.9	13.8	x	x

Figure 133.
Own funds and total capital requirement (PLN bn)

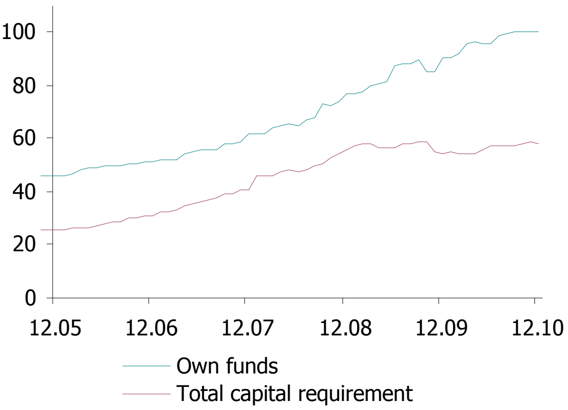
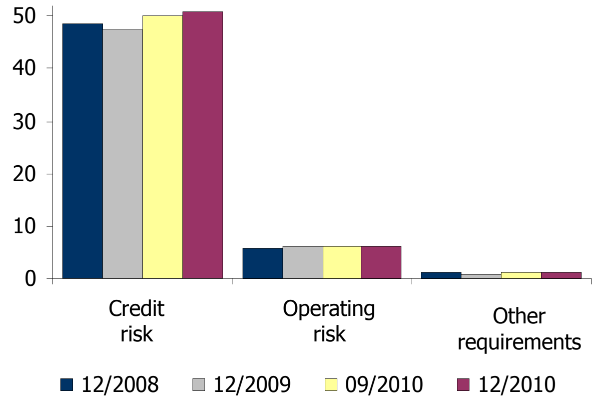


Figure 134.
Structure of total capital requirement (PLN bn)



Own funds of the domestic banking sector increased by 11.6% from PLN 90.1 bn at the end of 2009 to PLN 100.5 bn at the end of 2010.Of the total amount of PLN 100.5 bn own funds, 90.0% were core own funds, 9.7% were supplementary own funds, and 0.3% were short-term capital.

All banks met the minimum requirement for own funds (EUR 5 m for commercial banks and EUR 1 m for cooperative banks[50]).

[50] Strengthening of the zloty against the euro together with the actions taken earlier by the PFSA have meant that during the year only a few cooperative banks have had a problem in meeting the minimum own funds requirement.

Figure 135.
Surplus of own funds over total requirement (PLN bn)

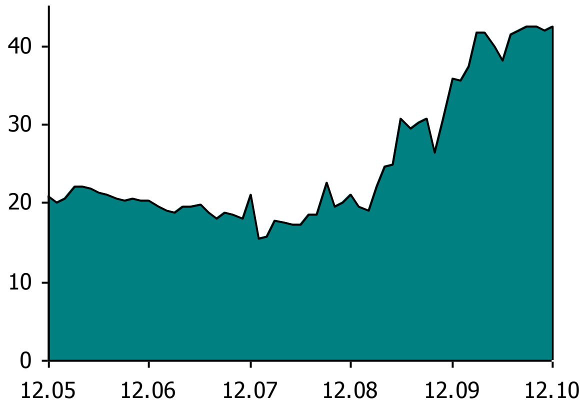


Figure 136.
CAR - solvency ratio (%)

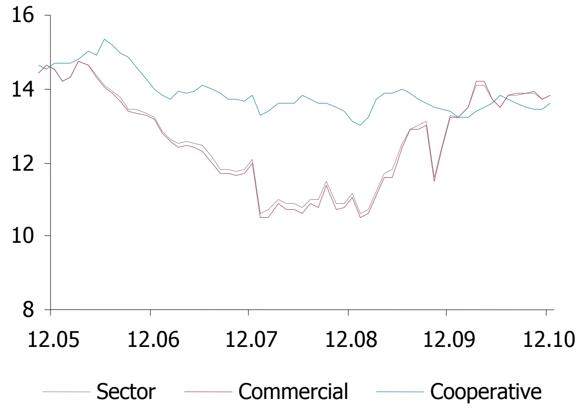


Figure 137.
Distribution of commercial banks by CAR (%)

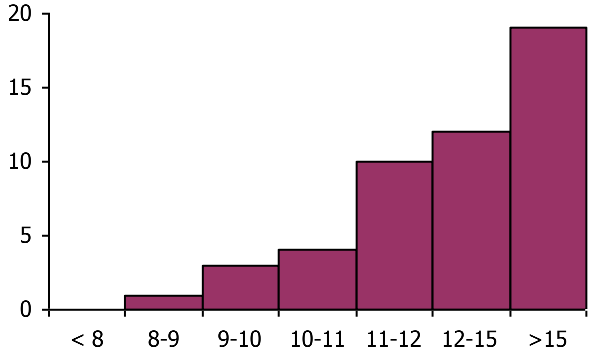
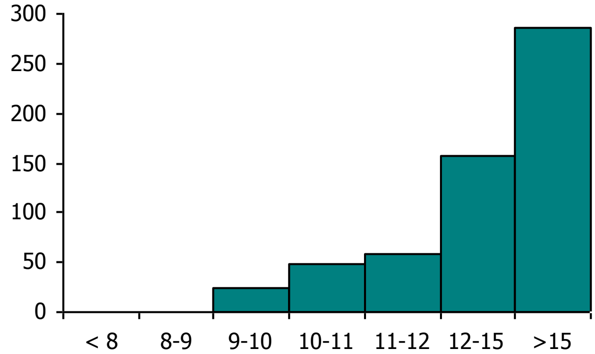


Figure 138.
Distribution of cooperative banks by CAR



The relatively slow growth of new lending meant that the **total capital requirement rose** by only PLN 4.0 bn in 2010, i.e. by **7.4%** to PLN 58.2 bn.Of this amount 87.3% was required for credit risk (an increase of PLN 3.5 bn or 7.4%), 10.8% for operational risk (an increase of PLN 0.3 bn or 5.8%) and 1.9% for other types of risk (an increase of PLN 0.1 bn or 14.6%).

Relatively high growth in own funds coupled with moderate growth in capital requirements meant that at the end of 2010 the banking sector had a **surplus** of own funds over its total capital requirement of PLN 42.3 bn (as compared with PLN 35.8 bn at the end of 2009).

The solvency ratio in the banking sector at the end of 2010 was 13.8%, which means it rose from its level at the end of 2009 (13.3%); in commercial banks it was 13.8% (13.2%) and in cooperative banks 13.6% (13.4%).

All banks had **solvency ratios at a level above the statutory minimum**[51] (of 8%).

At the level of individual banks the **strong capital position of most of the largest banks** should be noted. In most of the 20 largest banks the excess of own funds over total capital requirement was more than 50% of the total capital requirement and in several entities own funds were twice the total capital requirement.

Despite the good current situation, **banks must maintain an enhanced capital base** because of both the level of risk in banks' balance sheets and external conditions which remain difficult and which may cause severe disturbances in the functioning of financial markets.

[51] See Article 128 of the Banking Law.

To summarise, the **current situation regarding the capital base is good** (there has been an increase in own funds and solvency ratios, and all banks meet the requirements for a minimum level of funds and the minimum solvency ratio). Despite the good current situation, **banks must maintain an enhanced capital base** because of both the level of risk in banks' balance sheets and external conditions which remain difficult and which may cause severe disturbances in the functioning of financial markets.

The current situation regarding short-term liquidity is good. The main source of risk remains the continuing market uncertainty and reduced levels of mutual trust, which are results of the crisis of 2007-2009.As a consequence, the interbank market is still not functioning satisfactorily for transactions with maturities longer than 1 day.

The main area of risk is the quality of the loan portfolio, which has worsened substantially as a result of deterioration in the macroeconomic situation and excessive relaxation of lending policies. It should be added that the second half of the year saw a deceleration in the growth of unfavourable phenomena in certain areas. **The increase in impaired loans related mainly to households** and, to a much lesser extent, to the enterprise sector. The situation in the portfolio of loans to the financial sector and to the budget sector remained stable and the quality of these portfolios remained high.

The main source of danger remains the portfolio of consumer loans, the quality of which has deteriorated further. This substantial deterioration resulted from the increase in impaired loans by small and medium-sized banks operating in the area of consumer finance, which in the case of some banks has led to the occurrence of large losses. The deceleration in the growth of impaired loans which was seen in the fourth quarter is a positive development but analysis of the timeliness of servicing of these loans points to the possibility of further deterioration in the quality of these loans. BIK data also shows a **reduction in the scale of "overborrowing"**.

There has been a **gradual accumulation of problems with the servicing of housing loans**. In this context, the strong increase in the share loans with LTV greater than 80% (at a record high) in newly granted loans, renewed extension of the term of loan agreements and the expansion of new lending in foreign currencies should be regarded as negative. These activities are leading to increased risk at the level of both the customer and the bank and reducing the feasibility of possible debt restructuring in the future. The **very strong increase** in the period 2004-2010 (in some cases of more than 20%) **in the share of housing loans in the assets of most banks that hold leading positions** in the market for these loans also gives grounds for concern. **These banks have to a very great extent rendered their future financial situation dependent on the future quality of their portfolios of housing loans and on future conditions in the property market.** At the same time the **situation in the foreign exchange market** and the **level of interest rates set under the influence of foreign monetary authorities** (mainly the SNB and the ECB) will exert a strong influence on the quality of the housing loan portfolio because of the very high share of foreign currency loans.

The portfolio of loans extended to SMEs has shown a marked **deceleration in the growth of unfavourable phenomena and in the case of loans to large enterprises one can speak of a stabilisation of the quality of the loan portfolio.**

5 SUPERVISORY ACTIVITIES IN 2010[52]

The purpose of supervision by the Financial Supervision of the banking sector **is to ensure the safety of funds held in bank accounts and to ensure that each bank's activities comply with the provisions of the law and with the terms of the decision to issue a permit for its establishment**.

5.1 Actions of a regulatory nature

The purpose of the regulatory policies implemented in 2010 was the continuation of activities aimed at improving banks' risk management, and in particular their management of credit risk.

Some changes also resulted from the need to align Polish legal regulations with revised directives of the European Parliament and the Council, i.e. Directive 2006/48/EC on the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (the so-called CRD Directive), adopted by Directive of the European Parliament and the Council 2009/111/EC of 16 September 2009, Commission Directive 2009/27/WE of 7 April 2009 and Commission Directive 2009/83/WE of 27 July 2009.

Additionally, consideration was given to some proposals for changes submitted by the banking sector.

In 2010, the PFSA adopted the following resolutions:

- **PFSA Resolution 76/2010** of 10 March 2010 on the scope and detailed procedures for determining capital requirements for particular risks and **PFSA Resolution 369/2010** of 12 October 2010 amending PFSA Resolution 76/2010. These resolutions introduced changes associated with the need for transposition of the updating of the CRD and for clarification of the rules previously in force.
- **PFSA Resolution 77/2010** of 10 March 2010 on banks bound by the obligation to disclose information on the matters specified by PFSA Resolution 385/2008 of 17 December 2008 on the detailed principles and manner of disclosure by banks of qualitative and quantitative information relating to capital adequacy and the scope of information subject to disclosure. In accordance with the resolution all banks were covered by the obligation to disclose information on the matters specified by the resolution on the detailed rules and manner of disclosure by the banks of qualitative and quantitative information relating to capital adequacy and the scope of information subject to disclosure;
- **PFSA Resolution 367/2010** of 12 October 2010 on other deductions from original own funds, their amount, scope and conditions for a deduction of these items from a bank's own core funds, other items in banks' balance sheets that are included in supplementary own funds, the amount, scope and conditions of their inclusion in supplementary own funds, deductions from supplementary capital, their amount, scope and conditions of deducting them from supplementary own funds; and the scope and manner of recognising banks' activities in holding companies when calculating own funds. In relation to the changes made to Article 61 of Directive 2006/48/EC and the recommendations of the Committee of European Banking Supervisors (CEBS) and also on the basis of observations of banks' compliance with the resolution's provisions, accounting for banks' own funds was made more precise. The number of items that lower core funds was increased, as was the number of items included in supplementary funds and the manner and amount of consideration given to the so-called safety buffer were adjusted (correcting valuation effects arising from changes in IAS);
- **PFSA Resolution 368/2010** of 12 October 2010 amending PFSA Resolution 385/2008 of on the detailed principles and manner of disclosure by banks of qualitative and quantitative information relating to capital adequacy and the scope of information subject to disclosure. The resolution introduces changes that are related to the need to transpose the CRD Directives and extend the scope of disclosure of information regarding:
    - the use in calculation of capital requirements of the value-at-risk method,
    - the advanced measurement method used in accordance with the resolution on capital adequacy for calculation of capital requirements regarding operational risk, and
    - specifying that in the case of banks that use the advanced measurement method for calculation of capital requirements regarding operational risk, a 20% limit on reduction of the

[52] For further information see ["Sprawozdanie z działalności Komisji Nadzoru Finansowego w 2010 r." ["Report on the Activities of the Financial Supervision Commission in 2010,"] PFSA.

capital requirement applies both to the recognition of insurance and to other mechanisms for the transfer of risk.

- **PFSA Resolution 434/2010** of 20 December 2010 on the other balance sheet items included in a bank's core capital and on the amount, scope and conditions of including them in the bank's core capital. The resolution barred (with effect from 31 December 2010) the inclusion by banks in core funds of moneys obtained from new issues of convertible bonds and long-term bonds. At the same time, funds obtained from issue of long-term bonds that comply with the conditions specified in PFSA Resolution 314/2009, and on the basis of PFSA decisions were included in core funds as at 31 December 2010, will be included in core capital in accordance with Article 154, paragraph 9 of Directive 2009/111/EC (so-called grandfathering).

The following draft PFSA resolutions were prepared in 2010:

- **updating of PFSA Resolution 382/2008** of 17 December 2008 on detailed rules and conditions for considering exposure when determining the observance of the exposure concentration limit and the large exposure limit, determining the exposures that are not subject to the regulations on exposure concentration limit and limit of large exposures and the conditions they must meet, determining the exposures to which obtaining the consent of the Polish Financial Supervision Authority for not applying the regulations concerning exposure concentration limit and the limit of large exposures is required and the scope and method of including bank activities in holding companies when calculating exposure concentration limits. The resolution implements provisions of CRD II but the most important changes resulting from the provisions of the amended capital requirements directive have been included in the draft Banking Law act. The resolution plays only a complementary role in relation to those provisions. The date at which the resolution enters into effect depends on the date of amendment of the Banking Law act.
- **updating of PFSA Resolution 383/2008** of 17 December 2008 on detailed principles of functioning of the risk management system and internal control system, and specific terms of assessing internal capital, reviewing the assessment process and maintaining internal capital by banks. The updating of the resolution will introduce changes that are relating to the need to transpose the amendment of the CRD and others that do not result from the amendment of the CRD but are the result of proposed changes put forward within the Office of the PFSA and by banks. The proposed changes include:
    - the introduction of a requirement for banks to develop risk management procedures that allow evaluation of reputational risk. The resolution also includes an amendment that expands to banks that invest in securitisation the application of a provision on risk management regarding securitisation.
    - the introduction of regulations regarding policies and practices on remuneration,
    - determination of the parameters for the conduct of stress testing,
    - recasting and supplementing the regulations on risk management and on assessment and maintenance of internal capital and on undertaking reviews of the process of estimation.
- **updating of PFSA Resolution 385/2008** of 17 December 2008 on the detailed principles and manner of disclosure by banks of qualitative and quantitative information relating to capital adequacy and the scope of information subject to disclosure. The preliminary draft amendment to the resolution takes into account the aforementioned amendments to the CRD and makes changes to the disclosure of information about remuneration policy.

In 2010 the PFSA has adopted the following recommendations:

- **a revised Recommendation A** on management of the risk that accompanies the conclusion by banks of transactions in the derivatives market (PFSA Resolution 134/2010 of 5 May 2010). The amendment was aimed at **improvement of the quality of management of the risk that accompanies transactions in the derivatives market**. The changes relate to monitoring and controlling risk (particularly credit risk), to documentation and exchange of information with clients and to the development of systems and procedures that facilitate improvement of the flow of information between bank entities that are responsible for risk management;
- **a revised Recommendation I** on the management of currency risk at banks and the principles on which banks undertake transactions involving foreign exchange risk (PFSA Resolution 53/2010 of 23 February 2010). The amendment aimed at **reducing the credit risk associated with the conclusion of foreign currency lending transactions** and at improving management within banks of foreign

exchange risk. The recommendation extends the concept of currency risk by recommending examination of the impact of exchange rate fluctuations on other risks, including credit risk. In accordance with the recommendation, prior to the conclusion of derivatives transactions a bank should seek to identify the nature of a customer's business, the customer's needs for protection against currency risk and the customer's awareness that he is accepting such risk, and it should first offer customers uncomplicated products as instruments protecting against currency risk.

- **Recommendation T** dealing with good practices in risk management of retail credit exposures (PFSA Resolution 52/2010 of 23 February 2010). This recommendation is a collection of best practices in retail lending and is based on the principle of fair examination of customers' creditworthiness. **The main objective is to improve the quality of risk management in banks, including preventing excessive indebtedness of borrowers.**

Work was also begun in 2010 on work **on amendment of other PFSA recommendations**. Under preparation are, *inter alia*, amendments to the Recommendation on management in banks of operational risk (Recommendation M), the exercise of internal control (Recommendation H), and also on good practices in the management of credit exposures that finance property and are secured by mortgages (Recommendation S II). The proposed changes to PFSA recommendations follow changes that are underway in the profile of banks' risks and also reflect changes resulting from practice and changes underway in European markets.

Additionally in 2010 the PFSA prepared a proposed **draft regulation of the Minister of Finance on specific accounting principles for banks**. The project aims to partially eliminate the differences between PAS and IAS. The project was the subject of consultation with the banking sector and with the Ministry of Finance. The Regulation entered into force on 31 October 2010. In order to adapt the regulation to IAS/IFRS, further changes to the project will be implemented after the preparation of the final version of IFRS 9.

The main aim of regulatory supervision policy in 2011 will be to shape the appropriate structure of banks' sources of finance.

5.2 Analytical Supervision

Analytical Supervision consisted of continuous monitoring and evaluation of the condition of the banking sector and of particular entities so as to identify actual or potential hazards and, if necessary, to intervene. Financial institutions' economic and financial situation and exposure to individual risks are systematically analysed and evaluated on the basis of reports submitted by them, surveys and other available information. Changes occurring within entities and compliance with applicable regulations, especially those relating to capital adequacy, are particularly subject to evaluation.

Supervisory activities were focused on two main directions:

- assessment of the condition of individual banks (and particularly of the quality of risk management) and
- assessment of the stability of the banking sector, identification of risks of a systemic nature, taking preventive action and directing appropriate recommendations to banks.

Actions taken within this framework included, among others, the following:

- inspections were made of the liquidity position of individual banks. No banks were in danger of losing liquidity in 2010;
- respect of limits on concentration was monitored, analyses were developed of capital and personal linkages of banks and groups of borrowers, and comparative analysis was undertaken of how different banks classified receivables from the same borrower (when discrepancies were found suitable action was taken in the form of direction of appropriate comments to supervised entities);
- stress tests were performed, their aim being to determine the potential impact of a changing macroeconomic environment on the financial situation of institutions in the Polish banking sector;
- the condition of banks implementing resolution programmes (see below) was monitored;

- monitoring was maintained of banks' commitment to foreign financial institutions (including affiliated institutions) and of sources of funding obtained from those entities,
- monitoring and analysis was continued of foreign exchange derivative transactions concluded with non-financial sector entities and the PFSA continued cooperating with government authorities on determining the best way to solve problems arising from these transactions;
- analysis was undertaken of banks' adjustment to the new provisions of the Act on Trading in Financial Instruments;
- plans for bank mergers were analysed and opinions on them issued;
- the PSFA recommended that a cautious approach be taken to the payment of dividends and that the largest part of profits for 2009 should be devoted to strengthening banks' own funds;
- action was taken in relation to cooperative banks that failed to meet the requirement of having own funds of at least EUR 1 m;
- the PSFA reacted promptly to signs of problems in capital groups that could affect the condition of subsidiaries operating in Poland, focusing on meetings with banks' managers and with home country supervisory authorities. This included monitoring the impact on the activities of their Polish subsidiaries of the obligations imposed by the European Commission on banking groups that received government assistance.
- Research surveys were conducted of selected areas of banking activities: the portfolio of housing loans, financing of the local government sector by banks, tax-avoiding deposits, the security of payment cards, and banks' involvement in transactions in foreign exchange derivative transactions with non-financial entities together with restructuring actions and court proceedings relating to these;
- **necessary individual action was taken in relation to selected banks** in the areas referred to above (and especially in the field of lending policy),
- recommendations addressed to individual banks were monitored; and
- the methodology of Research and Supervisory Assessment (known after its Polish initials as BION), which is the basic tool for assessing the level and quality of a bank's risk management and capital, was modified.

As part of analytical supervision a **comprehensive analysis** was also undertaken of the **economic and financial condition of individual banks**. On the basis of this, banks were given a score in the CAEL[53] system and areas that might be a source of danger and require particular supervision were identified. **Comprehensive analyses of the banking sector's condition** were also performed (quarterly and annually).

On the basis of analytical supervision's findings banks that required comprehensive or problem-focused inspections were singled out.

At the end of 2010 a **program of resolution proceedings** covered nine commercial banks and 12 cooperative banks[54] (after 10 and 9, respectively, at the end of 2009); these banks held 6.7% of non-financial sector deposits (compared with 7.2% at the end of 2009).

PFSA actions regarding banks covered by resolution proceedings were aimed at improving their business efficiency and the quality of management, with supervisory measures taken being adjusted to the risks found in specific banks.

[53] CAEL - C denotes capital adequacy, A - asset quality, E - earnings, and L - liquidity.

[54] One of these banks completed the program on 31 December 2010.

The main tasks of the PFSA in the **area of licencing** of the banking sector in 2010 included the processing of applications and notices regarding, *inter alia*: the establishment of banks and commencement of operational activity, amendments to the statutes of the banks, changes in the composition of banks' boards, exercise of voting rights at a general meeting of shareholders of a bank operating as a joint-stock company, merger of banks, the conduct of business through branches or as part of cross-border activities, and the opening of representative offices by foreign banks and credit institutions. In this area the PSFA, among other things:

- issued a permit for the commencement of operational activity by FM Bank S.A. with its registered office in Warsaw;
- issued two permits for the merger of banks and two permits for the acquisition of a banking enterprise;
- issued 57 decisions concerning changes in the composition of banks' authorities (including 12 positive decisions regarding the appointment of presidents of banks operating as joint-stock companies and 26 that of presidents of the boards of cooperative banks);
- issued 55 decisions authorising amendment of the statutes of the banks operating as joint stock companies and 432 authorising amendment of the statutes of cooperative banks;
- took six decisions on applications and notices concerning the exercise of voting rights at general meetings of shareholders in a bank;
- received from the competent supervisory authorities of countries belonging to the European Economic Area four notifications on undertaking business in Poland through a branch, with the PFSA considering it necessary in one case to issue a decision that specified conditions that should be met in the interest of the common good. In addition, the PFSA issued one permit for the opening of a representative office by a foreign bank and one permit for the opening of a such an office by a foreign credit institution.

5.3 Direct supervision of banks through inspections

The purpose of the inspection policy carried out in 2010 was continuation of activities aimed at identifying dangers and areas of heightened risk in banks, together with checking on the implementation of previous recommendations.

Inspections were conducted on the basis of the annual plan of inspection activities. The inspection plan for commercial banks was developed in accordance with a research model that is based on a supervisory cycle and also took into account the results of ongoing analysis of banks' economic and financial situation. In turn the main criteria taken into account when planning the control activities in cooperative banks were: the date of the last comprehensive inspection, analytical assessments and forecasts of economic and financial conditions, the manner of implementation of post-inspection recommendations and supervisory activities undertaken earlier in regard of a bank.

In 2010, the banking supervision conducted:

- **55 comprehensive inspections**, eight of them in commercial banks and 47 in cooperative banks,
- **20 problem-focused inspections,** 16 being of commercial banks (five of which related to evaluation of banks' requests for consent to the use of statistical methods for calculating capital requirements) and four of cooperative banks,
- three explanatory investigations, these being one in a commercial bank, one in the representative office of a credit institution and one in a cooperative bank,
- one inspection into the preparations of a commercial bank for the commencement of operational activity.

Activities carried out as comprehensive inspections routinely included examination of the areas specified in PSFA Resolution 2/2008 of 7 January 2008 on procedures for the performance of banking supervision: the quality of assets, liquidity, interest rate risk, risk associated with foreign exchange operations, operational risk, earnings, capital, management - including compliance with legal provisions that regulate banking activities, statutes and compliance with conditions specified in the permit for establishment of the bank. Each area was studied and evaluated in accordance with established procedures and inspection methodologies. In the course of inspections an additional task was performed on behalf of the NBP, namely confirmation that the required quantity of reserves had been maintained.

In turn, in the course of **problem-focused inspections** the PFSA examined selected areas of banking activity which the banking supervision considered could be a source of heightened risk in the banking business.

During inspections conducted in 2010, particular attention was paid to the following issues:

- the manner in which way banks assess creditworthiness, with particular emphasis on assessment of the creditworthiness of customers who concluded derivative transactions with banks,
- management by the banks of the risks associated with loans secured by mortgages, *inter alia* regarding implementation of PFSA Recommendation S (II) of 2008 on good practices in the area of credit exposures secured by mortgages,
- the process of adjustment by banks to PFSA Recommendation T of 2010 on good practices in the management of risk of retail credit exposures,
- compliance with the provisions of PFSA Resolution 383/2008 on the process of banking risk management and internal control systems with particular emphasis on compliance with internal limits,
- compliance with the recommendations contained in PFSA Recommendation A (which was amended in 2010) on management by banks of the risk associated with transactions on the derivatives market, and in particular on the range of information presented to customers when offering foreign exchange derivatives,
- the valuation process for exposures arising from foreign currency transactions,
- the effectiveness of internal auditing and internal control, and
- the implementation of recommendations made after previous inspections.

The findings of inspections showed, *inter alia*, that the **most commonly occurring irregularities (broken down by type of risk)** in the banks surveyed were the following:

Credit risk

- **irregularities in the reviewing and classification of credit exposures**
- **excessively liberal rules for evaluation of borrowers' creditworthiness,** in the case of both individuals and businesses,
- irregularities in the identification of linkages between entities,
- systems of internal limits that were inappropriate to the specific nature of banks' activities,
- failure to match credit risk management information systems to banks' risk profiles,
- irregularities in the process of identification and monitoring of credit risk (e.g. irregularities in the process of monitoring borrowers' economic and financial condition and failure of internal control mechanisms to function properly in the area of derivative transactions),
- **ineffective internal controls in the area of credit risk**, which was shown by violations of legal provisions and of internal regulations and by errors in external reporting,
- **failure to adjust methods of valuing credit exposures to the requirements of IFRS/IAS and Recommendation R** of 2006 on rules for the identification of balance sheet credit exposures that have lost value, that determine write-offs regarding losses on balance sheet credit exposures and provisioning for off-balance sheet credit exposures, and
- failure to adjust fully to the requirements of PSFA Recommendation S (II) of 2008 on good practices in the area of credit exposures secured by mortgages.

Moreover, although only a short time that has passed since the introduction of PFSA Resolution 52/2010 of 23.02.2010 on the issuing of Recommendation T on good practices in risk management of retail credit exposures in connection with the performance of inspections in banks, the PFSA has already issued its first recommendations on the need to adjust the risk management process for retail credit exposures to match the requirements of Recommendation T.

Liquidity risk

- **failure to comply with the provisions of PFSA Resolution 386/2008** on the maintenance of liquidity norms and the way they are calculated or failure to adjust internal procedures to match the provisions of the Resolution,
- irregularities regarding methods for measuring liquidity risk (including rules relating to calculation of the liquidity gap, insufficient analysis of long-term liquidity, cash flow forecasts, methods of establishing the stability of the deposit base and its concentration, and lack of analysis of how easily deposits can be broken),
- **lack of stable, and especially long-term, sources of asset financing**,
- **inadequate contingency plans for the maintenance of liquidity** (including crisis scenarios or irregularities in the assumptions underlying such scenarios, failure to specify the conditions that would trigger a contingency plan, irregularities in specifying the organisation of actions in a crisis situation, failure to combine anticipated outflows of funds in particular scenarios with estimations of the prospects of raising funds in those scenarios),
- irregularities regarding the system of limits that contain liquidity risk (including their incompleteness in the form of lack of limits, ill-adjustment to the liquidity gap, foreign exchange liquidity, concentration of deposits, failure to verify limits, failure to comply with limits or failure to match the scale of limits to the size of business),
- incompleteness of internal procedures for management of liquidity risk (including in the organization of risk management, measurement methods, monitoring and control of risk, plan for the development of the deposit base, and assessment of the effects on impact liquidity of introducing of a new product),
- irregularities in the organisational approach to liquidity management (relating, *inter alia*, to failure to separate decision-making from execution, settlement and supervisory functions).

Market risk (interest rate risk and foreign exchange risk)

- the absence of rules for setting and updating market risk limits and for allocation of particular assets and liabilities that are sensitive to changes in interest rates to valuation classes in accordance with procedures governing the management of market risk, monitoring of limits, and conduct in the event that limits are breached,
- failure to specify in internal regulations the rules for calculating the interest rate gap and for analysis of customers' risk on options and its effect on banks' financial performance and on control of treasury operations,
- failure to define in internal regulations the bases for *post hoc* verification of the VaR model,
- less than fully effective system of internal control in the area of market risk,
- inadequate supervision by management and supervisory boards of the process of market risk management,
- errors in the measurement of interest rate risk and in reporting to the NBP,
- failure to ensure support from IT systems for the measurement of market risk,
- irregularities in the process for valuation of exposures arising from matured currency options,
- **lack of procedures that specify the range of information presented to the customer when a product is offered** and of regulations that oblige sales staff to present customers with the potential risks arising from derivatives transactions,
- irregularities in the process of concluding and confirming transactions and in monitoring the risk of transactions,
- failure to adjust fully regulations concerning the risks associated with derivatives transactions concluded with customers to meet the requirements of Recommendation A on management of the risk that accompanies the conclusion by banks of transactions on the derivatives market (and in particular failure to inform customers of the credit limit assigned to derivative transactions).

Operational risk

- failure to formalise fully processes for management of operational risk,
- the absence of operational risk management processes that are adjusted to meet the profile and size of risk,
- failure to take account in operational risk management policies of the risk associated with security of information,
- outdated operational risk management policies regarding the coordination, supervision, creation, updating and modification of business continuity plans,
- the lack of business continuity plans covering all organisational units and business areas,
- lack of independence of IT services from operating units,
- inadequate management information concerning the area of operational risk,
- failure to specify in the bank's internal procedures the method, principles, scope and frequency of preparation of management information on operational risk and the area of IT, and
- failure to assess operational risk in subsidiaries.

Capital adequacy

- failure of the rules for calculating the capital requirement set out in banks' internal regulations to comply with the provisions of PFSA Resolution 76/2010 or failure to abide by the Resolution(including incorrect classification of classes of exposure, incorrect segmentation of credit exposures and assignment to them of inappropriate risk weightings, lack of definition of the manner of calculating the balance sheet equivalents of exposures arising from off-balance sheet contingent liabilities, improper separation of the trading and banking portfolios and incorrect calculation of capital adequacy),
- failure to adjust banks' internal procedures to meet the requirements of PFSA Resolution 383/2008 (including errors in estimation of internal capital, absence of a capital contingency plan, lack of written policies and procedures for managing risks arising from changes in macroeconomic conditions, and failure to carry out stress tests in relation to significant kinds of risks),
- failure to adjust internal procedures to meet the requirements of PSFA Resolution 381/2008, in particular in regard to calculation of own funds,
- errors in the process of estimating internal capital, and in particular failure to take into account all potentially significant risks, absence of written criteria regarding recognition of particular kinds of risk as significant, absence of rules governing the performance of tests of extreme conditions in respect of certain significant risks, failure to adjust the manner in which internal capital is estimated for some risks to match the scale and complexity of a bank's risk, and lack of justification for the manner in which a bank allocates internal capital to group entities,
- incompleteness of information that is subject to disclosure in accordance with the requirements of PFSA Resolution 385/2008.

The process of bank management

- absence of formalised strategic and operational planning,
- failure to implement the key elements of a bank's strategy,
- **insufficient supervision as owner of** bank's **subsidiaries**,
- incomplete procedures and incomplete contents of management information,
- **ineffective supervision of bank's activities by management and supervisory boards**,
- **failure to comply with legal provisions**, PFSA resolutions and banks' internal regulations,
- incompleteness of bank's internal regulations,
- lack of independence of measurement, monitoring and risk control functions from operating activities,
- inadequate management of the risk of non-compliance,

- unsatisfactory performance of internal audit and functional control activities,
- **absence of independence of internal audit,**
- inadequate risk management process in relation to entrusting banking operations and activities related to banking activities to external entities (outsourcing),
- **errors in reports** made to the NBP,
- **incomplete implementation of recommendations made after the previous inspection.**

Findings that emerge from the conduct of supervisory actions were included in the records of inspections (and in the case of banks with foreign capital, information about findings was also sent to the home country supervisor of the bank's parent).

After inspections banks were required to remedy the irregularities found and to prepare a detailed schedule of works related to the implementation of the PFSA's recommendations. **Implementation of the Authority's recommendations is monitored** on the basis of banks' reports within the framework of desktop analysis and during the next inspection of banks, and also during the supervisor's meetings with bank management and with representatives of home-country supervisors. If a bank fails to PSFA recommendations effectively or provides the Authority with inaccurate information about their implementation then this may constitute grounds for the issue of a formal warning. In 2010 the FSA issued six formal warnings to commercial banks, *inter alia* for failing to take effective action to implement the Authority's recommendations and for failure to abide by specific legal provisions thus increasing the riskiness of a bank's business.

5.4 International cooperation

In 2010, the work of European institutions was focused on the design of prudential norms and institutional arrangements to minimise the likelihood of a repetition of the financial crisis. The most important initiatives in this regard included:

- strengthening the European dimension of financial supervision,
- revision of the Capital Requirements Directive (so-called CRD IV),
- creating an EU framework for counteracting and managing crises in the banking sector,
- revision of the directive on deposit guarantee systems,
- regulation of the rating agencies sector.

These issues have also become priorities for the PFSA's activity in the international arena. Apart from them, cooperation in the framework of the Host States Forum, which was established on the PFSA's initiative, has been of crucial importance for the Authority's foreign operations.

In December 2009 the Basel Committee on Banking Supervision issued two consultation documents that comprise a plan for reform of the New Capital Accord (Basel III). These documents became the foundation for a package of amendments to the CRD (so-called CRD IV) prepared by the European Commission in February 2010. It should be noted, however, that the EC's proposals on maintenance of liquidity by credit institutions went far beyond the Basel draft, and would give a group supervisor the power to decide on the transfer of liquidity requirements from the local level to the level of a cross-border banking group. The consequence of this proposal may be loss of a local supervisory authority's ability to control the liquidity situation and thus its inability to respond directly in the event of a threat to the sector's stability in a host country. This proposal met with objections from the Office of the PFSA. Additionally the Office of the PFSA has expressed doubts about the proposed exemption of branches of credit institutions from individually complying with liquidity requirements and removal from national authorities of the right to supervise branches' liquidity.

In discussions on how to prevent the emergence of crises in the financial sector, it was proposed to introduce harmonised rules for resolution proceedings, which, *inter alia*, would make it possible to take coordinated resolution actions within a group. In relation to this the PFSA pointed to the possible negative consequences that introduction of ability to transfer assets on non-market bases from group subsidiaries could have for the Polish banking sector. The Office of the PFSA also said that actions taken should take into account the structure and level of development of financial markets and the economic condition of individual member states.

In 2010 the EU started work on revision of the directive on deposit guarantee schemes. The European Commission proposed new rules which would increase the amount guaranteed (to EUR 100,000) and allow for reciprocal loans between deposit guarantee schemes, reduce the term for payment of the guaranteed amount and make possible payment by a home-country guarantee system in the event of the collapse of a branch operating on a cross-border bases (not all of these elements have been approved by member states).

In 2010 ongoing and continuous cooperation was maintained with banks and with consolidating supervisors regarding analysis of applications and planned proposals relating to the issue of decisions or expression of opinions regarding consent to the statistical methods used in calculation of capital requirements in regard of credit risk, operational risk and market risk.

Representatives of the Office of the PFSA also participated in meetings of colleges of supervisors and crisis management groups organised by home-country supervisors of banking groups that operate in Poland (the subjects of meetings included assessment of the economic and financial condition and the risks of particular financial groups to which banks supervised in Poland belong, exchange of information on supervisory activities undertaken and planned, and joint assessment of risk and capital).

To summarise, supervisory activities undertaken in 2010 in the area of analysis and inspection focused on monitoring the condition of individual banks and of the banking sector as a whole, on identifying potential sources of danger, and on monitoring bank's compliance with applicable regulations and implementation of the supervisory authority's recommendations.

In the area of regulation, selected PSFA resolutions and recommendations were updated, because, among other things, of the need for the supervisory authority to respond to previously identified areas of heightened risk or to adjust regulations to match changes introduced at the level of the EU. At the same time work was conducted on further adjustment of regulations in response to identification of risk areas and changes that are taking place in banks and their environment.

Annex 1a - Selected data on the structure of the banking sector

	Value (PLN bn)						Change from (%)		
	12/2008	12/2009	03/2010	06/2010	09/2010	12/2010	PLN m	%	adj.
Balance sheet total	1,035,356	1,057,376	1,083,242	1,127,242	1,142,293	1,158,011	100,635	9.5%	7.5%
Share of currency mismatch	-7.7%	-6.1%	-5.5%	-6.6%	-5.7%	-5.9%	x	x	x
Selected profit and loss account items									
1/ Profit on banking activities	48,412	49,608	12,611	26,078	39,435	53,107	3,500	7.1%	x
- net interest income	28,012	26,376	7,216	14,788	22,731	30,841	4,464	16.9%	x
- net fee and commission income	11,439	12,459	3,360	6,793	10,255	13,732	1,273	10.2%	x
- other items	8,961	10,772	2,035	4,496	6,449	8,535	-2,237	-20.8%	x
2/ Operating costs	24,713	24,814	6,032	12,366	18,738	25,534	720	2.9%	x
3/ provisions and write-offs (negative)	4,140	11,749	2,688	5,974	8,887	11,284	-465	-4.0%	x
4/ net financial profits	13,556	8,282	2,473	5,466	8,513	11,674	3,392	41.0%	x
Selected balance sheet items									
1 / Assets									
- cash and receivables from central banks	39,578	50,519	28,610	34,135	34,630	50,387	-133	-0.3%	x
- claims on banks	92,265	60,272	68,805	71,123	66,977	68,461	8,189	13.6%	x
- loans (carrying value)	635,522	686,997	682,211	721,162	728,906	753,092	66,095	9.6%	x
- debt instruments and equities	174,925	199,837	249,612	242,767	251,568	230,352	30,515	15.3%	x
2a/ Liabilities	947,211	954,066	974,262	1,017,810	1,026,533	1,041,792	87,726	9.2%	x
- liabilities to central banks	18,200	14,516	11,863	4,434	1,018	734	-13,783	-94.9%	x
- deposits and loans of the financial sector	230,952	216,794	221,944	236,553	235,203	244,304	27,510	12.7%	x
- deposits of the non-financial sector	499,040	567,169	566,945	584,023	587,129	620,379	53,210	9.4%	x
- households	336,865	387,681	394,812	401,300	404,558	422,374	34,693	8.9%	x
- enterprises	148,004	165,126	157,419	167,470	166,827	182,783	17,658	10.7%	x
- deposits of the budget sector	52,701	51,975	62,142	62,943	69,046	52,965	990	1.9%	x
- liabilities arising from issue of securities	12,480	19,417	19,945	25,619	25,366	24,370	4,952	25.5%	x
- subordinated liabilities	7,605	8,860	8,666	9,305	9,133	9,704	844	9.5%	x
Shareholders' funds	88,145	103,309	108,980	109,432	115,760	116,219	12,910	12.5%	x
Total loans (gross book value)	653,619	713,868	711,319	752,600	762,080	786,785	72,917	10.2%	7.5%
1/ Loans to the financial sector	19,071	24,585	24,102	23,335	23,385	24,872	287	1.2%	x
2/ Loans to the non-financial sector	608,016	641,226	641,623	680,957	683,676	698,514	57,287	8.9%	5.9%
Households	372,446	416,413	420,748	455,298	459,082	475,440	59,027	14.2%	9.1%
- housing loans	195,119	217,762	219,722	249,266	251,085	267,506	49,744	22.8%	13.0%
- zloty	59,100	75,640	79,745	85,190	91,405	98,223	22,584	29.9%	x
- foreign currency	136,019	142,123	139,977	164,076	159,680	169,283	27,161	19.1%	5.1%
- consumer loans	116,637	132,171	132,392	134,150	134,542	134,047	1,876	1.4%	x
- other	60,690	66,479	68,633	71,882	73,455	73,886	7,407	11.1%	x
Enterprises	233,280	222,080	218,113	222,793	221,490	219,652	-2,428	-1.1%	-0.6%
- SMEs	125,307	127,222	125,648	128,970	128,255	126,988	-235	-0.2%	0.2%
- large enterprises	107,973	94,858	92,465	93,823	93,235	92,664	-2,194	-2.3%	1.7%
3/ Budget sector	26,531	48,057	45,593	48,308	55,019	63,399	15,343	31.9%	x
Proportion of impaired loans									
Total loans	4.7%	7.1%	7.4%	7.7%	7.9%	7.8%	x	x	x
1/ Loans to the financial sector	2.0%	0.6%	0.8%	0.9%	0.8%	0.8%	x	x	x
2/ Loans to the non-financial sector	4.9%	7.9%	8.2%	8.5%	8.8%	8.8%	x	x	x
Households	4.0%	6.0%	6.6%	6.7%	7.2%	7.2%	x	x	x
- housing loans	1.1%	1.5%	1.5%	1.6%	1.8%	1.8%		x	x
- zloty	1.7%	2.3%	2.4%	2.5%	2.8%	2.8%	x	x	x
- foreign currency	0.8%	1.1%	1.0%	1.1%	1.2%	1.3%	x	x	x
- consumer loans	7.8%	13.0%	14.8%	15.8%	17.0%	17.3%	x	x	x
- other	6.0%	6.7%	6.9%	7.3%	7.6%	8.1%	x	x	x
Enterprises	6.5%	11.6%	11.3%	12.3%	12.3%	12.4%	x	x	x
- SMEs	7.5%	13.4%	12.5%	14.0%	14.2%	14.5%	x	x	x
- large enterprises	5.4%	9.2%	9.6%	9.9%	9.7%	9.5%	x	x	x
3/ Budget sector	0.9%	0.2%	0.2%	0.2%	0.2%	0.2%	x	x	x
Proportion of overdue loans									
Non-financial sector overdue > 30 days	x	x	6.9%	7.1%	7.4%	7.4%	x	x	x
of which > 90 days	x	x	5.4%	5.8%	6.2%	6.3%	x	x	x
Capital adequacy									
Own funds	76,857	90,062	95,842	95,666	99,855	100,546	10,484	11.6%	x
Total capital requirement	55,633	54,220	54,268	57,411	57,378	58,207	3,986	7.4%	x
Surplus of own funds above requirement	21,224	35,842	41,574	38,255	42,476	42,339	6,497	18.1%	x
Solvency ratio	11.2%	13.3%	14.1%	13.5%	13.9%	13.8%	x	x	x

Adj. - growth rate adjusted for the impact of exchange rate fluctuations

Appendix 1b - Selected data on commercial banks

	Value (PLN bn)				Change from (%)		Share in the sector (%) or Sector average		
	12/2008	12/2009	09/2010	12/2010	12/2009	09/2010	12/2008	12/2009	12/2010
Balance sheet total	922,617	939,919	1,017,313	1,032,822	9.9%	1.5%	89.1%	88.9%	89.2%
Share of currency mismatch	-9.1%	-7.1%	-6.6%	-6.7%	x	x	-7.7%	-6.1%	-5.9%
Selected income statement items									
1/ Profit on banking activities	43,116	43,995	35,134	47,364	7.7%	x	89.1%	88.7%	89.2%
- net interest income	24,556	22,815	19,970	27,191	19.2%	x	87.7%	86.5%	88.2%
- net fee and commission income	10,315	11,113	9,145	12,232	10.1%	x	90.2%	89.2%	89.1%
- other items	8,245	10,067	6,018	7,941	-21.1%	x	92.0%	93.5%	93.0%
2/ Operating costs	21,540	21,383	16,123	21,946	2.6%	x	87.2%	86.2%	86.0%
3/ Provisions and write-offs (negative)	3,703	10,664	8,005	10,155	-4.8%	x	89.4%	90.8%	90.0%
4/ net financial profits	12,475	7,620	8,009	11,058	45.1%	x	92.0%	92.0%	94.7%
Selected balance sheet items									
1 / Assets									
- cash and receivables from central banks	36,504	47,002	30,842	44,878	-4.5%	45.5%	92.2%	93.0%	89.1%
- claims on banks	67,072	36,022	43,138	39,530	9.7%	-8.4%	72.7%	59.8%	57.7%
- loans (carrying value)	569,875	613,463	652,914	677,454	10.4%	3.8%	89.7%	89.3%	90.0%
- debt instruments and equities	165,407	189,304	237,024	220,881	16.7%	-6.8%	94.6%	94.7%	95.9%
2a/ Liabilities	840,175	842,713	908,040	922,972	9.5%	1.6%	88.7%	88.3%	88.6%
- liabilities to central banks	16,586	14,471	1,018	734	-94.9%	-28.0%	91.1%	99.7%	100.0%
- deposits and loans of the financial sector	201,013	187,189	201,976	216,537	15.7%	7.2%	87.0%	86.3%	88.6%
- deposits of the non-financial sector	444,455	505,056	521,423	547,796	8.5%	5.1%	89.1%	89.0%	88.3%
- households	293,846	337,926	350,696	363,462	7.6%	3.6%	87.2%	87.2%	86.1%
- enterprises	137,826	154,317	156,845	170,839	10.7%	8.9%	93.1%	93.5%	93.5%
- deposits of the budget sector	46,242	45,467	61,871	46,723	2.8%	-24.5%	87.7%	87.5%	88.2%
- liabilities arising from issue of securities	12,172	19,198	25,281	24,225	26.2%	-4.2%	97.5%	98.9%	99.4%
- subordinated liabilities	7,329	8,503	8,737	9,285	9.2%	6.3%	96.4%	96.0%	95.7%
2b/ Shareholders' funds	82,442	97,206	109,272	109,850	13.0%	0.5%	93.5%	94.1%	94.5%
Total loans (gross book value)	586,895	638,133	683,100	708,148	11.0%	3.7%	89.8%	89.4%	90.0%
1/ Loans to the financial sector	16,961	22,539	22,030	23,520	4.4%	6.8%	88.9%	91.7%	94.6%
2/ Loans to the non-financial sector	545,449	570,352	609,115	624,742	9.5%	2.6%	89.7%	88.9%	89.4%
Households	327,084	363,711	403,593	420,125	15.5%	4.1%	87.8%	87.3%	88.4%
- housing loans	181,153	201,375	232,285	247,991	23.1%	6.8%	92.8%	92.5%	92.7%
- zloty	54,535	70,467	85,622	92,333	31.0%	7.8%	92.3%	93.2%	94.0%
- foreign currency	126,617	130,908	146,664	155,658	18.9%	6.1%	93.1%	92.1%	92.0%
- consumer loans	105,156	117,789	120,760	120,730	2.5%	0.0%	90.2%	89.1%	90.1%
- other	40,775	44,547	50,548	51,403	15.4%	1.7%	67.2%	67.0%	69.6%
Enterprises	216,288	204,202	202,754	201,567	-1.3%	-0.6%	92.7%	91.9%	91.8%
- SMEs	112,912	113,803	113,478	112,752	-0.9%	-0.6%	90.1%	89.5%	88.8%
- large enterprises	103,376	90,400	89,276	88,815	-1.8%	-0.5%	95.7%	95.3%	95.8%
3/ Budget sector	24,485	45,241	51,956	59,885	32.4%	15.3%	92.3%	94.1%	94.5%
Proportion of impaired loans									
Total loans	4.9%	7.4%	8.1%	8.0%	x	x	4.7%	7.1%	7.8%
1/ Loans to the financial sector	2.2%	0.7%	0.9%	0.8%	x	x	2.0%	0.6%	0.8%
2/ Loans to the non-financial sector	5.1%	8.3%	9.1%	9.0%	x	x	4.9%	7.9%	8.8%
Households	4.1%	6.1%	7.2%	7.2%	x	x	4.0%	6.0%	7.2%
- housing loans	1.1%	1.5%	1.9%	1.9%	x	x	1.1%	1.5%	1.8%
- zloty	1.7%	2.3%	2.8%	2.9%	x	x	1.7%	2.3%	2.8%
- foreign currency	0.9%	1.1%	1.3%	1.3%	x	x	0.8%	1.1%	1.3%
- consumer loans	7.8%	13.1%	16.8%	17.2%	x	x	7.8%	13.0%	17.3%
- other	7.6%	8.4%	9.2%	9.6%	x	x	6.0%	6.7%	8.1%
Enterprises	6.7%	12.2%	12.8%	12.8%	x	x	6.5%	11.6%	12.4%
- SMEs	7.8%	14.3%	14.9%	15.1%	x	x	7.5%	13.4%	14.5%
- large enterprises	5.6%	9.5%	10.0%	9.8%	x	x	5.4%	9.2%	9.5%
3/ Budget sector	1.0%	0.2%	0.2%	0.2%	x	x	0.9%	0.2%	0.2%
Proportion of overdue loans									
Non-financial sector overdue > 30 days	x	x	6.7%	6.6%	x	x	x	x	6.6%
including> 90 days	x	x	5.6%	5.6%	x	x	x	x	5.6%
Capital adequacy									
Own funds	71,697	83,980	93,039	93,574	11.4%	0.6%	93.3%	93.2%	93.1%
Total capital requirement	52,482	50,581	53,342	54,098	7.0%	1.4%	94.3%	93.3%	92.9%
Surplus of own funds above requirement	19,215	33,399	39,697	39,476	18.2%	-0.6%	90.5%	93.2%	93.2%
Solvency ratio	11.1	13.2	13.9	13.8	x	x	11.2	13.3	13.8

Note: for share of currency mismatch, proportion of impaired loans, proportion of overdue loans and solvency ratio – share in sector signifies average value in sector.

Appendix 1c - Selected data on branches of credit institutions

	Value (PLN bn)				Change from (%)		Share in the sector (%) or Sector average		
	12/2008	12/2009	09/2010	12/2010	12/2009	09/2010	12/2008	12/2009	12/2010
Balance sheet total	56,203	55,741	58,326	54,734	-1.8%	-6.2%	5.4%	5.3%	4.7%
Share of currency mismatch	7.8%	2.9%	3.2%	2.2%	x	x	-7.7%	-6.1%	-5.9%
Selected profit and loss account items									
1/ Profit on banking activities	1,652	2,204	1,517	1,997	-9.4%	x	3.4%	4.4%	3.8%
- net interest income	713	1,150	752	939	-18.3%	x	2.5%	4.4%	3.0%
- net fee and commission income	248	397	371	509	28.2%	x	2.2%	3.2%	3.7%
- other items	691	656	393	549	-16.3%	x	7.7%	6.1%	6.4%
2/ Operating costs	927	1,126	846	1,152	2.3%	x	3.8%	4.5%	4.5%
3/ Provisions and write-offs (negative)	339	997	772	965	-3.2%	x	8.2%	8.5%	8.6%
4/ net financial profits	181	-27	-100	-135	397.2%	x	1.3%	-0.3%	-1.2%
Selected balance sheet items									
1 / Assets									
- cash and receivables from central banks	1,579	2,096	2,348	3,997	90.7%	70.2%	4.0%	4.1%	7.9%
- claims on banks	9,284	7,345	5,802	7,148	-2.7%	23.2%	10.1%	12.2%	10.4%
- loans (carrying value)	31,862	35,011	33,446	33,046	-5.6%	-1.2%	5.0%	5.1%	4.4%
- debt instruments and equities	6,500	8,141	12,552	7,333	-9.9%	-41.6%	3.7%	4.1%	3.2%
2a/ Liabilities	56,350	56,174	59,012	55,687	-0.9%	-5.6%	5.9%	5.9%	5.3%
- liabilities to central banks	1,613	45	0	0	-100.0%	x	8.9%	0.3%	0.0%
- deposits and loans of the financial sector	29,116	28,583	32,145	26,658	-6.7%	-17.1%	12.6%	13.2%	10.9%
- deposits of the non-financial sector	13,170	16,432	16,741	18,760	14.2%	12.1%	2.6%	2.9%	3.0%
- households	6,595	9,920	11,305	12,030	21.3%	6.4%	2.0%	2.6%	2.8%
- enterprises	6,478	6,419	5,354	6,642	3.5%	24.1%	4.4%	3.9%	3.6%
- deposits of the budget sector	114	134	340	117	-12.8%	-65.6%	0.2%	0.3%	0.2%
- liabilities arising from issue of securities	308	219	0	0	-100.0%	0.0%	2.5%	1.1%	0.0%
- subordinated liabilities	x	x	x	x	x	x	x	x	x
2b/ Shareholders funds	x	x	x	x	x	x	x	x	x
Total loans (gross book value)	32,411	36,647	35,803	35,384	-3.4%	-1.2%	5.0%	5.1%	4.5%
1/ Loans to the financial sector	2,007	1,945	1,217	1,201	-38.2%	-1.2%	10.5%	7.9%	4.8%
2/ Loans to the non-financial sector	30,399	34,699	34,584	34,181	-1.5%	-1.2%	5.0%	5.4%	4.9%
Households	20,251	25,032	25,478	25,846	3.3%	1.4%	5.4%	6.0%	5.4%
- housing loans	10,858	12,679	14,596	15,236	20.2%	4.4%	5.6%	5.8%	5.7%
- zloty	1,457	1,469	1,587	1,620	10.3%	2.1%	2.5%	1.9%	1.6%
- foreign currency	9,401	11,211	13,009	13,616	21.5%	4.7%	6.9%	7.9%	8.0%
- consumer loans	7,255	9,443	8,277	7,879	-16.6%	-4.8%	6.2%	7.1%	5.9%
- other	2,138	2,910	2,605	2,731	-6.2%	4.8%	3.5%	4.4%	3.7%
Enterprises	10,146	9,667	9,106	8,335	-13.8%	-8.5%	4.3%	4.4%	3.8%
- SMEs	5,671	5,415	5,394	4,713	-13.0%	-12.6%	4.5%	4.3%	3.7%
- large enterprises	4,476	4,252	3,712	3,621	-14.8%	-2.4%	4.1%	4.5%	3.9%
3/ Budget sector	5	3	2	2	-41.7%	-25.7%	0.0%	0.0%	0.0%
Proportion of impaired loans									
Total loans	2.3%	5.4%	8.9%	8.8%	x	x	4.7%	7.1%	7.8%
1/ Loans to the financial sector	0.0%	0.0%	0.0%	0.0%	x	x	2.0%	0.6%	0.8%
2/ Loans to the non-financial sector	2.5%	5.7%	9.2%	9.1%	x	x	4.9%	7.9%	8.8%
Households	3.0%	7.1%	10.5%	10.1%	x	x	4.0%	6.0%	7.2%
- housing loans	0.1%	0.4%	0.7%	0.8%	x	x	1.1%	1.5%	1.8%
- zloty	0.3%	0.9%	1.3%	1.7%	x	x	1.7%	2.3%	2.8%
- foreign currency	0.0%	0.3%	0.6%	0.7%	x	x	0.8%	1.1%	1.3%
- consumer loans	8.3%	16.8%	27.7%	27.1%	x	x	7.8%	13.0%	17.3%
- other	0.2%	5.1%	11.2%	12.3%	x	x	6.0%	6.7%	8.1%
Enterprises	1.3%	2.2%	5.5%	6.3%	x	x	6.5%	11.6%	12.4%
- SMEs	1.5%	2.5%	8.1%	9.7%	x	x	7.5%	13.4%	14.5%
- large enterprises	1.2%	1.7%	1.8%	2.0%	x	x	5.4%	9.2%	9.5%
3/ Budget sector	0.0%	0.0%	0.0%	0.0%	x	x	0.9%	0.2%	0.2%
Proportion of overdue loans									
Non-financial sector overdue > 30 days	x	x	8.8%	8.7%	x	x	x	x	6.6%
including> 90 days	x	x	7.8%	7.7%	x	x	x	x	5.6%
Capital adequacy									
Own funds	x	x	x	x	x	x	x	x	x
Total capital requirement	x	x	x	x	x	x	x	x	x
Surplus of own funds above requirement	x	x	x	x	x	x	x	x	x
Solvency ratio	x	x	x	x	x	x	x	x	x

Note: for the share of currency mismatch, the share of problem loans, the share of loans in repayment of delayed and the solvency ratio the share of the sector is the mean value in the sector.

Appendix 1d - Selected data on cooperative banks

	Value (PLN bn)				Change from (%)		Share in the sector (%) or Sector average		
	12/2008	12/2009	09/2010	12/2010	12/2009	09/2010	12/2008	12/2009	12/2010
Balance sheet total	56,537	61,715	66,654	70,455	14.2%	5.7%	5.5%	5.8%	6.1%
Share of currency mismatch	-0.1%	0.0%	0.0%	0.0%	x	x	-7.7%	-6.1%	-5.9%
Selected profit and loss account items									
1/ Profit on banking activities	3,645	3,409	2,784	3,746	9.9%	x	7.5%	6.9%	7.1%
- net interest income	2,743	2,411	2,008	2,711	12.4%	x	9.8%	9.1%	8.8%
- net fee and commission income	876	949	738	990	4.4%	x	7.7%	7.6%	7.2%
- other items	26	49	37	45	-7.7%	x	0.3%	0.5%	0.5%
2/ Operating costs	2,247	2,305	1,769	2,436	5.7%	x	9.1%	9.3%	9.5%
3/ Provisions and write-offs (negative)	99	88	110	165	85.9%	x	2.3%	0.8%	1.4%
4/ net financial profits	900	690	604	751	8.9%	x	6.4%	6.9%	5.8%
Selected balance sheet items									
1 / Assets									
- cash and receivables from central banks	1,494	1,421	1,440	1,511	6.3%	4.9%	3.8%	2.8%	3.0%
- claims on banks	15,909	16,904	18,037	21,784	28.9%	20.8%	17.2%	28.0%	31.8%
- loans (carrying value)	33,785	38,523	42,546	42,592	10.6%	0.1%	5.3%	5.6%	5.7%
- debt instruments and equities	3,018	2,391	1,992	2,138	-10.6%	7.3%	1.7%	1.2%	0.9%
2a/ Liabilities	50,686	55,179	59,480	63,133	14.4%	6.1%	5.4%	5.8%	6.1%
- liabilities to central banks	1	0	0	0	-17.5%	-6.9%	0.0%	0.0%	0.0%
- deposits and loans of the financial sector	823	1,023	1,082	1,109	8.4%	2.5%	0.4%	0.5%	0.5%
- deposits of the non-financial sector	41,415	45,681	48,965	53,823	17.8%	9.9%	8.3%	8.1%	8.7%
- households	36,424	39,835	42,557	46,882	17.7%	10.2%	10.8%	10.3%	11.1%
- enterprises	3,701	4,390	4,628	5,302	20.8%	14.6%	2.5%	2.7%	2.9%
- deposits of the budget sector	6,345	6,373	6,835	6,125	-3.9%	-10.4%	12.0%	12.3%	11.6%
- liabilities arising from issue of securities	0	0	85	144	x	69.8%	0.0%	0.0%	0.6%
- subordinated liabilities	276	357	396	419	17.2%	5.7%	3.6%	4.0%	4.3%
2b/ Shareholders funds	5,850	6,536	7,174	7,322	12.0%	2.1%	6.6%	6.3%	6.3%
Total loans (gross book value)	34,313	39,088	43,177	43,253	10.7%	0.2%	5.2%	5.5%	5.5%
1/ Loans to the financial sector	103	100	139	151	50.2%	8.7%	0.5%	0.4%	0.6%
2/ Loans to the non-financial sector	32,169	36,174	39,977	39,590	9.4%	-1.0%	5.3%	5.6%	5.7%
Households	25,110	27,670	30,011	29,469	6.5%	-1.8%	6.7%	6.6%	6.2%
- housing loans	3,108	3,708	4,204	4,279	15.4%	1.8%	1.6%	1.7%	1.6%
- zloty	3,108	3,704	4,196	4,270	15.3%	1.8%	5.3%	4.9%	4.3%
- foreign currency	1	4	8	9	120.9%	10.7%	0.0%	0.0%	0.0%
- consumer loans	4,225	4,940	5,505	5,439	10.1%	-1.2%	3.6%	3.7%	4.1%
- other	17,777	19,022	20,302	19,752	3.8%	-2.7%	29.3%	28.6%	26.7%
Enterprises	6,846	8,211	9,631	9,751	18.8%	1.2%	2.9%	3.7%	4.4%
- SMEs	6,724	8,004	9,383	9,522	19.0%	1.5%	5.4%	6.3%	7.5%
- large enterprises	121	207	247	228	10.4%	-7.8%	0.1%	0.2%	0.2%
3/ Budget sector	2,042	2,813	3,061	3,512	24.9%	14.7%	7.7%	5.9%	5.5%
Proportion of impaired loans									
Total loans	3.8%	4.0%	4.4%	4.8%	x	x	4.7%	7.1%	7.8%
1/ Loans to the financial sector	1.7%	1.9%	1.0%	0.9%	x	x	2.0%	0.6%	0.8%
2/ Loans to the non-financial sector	4.1%	4.3%	4.7%	5.2%	x	x	4.9%	7.9%	8.8%
Households	3.4%	3.3%	3.5%	3.9%	x	x	4.0%	6.0%	7.2%
- housing loans	1.3%	1.7%	2.0%	2.3%	x	x	1.1%	1.5%	1.8%
- zloty	1.3%	1.7%	2.0%	2.3%	x	x	1.7%	2.3%	2.8%
- foreign currency	0.0%	0.0%	0.0%	0.0%	x	x	0.8%	1.1%	1.3%
- consumer loans	6.6%	5.3%	5.6%	5.8%	x	x	7.8%	13.0%	17.3%
- other	3.0%	3.1%	3.3%	3.8%	x	x	6.0%	6.7%	8.1%
Enterprises	6.5%	7.9%	8.5%	9.2%	x	x	6.5%	11.6%	12.4%
- SMEs	6.6%	7.9%	8.5%	9.2%	x	x	7.5%	13.4%	14.5%
- large enterprises	1.5%	9.9%	9.9%	10.1%	x	x	5.4%	9.2%	9.5%
3/ Budget sector	0.1%	0.1%	0.4%	0.3%	x	x	0.9%	0.2%	0.2%
Proportion of overdue loans									
Non-financial sector overdue > 30 days	x	x	4.5%	4.9%	x	x	6.6%	7.2%	7.4%
including> 90 days	x	x	3.5%	3.7%	x	x	5.2%	5.9%	6.3%
Capital adequacy									
Own funds	5,161	6,083	6,816	6,972	14.6%	2.3%	6.7%	6.8%	6.9%
Total capital requirement	3,152	3,640	4,036	4,109	12.9%	1.8%	5.7%	6.7%	7.1%
Surplus of own funds above requirement	2,009	2,443	2,780	2,863	17.2%	3.0%	9.5%	6.8%	6.8%
Solvency ratio	13.1	13.4	13.5	13.6	x	x	11.2	13.3	13.8

Note: for the share of currency mismatch, the share of problem loans, the share of loans in repayment of delayed and the solvency ratio the share of the sector is the mean value in the sector.

Appendix 2 - SECTORAL BREAKDOWN OF THE ECONOMY [55]

Financial sector

- Monetary financial institutions
    - Central banks
        - NBP
        - Central banks - non-resident
    - Other monetary financial institutions
        - Banks and branches of credit institutions
        - Other monetary financial institutions
            - SKOK credit unions
            - Money market funds
- Other financial sector institutions
    - Insurance institutions
    - Pension funds
    - Other financial intermediaries
        - Investment funds (excluding money market funds)
        - Other financial intermediaries (excluding investment funds)
    - Ancillary financial institutions
    - International financial organisations (only those that are non-resident)

Non-financial sector

- Enterprises
    - SMEs
    - Large enterprises
- Households
    - Individual entrepreneurs
    - Private persons
    - Individual farmers
- Non-profit institutions serving households

Sector of government and local government institutions

- Central government institutions
- Local government institutions
- Social insurance funds

[55] The material presented is a slightly modified extract from the "Instrukcja uzupełniająca do pakietu FINREP" [”Supplementary instructions on the FINREP package"], NBP

FINANCIAL SECTOR - entities whose principal activity is financial intermediation, i.e. the acquisition of financial assets and simultaneous incurring of liabilities on their own account as a result of carrying out market financial transactions, together with individuals providing services that are ancillary to financial intermediation.

Central banks – the Polish National Bank - operating under the Act on the Polish National Bank of 29 August 1997 (Journal of Laws 2005 No. 1 item 2 as amended).

Central banks - non-resident – the institution in the country of a non-resident that serves the functions of monetary authority, whose main activity is the issuance of national currency and the safekeeping of all or part of the state's foreign exchange reserves. The central bank may also perform other functions such as controlling the size of the money supply and of credit in the economy, conducting exchange rate policy, financial servicing of the government sector, supervision of the banking system, holding and refinancing banks' reserves, and organisation of financial settlements. Some of these functions may be performed by other institutions. This category also includes the European Central Bank.

Other monetary financial institutions - financial institutions whose business is to receive deposits and/or close substitutes for deposits from entities other than monetary financial institutions and to grant loans and/or invest in securities for their own account. For countries within the European Union, these institutions are classified according to an updated list, which is published in the Internet on the NBP's website (www.nbp.pl) and on the European Central Bank's website (www.ecb.int). For other countries, it is assumed that other monetary financial institutions means banks (other than the central bank).

Banks (excluding banks that are bankrupt, in liquidation or being established) - a unit created and operating under the Banking Law Act of 29 August 1997 (Journal of Laws No. 140, item 939 as later amended),, or, in the case of cooperative banks, under the Cooperative Law Act of 16 September 1982(Journal of Laws of 1995 No. 54, item 288 as later amended),or in the case of associating banks under the Act on the Functioning of Cooperative Banks, their Association and Associating Banks of 28 December 2000 (Journal of Laws No. 119, item 1252 as later amended),, or in the case of mortgage banks under the Act on Mortgage Bonds and Mortgage Banks of 29 August 1997(Journal of Laws No. 140, item 940 as later amended).

Branches of credit institutions - organisational units of a credit institution that perform in its name and on its behalf all or some of the activities covered by the permit issued to that credit institution, with all organisational units of a credit institution that have these features and are established in Poland being considered to be a single branch.

Cooperative Savings and Credit Unions [Spółdzielcze Kasy Oszczędnościowo-Kredytowe, SKOK] - units created and operating under the Act on Cooperative Savings and Credit Institutions of 14 December 1995 Journal of Laws of 4 January 1996, No. 1, item 2 as amended).

Money market funds - funds established under the Act on Investment Funds of 27 May 2004 (Journal of Laws 2004 No. 164 item 1546).

Insurance institutions - institutions offering insurance products and pursuing their own objectives and tasks through an insurance company, operating in the form of a joint-stock company or as a mutual insurance company, operating under the Law on Insurance Activities of 22 May 2003 (Journal of Laws No. 124, item 1151 as later amended). The concept of insurance institution does not cover entities that operate in the area of social insurance (the ZUS Social Insurance Institution, the KRUS Agricultural Social Insurance Fund, the NFZ National Health Fund or the FP Labour Fund) or the entities that supervise insurance companies and pension funds (the Polish Financial Supervisory Authority), which are counted as belonging to the sector of government and local government institutions.

Pension funds - institutions the subject of whose business is collecting moneys and investing them with a view to making payment to members of the funds after they reach retirement age, acting under the Act on Organization and Operation of Pension Funds of 28 August 1997 (Journal of Laws 2004 No. 159, item 1667 as later amended).

Other financial intermediaries - financial institutions whose primary activity is financial intermediation carried out by incurring liabilities in forms other than cash, deposits and/or substitutes for deposits in institutional entities other than monetary financial institutions.

Investment funds (excluding money market funds) - legal persons, as defined in the Act on Investment Funds of 27 May 2004 (Journal of Laws 164/04 item 1546),whose sole business consists in investing moneys, raised by public, or in circumstances specified in the act by private, invitations to acquire participation units or investment certificates, in securities, money market instruments and other property rights defined in that act. This category also includes National Investment Funds.

Other financial intermediaries (apart from investment funds) - financial institutions whose primary activity is financial intermediation carried out by incurring liabilities in forms other than cash, deposits and/or substitutes for deposits in institutional entities other than monetary financial institutions. This sub-sector includes, among others: financial leasing enterprises (enterprises that provide operating lease services be shown in the non-financial sector under enterprises), factoring enterprises, brokerages, institutions of the Private Equity/ Venture Capital type, firms established for the purpose of asset securitization, and banks that are bankrupt, in liquidation or being established.

Auxiliary financial institutions - financial institutions that do not conduct financial intermediation on their own behalf, but only contribute to creating the conditions for such intermediation. This sub-sector includes, among others: brokers, insurance and pension agents and consultants, investment advisors, foreign exchange bureaux, stock exchanges, commodity exchanges, institutions that form the infrastructure for the functioning of financial markets such as settlement chambers and centres (e.g. Polcard), security depositories (e.g. Krajowy Depozyt Papierów Wartościowych SA [the National Depository for Securities], guarantee institutions (e.g. the Bank Guarantee Fund), financial funds and foundations (including: the Cooperation Fund), investment fund companies, pension fund companies, institutions dealing with instalment sales, asset management companies, the Polish Bank Association, the National Association of Savings and Credit Unions and representative offices of foreign banks.

International financial organisations - financial institutions engaged in multilateral cooperation and extension of assistance to member states or third countries, e.g. the International Monetary Fund, the International Bank for Reconstruction and Development (the World Bank), the Bank for International Settlements and the European Bank for Reconstruction and Development. Also included here are international financial institutions in the meaning given to that term by Article 4 paragraph 3 of the Banking Law Act of 29 August 1997 (Journal of Laws 2002 No. 72, item 665 as amended).

NON-FINANCIAL SECTOR - entities whose principal activity is the production and trading of goods or the provision of non-financial services (including operating leases), entities performing non-financial functions and natural persons. The non-financial sector **includes businesses, households and non-profit institutions**.

Enterprises - all entities whose principle activity is production or trading in non-financial goods or services. This group also includes natural persons engaged in business activities on their own account unless the number of people working in a business was more than nine at the end of the financial year last completed.

Small and medium-sized enterprises (SMEs) - entities in which the number of people working at the end of the fiscal year last completed was less than 250 and natural persons conducting business on their own account if the number of people working in a business was more than nine but fewer than 250 at the end of the fiscal year last completed. This category also includes micro-enterprises (enterprises, in which no more than nine people were working at the end of the financial year last completed). Natural persons conducting economic activity on their own account in which no more than nine people were working at the end of the fiscal year last completed are classified as individual entrepreneurs (households).

Large enterprises - entities in which the number of people working at the end of the fiscal year last completed was at least 250 and natural persons conducting business on their own account if the number of people working at the end of the fiscal year last completed was at least 250.

Households - individuals or groups of individuals who are consumers and/or a person or group of persons who are producers of market goods and non-financial services intended solely for their own needs.

Individual entrepreneurs - natural persons engaged in business on their own account, to whom the reporting bank provides services related to their activities, where the number working in the business was at the end of the fiscal year last completed no more than nine (e.g. members of the professions, if they meet these conditions). Loans granted to persons engaged in business that are intended to fund consumption needs or to meet their needs for housing should be reported as loans to private persons. Similarly, deposits for these people if they are established separately for private purposes should be shown as the deposits of private persons. Non-public health facilities and non-public schools run by natural persons should also be included here if the number of people working in the business was no more than nine at the end of the financial year last completed.

Private persons – natural persons, with the exception of those engaged in business or in agricultural activities (i.e. categorised as individual entrepreneurs or as individual farmers). This category also includes: employee assistance and loan funds run by workplaces, school savings banks and parents councils operating in schools, kindergartens and other facilities.

Individual farmers – natural persons whose main source of income is agricultural production and whose business is not registered in the form of enterprises, companies, partnerships, cooperatives or producer groups. Loans granted to individual farmers that are intended to fund consumption needs or to meet their needs for housing should be reported as loans to private persons. Similarly, if deposits for these people are established separately for private purposes they should be shown as the deposits of private persons.

Non-profit institutions serving households - non-profit institutions which are separate legal entities and serve households whose primary income, apart from that obtained from occasional sales, is voluntary contributions in cash or in kind from households, government and local government grants and income derived from ownership. This sub-sector includes, among others: trade unions, professional and scientific associations and societies, consumer associations, political parties, churches and religious organisations, volunteer fire departments, funds and foundations serving households, social clubs, cultural, recreation and sports clubs, housing commonholds, non-public health care facilities and non-public schools if these are maintained by churches and religious associations, foundations serving households, trade unions, professional self-governing bodies and associations and other entities classified as non-profit institutions, charitable institutions, and humanitarian aid organisations financed by voluntary transfers in cash or in kind from other institutional entities.

SECTOR OF GOVERNMENT AND LOCAL GOVERNMENT INSTITUTIONS - the sector of government and local government includes public authorities and organisational entities that are subordinate to them, state legal persons and other state organisational entities that are not covered by the National Court Register, whose activities are financed in whole or predominantly from public funds, except state enterprises, state banks, and state-owned commercial companies.

Central government institutions - all the ministries and other central institutions whose area of competence normally extends to a country’s entire economic territory with the exception of the management of social insurance funds. This subsector includes central authorities of government administration and entities subordinate to them whose activities are financed to a specified extent from the state budget.

Local government institutions - local government bodies (municipal, county and provincial) and organisational entities subordinate them to whose activities are financed from the budget of local government entities, with the exception of regional branches of social insurance funds. The area of competence of local government institutions covers only local parts of a country's economic territory.

Social insurance funds – these include all central and local institutional units whose principal activity is to provide social benefits provided that they meet both of the following criteria: by law or on the basis of relevant regulations specified population groups are required to participate in the plan (e.g. a pension plan) or to pay premiums and the government is responsible for management of the institution in terms of setting or confirming the amount of premiums and benefits. This sub-sector includes: the Social Insurance Institution and the Agricultural Social Insurance Fund and the funds managed by them (the Social Insurance Fund, the Demographic Reserve Fund, the Contribution Fund, the Prevention and Rehabilitation Fund, the Pension and Disability Benefit Fund, the Administration Fund, the Incentive Fund, the Reserve Fund and the Labour Fund), the National Health Fund and the latter’s provincial branches.

Annex 3 - DISTRIBUTION OF LOAN PORTFOLIO – PFSA METHODOLOGY

The financial sector (apart from banks and branches of credit institutions)

The non-financial sector

- Enterprises
    - SMEs
        - Operating
        - Investment
        - For property
        - Other loans and receivables
    - Large enterprises
        - Operating
        - Investment
        - For property
        - Other loans and receivables
- Households
    - Housing
        - Zloty
        - Foreign currency
    - Consumer
        - Credit cards
        - Vehicle
        - Instalment
        - Other
    - Other
        - Operating
        - Investment
        - For property
        - Other loans and receivables
- Non-profit institutions serving households

The sector of government and local government institutions

- Central government institutions
- Local government institutions
- Social insurance funds

Operating loans - loans for the financing of the ongoing business of a firm or farm, i.e., for example, for payment of obligations to suppliers and payment of salaries and running costs. In this category should also be shown: discount and export loans together with overdrafts (excluding overdrafts for private persons).

Investment loans - loans to finance the borrower's new production or servicing capacity, or to increase existing capacity, and other endeavours whose nature is that of joint and accompanying investment extended for the financing of endeavours aimed at: restoring, modernising and increasing fixed assets, with the exception of vehicle loans and property loans (these are shown separately). Where a loan is granted in support of a variety of purposes (e.g. purchase of land, construction of industrial plant and purchase of machinery and equipment) classification of the loan should be based on the purpose that predominates in the amount of the loan.

Housing loans – it is conventionally accepted that these are loans granted to households for: the acquisition, construction, reconstruction, extension or development of a house or of a dwelling that constitutes a separate property, and adaptation of non-residential premises (or buildings) for housing purposes, the acquisition of co-operative rights to a dwelling or the right of separate ownership of a unit in a housing cooperative, repairs to a house or a dwelling as referred to above, the acquisition of a building plot or part of one for the construction of a detached house or of an apartment building which contains, or is to contain, a dwelling, and other objectives relating to meeting housing needs, particularly coverage of the costs of participation in the cost of construction of dwellings by a social housing association.

Property loans - other housing loans (granted to entities other than households), commercial property loans and loans for other property.

Consumer loans - loans granted to private persons for purposes unrelated to business or the running of a farm. These loans include:

- loans **on a credit card account** - the use of funds up to the credit limit set by the bank when the credit card was issued without any restriction on the purpose for which the loan was granted and independently of the method of repayment;
- **vehicle** loans;
- **instalment** loans - loans repayable in instalments (usually over between one and three years) and intended for the purchase of consumer goods (e.g. white goods) or the financing of the current needs of households (e.g. holiday and vacation loans). This category also includes balloon loans. **This category does not include car loans and loans that are repaid by a single payment;**
- **other** - loans that are repaid **by a single payment**. They also include **overdrafts on current accounts** for households that are not connected to business or the running of a farm.

Other loans and receivables - other loans (not included in the groups named above) and other receivables.

Annex 4 - GLOSSARY OF SELECTED TERMS[56]

Nominal value of financial instruments - the amount of receivables, liabilities or off-balance sheet liabilities or the value of a security denoting the amount of capital (together with accrued interest) at the reporting date that a debtor is contractually obliged to pay to a creditor. In the case of debt securities such as bonds and bills of exchange, this amount denotes the sum that will be payable at maturity (together with accrued interest). In the case of shares, nominal value is the value shown in the statutes and entered into the court registry.

Carrying value - the value consistent with valuation at the balance sheet date, i.e.:

- financial assets are measured at: amortised cost calculated using the effective rate interest less any write-down made for impairment or provisions created intentionally or at fair value and in the case of financial assets classified as available for sale fair value should be reduced by any write-down for impairment or at cost less any write-down for impairment,
- shares in subsidiaries are valued at the purchase price taking account of any write-down for impairment or in accordance with IAS 39,
- shares in other entities: banks preparing financial statements in accordance with IAS make valuations in accordance with IAS 39, while banks preparing financial statements in accordance with PAS value financial fixed assets at purchase price taking account of any write-down for impairment,
- financial liabilities are measured at: fair value or at amortised cost using the effective interest rate
- tangible fixed assets are valued at: purchase price or production cost less accumulated depreciation or at post-revaluation amount corresponding to fair value less accumulated depreciation and any write-downs for impairment,
- investment properties are valued: at fair value or at cost less accumulated depreciation and any write-downs for impairment,
- intangible assets are measured at: purchase price or production cost less accumulated depreciation and any write-downs for impairment or at post-revaluation amount corresponding to fair value less accumulated depreciation and any write-downs for impairment,
- fixed assets classified as held for sale are valued at the lower of carrying amount and fair value less costs of sale (IFRS 5)
- stocks are valued at purchase price or production cost or at net obtainable realisable value, depending on which is the lower amount.

Net carrying value - the carrying value.

Gross carrying value – carrying amount without deduction for accumulated depreciation and any write-down for impairment/specific provisions created.

Net assets - assets of the entity less liabilities, corresponding to the value of own funds.

Portfolio A - other receivables from the portfolio of financial assets valued at fair value through the profit and loss account and financial assets held for trading.

Portfolio B - other receivables from the portfolio of financial assets available for sale and investments held to maturity and the entire portfolio of loans and other claims.

[56] The material presented is a slightly modified extract from "Instrukcja uzupełniająca do pakietu FINREP" [”Supplementary instructions on the FINREP package"], NBP

Unimpaired receivables (for banks using IAS) – financial assets without confirmed loss of value. Receivables subject to incurred but not reported write-downs should be shown in the "without loss of value" columns. Receivables without loss of value **for banks using PAS** - credit exposures categorised as normal and under observation.

Impaired receivables (for banks using IAS) – financial assets objective evidence of the loss of value of which has been confirmed as referred to in § 59 of IAS 39 and recognised as impaired assets, in accordance with the principles of IAS 39. Receivables with loss of value **(for banks using PAS)** – credit exposures classified as threatened.

Gross carrying amount of exposure no loss of value of which has been confirmed - banks applying PAS show these as normal and under observation, while banks applying IAS show exposures as unimpaired and as those for which indications of loss of value have appeared but write-downs have not been made. **Gross carrying amount of exposure with recognised loss of value** - banks applying PAS show threatened loans, while banks applying IAS should show impaired exposures for which a write-down has been made for loss of value.

Revaluation write-downs for assets that are valued individually - banks applying PAS show the creation of specific provisions for credit exposures with the exception of specific provisions created for exposures arising from loans and retail loans classified as "normal", while banks applying IAS show the value of write-downs made for loss of value on individual exposures. **Revaluation write-downs for financial assets that are valued as a portfolio** - banks applying PAS show the creation of specific provisions for credit exposures arising from loans and retail loans classified as "normal", while banks applying IAS show the value of write-downs made for credit exposures the loss of value of which has been assessed jointly.

Write-down for loss of value/specific provision is the amount by which the carrying amount of an asset exceeds its recoverable amount. **Recoverable value** – corresponds to the fair value less costs of sale or the value in use of an asset or cash-generating unit, depending on which is the higher (IAS 36.6) or the present value of estimated future cash flows discounted using the effective interest rate (IAS 39.63).

Initial term (to maturity) - the period for which a contract was concluded with a customer. The contractual period is also the period amended by an annex that is an integral part of the contract. In the case of deposits this will be the period for which the deposits have been declared to have been lodged in the bank. With respect to loans the initial term is the period for which the loan was extended taking into account the date set for repayment of the last instalment, while in the case of securities it is the period from the date of issue until the maturity or redemption of the securities. For deposits where the date of deposit of funds is other than the date of conclusion of the contract (e.g, interbank T/N and S/W deposits) the maturity date is counted from the date of deposit (i.e. of rebooking from off-balance sheet to the bank balance sheet) until the date of repayment of the funds.

Term to maturity - the period remaining between the reporting date to the date specified in the contract for payment of receivables, this being for receivables payable in one payment the date specified in the contract for payment of the entire debt and for receivables payable in instalments the date specified in the contract for payment of individual instalments.

Term to maturity - the period remaining between the reporting date and the date specified in the contract for payment of obligations.

Term of bank's commitment - the year in which the bank's receivable arose.

Non-delinquent receivable – a receivable paid in accordance with the schedule specified in the contract for the repayment of receivables, i.e. no delays have occurred in payment of capital or principal.

Overdue receivables – receivables for which payment of interest or principal amounts have not been mde on the dates specified in the contract. By overdue period should be understood the period from the date due for payment (the specified date for payment of an instalment, interest or the entire amount) to the balance sheet date. The length of the overdue period for receivables repaid in instalments should be taken to mean the period from the date on which the earliest instalment was due if delayed payment has occurred.

Unserviced receivables - consist of claims in the case of which a payment has not been made for more than three months after the contractual date (calculated from the date of payment specified in the contract to the reporting date). For unserviced claims all amounts due must be shown, even if the delay in payment relates to particular instalments of principal or payments of interest. Under unserviced receivables should also be shown those on which a delay (of more than three months) has affected only interest payments while payments of principal have been made on time.

Deposits - a bank's liabilities arising from the funds deposited in customers' accounts, with the exception of liabilities arising from cash collateral taken.

Sight deposits - funds deposited in entities' current accounts in a reporting institution which may be payable on demand.

Time deposits - funds deposited with a reporting institution for a specified term.

Deposits redeemable at notice - funds deposited in a reporting institution without a specific maturity date which cannot be withdrawn without prior notice to the reporting institution of intention to withdraw all or part of the deposit. The notice period is specified in the contract. Withdrawal of the deposit without prior notice is impossible or causes the loss of a substantial part or all of the interest due.

Blocked deposits - funds deposited in a reporting institution which the depositor cannot dispose of freely because of their use for specified purposes, *inter alia* for the settlement of letters of credit or as security for risk borne by the reporting institution in relation, for example, to a loan granted or to credit card transactions. If it is possible to determine an initial term for raising the blockage, the deposit should be allocated to the appropriate group of time deposits. Inability to determine such a term leads to allocation of the deposit to the "blocked deposits" category.

Loans on the liability side - the obligations of a reporting institution relating to loans it has received. This category excludes liabilities related to securities issued.

LIST OF FIGURES

LIST OF TABLES

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