REPORT ON THE CONDITION OF BANKS IN 2012

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KEY INSIGHTS AND CONCLUSIONS

Condition of the banking sector remained stable in 2012.

Stronger capital position

The capital base improved (the equity increased from PLN 110.7 billion as at the end of 2011 to PLN 128.8 billion as at the end of 2012, the solvency ratio increased from 13.1% to 14.7%, Tier 1 ratio increased from 11.7% to 13.1%). The sound capital position of the sector is reflected in only a small number of banks with the solvency ratio and Tier 1 ratio at the level of below, 12% and 9% correspondingly (which cover respectively 9.9% and 6.1% of the assets of the banking sector).

Considering the increased risk level in the external environment, it is important to maintain the strong capital base and - in case of some banks – its further improvement. This is because of relatively high level of accumulated risk reported in the banks' balance-sheets and because of difficult macrofinancial conditions – both of them may negatively affect the financial standing of some banks' customers and cause disturbances at the financial markets. Considering that, KNF published recommendations regarding the distribution of profit of 2012. Their implementation should preserve stability and security, ensure further development of the sector and facilitate the acquisition of alternative source of funding for the banking activities.

Good situation in terms of current liquidity

Situation in terms of current liquidity was good. The KNF Resolution no. 386/2008 was not breached frequently and, if yes, such breaches came from entities with an insignificant share in the total assets of the whole sector. The basic liquidity ratios remain stable and are still at satisfactory level (positive liquidity gap increased from PLN 140.3 billion as at the end of 2011 to PLN 156.9 billion as at the end of 2012, the short term liquidity ratio increased from 1.46 to 1.55). The loan to deposit ratio to non-financial sector improved (i.e. it dropped from 109.4% to 106.6%).

Although the current situation is good, it is recommended to carry out further actions aimed at extending the maturity of the banking sector's liabilities so as to adjust them to the maturity structure of assets, to improve the stability of the financing sources and to implement, considering difficult external conditions, the development strategies aimed at reducing the liquidity risk.

The financial result similar to 2011, however with a considerable impact of non-stable factors

Despite adverse external situation, the financial results generated by the banking sector were similar to those of 2011 (net financial result was PLN 15 521 million, i.e. it was PLN 19 million (0.1%) lower than in 2011; the results improved in 413 institutions that hold 57.2% of all assets of the banking sector; financial results of other institutions deteriorated; 18 institutions reported losses of the total amount of PLN 340 million).

The net interest income grew at a slower pace in 2012 (increase by PLN 501 million; 1.4%). This was the result of a moderate increase in the interest revenue (by PLN 6,520 million; 10.1%) combined with a high increase in the interest costs (by PLN 6,019 million; 20.2%). The significant increase in the interest costs was caused by a steep increase in the household deposit costs (by PLN 3,828 million; 28.8%) – as the result of the increase in the deposit base and the interest rates (the effect of the monetary policy tightening in 2011 and in the first half of 2012), as well as of the growing competition at the deposit market. The result on fees and commissions has not changed (increase by PLN 59 million; 0,4%) and the result on other banking activities slightly increased (by PLN 886 million; 11.0%), among others, because of selling a portion of the bond portfolio to realise the profits resulting from increased prices. The consequence of the above changes is the slight increase in the result on banking activities (by PLN 1,445 million; 2,5%).

Difficult external conditions translated into a stronger pressure on cost control. As the result, the operating costs increased slightly (PLN 1,092 million; 4.1%), mainly due to the increase in the employment costs (by PLN 706 million; 4.8%) and, to a smaller extent, in overhead costs (by PLN 386 million; 3.2%). The amortization/depreciation remained unchanged as compared to 2011.

The negative balance of impairment losses and provisions increased in 2012, as compared to two previous years (by PLN 1,133 million; 12.8%). This was the result, first of all, of a deteriorated condition of several large construction enterprises, the fact that translated into a steep increase in the balance of impairment losses for the enterprise sector (by PLN 2,134 million; 169.7%). On the other hand, the balance of impairment losses for consumer loans dropped sharply (by PLN 1,285 million; -34.7%). The following dropped as well: the balance of impairment losses for household loans (by PLN 135 million; -10.1%) and for other household debts (by PLN 169 million; -12.8%). The negative IBNR result was reduced (by PLN 90 million; -18.8%).

Despite marginal role of the items, increased result on other operating income and costs (by PLN 396 million; 72.0%) as well as limited losses on discontinued operations (by PLN 188 million; -92.4%) heavily impacted the financial results of the sector in 2012.

Key performance indicators were at the level close to 2011 (C/I: 50.9%; ROA 1.2%; ROE dropped to 11.2% but it resulted from considerable capital growth).

In the coming periods, one may expect that the negative pressure on the banks' financial results will intensify, which is the consequence of the economy downturn which, in turn, may translate into a deteriorated financial condition of some borrowers and a reduced demand for loans and banking products. The strong reduction of interest rates will exercise pressure on banks' results. As the result, the banks' net interest income will drop. In addition, new contributions to the stabilization fund and the resolution fund (to be paid to BFG) and reduced interchange fee are expected.

The banking sector structure is stable in long-term

The sector structure has not significantly changed. The restrained growth of the banking sector, as well as certain negative occurrences in the banking environment, have resulted, however, in actions taken by some banks aiming at improving the operating efficiency through employment and sales network optimization. In consequence, the number of persons employed at the banking sector in 2012 dropped (by 1.8 thousand persons). The sales network size was similar to 2011. Two large acquisitions continued, i.e. Polbank EFG S.A. and Raiffeisen Bank Polska S.A. (the acquiring bank) as well as Kredyt Bank S.A. and Bank Zachodni WBK S.A. (the acquiring bank). They were both finalized at the end of 2012/beginning of 2013.

As regards the ownership structure, further growth of local investors' share in the banks' assets (from 35.0% to 36.4%) was observed. The concentration slightly increased (the share of the 5 largest banks in the total sector's assets increased from 44.3% to 44.9%, the share of the 10 largest banks in the total sector's assets increased from 63.4% to 64.6%).

Moderate increase in the activity of the banking sector

Continued difficult external conditions and uncertainty as to the future growth, combined with limited access to funding sources and reduced willingness of households and enterprises to take loans (in particular the long-term loans), translated into a moderate growth in scale of banking activities.

The balance-sheet total increased by PLN 58.4 billion, i.e. by 4.5%, and, after excluding the exchange rate changes, by approx. PLN 84.9 billion, i.e. by 6.7% (the increase was slightly lower than that reported for years 2010-2011, correspondingly 7.5% and 7.8%). That increase was the result of the increase in lending and in volume of the most liquid assets, financed from increased household and public sector deposits, issuance of own securities and capitals.

Reduced lending growth

In 2012 the lending growth slowed down (the total value of loans increased by PLN 23.9 billion, i.e. by 2.6%, and, after excluding the exchange rate changes, by approx. PLN 46.0 billion, i.e, by approx. 5.2%). In Q4 lending stalled. The growth decelerated as the result of reduced growth in lending for households and enterprises, despite relatively strong increase in lending for the finance and public sector.

Slowdown in lending for households and enterprises was caused by mixed supply-related and demand-related reasons, the key factor being the weakened economic growth and deteriorated growth expectations and labour market conditions – as the result, the lending demand dropped and balance sheets were cleaned by getting rid of bad debt items.

Deterioration of the investment climate, anticipated economy downturn in Poland and business slowdown of the Poland's main trade partners are the major threats to lending expansion in the coming periods. This may lead to reduced lending demand from enterprises and households as well as its more selective supply by banks. Limited funding sources (in particular long-term) may also materially impede further expansion.

Reduced growth in household loans

The growth rate in household lending in 2012 was the lowest in recent years (PLN 1.2 billion, i.e. by 0.2%, adjusted approx. PLN 16.2 billion, i.e. by 3.1%). This was the result of a slowdown in housing lending and reduction in consumer loans. The growth rate for other household loans remained stable.

Slowdown in household lending was a common phenomenon for the majority of the EU countries; lending growth in Poland was, however, higher as compared to other countries.

Reduced growth in housing loans

Growth in housing loans decelerated (increase by PLN 2.8 billion, i.e. by 0.9%; adjusted approx. PLN 16.5 billion, i.e. 5.4%). The positive trend was continued where the PLN loans predominated in the new lending development. Majority of banks either strongly limited, or completely withdrew, from the loans in foreign currencies. Combined with the PLN appreciation, this resulted in reduced share of FX loans in total housing loans (from 62.0% at the end of 2011 to 55.4% at the end of 2012). According to UKNF and NBP, the FX loans should be removed from the standard offer and they should be available only for customers who earn incomes in the loan currency. The negative fact is that there is still a large share of new loans granted with LTV exceeding 80% (approx. 50% of the total sales) and with excessively lengthened tenors (loans with tenors of 25 years and longer accounted for 65% of new loans).

There are numerous reasons for slowdown in housing loans. In particular, continued correction of prices at the real property market restrained some portion of demand as the potential buyers waited for more attractive sales prices (which is opposite to what happened during the economic boom of 2005-2008) and reduced the loan demand in terms of its value. At the same time, increased concerns of households as to their future financial condition translated into reduced interest in taking long-term loans. Additional factors that reduced lending included changes to the Rodzina na Swoim "Family on Its Own" Programme (by lowering of the programme limits), tightened lending policy of some banks and regulatory changes (including, among others, the 50%/65% limit for the maximum DTI value and the requirement to take the 25-years period for calculation of credit capacity; the results of analyses performed by UKNF show that the regulatory factor is not a material barrier – regulators just prevent adverse phenomena which translate into increased risk for the customer, the bank and the economy as a whole). In addition, the unfavourable relation of the average flat price to the average salary translated into the fact that large part of households with average (or lower) incomes were unable to take out a loan or, if taken, it would entail excessive risk, reduced current consumption and limited ability to generate savings. The above relation improves gradually in recent years as the result of correction of the real property prices combined with the increasing salaries. It must be noted that the loan demand has been largely satisfied through extensive lending in previous years (the number of active loan agreements increased from almost 300 thousand at the end of 2002 up to 1.7 million at the end of 2012; the value of loans awarded at that time increased from PLN 20 billion to more than PLN 300 billion; the share of loans in GDP increased from 2% to 20%). In consequence, the demand has gradually dropped down and stabilized at a level lower than in the period of the loan boom.

Stabilised lending in the area of consumer loans

The consumer loan portfolio shrank (by PLN 6.9 billion, i.e. by –5.3%; adjusted by approx. PLN 6.2 billion, i.e. by –4.8%). Reduced loan volume has not been, however, a direct result of reduced lending. This was rather the effect of cleaning the balance-sheets and removing low quality assets (according to the UKNF analyses, as the result of that process, the loan portfolio dropped down in 2011, by PLN 4.7 billion, and in 2012, by PLN 5.3 billion). Additional reason for reduced loan portfolio was a transfer, by some banks, of the instalment loans to lending companies set up as a subsidiary of the group in order to avoid regulatory constraints (in terms of value, these activities account for approx. PLN 3-5 billion). Although negatively viewed by UKNF, this phenomenon is neutral for households (loans are simply provided through another sales channel). Considering the above two phenomena, it turns out that lending in recent years has been stable. Analyses from other institutions do not take into account the above two factors. As the result, incorrect conclusions are drawn regarding the development of the consumer loans.

The slower growth of consumer loans observed in recent years is the result of, in addition to the phenomena described above, limited demand and supply. Reduced demand is a consequence of deteriorated consumer sentiment and growing uncertainty as regards the future financial situation. In addition, as the result of intense lending in previous years, some households satisfied their needs through loans. Limited supply is in turn the effect of self-regulatory actions taken by the banks in response to deterioration of the loan portfolio quality in years 2009-2010 (share of non-performing loans increased from less than 8% at the end of 2008 to more than 17% at the end of 2010; the negative balance of impairment losses increased from PLN 3 billion to PLN 7 billion), increased aversion to take risk considering unfavourable phenomena taking place in the external environment and changed strategies of some banks in consequence of changed strategies of the strategic investors. The analysis shows that the role of regulatory factor (Recommendation T) in slowing down the lending growth was limited.

Stable growth in the area of other household loans

Other household loans (mainly operating and investment loans) has grown at a stable pace in recent years (by PLN 5.4 billion, i.e. by 6.5%; adjusted by approx. PLN 5.9 billion, i.e. by 7.2%).

Reduced growth in enterprise loans

The growth rate of enterprise loans dropped down (increase by PLN 7.7 billion, i.e. by 2.9%; adjusted by approx. PLN 13.4 billion, i.e. by 5.2%). In addition, the enterprise debt in the banking industry was reduced in Q4, a result of reduced economic activity, deteriorated economic growth outlook and increased uncertainty as regards future economic growth. In consequence, the demand for loans (in particular, investment loans) dropped. Lending growth was strongly affected by reduction of debt by several large enterprises, in particular from fuel and telecommunication industry (partially, a result of a changed financing structure); as the result, their debt at banks dropped down by approx. PLN 5 billion.

The loan quality remains stable, although deteriorated in some areas

Despite reduced economic growth in 2012, the loan portfolio quality remained relatively stable (increase in non-performing loans by PLN 6.0 billion, i.e. by 9.0%, their share increased from 7.3% to 7.7%). The most affected area was the enterprise loans, followed, to a lesser extent, by small enterprise and housing loans. On the other hand, the quality of consumer loans improved. The loan quality of financial and public sectors remained high and stable.

Deteriorated quality of housing loans

The quality of housing loans deteriorated, the fact reflected in the increased value of non-performing loans (by PLN 1.6 billion; 21.0%), their higher share in the portfolio (from 2.3% to 2.8%) and deteriorated repayability (the value of 30+ DPD loans augmented by PLN 1.6 billion, i.e. by 17.3%, while their share in portfolio increased from 2.8% to 3.3%). The positive fact is that the growth of non-performing and defaulted loans was significantly lower than in 2011. It is true that it was largely caused by changes in the impact of FX rates (for main currencies) on PLN, however, in general negative trends grew at a slower pace in the second half of 2012 (particularly in Q4). It is difficult to say if that phenomenon is of a permanent or only a temporary nature.

The increase of the value of non-performing and 30+ DPD loans was accompanied by the increase in their volume (as at the end of 2012, the banks' portfolios comprised 34.1 thousand non-performing housing loans and 38.2 thousand 30+ DPD loans).

The quality of housing loans (measured with the share of non-performing loans) is high as compared to other loan types; however, considering the risk generated by the housing loan portfolio, one must take into account, among others, the dominant role of the housing loans in the banking sector balance-sheet (as at the end of 2012, they accounted for 35.4% of all loans and 23.5% of the banking sector balance-sheet total; those shares were much higher at key banking players) and the short history of the majority of the loans (more than 80% of the loan value was awarded in years 2007-2012).

A significant source of risk is the large share of FX loans. From the borrowers' perspective, the highest risk is connected with adverse changes of FX rates in a situation where they must prematurely terminate the loan agreement. In such situation they must consider a steep increase of their debt which, in case of households with average income, may destabilize them (adverse changes of the FX rates make it more difficult or impossible to sell/change a real property). From the banks' perspective, the risk is that repayability of loans may drop sharply in case of depreciation of PLN and unfavourable market conditions, which, in turn, may result in large losses. At the same time, the hypothesis regarding better quality of the FX housing loans as compared to loans in PLN has not been confirmed in the analyses carried out by UKNF. Higher share of non-performing loans in the PLN loan portfolio is the result of conversion of a part of the non-performing FX housing loans into housing loans in PLN. After the correction, the quality of the PLN loans as at the end of 2012 (2.67%) was slightly better than that of FX loans (2.93%). The results of the UKNF analyses do not confirm the hypothesis of higher incomes of persons with FX loans. The majority of FX loans was granted to households with average financial condition.

Another threat related to housing loans is the high LTV rate for the majority of the loan portfolio – as at the end of 2012, the banks' portfolios comprised more than 500 thousand loans with LTV rate > 80% (i.e. 51.0% of the total portfolio value), including 238.8 thousand loans with LTV > 100% (i.e. 27.3% of the total portfolio value); in fact, the number of loans with high LTV ratios may be higher considering the fact that banks have underestimated the reduction of prices of real properties in recent years. The high LTV ratios raise concerns as to the financial condition of banks in case of worsened repayability of loans (the low repayability scale) and of households covered by the debt enforcement procedures (a portion of them would still have very large debts even if their real properties are sold).

Another significant risk is related to loans granted under the Rodzina na Swoim "Family on Its Own" Programme. The risk is that the instalments rise sharply after 8-years of subsidies. The impact may be strong on households with relatively low income.

In discussions regarding the housing loans, the limited liquidity of the real property market must be taken into account. In case of short-term sales, by the banks or other entities, of flats secured with mortgages, one may expect steep decline in prices and in sales levels realized by developers and secondary market players (as at the end of 2012, the number of 30+ DPD loans was close, at some markets, to 10% of the total offer from developers). Therefore it is in the best interest of all market participants to maintain the high loan quality.

In addition, a large number of other household loans secured with mortgages must be taken into account (as at the end of 2012, the banks' portfolios comprised 14.1 thousand non-performing loans and 16.3 thousand 30+ DPD loans awarded to households for other purposes, but mortgaged with a real property).

Finally, the housing loan-related risk is partly generated by incomplete and unsatisfactory real property market and borrowers financial condition databases, lack of proper lending funding sources and improper risk management processes.

Considering the adverse phenomena regarding the housing loan portfolio and the above mentioned exposures connected with specific characteristics of the real property market, a large correction of the to-date housing loan development model is needed. This is the objective of actions taken by KNF/UKNF (among others, amendment to the Recommendation J, draft amendment of the Recommendation S, initiatives for development of long-term banking debt instruments).

Stabilised / improved quality of consumer loans

The quality of consumer loans gradually stabilised in 2011 and then improved in 2012 – the volume of non-performing and 30+ DPD loans went down by correspondingly PLN -2.1 billion (-9.1%) and PLN -2.4 billion (-9.3%); their share in the portfolio went down, correspondingly, to 17.2% and 18.9%. Actual situation is not so optimistic as some part of positive observations takes into account the process of purifying the balance-sheets and removing low quality assets through sale.

Stabilization and gradual improvement of the consumer loan quality in years 2011-2012 is mainly the effect of self-regulatory actions taken by banks in years 2008-2010. The additional factor is the introduction of the Recommendation T and on-going actions of the supervision authorities aimed at improving the loan management processes both at the industry and individual bank level.

The emerging improvement in consumer lending quality may result in gradual increase in funding within this area. The main threat regarding the quality of the consumer loans is adverse macroeconomic situation that may lead to considerable deterioration of the financial condition of a part of households.

Deteriorated quality of other household loans

The quality of other household loans deteriorated, the fact reflected in the increased volume of non-performing loans (by PLN 1.6 billion; 20.3%) and the increased share of non-performing loans in the portfolio (from 9.3% to 10.5%). The above was the consequence of deteriorated quality of operating loans granted to small entrepreneurs and, to a lesser extent, of investment and other loans. The main reason for negative developments is the progressive economic slowdown that translates into deteriorated financial condition of some enterprises and their business partners.

Deteriorated quality of enterprise loans

The enterprise loan quality deteriorated exponentially in 2012, the fact reflected in the significant growth of non-performing loans (by PLN 4.8 billion; 17.6%) and their increased share in the portfolio (from 10.4% to 11.8%). This affected both the SME (rise in the volume of non-performing loans from 12.3% to 13.1%) and large enterprises (rise of the volume of non-performing loans from 7.4% to 9.8%). The same as in case of small enterprises, the main reason for deteriorated loan quality was progressive economic slowdown that translated into deteriorated financial condition of a part of enterprises.

In sectoral terms, the deterioration of the quality of enterprise loans was mainly caused by difficulties of the construction sector (increase of non-performing loans by PLN 4.0 billion) and, to a smaller extent, of the real property management (by PLN 1.4 billion) and of trade (by PLN 1.3 billion). The impact from enterprises representing other economy sectors was limited. The steep increase in the non-performing loans from the construction sector was mainly caused by deteriorated financial condition of several construction enterprises dealing with large infrastructural contracts.

The key factor influencing the quality of the loan portfolio in the future will be the macroeconomic situation. A sharp economic slowdown may negatively affect the financial condition of some borrowers, the fact that will translate into a strong negative pressure on the loan portfolio quality and the banks' results. On the other hand, as a consequence of considerable easing of the monetary policy by the Polish Monetary Policy Council, the loan handling costs (in particular, as regards housing and enterprise loans) dropped down considerably and the financial condition of a part of the borrowers stabilised or even improved.

Increased volume of the most liquid assets followed by reduction in treasury instrument portfolio

Reduced growth in lending translated into the increased volume of the most liquid assets (cash in hand or at NBP, receivables from banks, debt and capital instrument portfolio) and their increased share in the balance-sheet total (increase by PLN 30.3 billion, i.e. by 8.5%; increase of their share in balance-sheet from 27.5% at the end of 2011 to 28.5% at the end of 2012).

The majority of the liquidity surplus was invested in government securities and NBP bills. Some banks, however, took advantage of the treasury securities market hikes and decided to realize profits through sales of a portion of their papers. In consequence, the treasury bond portfolio shrank (by 6.5%). At the same time, the long lasting treasury bills marginalization trend continued.

Moderate increase in liabilities and significant rise in capitals

Moderate increase in the scale of activities and the appreciation of PLN translated into a limited increase in liabilities of the banking sector in 2012 (by PLN 40.7 billion, i.e. 3.5%; adjusted approx. by PLN 62.3 billion, 5.4%); that increase was lower than the increase in the balance-sheet total. The increase of liabilities was, to the largest extent, a consequence of the increase in household deposits, public sector deposits and issuance of own securities; decrease in liabilities was caused by drop in enterprise deposits. On the other hand, capitals raised up considerably (by PLN 17.7 billion; 13.7%). The above changes contributed to improved stability of funding sources.

Lower increase in the non-financial sector deposits may hamper lending

2012 saw the lowest growth of the non-financial sector deposits within the last few years (PLN 25.4 billion, 3.6%; adjusted approx. PLN 31.4 billion, 4.5%). This growth was bymore than half lower than that realised in 2011. It was the consequence of the first ever since 2004 drop in enterprise deposits (PLN -14.7 billion, -7.1%; adjusted PLN –11.9 billion, -5.9%) and of a reduced growth in household deposits (PLN 38.6 billion, 8.1%; adjusted PLN 41.8 billion, 8.8%).

Lower growth of deposits may be linked with the economic slowdown that contributes to deteriorated financial condition of some enterprises and lowered salary growth. In addition, significant gradual easing of the monetary policy by the Polish Monetary Policy Council caused sizeable decline in deposit interest rates at the end of 2012; that, in turn, may negatively affect the customers' propensity to save and reduce the growth of deposits generated by interest accrued on existing deposits. Furthermore, reduction of the enterprise deposits was also the effect of acquisition of the Canadian company Quadra FNX Mining Ltd by KGHM Polska Miedź S.A.

Lower growth of deposits may be another barrier for lending in subsequent periods although, in 2012, lower nominal growth of loans (material impact of the PLN appreciation) resulted in improved loan to deposit relation of non-financial sector.

Stable level of financial sector deposits and loans and drop in non-resident funds

The level of the financial sector deposits and loans remains stable. In nominal terms, they dropped (PLN –11.9 billion, -4.5%) – it was, however, the result of appreciation of PLN. After the FX adjustment, their level was similar to that reported for the end of 2011 (rise by PLN 0.1 billion, 0.1%).

The reduction of non-resident funds is noticeable (PLN –31.3 billion; -16.6%). As already mentioned above, it was the effect of PLN appreciation (majority of the non-resident funds are in foreign currencies), gradual expiration of the "old portfolio" FX loans, changes in the operational strategy, including changes of the funding structure at some banks and changes in the volume of monetary market transactions carried out by some entities. Reduction of non-resident funds was accompanied by the increase in funds from residents (PLN 19.4 billion, 24.8%).

Growth in public sector deposits and issuance of own securities; however, their role is still limited

Public sector deposits grew considerably in 2012 (by PLN 10.8 billion, 22.1% as compared to 2011), the combined effect of the increase in deposits from the central governmental institutions (outflow of deposits at the end of the year was not so large as in previous years) and of long-term stability of deposits from the local governmental sector. Despite considerable growth, the role of the public sector in financing the banking activities is limited considering their low value and strong concentration.

Issuances of own securities further grew (by PLN 9.9 billion, 23.1% as compared to 2011) although their role at the majority of banks was still insignificant; in addition, they are highly concentrated (more than a half of all issues came from one state bank; by the end of 2012, the issuance of debt papers were carried out by 54 banks; at 10 of them, the value of issuance was PLN 1 billion or higher). Growing importance of this funding source is a positive phenomenon, in particular considering the long- and medium-term nature of funds acquired through this channel (the maturity date of more than 80% of all funds is above 1 year; the maturity date of more than 50% of them is above 5 years) and the limited deposit base growth potential.

Limited decline in foreign funding sources

Predominant component of liabilities are the domestic liabilities (81.9%); at some banks, however, foreign funding plays a significant role. In 2012 liabilities towards non-residents dropped (PLN –24.0 billion, -9.9%; adjusted PLN –10.7 billion, -4.7%), which resulted in their reduced share in the balance-sheet (from 18.7% to 16.2%). Combined with the increased balance-sheet total and increased receivables from non residents, it resulted in reduced negative foreign funding gap (from –13.7% down to –11.3%) and more stable banking sector.

As mentioned above, liabilities towards non-residents dropped for the following reasons: appreciation of PLN, change of the operation strategy and fluctuations in operations at the debt papers and inter-bank market. In particular, some banks changed their strategy in such a manner that they withdrew from selling FX household loans and reduced their dependence on funds from the parent capital groups and focused more on development of local deposit base. In consequence, the demand of those banks for foreign funds falls down. This process is expected to continue in the future.

More than a half of all liabilities towards the non-residents come from entities forming part of the parent capital group. In 2012, as the result of the above factors (not including branches of credit institutions), those liabilities dropped down sharply (PLN –34.6 billion; -23.8%). The maturity of the majority of funds from the parent capital groups is above 1 year (approx. 60%); the large portion of that is long-term funds (maturity of approx. 15% of them is above 5 years). Others are short-term funds, however they are being successively revolved, if needed, by local banks.

Considering the above, the reduction of funds from non-residents cannot be regarded as directly linked with withdrawal of capital from Poland; such phenomenon does not exist and the reasons for observed changes are different. The negative aspect of those changes is, however, that, in the light of limited increase in other funding sources (in particular, deposits from the non-financial sector), reduction of foreign funds may negatively affect lending. Further, any change in funding structure may result in increased funding costs and increased competition at the deposit market (the latter may be regarded as positive considering rapidly falling deposit interest rates as the result of strong monetary policy easing).

Improved balance-sheet currency structure

In 2012 currency assets and liabilities dropped down, correspondingly by –8.2% and –5.2%; their share in the balance-sheet total decreased (correspondingly, to 24.6% and 20.0%). In consequence, the negative currency funding gap fell down to PLN –63.3 billion; their share in the balance-sheet total decreased to –4.7% (at some banks it was much higher). Positive developments were linked with appreciation of PLN, limited issue of new FX household loans (assets) and modified funding structure at some banks (liabilities).

High share of FX assets is explained by high volume of FX household loans (57.5% of all FX receivables) and, to a significantly lesser extent, FX enterprise loans (18.8%). High value of the FX household loans, the majority of which is not, in any way, hedged against the currency risk by borrowers, shows how much risk the banks and their customers took and explains the increased risk of the financial system as a whole.

Increased long-term funding

The long-term funding increased in 2012 (liabilities with maturities above 1 year increased from PLN 168.7 billion to PLN 193.3 billion, of which liabilities with maturities above 5 years from PLN 69.0 billion to PLN

80.7 billion). Their share in the balance-sheet total increased from 13.1% to 14.4%. This was the result of extended liabilities towards the financial sector despite appreciation of PLN which contributes to reduction of long-term FX liabilities (the value of the non-financial sector funds with maturities above 1 year was only PLN 8.4 billion and accounted for 1.2% of total liabilities towards that sector).

On the other hand, the reduced growth in housing lending and appreciation of PLN resulted in stabilised value and reduced share of long-term assets (assets with maturities above 1 year increased from PLN 771.2 billion to PLN 779.5 billion and their share in the balance-sheet total drop down from 58.1% to 56.4%).

Despite positive occurrences in 2012, large disproportions in terms of maturities of assets and liabilities clearly show that the long-term lending has been based on short-term deposits, the effect of which being the increased liquidity risk. The basic reason for those disproportions is the rapid growth in housing loans in recent years. Funding in this case was based on short-term deposits from the non-financial sector and funds from foreign parent companies (largely short-term as well, however successively revolved), and, only to a small extent, on long-term liabilities. Therefore it is necessary that banks increase the share of long-term stable funding sources.

Stabilised volume of the off-balance sheet transactions

Moderate growth in the scale of operations, small fluctuations in interest rates and limited fluctuations of PLN resulted in stabilisation of the off-balance sheet operation volume (in 2012, the value of funding-related exposures increased by 0.7% up to PLN 202 billion, the value of guarantees granted increased by 10.5% up to PLN 55.9 billion and the nominal value of derivative transactions dropped by 2.1% down to PLN 1,975.9 billion).

Higher risk of the banking sector operations will sustain in subsequent periods

Steep slowdown of the Polish economy and deteriorated perspectives as regards its future growth

In 2012 the Polish economy experienced a steep slowdown and perspectives as to its growth in the future deteriorated (in 2012 the GDP growth was 1.9%, as compared to 4.5% in 2011; the Polish economy slowed down progressively quarter by quarter; in subsequent quarters the slowdown was, correspondingly: 3.5%; 2.3%; 1.3% and 0.7%). Worth noticing in this regard is deteriorated enterprise financial results and labour market situation, reflected in, among others, increased unemployment rate and reduced, first time for many years, real wages. Slowdown was mainly caused by the economic slowdown abroad, tightened fiscal policy and reduced absorption of the EU funds (in particular, the EU Structural Funds). At the same time, as the result of the economic slowdown abroad and the necessity to further consolidate the public finances, the growth outlook for the Polish economy deteriorated (according to the projections from the National Bank of Poland, the economic growth in Poland in 2013 will be 1.3%, in 2014: 2.6%, and in 2015: 3,1%; according to the projections from the Polish Ministry of Finances, it will be, correspondingly, 1.5%; 2.5% and 3.8%). Large uncertainty as to projecting the future developments is emphasised.

Negative pressure from external environment

Polish economy downturn and worsened economic outlook in the coming periods, coupled with recurring severe disturbances in certain areas of financial markets, cause the banks to face a number of potential threats. In particular, banks need to take into account declining financial standing of some borrowers which will adversely impact on the quality of lending portfolio and financial results. Another considerable pressure on the banks' financial results will be from rapidly falling interest rates. That the support provided by the parent capital group members will be limited, that periodical liquidity management problems will occur and that the reputation risk domino effect will be triggered cannot be ignored either.

Accordingly, despite stable and sound current situation, the risk of banking sector operations remains high.

EXTERNAL CONDITIONS[1]

Strong deceleration in the economic growth
Drop in real salaries (for the first time within more than 10 years)

In 2012 the Polish economy strongly decelerated and the economic growth outlook for the future periods deteriorated. The annual real growth of GDP was 1.9% in 2012 (as compared to 4.5% in 2011); the Polish economy slowed down progressively quarter by quarter; in subsequent quarters the slowdown was, correspondingly, 3.5%; 2.3%; 1.3% and 0.7%).

The economic slowdown was mainly caused by reduced internal demand (from positive 3.4% in 2011 to negative -0.2% in 2012); the positive impact of net export continued. Drop in the domestic demand was the effect of considerable reduction in accumulation (from 11.2% down to –3.3%, including reduction in gross expenses on non-current assets and reduction of inventories) and reduction of total consumption (from 1.6% to 0.6%, including reduction of individual consumption from 2.6% down to 0.8% and stagnation in public consumption). Slowdown in investments was caused by reduced growth of enterprise and household investments as the result of deteriorated economic growth outlook (the same factors caused reduction in inventories) and limited public investments in connection with the need to reduce the public finance deficit. Reduction of the individual consumption growth was a consequence of diminished income available to households which, in turn, was the effect of deteriorated labour market conditions, slowdown in household lending and negative consumer sentiment. Stagnation in the public consumption was linked with actions aimed at reduction of the public finance deficit.

The following phenomena were observed in 2012:

- sold industrial output grew at a much slower pace (from 7.5% in 2011 to 0.9% in 2012); construction-assembly output dropped (from 12.3% down to -1.0%);
- retail sale grew at a slower pace (from 3.2% down to 0.8%);
- foreign commercial trade grew at a slower pace (the export in PLN grew by 6.9%, in EUR by 3.8%; the import, correspondingly, by 2.4% and –0.6%) which was followed by reduced negative commodities turnover balance and improved relation of that balance to GDP (from –4.2% to –2.6%);
- reduced net financial result of the enterprise sector[2] (by 21.0%) and deteriorated key financial and economic ratios (the C/I ratio went up from 94.6% to 95.8% and the first grade liquidity ratio fell from 38.1% to 34.1%, among others);
- deteriorated labour market condition reflected in reduced growth of the employment rate (the average employment rate in 2012 at the enterprise sector was by 0.1% higher than in 2011), reduced growth in salaries (the average monthly gross salary at the enterprise sector increased by 3.4%, however, the purchasing power dropped down, first time for more than ten years, by 0.1%) and the increased unemployment rate (the registered unemployment rate grew up from 12.5% as at the end of 2011 up to 13.4%). On the other hand, the value of social benefits grew (the average gross monthly old-age and disability pension from non-agriculture social security system increased by 5.4% (or, by 1.3% in real

[1] For more details see: "Social and Economic Situation of Poland" Central Statistical Office; "Report on Inflation", National Bank of Poland; "The Convergence Programme", the Polish Ministry of Finance", "Report of Financial System Stability", National Bank of Poland; "Gross Domestic Product" Preliminary Estimates", Central Statistical Office; "Foreign trade in total and per Country", Central Statistical Office; "Financial Results of Non-financial Companies", Central Statistical Office; "Polish Monetary Policy Council Communication", National Bank of Poland; "Residential Construction Industry", Central Statistical Office; "Apartment Prices and Condition of the Polish Housing Real property Market", National Bank of Poland; "Monthly Bulletin", ECB

[2] These data concern 17594 business entities which maintain accounting records and employ 50 persons or more.

terms), the average gross monthly old-age and disability pension for individual farmers increased, correspondingly, by 6.9% and 2.8%);
- inflation dropped down (CPI from 4.6% to 2,4%; PPI from 9.0% to −1.7%); the increased inflation pressure maintained for almost the whole year, it dropped down only at the end of the year.

According to the National Bank of Poland, the main factors that affected the economic growth was the economic slowdown abroad, tightened fiscal policy and reduced absorption of the EU funds, in particular, the EU Structural Funds (according to the National Bank of Poland, the economic slowdown in the Eurozone negatively affects the economic growth in Poland, delayed by approx. 2 quarters; at the same time, it results in the increased aversion of the domestic entities to take risk and to invest). The economic slowdown was also partly caused by limited consumer expenses by households resulted from deteriorated labour market condition and their inability to maintain consumption at the cost of reduced saving rate.

A similar assessment has been proposed by the Ministry of Finance which sees the deteriorated economic growth at the exporting markets and relatively restrictive microeconomic policy (the fact resulting from the necessity to consolidate the public finances) and restrictive monetary policy (oriented towards reduction of inflation phenomena and expectations) as the main reasons for the economy downturn.

Stable condition of public finances

Despite progressive economy downturn, public finances remained stable. The government and self-government institution deficit dropped down[3] (from −5.0% GDP in 2011 down to −3.9% GDP in 2012), the national public debt and the government and self-government institution debt augmented (correspondingly, by 3.1% up to PLN 842.7 billion and by 3.2% up to PLN 886.8 billion); their share in GDP dropped down (the national public debt, calculated using the domestic methodology, dropped down from 53.4% down to 52.7%; the government and self-government institution debt calculated using the ESA95 methodology dropped down from 56.2% down to 55.6%), a partial effect to the appreciation of PLN. The ratings for Poland remained stable as well (long-term debt in foreign currencies: Standard & Poor's A-; Moody's A2, Fitch A-). Remarkable in this regard is the low increase in tax incomes (by 2.1% higher than in 2011 and by 6.2% lower than assumed for 2012).

Relatively good condition of the public finances and high demand for Polish treasury securities from the foreign investors enabled the Ministry of Finances to quickly realize the loan needs for 2012 and to start to collect funds for 2013.

[3] In 2012, the structure of the fiscal adaptation changed (as compared to 2011). The fiscal consolidation was carried out by now mainly through increased taxes and limited current expenses, in large part supplemented in 2012 with reduction in public investments (both at the central level and at the self-government institutions). At the same time, the reduced economic growth (and, as the result, indirect tax incomes lower than expected), higher current expenses and lower incomes from capital transfers prevented the reduction of the government and self-government institution deficit (down to 2.9% of GDP in 2012) as assumed in the "Convergence Programme" (revised in 2012).

Deteriorated growth perspectives for the Polish economy

The deteriorated growth outlook for the Polish economy are reflected in low projections as to its development in the nearest years. According to the projections from the National Bank of Poland, comprised in the so called central inflation and GDP prognosis path ("Inflation and GDP prognosis" – March 2013), the growth of the Polish economy in 2013 will be 1.3% and it will accelerate up to 2.6% in 2014 and 3.1% in 2015. According to the projections from the Ministry of Finance ("Convergence Programme" – update of 2013), the GDP growth in 2013 should be 1.5%, and later on it should accelerate to 2.5% in 2014 and to 3.8% in 2015.

Less favourable are projections from the European Commission (revised in spring 2013) which expects that the growth of the Polish GDP in 2013 and 2014 will be, correspondingly, 1.1% and 2.2%.

Continued correction of prices at the real property market

Prices at the real property market continued to fall down (in Q4 2012 the average transaction prices at the primary and secondary markets were by 9.7% and 7.4% lower as compared to Q4 2011). This was, however, strongly affected by the fact of closing the Rodzina na Swoim "Family on Its Own" Programme which resulted in higher supply of cheaper flats, the price of which was within the limits of the Programme. The reduction of the transaction prices was also the effect of the supply exceeding the demand, limited demand considering deteriorated economic growth outlook (one of the effects is the increased aversion to take long-term debts), some demand reduction expecting better selling prices (a mechanism opposite to that in the economic boom), tightened lending policy of banks and gradual satisfaction of the housing needs from households[4].

The price correction observed in recent years, combined with increased salaries, results in gradual improvement of the relation of the average flat price to average salary and, therefore, to increased availability of flats for average households. Better adaptation of the average real property prices to the average household incomes translates into limited risk in connection with granting new loans.

The number of commissioned flats increased (by 16.4%). On the other hand, the number of flats whose construction has just begun and the number of the construction permits dropped down, correspondingly, by 12.6% and 10.3%). It was, however, connected with relatively high availability of flats (including the non-sold flats)[5] and high number of flats under construction (713.1 thousand), close to record-breaking levels.

[4] In Q4 the number of primary market transaction rised sharply (up to 8.4 thousand), similar to that of the economic boom of 2007-2008. In large part it was connected, however, with the expiration of the "Rodzina na Swoim" Programme (see "Residential Market in Poland", REAS).

[5] According to REAS data, in Q4 2012, for 6 main markets analysed (Warsaw, Kraków, Łódź, Wrocław, Trójmiasto and Poznań) there were 54 thousand apartments on developers' sale offer, out of which 15 thousand were ready for commissioning – see: "Housing Market in Poland", REAS [in Polish: „Rynek mieszkaniowy w Polsce", REAS].

Situation at the financial markets was shaped mainly by developments in the Eurozone and in the USA and by the EBC and FED activities

The financial market situation in 2012 still characterised by fluctuations in the investor sentiments and, in consequence, fluctuations in valuations of particular asset classes. Three periods can be distinguished: January-February (improved investor sentiments), March-May (deteriorated investor sentiments) and June-end of the year (the investor sentiments improved once again). Improved sentiments translated into higher demand for risky assets and their increased prices; deteriorated sentiments translated into increased sale of such assets and drop in their prices.

The key factors affecting the investment decisions was the continued crisis in the Eurozone (in particular in Greece and in Spain), negative data from the world biggest economies (the Eurozone, USA, China) and specific activities of the central banks. The key importance in this regard were the decisions taken by the most important central banks which decided to continue a strongly expansive monetary policy, the fact reflected in maintaining historically-lowest interest rates and maintaining, or expanding, the liquidity support programmes and the so called "quantitative easing" programmes[6].

Situation at the domestic financial market is relatively stable
Steep drop in government securities yield

The situation at the domestic financial market is relatively stable, however, the PLN and share market were under continuous influence of sentiments at the global markets. The following has to be noted:

- tightening and then loosening of the monetary policy (in May, the Polish Monetary Policy Council decided, considering continued inflation pressure, to increase the base NBP rates by 25 base points; in November and December, it decided to further reduce them, each time by 25 base points (as a consequence of large economic slowdown in Poland) which, according to the Council, lead to reduction of the salary and inflation pressure);
- drop in the inter-bank market interest rates (the average WIBOR 3M rate dropped from 4.9% in December 2011 down to 4.2% in December 2012); they slightly increased in the middle of the year as a consequence of tightening the monetary policy. At the same time, the FRA quotations suggested further reductions in the interest rates – as expected by the market participants (in December 2012 the average FRA 6x9 quotations were at 3.2%);
- steep drop in profitability of government securities (the average profitability of 2-; 3-; 5- and 10-year T-bonds at the secondary market fell down from 4.9%; 5.1%; 5.3%; 5.9% in December 2011 down to 3.2%; 3.3%; 3.3%; 3.9% in December 2012). This was, to a large extent, the effect of the increased activity of the foreign investors at the domestic government securities market (from PLN 154.2 billion at the end of 2011 up to PLN 190.5 billion at the end of 2012, i.e 35.7% of their total value) – they looked for instruments with high rating which ensures relatively high rates of return. This phenomenon is positive for the Polish economy, however it generates higher risk linked with the likelihood of withdrawal of a

[6] In particular, EBC carried out a second LTRO transaction (the aim of which was to increase the liquidity of banks) and announced the OMT programme (which assumes unlimited purchase of T-bonds at the secondary markets), FED introduced LSAP 3 (a programme for purchasing the securitised securities where base assets are mortgage loans, later on expanded to the purchase of T-bonds) – more information, see "Report on Inflation", National Bank of Poland.

portion of capital, the fact that would result in a steep increase in profitability of government securities and depreciated PLN. Therefore, it is of key importance to ensure the long-term creditworthiness and stability of the financial system of Poland. On the other hand, noticeable is diminished volume of papers held by the Polish banks. They benefited from the increased prices to realize a portion of profits (from PLN 120.2 billion down to PLN 98.6 billion);

- PLN appreciated versus main foreign currencies (as at the end of 2012 the average NBP exchange rate of 1 EUR, 1 CHF and 1 USD was, correspondingly, 4.0882; 3.3868; 3.0996, as compared to 4.4168; 3.6333; 3.4174 as at the end of 2011);
- reduced deposit interest rate (from 4.4% in December 2011 down to 4.0% in December 2012) and loan interest rate (from 8.0% down to 7.8%)[7]. At the beginning of the year, the interest rates were stable, then, in the middle of the year they went up slightly. They dropped only as the result of changes made at the end of the year. At the individual customer group and product level, interest rate changes made by the banks varied in terms of orientation and scale (worth noticing in this regard is the increased interest rate of consumer loans);
- share market prices became higher (as at the end of 2012 the WIG, WIG 20, mWIG40, sWIG80 and WIG Banki ratios were higher, correspondingly by: 26.2%; 20.4%; 17.4%; 22.9%; 22.6% as compared to the end of 2011; at the main market, the value of shares of 234 issuers went up and the value of shares of 230 issuers went down). Worth noticing is reduced turnover (including very low liquidity in turnover in papers of small and medium enterprises) and reduced share of individual and domestic institutional investors. One of the reasons for low turnover in papers of small and medium enterprises at the Warsaw stock exchange is the excessive growth in the number of issuers (often ”weak” and insufficiently transparent) that took place in recent years (excessive size of the market as compared to the size of the economy as a whole).

Difficult external conditions result in higher risk of banking sector operations

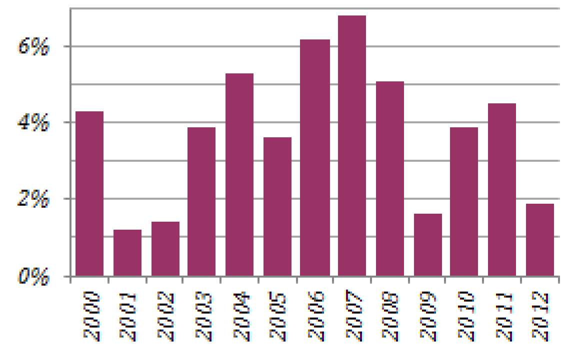
Economy downturn in Poland and worsened economic outlook in the coming periods, coupled with debt crisis of certain Eurozone member states, global economy downturn and recurring severe disturbances in certain areas of financial markets, cause the banks to face a number of potential threats. In particular, banks need to take into account declining financial standing of some borrowers which will adversely impact on the quality of lending portfolio and financial results. Another considerable pressure on the banks' financial results will be from rapidly falling interest rates. That the support provided by the parent capital group members will be limited, that periodical liquidity management problems will occur and that the reputation risk domino effect will be triggered cannot be ignored either.

Accordingly, despite stable and sound current situation, the risk of banking sector operations remains high.

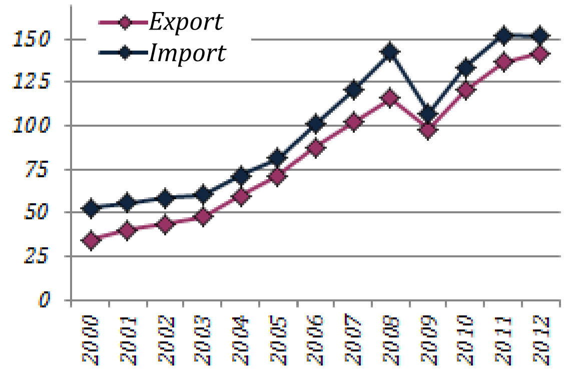
[7] The average interest rate on new household deposits and enterprise deposits (OPN approach) decreased, correspondingly, from 4.7% to 4,2% and from 4.3% to 4,0%. The average interest rate on newly granted consumer loans, housing loans and enterprise loans changed, correspondingly, from 15.2% to 16.0% (the real interest rate increased from 21.3% to 22.2%), from 7.0% to 6.6% (the interest rate decreased from 7.4% to 7.1%) and from 6.6% to 6.2%.

Selected characteristics of the microeconomic and financial market situation

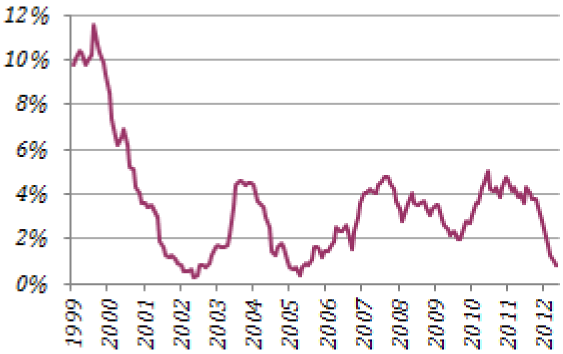
GDP (real)



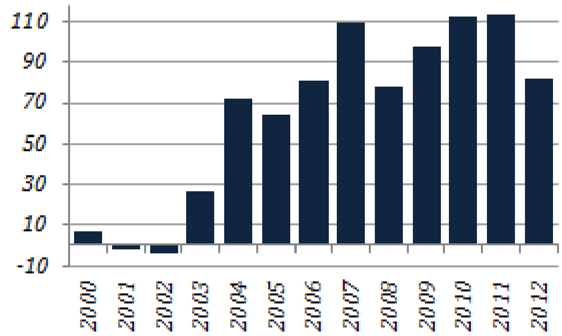
International trade (EUR billion)



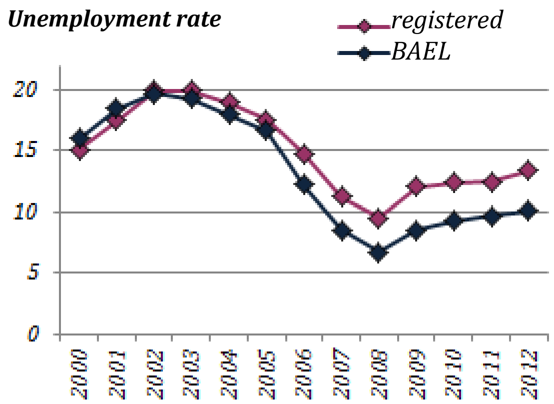
CPI



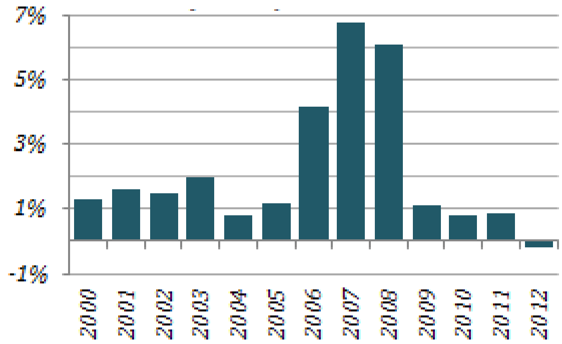
Financial results of enterprises (PLN billion)



Unemployment rate

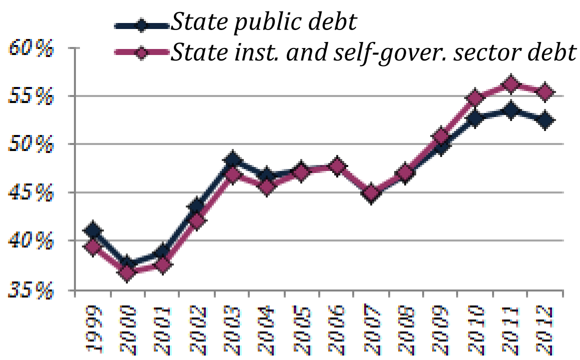


Increase of real salaries in the enterprise sector



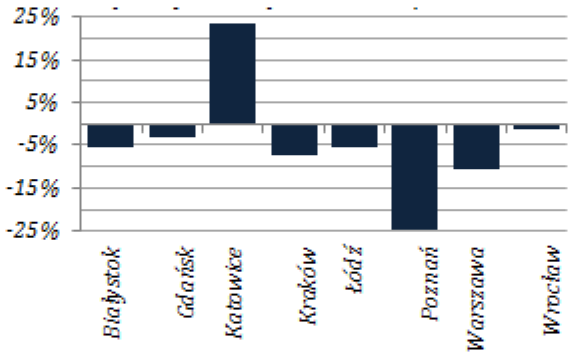
State institution and self-government sector deficit / GDP

Public debt / GDP

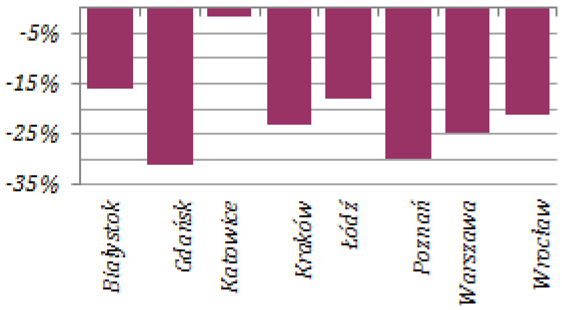


Source: GUS

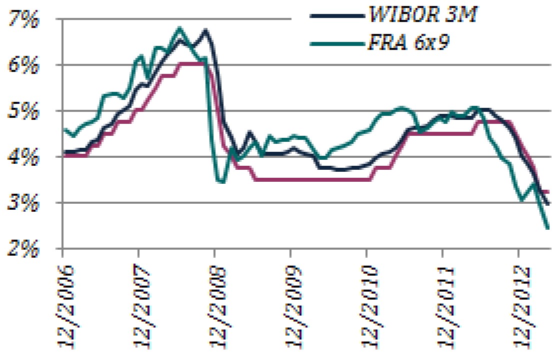
Changes in transaction prices of flats at the primary market – IV 2012 / IV 2011



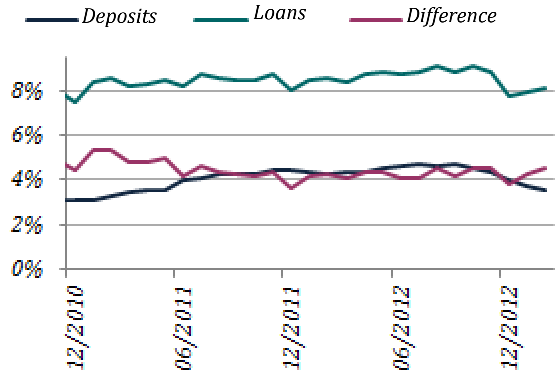
Changes in transaction prices of flats at the primary market since the beginning of the economic boom



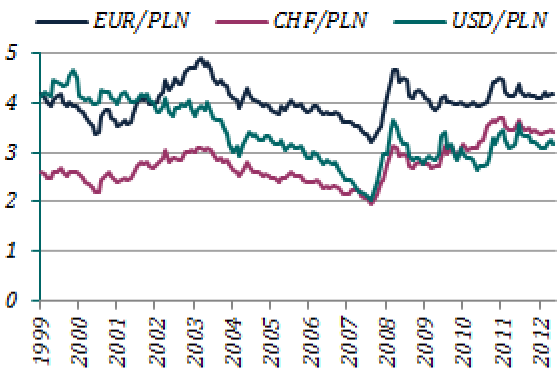
Interest rates



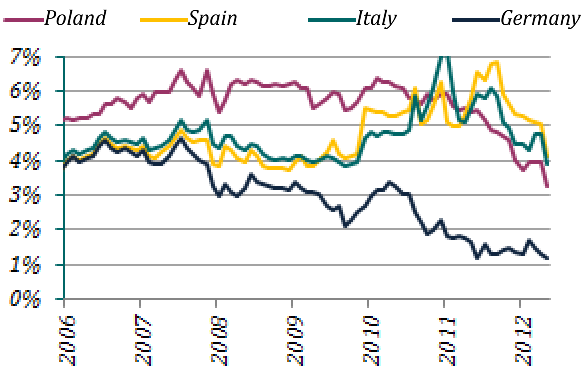
Banking interest rate (OPN)



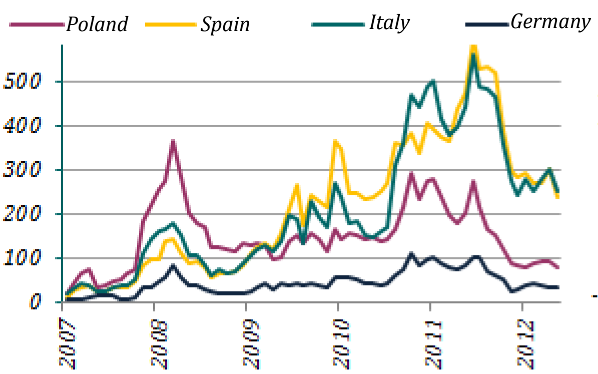
FX rates



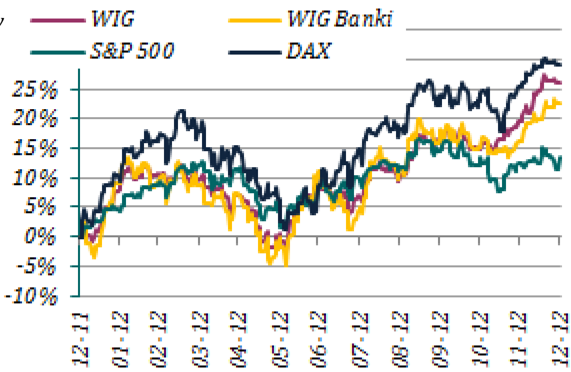
State bonds yield (10Y)



CDS quotations



Changes of indexes in 2012



Source: NBP, Bloomberg

1. BANKING SECTOR STRUCTURE AND THE ROLE OF BANKS IN THE ECONOMY

Long-term stability of the banking sector structure

Despite changes in individual periods, the banking sector characteristics show that the banking sector is table in the long term.

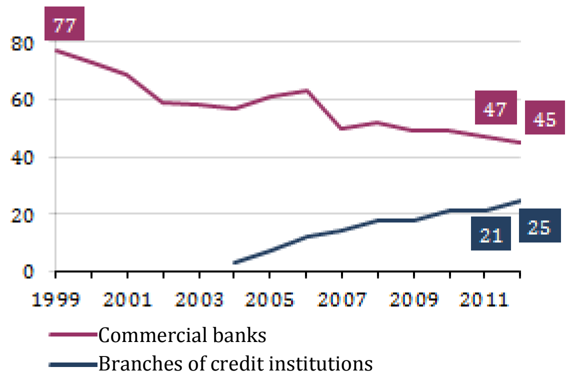
Table 1. Selected ratios describing the sector structure

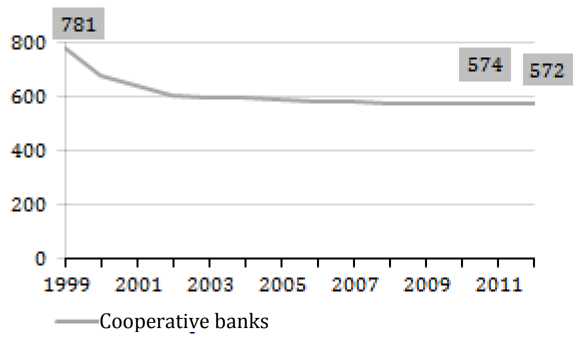
	2008	2009	2010	2011	2012
Number of entities dealing with banking operations	649	643	646	642	642
- commercial banks	52	49	49	47	45
- branches of credit institutions	18	18	21	21	25
- cooperative banks	579	576	576	574	572
Employment	181 114	175 249	176 916	176 658	175 087
Number of banking establishments[8]	13 655	13 910	14 207	13 921	15 430
Share in the sector assets					
- banks controlled by domestic investors	27.7%	31.9%	33.8%	35.0%	36.4%
- banks controlled by foreign investors	72.3%	68.1%	66.2%	65.0%	63.6%
Share in the sector assets					
- of the 5 largest banks	44.6%	44.3%	43.9%	44.3%	46.0%
- of the 10 largest banks	62.5%	63.6%	63.1%	63.4%	64.6%

The number of entities dealing with banking operations has not changed

In 2012 Polbank EFG S.A. merged with Raiffeisen Bank Polska S.A. (the merged bank become one of the 10 largest banks), Getin Noble Bank S.A. merged with Get Bank S.A.; other two mergers took place in the cooperative bank sector. On the other hand, 4 new branches of credit institutions opened up. As a consequence, the number of entities dealing with banking operations has not changed.

Chart 1.
The number of banks and branches of credit institutions





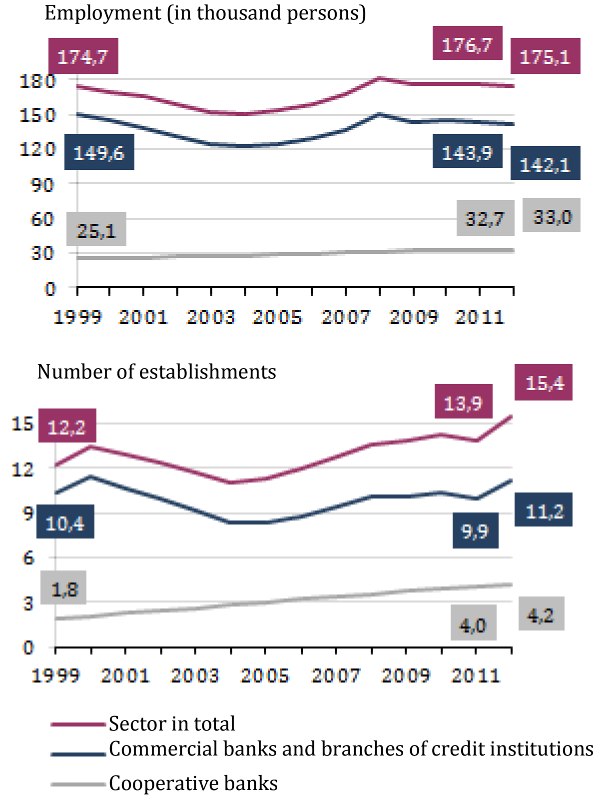
8 Note: data as at the end of 2012 are not fully comparable with other periods as they also include the so called partner establishments; the partner establishments were not included in previous reports

Reduced employment, stable sales network

Following the recent decelerated growth of the banking sector and unfavourable phenomena in the banking sector environment, some banks decided to improve the efficiency through optimisation of the employment and the sales network. In consequence, the employment in the banking sector dropped by 1.8 thousand persons but the sales network remained unchanged when compared to 2011.

The situation was not, however, uniform for all banks, some of them reported the increased employment and the increased number of sales establishments.

Chart 2.
Employment and the sales network

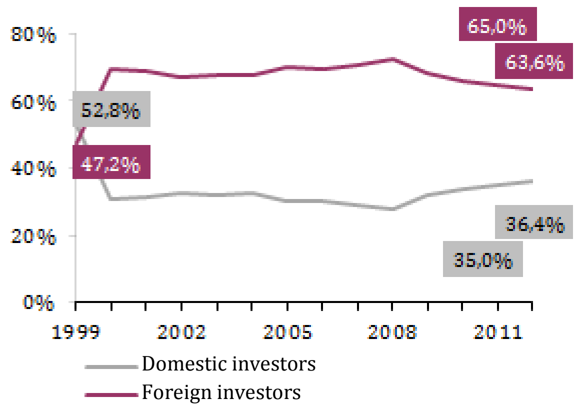


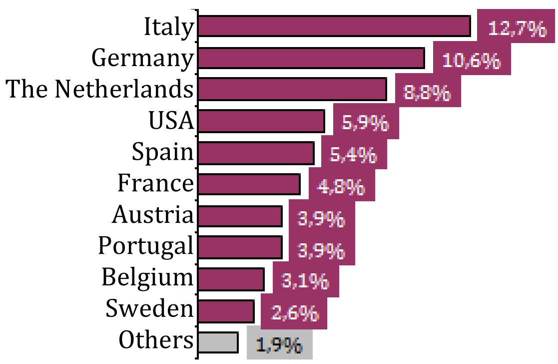
Gradual rise in the number of banks controlled by domestic investors

Share of banks controlled by domestic investors further increased in the total assets of the sector.

As at the end of 2012, the domestic investors controlled 9 commercial banks and all cooperative banks (the Treasury of State controlled 4 commercial banks); the foreign investors controlled 36 commercial banks and all branches of the credit institutions. Controlling interest was held by investors representing 19 different countries, the majority of them being from Italy, Germany and the Netherlands.

Chart 3.
Ownership structure (share in the sector assets)





Slight rise in concentration

The banking sector concentration remains stable, however, in 2012 the share of the largest banks in the total sector assets increased, the fact related with mergers mentioned above and relatively large increase of the scale of operations of some large banks.

Chart 4.
Sector concentration

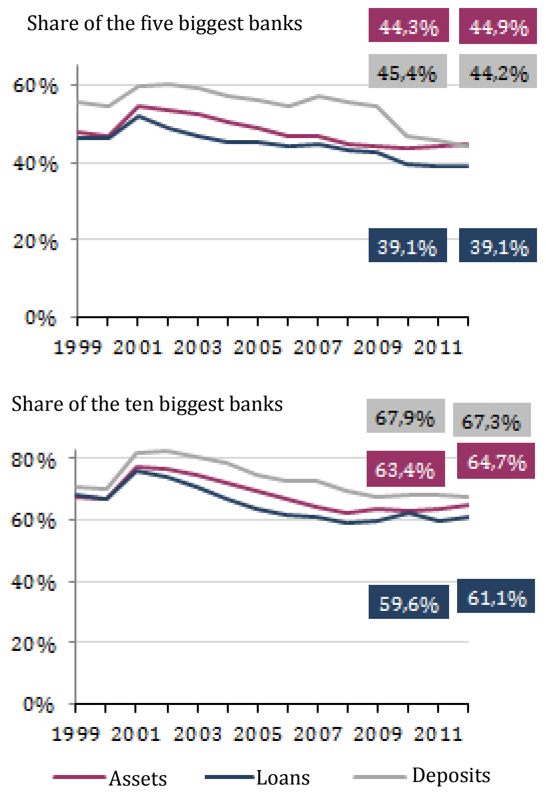


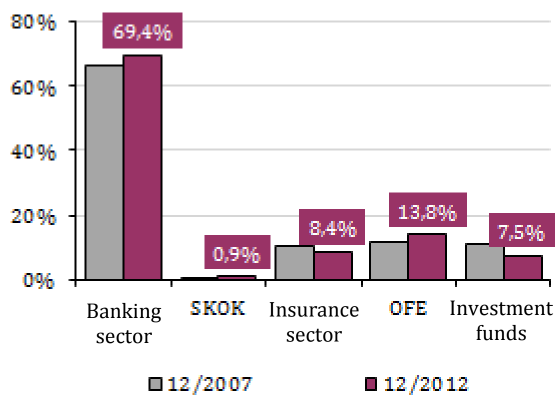
Table 2. Assets of the financial system in years 2008-2012

	Value (PLN billion)					Change to 2011	
	2008	2009	2010	2011	2012	PLN bn	%
Financial sector in total, including:	1 394.9	1 480.5	1 660.1	1 795.1	1 948.1	153.1	8.5%
- banking sector	1 035.4	1 057.4	1 159.4	1 294.6	1 352.9	58.4	4.5%
- SKOK	9.4	11.6	14.0	15.2	16.9	1.7	11.1%
- insurance sector	138.0	139.1	145.2	146.2	162.9	16.7	11.4%
- OFE	138.2	179.0	221.5	224.7	269.6	44.9	20.0%
- investment funds	73.9	93.4	120.1	114.4	145.8	31.5	27.5%

The key role of banks for ensuring stability of the financial system

In 2012 the value of assets of the financial system (excluding NBP) approached PLN 2 billion, 70% of which concerned the banking sector. The value of the assets of the largest banks was similar or higher than the assets reported for other segments. The above means that the stability of the banking sector is of key importance for the stability of the whole financial system.

Chart 5.
Financial system structure



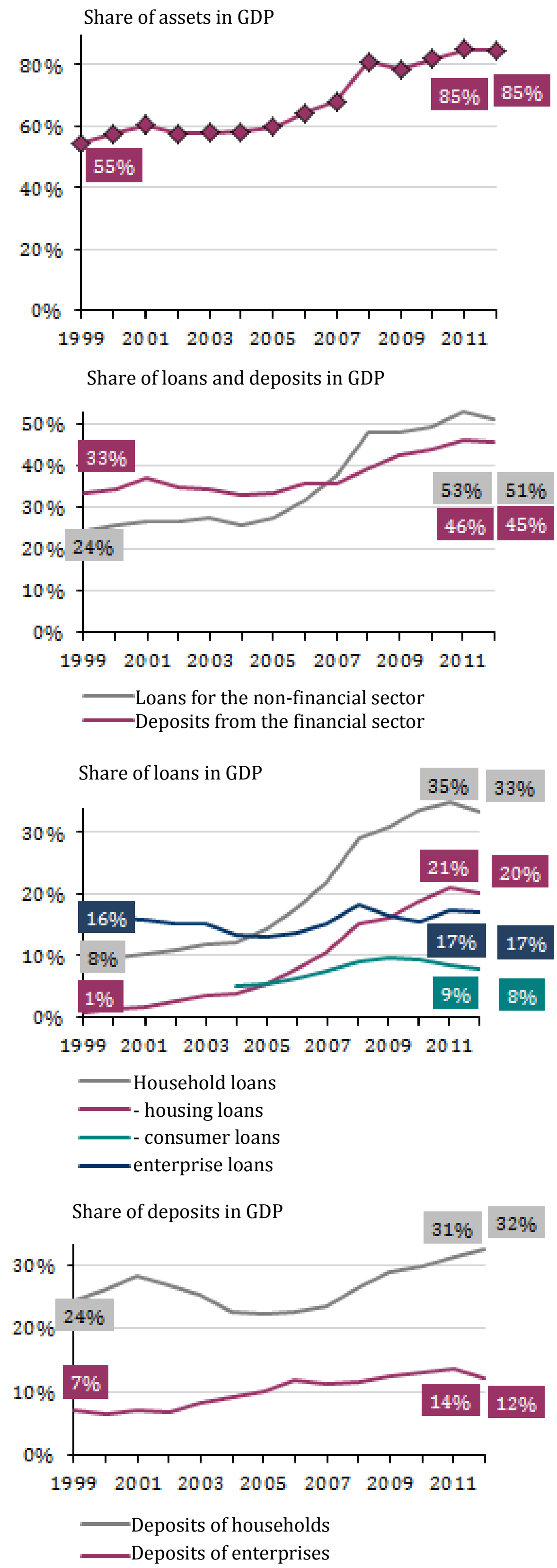
Growing importance of the banking sector in the economy

The role of banks in the economy grows systematically, the fact confirmed, among others, by the increasing share of the sector assets in the GDP (from 55% in 1999 up to 85% in 2012).
Noticeable in this regard is the increase of the share of household loans (from 16% up to 33%), in particular of the housing loans (from 1% up to 20%) and of the household deposits (from 24% up to 32%) and enterprise deposits (from 7% up to 12%). Another noticeable phenomenon is long-term stability of the share of enterprise loans (15%-17%).

Share of household loans and enterprise deposits in GDP dropped slightly in 2012

The share of household loans and enterprise loans in GDP slightly dropped in 2012 (drop in share of consumer loans has been observed since 2010). This is the consequence of decelerated growth of the sector, appreciation of PLN (resulting in lowered PLN value of the balance-sheet items reported in foreign currencies) and reduced enterprise deposits.

Chart 6.
Role of the banking sector in the economy



2. CAPITAL POSITION

The capital position of the banking sector is strong

The capital base strengthened considerably and the main capital adequacy measures improved in 2012.

Table 3. Capital adequacy

	Value (PLN billion)				Change to 2011	
	2010	2011	09/12	2012	PLN bn	%
Equity	100.6	110.7	126.4	128.8	18.1	16.4%
Total capital requirement	58.2	67.6	72.0	70.0	2.3	3.5%
- credit risk	50.9	59.7	62.6	60.8	1.1	1.8%
- operational risk	6.1	6.4	6.6	6.5	0.1	2.2%
- other risks	1.2	1.5	2.9	2.6	1.1	74.4%
Equity surplus / shortage	42.4	43.1	54.3	58.9	15.8	36.7%

Strong equity growth

The equity rose sharply in 2012 (by PLN 18.1 billion, i.e. by 16.4%); the equity growth was twice higher than the balance-sheet total growth. To the large extent, it was the consequence of implementation of recommendations from the Chairman of the Polish Financial Supervision Authority who, considering the risk accumulated in the banks' balance-sheets and difficult external conditions, defined principles for distribution of profits of 2011 by the banks. In consequence, 72% of profits were retained by the banks to increase the bank capitals (commercial banks: 70%, cooperative banks: 95%).
Capitals further increased as the result of recapitalization of some banks.

As at the end of 2012, all banks satisfied the minimum capital requirement (commercial banks: EUR 5 million, cooperative banks: EUR 1 million).

Chart 7.
Capital adequacy

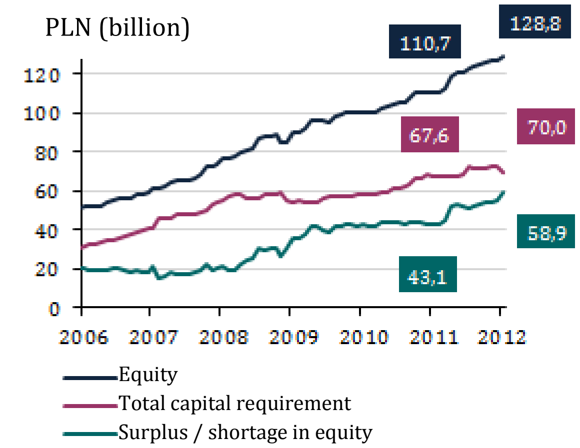
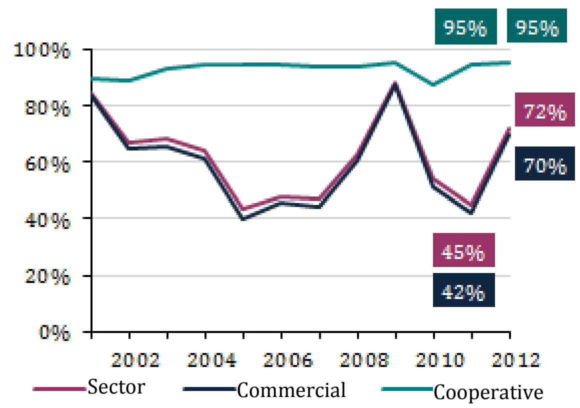


Chart 8.
Distribution of profit of previous year – share of retained profit



Relatively low increase of the capital requirement

Growth of the total capital requirement in 2012 was relatively low (PLN 2.3 billion, 3.5%). This was the consequence of the low increase in the credit risk capital requirement (PLN 1.1 billion, 1.8%) being the main item of the capital requirements. This, in turn, was the effect of slowdown in lending and PLN appreciation which effected a lower requirement for FX loans.

In the context of the credit risk capital requirement, it must be noted that in June 2012 the risk weight was increased (from the preferential level of 75% up to the base level of 100%) for retail exposures and housing mortgage-backed exposures wherefore the principal or interest rate is driven by FX rates for the currencies other than the ones of debtor's income. Capital requirements were raised so as to make banks more resilient to the risk of FX household loans.

The increased capital requirements for other risk categories was also limited, although the significant growth in the capital requirement for other risks was caused by a changed method of the credit risk measurement at one of large banks (for the duration of the implementation of the new model, the difference between the standard method previously applied by the bank and the current advanced method is reported in other capital requirement item).

Considerable growth of the equity surplus over the total capital requirement

The considerable growth of equity accompanied by limited total capital requirement increase translated into higher equity surplus over the total capital requirement (from PLN 43.1 billion to PLN 58.9 billion).

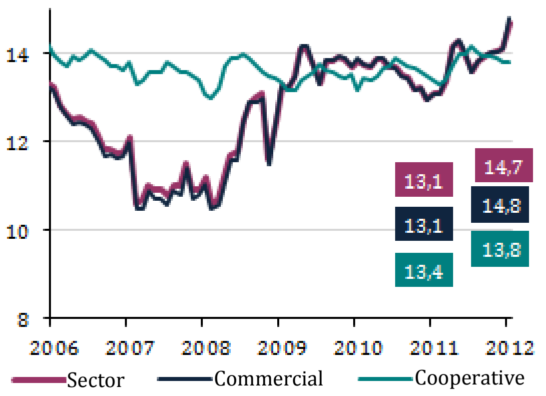
Table 4. Solvency ratio and Tier 1 ratio

	Solvency ratio (%)				Share in the sector assets (%)			
	2010	2011	09/12	2012	2010	2011	09/12	2012
Solvency ratio (CAR)								
Sector	13.8	13.1	14.0	14.7				
Commercial banks	13.9	13.1	14.0	14.8				
Cooperative banks	13.2	13.4	13.9	13.8				
Bank distribution by solvency ratio								
Below 8%	2	-	-	-	0.1%	-	-	-
8-10%	28	28	20	15	7.4%	8.5%	4.2%	0.5%
10-12%	115	120	92	99	25.4%	35.8%	14.0%	9.5%
12% and more	480	473	507	503	62.4%	53.5%	79.8%	88.0%
Tier 1 ratio								
Sector	12.4	11.7	12.7	13.1				
Commercial banks	12.5	11.6	12.6	13.1				
Cooperative banks	12.4	12.6	13.1	13.0				

Considerable growth of CAR and Tier 1

The consequence of the above changes was a considerable growth of the solvency ratio (from 13.1 to 14.7) and of the Tier 1 ratio (from 11.7 to 13.1).

Chart 9.
Solvency ratio (CAR)

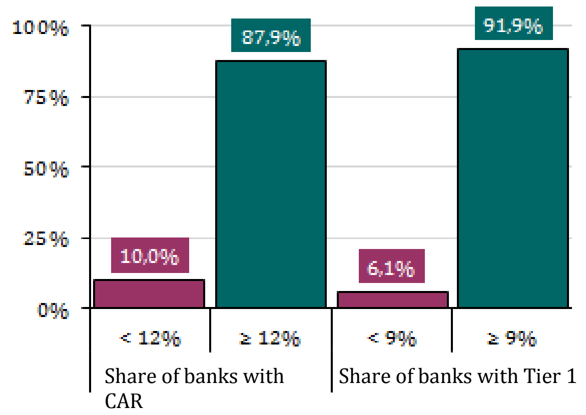


Limited share of banks with CAR < 12% and Tier 1 < 9%

The strong capital position of the banking sector is reflected in the fact that only a small number of banks has the solvency ration of less than 12% or Tier 1 less than 9%.

As at the end of 2012, the solvency ratio of only 7 commercial and 107 cooperative banks was below 12% and their total share in sector assets was only 9.9%. At the same time, the Tier 1 ratio of only 5 commercial and 18 cooperative banks was below 9% and their share in the sector assets was only 6,1%.

Chart 10.
The banking sector structure in terms of CAR and Tier 1



Further consolidation of the capital base recommended

Although the current situation is sound, banks are recommended to maintain a strong capital base. Simultaneously, some of them should further strengthen it due to the risk accumulated in their balance sheets as well as difficult external conditions which may trigger disturbances on the financial markets and deterioration of the clients' creditworthiness.

Considering the above, the PFSA issued recommendations (to banks and other supervised institutions) as to distribution of profit for 2012.

3. LIQUIDITY POSITION

The current liquidity position is good

The current liquidity position is good. Still, further actions to stabilise funding sources prove indispensable.

Table 5. Selected liquidity ratios

	Value (PLN billion)				Change to 2011	
	2010	2011	09/12	2012	PLN bn	%
Primary liquidity reserve	276.2	294.0	293.4	301.0	6.9	2.4%
Supplementary liquidity reserve	119.6	148.5	148.1	142.6	-6.0	-4.0%
Unstable third-party funds	253.4	302.3	298.6	286.6	-15.6	-5.2%
Liquidity coverage ratio gap	142.4	140.3	142.9	156.9	16.6	11.8%
Liquidity coverage ratio	1.56	1.46	1.48	1.55	x	x
Stable third-party funds	794.1	889.0	897.6	913.8	24.8	2.8%
Loans for non-financial sector	664.9	764.3	774.4	771.2	7.0	0.9%
Deposits of non-financial sector	620.4	698.6	695.7	724.0	25.4	3.6%
Deposit surplus/ shortage	-44.6	-65.7	-78.7	-47.3	18.4	-28.0%
Loan to deposit ratio	107.2%	109.4%	111.3%	106.6%	x	x

The base liquidity ratios are satisfactory and stable

The base liquidity ratios were relatively stable and satisfactory.

At the end of 2012 the positive liquidity gap increased up to PLN 156.9 billion and the liquidity coverage ratio increased up to 1.55, both the effect of reduced unstable third-party funds.

Chart 11.
Selected liquidity ratios

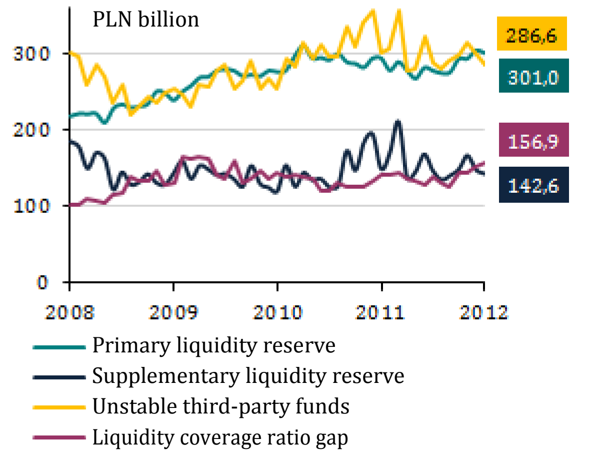


Chart 12.
Liquidity coverage ratio

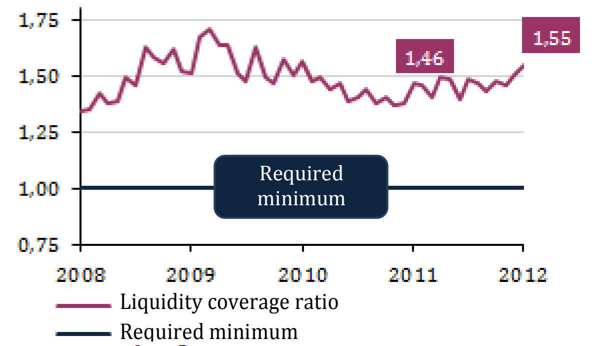


Table 6. Number of entities not satisfying PFSA Resolution No. 386/2008 as at the period end

	Number of entities not satisfying PFSA Resolution No. 386/2008				Share in sector assets			
	2009	2010	2011	2012	2009	2010	2011	2012
January	11	5	3	2	2.7%	0.2%	0.0%	0.1%
February	8	7	1	6	0.4%	0.7%	0.0%	0.3%
March	10	7	1	1	4.7%	0.2%	0.0%	0.1%
April	15	8	3	2	0.3%	0.7%	2.1%	0.2%
May	12	5	1	4	0.7%	0.1%	2.1%	0.2%
June	13	10	4	1	0.3%	0.2%	2.1%	0.0%
July	8	6	3	2	0.2%	0.1%	2.1%	0.0%
August	13	7	-	1	0.3%	0.2%	-	0.0%
September	14	6	5	3	0.4%	0.2%	0.1%	0.0%
October	15	4	5	2	0.4%	0.1%	0.0%	0.0%
November	9	5	2	1	0.3%	0.1%	0.0%	0.0%
December	11	4	2	5	0.3%	0.1%	0.1%	0.1%

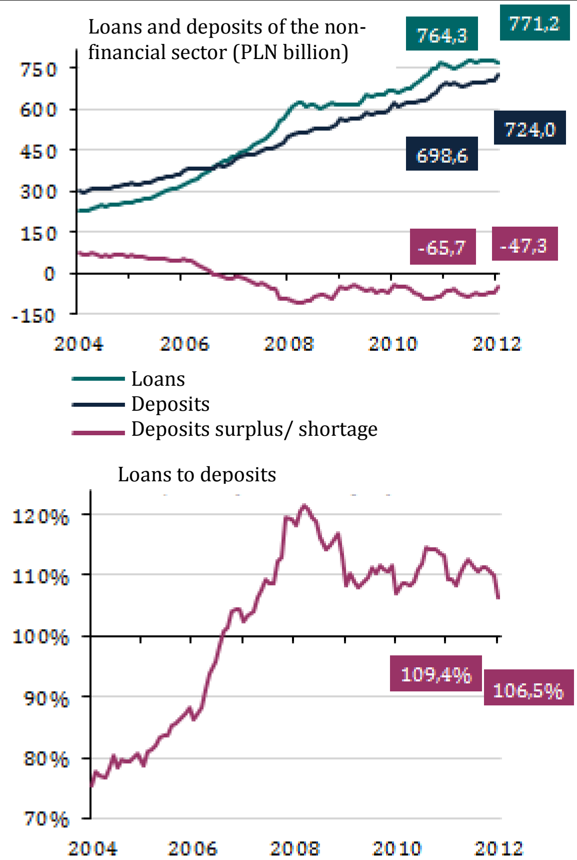
Provisions of PFSA Resolution No. 386/2008 are abided by to a satisfactory degree

Provisions of PFSA Resolution No. 386/2008 are abided by to a satisfactory degree. There were few instances of non-compliance identified which concerned entities of system-wise marginal importance (as at the end of 2012, only 2 branches of credit institutions and 3 cooperative banks breached the provisions of the Resolution).

Loan to deposit ratio was stable

The loan to deposit ratio for the non-financial sector – indirectly determining the scale of demand for financial market funds – remains stable since 2009. As the result of slowdown in lending and the PLN appreciation, the above relation improved at the end of 2012 and reached the lowest level reported for the last two years (106,5%).

Chart 13.
LTD ratio of the non-financial sector



Actions to further stabilise funding sources prove indispensable

Lower mutual trust of market participants and recurring severe disturbances on the financial markets remain the main impediment to liquidity management. In particular, the situation on the local interbanking market was stable, characterised by low reciprocal lending limits and marginal share of deals with maturities exceeding 1 day.

With the above in mind, actions to further stabilise funding sources and strategies that match difficult external circumstances are needed.

4. FINANCIAL RESULTS[9]

Net financial result similar to 2011, considerable impact of unstable factors

Despite difficult external conditions, the financial results of the banking sector remained at the level of 2011 however, to a large extent, it was caused by factors of unstable nature.

Table 7. Selected components of income statement

	Value (PLN million)			Change to 2011		Result in the last four quarters			
	2010	2011	2012	PLN million	%	I/12	II/12	III/12	IV/12
Net income on banking activities	53 083	57 305	58 751	1 445	2.5%	14 857	14 999	14 579	14 316
- net interest income	30 899	34 979	35 480	501	1.4%	9 071	8 809	9 034	8 566
- net income on fees and commissions	13 754	14 283	14 342	59	0.4%	3 539	3 632	3 592	3 580
- other items	8 429	8 042	8 928	886	11.0%	2 247	2 559	1 953	2 169
Operating costs	25 477	26 684	27 776	1 092	4.1%	7 008	6 938	6 869	6 961
Depreciation / amortisation	2 534	2 576	2 582	6	0.2%	649	638	635	660
Provisioning and impairment loss balance (negative)	11 235	8 855	9 988	1 133	12.8%	2 170	2 909	2 311	2 598
NET FINANCIAL RESULT	11 420	15 539	15 521	-19	-0.1%	4 215	3 813	4 002	3 491

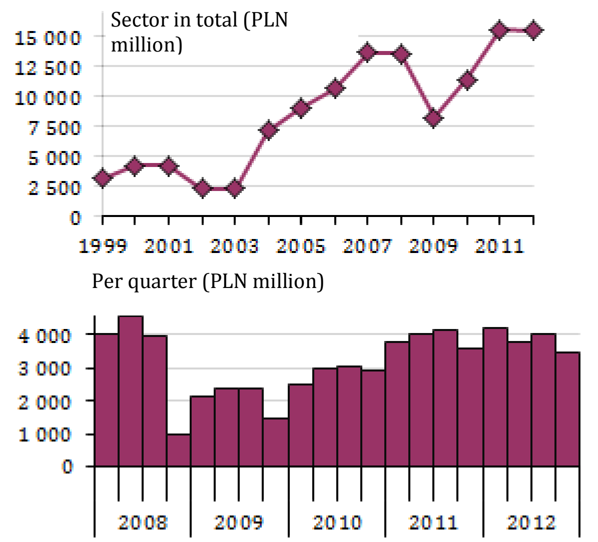
The net financial result of the banking sector in 2012 was by −0.1% (PLN -19 million) lower as compared to 2011.

413 entities accounting for 57.2% of the sector assets saw results improve; in other entities the results deteriorated. 3 commercial banks, 4 cooperative banks and 11 branches of credit institutions reported a loss of the total amount of PLN 340 million (their total share in the sector assets was 8.0%).

The net result of the commercial banks and the cooperative banks rose correspondingly by 0.2% and 8.8%; the net result of branches of credit institutions dropped by 37.8%.

Two largest banks still generate the majority of the whole sector profit (in 2012 they generated 40% of the whole profit while their share in sector assets was only 25%).

Chart 14.
Net financial result



	2008	2009	2010	2011	2012
SECTOR	13 556	8 278	11 420	15 539	15 521
Commercial banks	12 475	7 620	10 833	14 309	14 337
Bran. of credit inst.	181	-27	-148	332	206
Cooperative banks	900	686	736	898	977

[9] Note: the data regarding the 2012 financial results are distorted due to the method of how the merger between Polbank EFG S.A. and Raiffeisen Bank Polska S.A. was settled (impact of other mergers was immaterial). The effect was that the net result of the banking sector was slightly overvalued and the incomes and costs and the negative impairment loss balance and provisions were slightly undervalued. However, the data regarding the 2011 financial results of the banking sector are also distorted (as the result of change legal form of Polbank EFG) – in consequence, the effects of the above changes are offset.

Table 8. Net financial result change drivers, 2012

	Value (PLN million)		
	2011	2012	Change driven
1. **Net income on banking activities**	57 305	58 751	
- net interest income	34 979	35 480	+501
- net income on fees and commissions	14 283	14 342	+59
- other net income on banking operations	8 042	8 928	+886
2. Other operating incomes /costs (balance)[10]	404	862	+458
3. Bank operation costs	26 684	27 776	-1 092
4. Depreciation / amortisation	2 576	2 582	-6
5. Provisioning and impairment loss balance (negative)	8 855	9 988	-1 133
6. Net income on operating activity (1+2-3-4-5)	19 594	19 266	
7. Net income on non-operating activity	11	0	-11
8. Income on continued operations (6+7)	19 605	19 266	
9. Statutory charges	3 862	3 730	+132
10. Net profit on continued operations (8+9)	15 743	15 536	
11. Net profit on discontinued operations	-203	-15	+188
12. **Net financial result** (10+11)	15 539	15 521	-19

Considerable impact of unstable factors

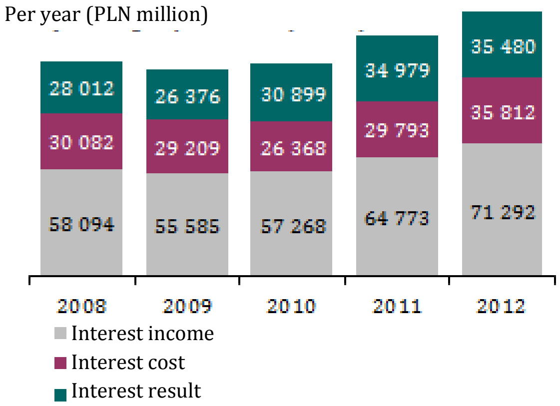
Unlike in years 2010-2011 (where the net profit of the banking sector was driven by the higher interest result and lower negative balance of impairment losses and provisions), in 2012 the main factor driving the result was the result on other banking activities, then the result on interest, the result on other operating costs and revenues, reduced losses on discontinued activities and reduced statutory charges on the financial result, i.e. factors of an unstable or one-time character. On the other hand, the negative balance of impairment losses and provisions increased.

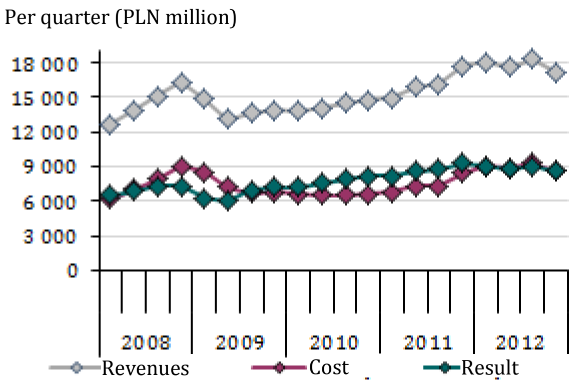
Interest result grew at a slower pace

In 2012 the net interest income grew at a slower pace as compared to that observed since 2010 (the highest interest result was reported for Q4 2011). This was the consequence of moderate increase in the interest revenues (by PLN 6,520 million; 10.1%) combined with high increase in interest cost (by PLN 6,019 million; 20.2%). As the result, the banks' net interest income for 2012 was similar to that of 2011 (increase by PLN 501 million; 1,4%).

Some banks faced the decline of the net interest income. These were in particular the banks specialising in consumer lending as well as car and mortgage loans and banks wherefore change in funding structure (from the parent group funds to market funds) proved unfavourable. Noticeable is the relatively large growth of the interest result at the cooperative banks (by PLN 347 million; 10.9%).

Chart 15.
Revenues, costs and the net interest result





[10] The following were also taken into account: result on adjustments of goodwill (hedge accounting) and the result on discontinuation of recognising assets other than assets for sale.

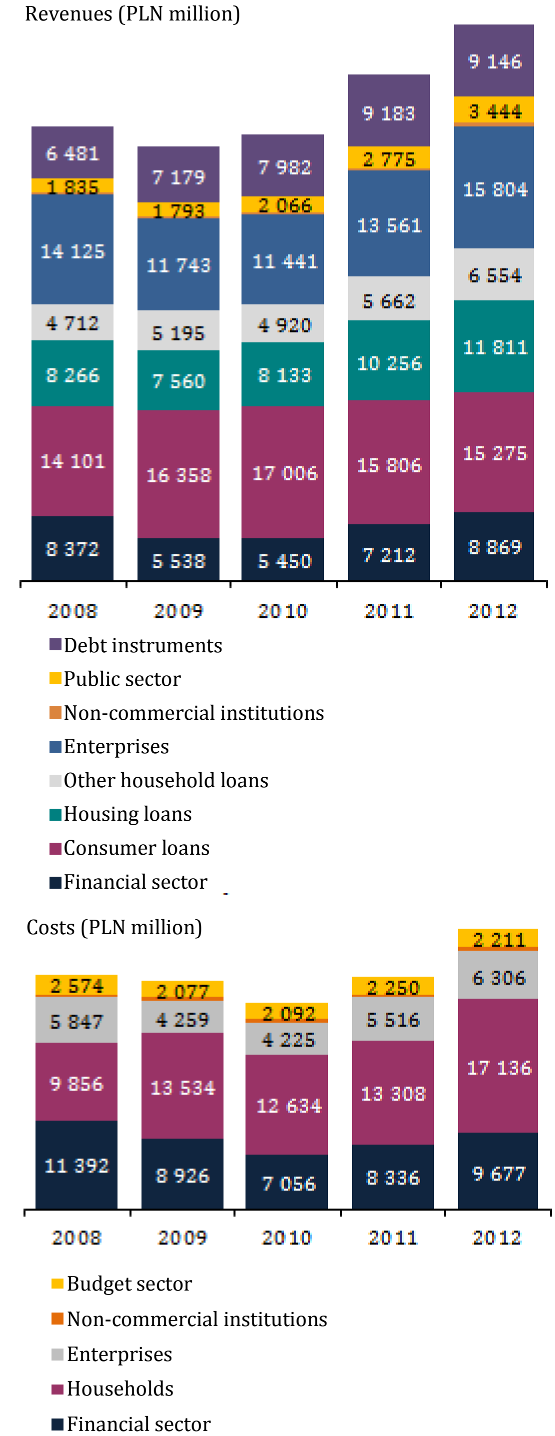
Reduced net interest income from the consumer loans

The increase in the interest revenues was mainly caused by the increase in revenues on enterprise loans (by PLN 2,243 million; 16.5%), receivables from the financial sector (by PLN 1,657 million; 23.0%), housing loans (by PLN 1,556 million; 15.2%) and, to a lesser extent, on other household loans (by PLN 892 million; 15.8%) and on public sector entity loans (by PLN 669 million; 24.1%). The above increases were the consequence of larger business transaction volume and higher interest rates valid for 2011 and the first half of 2012 r.

On the other hand, revenues on debt securities and consumer loans dropped (correspondingly, by PLN 36 million (-0.4%) and by PLN 531 million (-3,4%)), the result of their reduced volume.

The decline of 2011-2012 in interest revenue on consumer loans resulted in significantly lower share in the interest revenue structure (from almost 30% in years 2009-2010 down to 21.4% in 2012 r.).

Chart 16.
Interest revenue and cost structure



Steep increase in the interest costs on the household loans

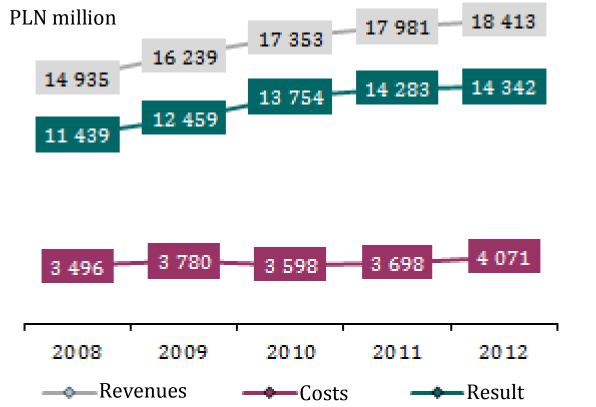
The increased interest cost was the consequence of the steep increase in costs of the household deposits (by PLN 3,828 million; 28.8%). This was the result of increased deposit base, increased interest rates (the effect of tightening the monetary policy in 2011 and in the first half of 2012) and stronger competition at the deposit market.

The increase in the interest costs paid to other customers groups was materially lower (interest for the financial and enterprise sector increased, correspondingly, by PLN 1,341 million (16.1%) and by PLN 789 million (14.3%).

Stagnated result on fees and commissions

The result on fees and commissions has not changed (increase by PLN 59 million; 0.4%), the result of decelerated growth in lending (translated into low increase in commissions on loans granted and on sales of related insurance policies), reduced turnover at the capital market and limited potential to increase fees for banking services.

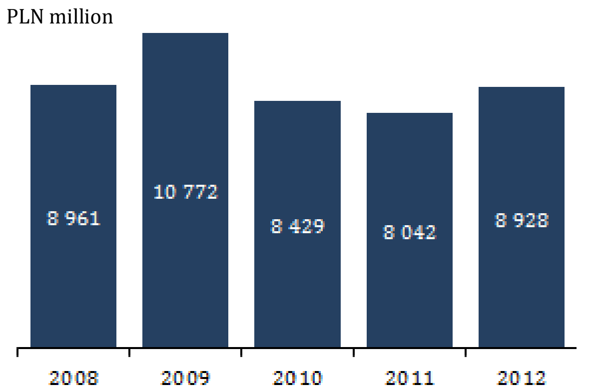
Chart 17.
Result on fees and commissions



Increased result on other banking activities

The result on other banking activities went up (by PLN 886 million; 11.0%), the effect, among others, of the situation at the government securities market. As the profitability of the T-bonds fell down and their value increased, some banks decided to sell a portion of their portfolio to realize profits.

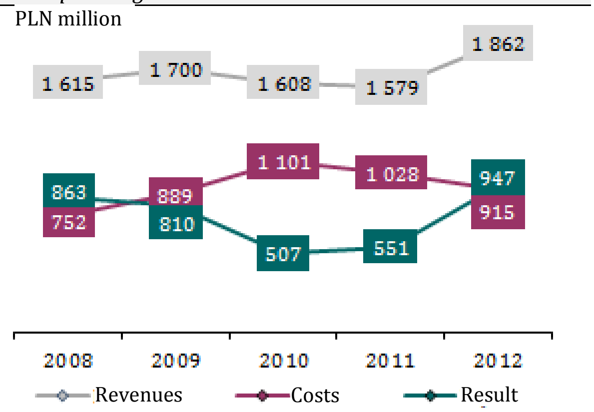
Chart 18.
Result on other banking activities



Increased result on other operating revenues and costs

The increase in the result on operating revenues and costs (by PLN 396 million; 72.0%) took place as the result of increased revenues combined with reduced costs. Noticeable in this regard is the increase in revenues from recovery of non-collectible debts.

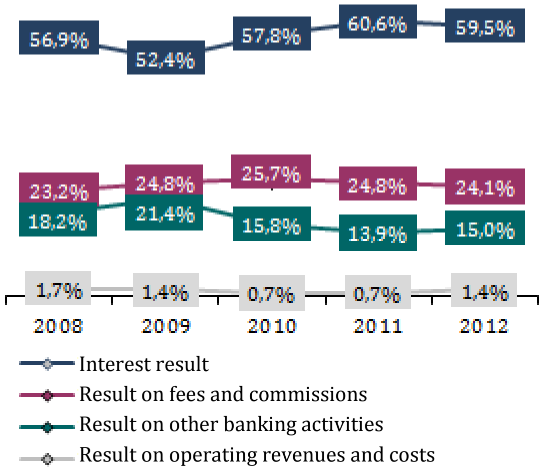
Chart 19.
Other operating revenues and costs



Structure of the result on banking activities remains stable

In a long-term, the structure of the result on banking activities and other operating revenues and costs is stable. Predominant portion is the net interest income (approx. 60%) and the result on fees and commissions (approx. 25%). It is the consequence of a traditional model of the Polish banking, local character of the banking activities and the limited development of the Polish financial system.

Chart 20.
Structure of the result on banking activities and on other operating revenues and costs

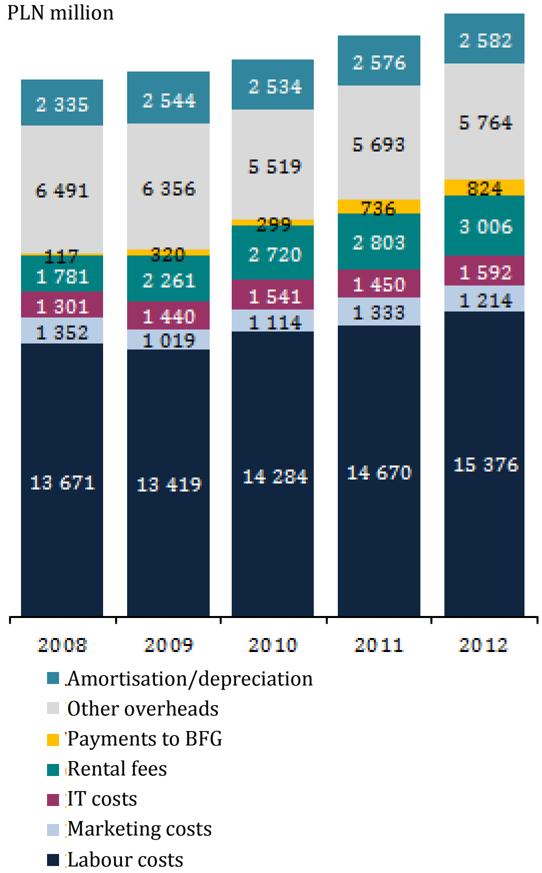


Moderate/low increase in the operating costs

Continued difficult external conditions translated into increased pressure on cost control. In consequence, the operating costs rose slightly/moderately in 2012 (PLN 1,092 million; 4,1%) and was mainly due to the increased employment costs (by PLN 706 million; 4.8%) and, to a lesser extent, to the increased overheads (by PLN 386 million; 3.2%). The rise in the the employment costs was due to higher remunerations and related costs (despite lower employment rate) and to payments in the form of own shares. The main reasons for the increased overheads were higher rentals, IT-related expenses and payments to BFG. On the other hand, the marketing related expenses dropped.

The amortization/depreciation was similar to that of 2011.

Chart 21.
Operating costs and depreciation/amortisation



Share of costs in the result on banking activities is stable

The share of total operating costs and amortization/depreciation in the banks' results has not materially changed (50.9% as compared to 50.7%).

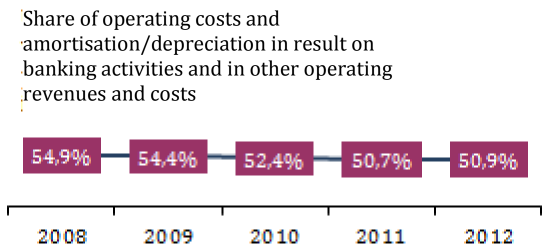


Table 9. Balance of impairment losses and provisions

	Value (PLN million)			Change to 2011		Result in the last four quarters			
	2010	2011	2012	PLN ml	%	I/12	II/12	III/12	IV/12
Balance of imp. losses and provisions, incl.:	-11 235	-8 855	-9 988	-1 133	12.8%	-2 170	-2 909	-2 311	-2 598
1/ Impairment losses on financial assets	-10 545	-7 611	-8 168	-557	7.3%	-1 813	-2 419	-2 052	-1 883
Households	-9 004	-6 360	-4 771	1 589	-25.0%	-1 299	-1 426	-1 381	-665
- consumer loans	-7 017	-3 707	-2 422	1 285	-34.7%	-714	-658	-751	-298
- housing loans	-867	-1 331	-1 196	135	-10.1%	-335	-369	-323	-170
- other loans	-1 120	-1 322	-1 153	169	-12.8%	-250	-399	-308	-197
Enterprises	-1 524	-1 257	-3 391	-2 134	169.7%	-517	-985	-679	-1 209
Other entities	-17	6	-6	-12	x	3	-8	8	-8
2/ provisions	-769	-670	-1 136	-466	69.6%	-172	-265	-200	-499
3/ impairment losses on non-financial assets.	-87	-95	-295	-201	212.1%	-29	-19	-17	-231
4/ IBNR/General risk	166	-479	-389	90	-18.8%	-156	-206	-43	15

Increased impairment losses due to deteriorated quality of enterprise receivables

The negative balance of impairment losses and provisions went up considerably in 2012 (by PLN 1,133 million; 12.8%), the fact caused by strong rise in impairment losses for receivables from the enterprise sector (by PLN 2,134 million; 169.7%), mainly due to the deteriorated financial condition of some large construction sector enterprises (see herein below). To much smaller extent, the rise in negative balance of impairment losses and provisions was caused by increased costs of setting up other provisions and increased impairment losses for non-financial assets.

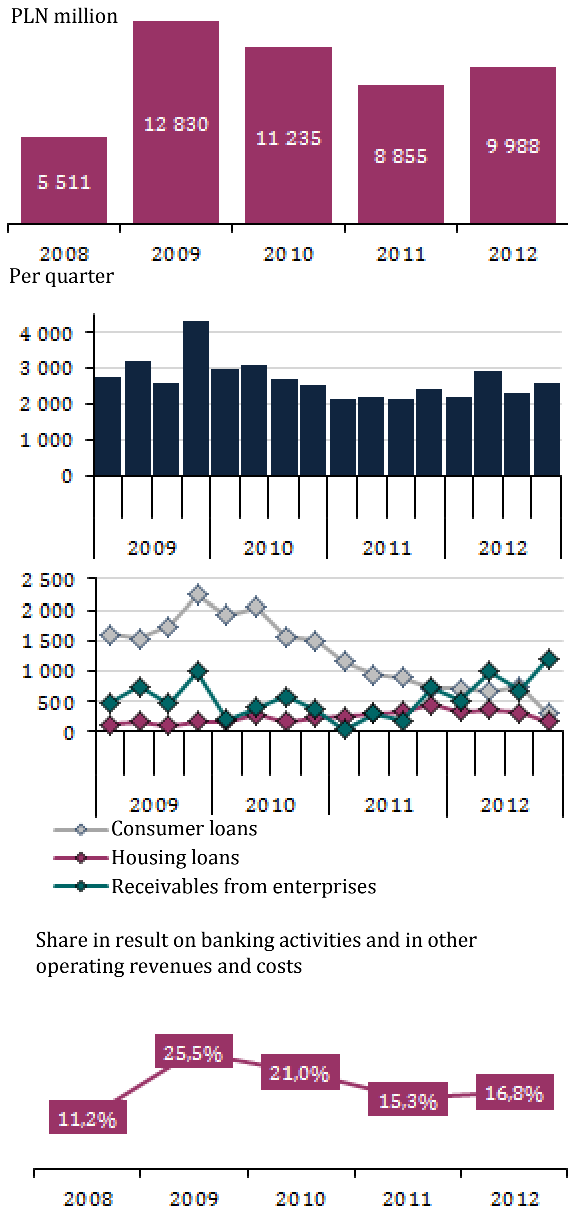
Drop in impairment losses on household receivables

On the other hand, the negative balance for household receivables went down significantly (by PLN 1,598 million; -25.0%). This was mainly the effect of considerable drop in impairment losses for consumer loans (by PLN 1,285 million; -34.7%) - they have been dropping gradually since the second half of 2010 (the record-low balance of impairment losses for consumer loans was reported for Q4 2012). At the same time, the balance of impairment losses for housing loans and other household receivables dropped, for the first time, consequently by PLN 135 million (-10.1%) and by PLN 169 million (-12.8%).

The negative result on IBNR dropped (by PLN 90 million; -18.8%).

Higher balance of impairment losses and provisions translated into their higher share in results generated by the sector (from 15.3% in 2011 up to 16.8% in 2012).

Chart 22.
Balance of impairment losses and provisions

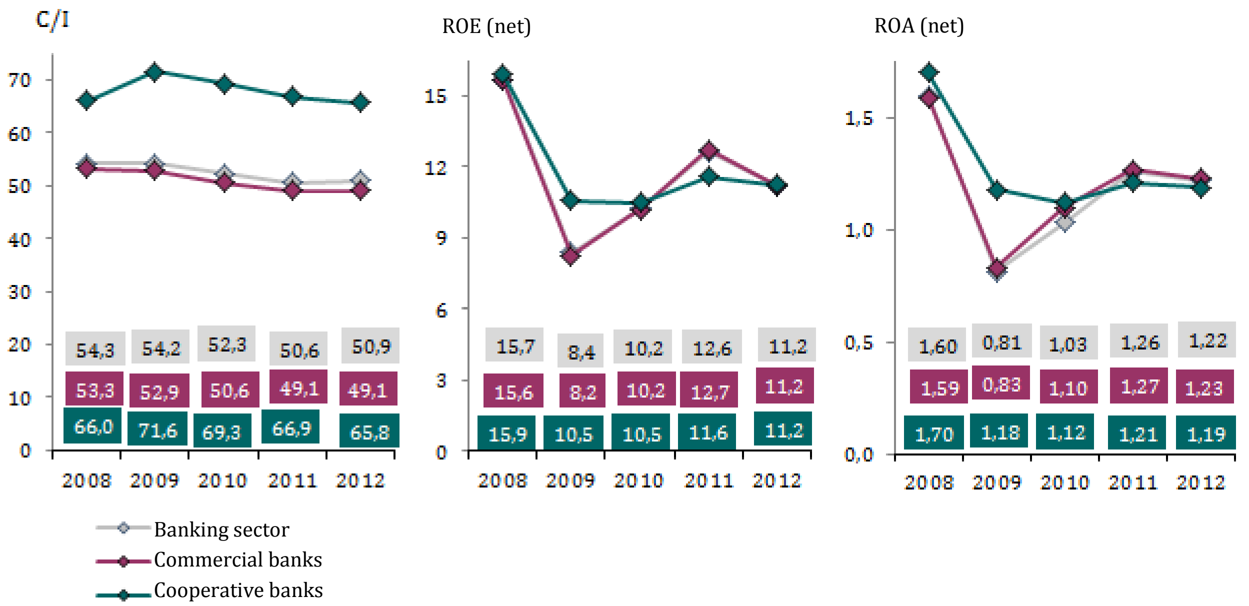


No big changes in the key performance indicators for the sector

Table 10. Selected key performance indicators

	Sector			Commercial banks			Cooperative banks		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Net financial result (PLN million)	11 420	15 539	15 521	10 833	14 309	14 337	736	898	977
Banks reporting losses									
- number of banks reporting losses	20	18	18	7	7	3	2	2	4
- share in the sector assets	8.2%	3.0%	8.0%	5.6%	2.8%	7.8%	0.0%	0.0%	0.0%
- total losses (PLN million)	-1 265	-585	-340	-648	-507	-270	-15	-3	-6
NIM	3.20	3.23	3.19	3.18	3.17	3.11	4.43	4.60	4.61
ROA	1.03	1.26	1.22	1.10	1.27	1.23	1.12	1.21	1.19
ROE	10.21	12.64	11.19	10.19	12.71	11.19	10.46	11.59	11.23
C/I	52.26	50.58	50.86	50.61	49.09	49.12	69.31	66.89	65.78
Share in assets (average)									
Result on banking activities	4.78	4.66	4.62	4.80	4.61	4.58	5.71	5.74	5.60
- interest result	2.79	2.85	2.79	2.76	2.79	2.72	4.14	4.30	4.31
- non-interest result	2.00	1.82	1.83	2.03	1.82	1.86	1.58	1.43	1.28
Banking costs	2.30	2.17	2.19	2.22	2.07	2.08	3.72	3.61	3.50
- employee-related	1.29	1.19	1.21	1.22	1.11	1.12	2.66	2.53	2.45
- overheads	1.01	0.98	0.98	1.00	0.97	0.96	1.06	1.08	1.05
Balance of impairment losses/provisions	1.04	0.64	0.72	1.06	0.67	0.77	0.27	0.31	0.38
Assets per employee (PLN million)	6.6	7.3	7.9	7.5	8.4	9.2	2.2	2.4	2.6
Employee-related costs per employee (PLN thousand)	81	83	90	87	88	96	55	58	61
Gross profit per employee (PLN thousand)	89	114	115	102	131	134	30	36	38

Chart 23.
Selected key performance indicators



Key performance indicators were at the level close to 2011, except for ROE which dropped down. This was, however, not the effect of deteriorated operating efficiency but of considerable capital growth mentioned above (positive phenomenon).

Further improvement of cost effectiveness of cooperative banks is worth noting.

Expected negative pressure on banks' financial results
Negative impact of the interest rate reduction on the banks' financial

In coming periods, one may expect that the negative pressure on the banks' financial results will intensify, which is the consequence of the economy downturn which, in turn, translates into deteriorated financial condition of some borrowers and reduced demand for loans and banking products.

Big challenge for banks will be dropping interest rates – on one hand it may drive the loan demand, on the other hand it may negatively affect the interest revenues and limit the deposit base growth potential, among others, through reducing the customers' propensity to save.

The financial plans for 2013 sent to UKNF assumed the reduced sector profits for 2013 by 0.2%. However, as the result of strong reduction of interest rates, banks updated the plans and reduced the projections as regards the interest result (by approx. PLN 2 billion). In consequence the projections regarding the banking operations results and the net results were adjusted downwards. The current estimated level is almost 7% lower than the result realised in 2012.

As the financial plans show, banks' views as regards the perspectives for 2013 are very different. In particular, some banks assume significant improvement of the financial results. At the same time, other banks assume considerable deterioration of their financial results. And that despite the fact that the scale and the business model used by them are similar. Therefore one may assume that some banks are too optimistic and some are too pessimistic as regards the business perspectives (this may be explained by high uncertainty as regards the economy growth perspectives). In consequence, the actual results may differ significantly from the projections.

In the context of updated financial plans, noticeable is that, in case of loans for the non-financial sector, significantly larger reduction in the interest rates (as compared to that expected by the banks) does not translate into increased lending (as projection in the original plans). Some banks reduced their projections as regards lending development and the consequence is that the actual lending growth is lower than that assumed by the banks in the original financial plans. The reasons for that may be three-fold: the economy downturn (affecting the loan demand and supply), the expected deteriorated financial results of the banks (the consequence being lower appetite for risk) and the reduced expected deposit growth.

The additional pressure on the banks' financial results will be from planned fee for the stabilisation fund and the orderly liquidation fund to be paid to BFG and from reduced interchange fees.

5. MAIN LINES OF DEVELOPMENT

Moderate growth in scale of operations of the banking sector

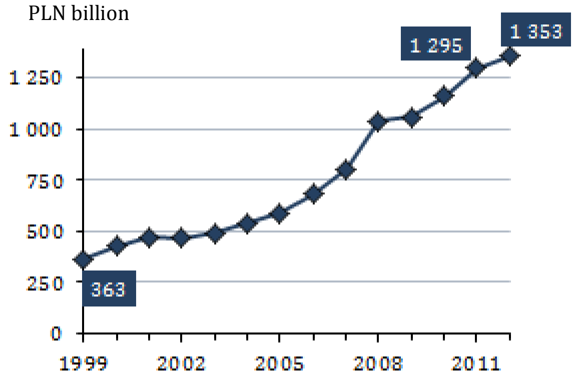
Still difficult external conditions and uncertainty as to the future economic growth, combined with limited funding sources and reduced willingness of households and enterprises to take debts, resulted in moderate growth in banking sector activities (measured by the balance-sheet total growth).

The balance-sheet total growth approximately the same as in years 2010-2011

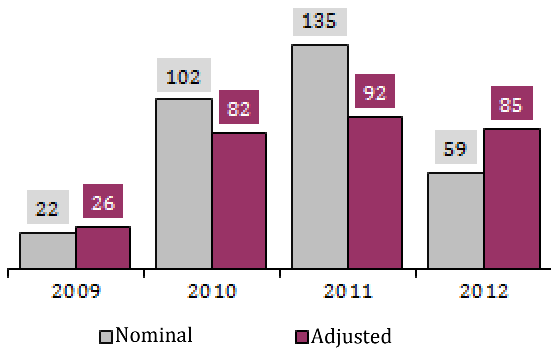
In 2012 the balance-sheet total of the banking sector increased by PLN 58.4 billion, i.e. by 4.5% (the relatively low increase in nominal terms was the effect of PLN appreciation which, in turn, resulted in lower PLN value of the balance-sheet items expressed in foreign currencies). If adjusted for FX rates[11] the growth would be approx. PLN 84.9 billion, i.e. 6.7% and was slightly lower than that in years 2010-2011 (correspondingly 7.5% and 7.8%).

The balance-sheet total grew mainly due to increased lending and increase in the most liquid assets.

Chart 24.
The banking sector assets



Change in the balance-sheet total in years 2009-2012



	2008	2009	2010	2011	2012
SECTOR	1 035,4	1 057,4	1 159,4	1 294,6	1 352,9
Commercial banks	922,6	939,9	1 034,2	1 187,7	1 238,9
Branch. of credit inst.	56,2	55,7	54,7	28,5	28,2
Cooperative banks	56,5	61,7	70,4	78,4	85,8

Higher growth of banks controlled by the domestic investors

The same as in previous years, the growth of banks controlled by the domestic investors was higher as compared to banks controlled by the foreign investors (adjusted annual growth of the balance-sheet total was, correspondingly, 10.3% and 4.7%).

[11] Note: to determine the growth adjusted for FX rates, FX rates at the year-end 2012 were taken (considering certain limitations of the reporting system, data presented should be regarded as estimated values).

Table 11. Lending Portfolio

	Gross carrying amount (PLN bn)				Change to 2011			
					nominal		adjusted	
	2010	2011	09/12	2012	PLN bn	%	PLN bn	%
Lending total	787.5	911.3	935.6	935.2	23.9	2.6%	46.0	5.2%
1/ Financial sector	25.5	25.8	33.2	32.8	7.0	27.0%	7.4	29.3%
2/ Non-financial sector	698.5	800.7	813.4	810.4	9.7	1.2%	30.2	3.9%
- households	475.4	532.0	532.6	533.2	1.2	0.2%	16.2	3.1%
- enterprises	219.7	264.5	276.2	272.3	7.7	2.9%	13.4	5.2%
- non-commercial institutions	3.4	4.2	4.7	4.9	0.7	17.0%	0.7	17.0%
3/ Public sector	63.4	84.8	89.0	92.0	7.2	8.5%	8.3	10.0%
Per currency								
- PLN	534.7	604.5	655.0	659.1	54.6	9.0%	54.6	9.0%
- currencies	252.7	306.8	280.7	276.1	-30.7	-10.0%	-8.7	-3.0%

Reduced growth in lending for the non-financial sector

The lending growth decelerated in 2012 (in Q4 lending stagnated). In consequence, the total value of loans in nominal terms increased by PLN 23.9 billion, i.e. by 2.6% (adjusted for FX rates: approx. PLN 46.0 billion, i.e. approx. 5.2%).

Reduced growth in the loan portfolio was the result of reduced lending for households and enterprises; at the same time, growth in loans for the financial and public sector was relatively high.

Reduced growth in household and enterprise lending was the effect of several different factors; the factors of key importance were the economy downturn and deteriorated economic growth perspectives which translated into limited demand for loans and more selective supply. Another barrier was limited funding sources. Further, reduction in volume of consumer loans was, to a large extent, due to the sale of a portion of the bad debt portfolio.

Lending development is of cyclical nature

In the context of reduced lending growth, it must be noted that lending development is of cyclical nature. Decelerated growth of lending took place in the past as well. It is a natural characteristic of each economy.

Chart 25.
Loan value change, in total

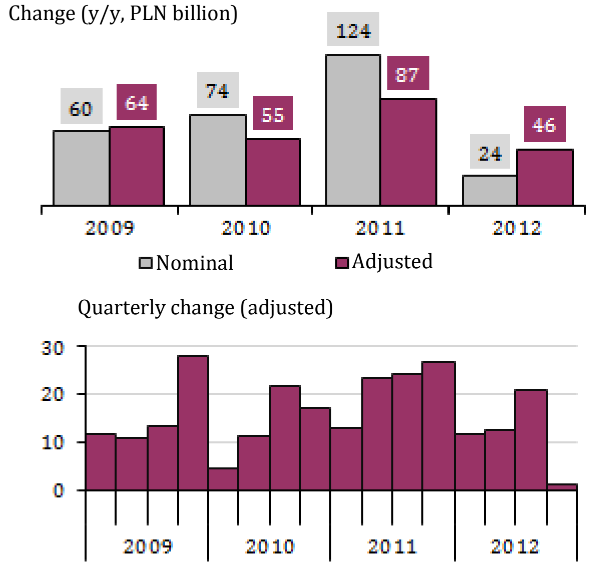


Chart 26.
Loan portfolio structure

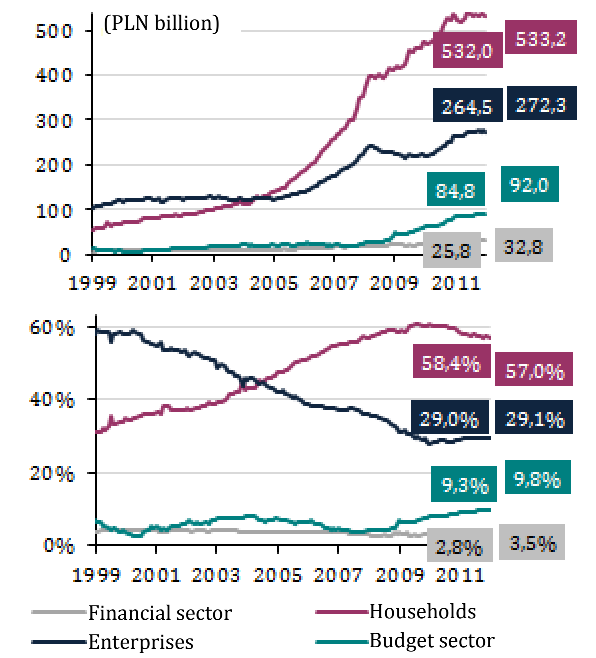


Table 12. Household loans

	Gross carrying amount (PLN bn)				Change to 2011			
					nominal		adjusted	
	2010	2011	09/12	2012	PLN bn	%	PLN bn	%
In total	475.4	532.0	532.6	533.2	1.2	0.2%	16.2	3.1%
1/ Housing loans	267.5	319.0	319.1	321.8	2.8	0.9%	16.5	5.4%
- PLN	98.2	121.2	137.5	143.5	22.3	18.4%	22.3	18.4%
- FX	169.3	197.8	181.5	178.3	-19.5	-9.9%	-5.8	-3.2%
2/ Consumer	134.1	130.3	125.6	123.4	-6.9	-5.3%	-6.2	-4.8%
- credit cards	14.7	13.5	12.8	12.6	-0.9	-7.0%		
- car loans	7.7	6.8	6.0	5.7	-1.1	-16.1%		
- instalment loans[12]	46.4	45.9	42.4	41.2	-4.8	-10.4%		
- other[13]	65.3	64.1	64.4	64.0	-0.1	-0.2%		
3/ Other	73.9	82.7	87.9	88.1	5.4	6.5%	5.9	7.2%
- operacyjne	23.3	27.1	31.2	31.0	3.9	14.4%		
- inwestycyjne	25.1	28.8	28.8	28.8	0.1	0.2%		
- nieruchomości	8.1	8.8	9.2	9.6	0.7	8.4%		
- pozostałe należności	17.4	18.0	18.7	18.7	0.7	3.9%		
wg waluty								
- złote	290.8	317.5	337.0	341.4	23.8	7.5%	23.8	7.5%
- waluty	184.6	214.5	195.5	191.9	-22.6	-10.5%	-7.7	-3.9%

Slowdown in household lending

In 2012 saw the lowest growth in household lending within the last several years. The value, in nominal terms, increased by PLN 1.2 billion, i.e. by 0.2% (adjusted for FX rates: by approx. 16.2 billion, i.e. by 3.1%).

The slow growth was the result of decelerated growth in housing loans and reduced volume of consumer loans. Other household loans (the majority of them for small enterprises) grew at a stable pace.

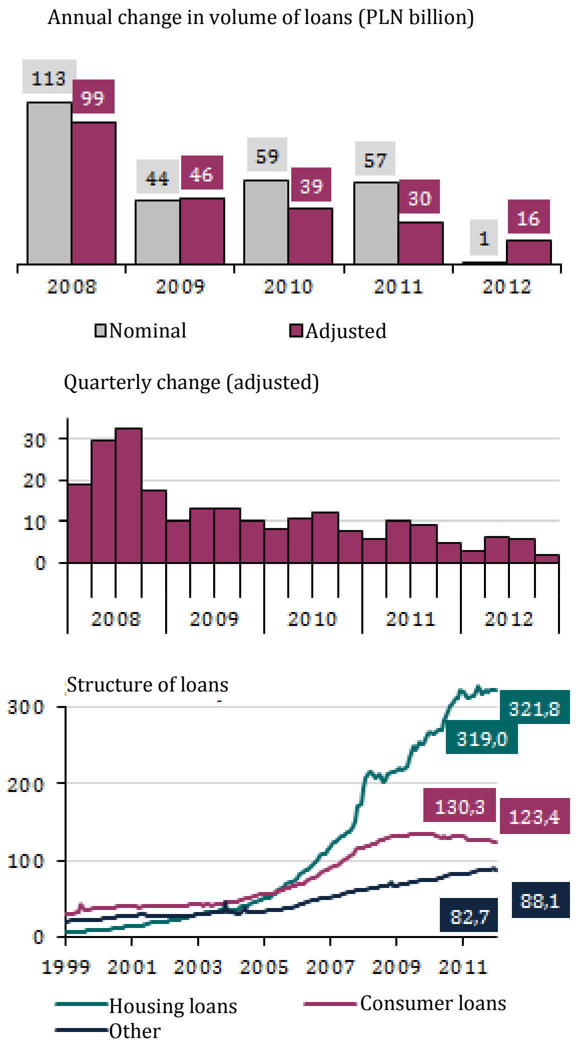
The decelerated growth was caused, in addition to the factors specified above, by factors specific for each individual loan category (see herein below).

The decelerated growth in lending for households has been observed not only in Poland, but in the majority of the EU countries (see herein below).

Positive drop in share of FX loans

Limited lending in foreign currencies combined with PLN appreciation resulted in positive drop in share of FX loans (from 40.3% as at the end of 2011 down to 36.0% as at the end of 2012).

Chart 27.
Household loans



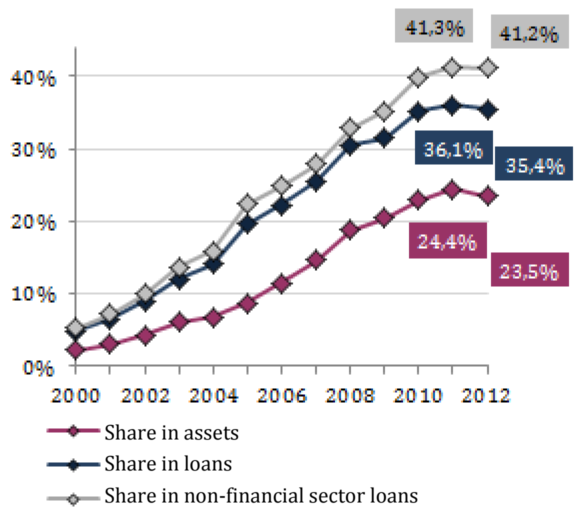
12 This category includes cash loans repaid in instalments.
13 This category includes current account loans and cash loans repaid in full.

Housing loans is the main banks' assets item

The housing loans are[14] the main loan portfolio and asset item of the sector.

As at the end of 2012, they accounted for 35.4% of the loan total (loans according to their balance-sheet value) and 23.5% of the balance-sheet total of the banking sector (in the key banks, the share of housing loans was considerably higher). This means that the financial condition of the banks is largely dependent on the quality of the housing loans and the situation at the real property market.

Chart 28.
Role of housing loans in the banks' balance-sheets

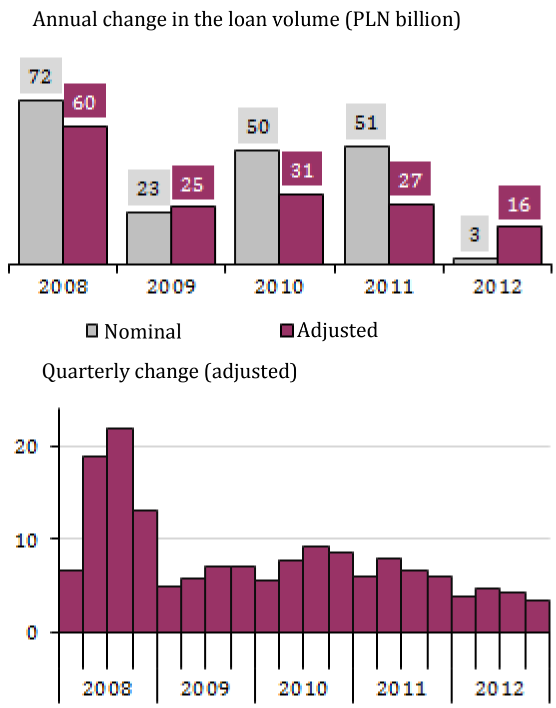


Slowdown in housing loans

Growth in housing loans further decelerated in 2012. In nominal terms, the portfolio value increased by PLN 2.8 billion, i.e. by 0.9%. This was due to the large share of FX loans, the value of which expressed in PLN dropped down as the result of the PLN appreciation. Adjusted for FX rates, the growth would be approx. PLN 16.5 billion, i.e. 5.4%. This means that the realised growth in lending was the smallest in recent years.

The reduced growth was due to a number of factors of demand, supply and regulatory nature. Futher, it was also due to reduced market prices which translated into reduced lending needs (in terms of value, see herein below).

Chart 29.
Housing loans for households



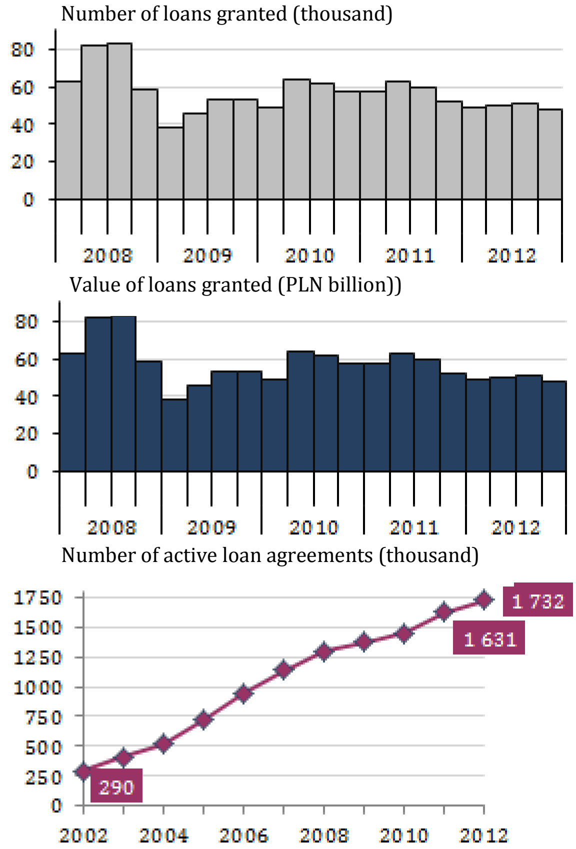
[14] Note: additional information regarding the housing loan portfolio have been provided in Annex

The number of active loan agreements increased

According to AMRON-SARFiN, in 2012 banks granted 196.6 thousand loans for the total amount of PLN 39.1 billion and the number of active loan agreements increased by 100.9 thousand up to 1,731.6 thousand. The drop is considerable as compared to 2011 (the number and the value of loans granted dropped, correspondingly, by 15.0% and 20.5%), however, considering the current market conditions and saturation, the loan sales level is satisfactory. Although the annual growth in the number of active loan agreements is lower than in 2011, it is still higher as compared to years 2009-2010.

Interpreting the data provided by AMRON-SARFiN (as regards the number and the value of loans granted), one must take into account the fact that they do not reflect the true scale of lending. These data also include the customers that change the financing bank. As the result, the actual scale of lending is overvalued. Additionally, it may be the source of misunderstandings in case of considerable changes in terms of the number and the value of those operations between periods included in comparisons.

Chart 30.
Development of housing loans



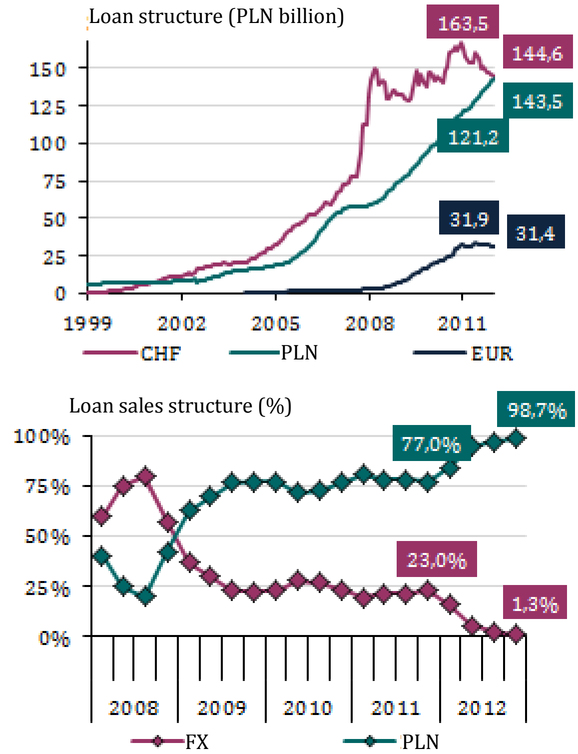
Source:AMRON-SARFiN

Improved currency structure of housing loans

The positive trend was continued where the PLN loans predominated in the new lending development. Majority of banks either strongly limited, or completely withdrew from the loans in foreign currencies (throughout 2012 banks granted 8.4 thousand FX loans, 5.8 thousand of which were granted in the first quarter). Combined with the PLN appreciation, this resulted in reduced share of FX loans in total housing loans (from 62.0% at the end of 2011 down to 55.4% at the end of 2012).

Considering various risks generated by FX loans, negative impact on the real property prices and limited counteractions from the monetary authorities, the FX loans should constitute an exclusive offer available only for customers who receive regular incomes in the loan currency (see herein below).

Chart 31.
FX structure of housing loans

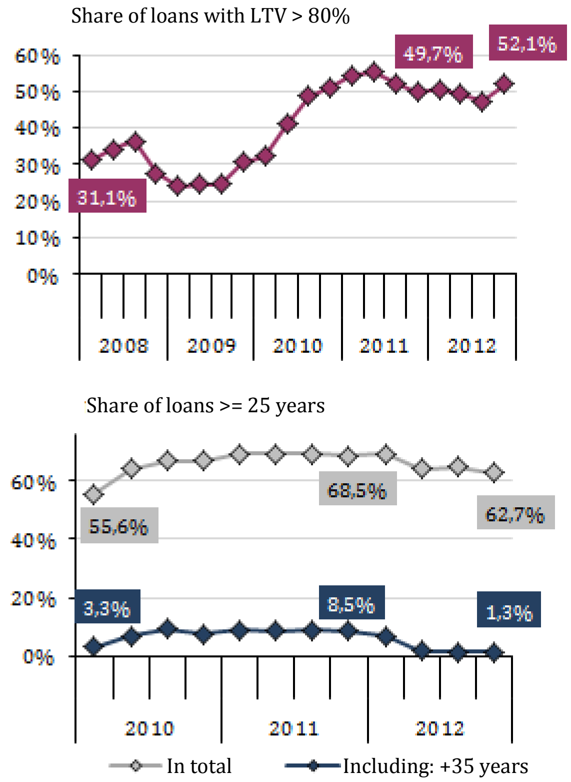


The trend of large share of new loans granted with LTV>80% and excessively lengthened tenors continues

The negative fact is that there is still a large share of new loans awarded with LTV exceeding 80% (approx. 50% of the total sales) and with excessively lengthened tenors (loans with tenors of 25 years and longer accounted for approx. 65% of new loans).

Loans with high LTV ratio and excessively lengthened tenors (the same as FX loans) contribute to increased risk for the customer, the bank and the economy as a whole (see herein below). These are the factors that contribute to creation of the speculative bubble at the real property market. This, in turn, results in limited access to market for households with average income.

Chart 32.
LTV and tenors for newly granted loans



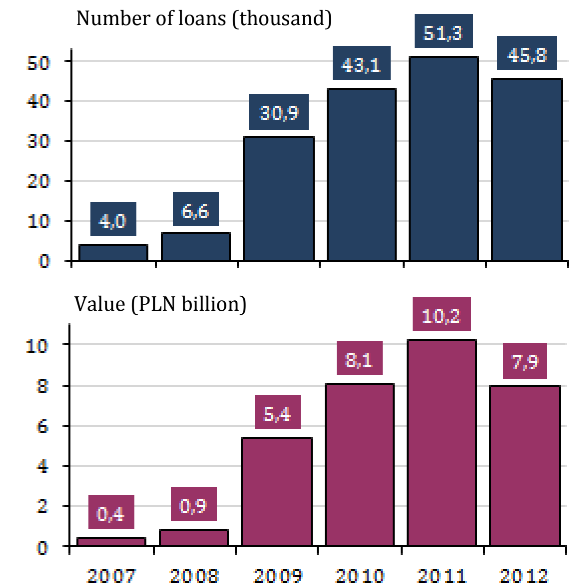
Source:AMRON-SARFiN

Reduced sales of loans under the Rodzina na Swoim "Family on Its Own" Programme

The number and the value of loans granted in 2012 under the Rodzina na Swoim Programme dropped (correspondingly, by -10.8% and -22.5%). This was the effect of changes in the Programme, the result of was limited access to those loans[15].

Changes introduced to the Rodzina na Swoim Programme in 2011 and its expiration at the end of 2012, despite resulting in reduced sales of loans, were positive. On one hand, under the Programme some families afforded to buy a flat and the residential construction market flourished, on the other, however, it was a large burden for the public finances and a source of the systemic risk connected with the abrupt growth of instalments to be repaid after 8 years of subsidies.

Chart 33.
Loans granted under the Rodzina na Swoim Programme



Source:BGK

[15] In the mid 2011 the ratios used to calculate the maximum flat prices that may be subsidised were reduced (from 1.4 to 1.0 (primary market) and to 0.8 (secondary market)) and the principle started to apply according to which the age of a borrower cannot exceed 35 years (for marriages, as least one of the spouses must not exceed 35 years).

Furthermore, in its previous form, the Programme contributed to maintaining negative price relationships at the real property market, and that through using excessively high ratios for determining the maximum price of flats that might be included in the Programme. This issue was limited, to a large extent, by introducing the above mentioned changes in 2011, however the negative impact of the Programme was not fully eliminated as there were still no mechanisms to ensure full objectivity when calculating the limits for the maximum flat prices[16].

The Mieszkanie dla Młodych Programme is a better solution as, under that programme, the risk of abrupt growth of the instalments to be repaid has been eliminated. However, there are still doubts regarding other assumptions used in the Programme[17]. The drawback of both programmes is that they are oriented towards the demand instead of towards creating supply and increased competition which would both result in greater volume of available flats.

Reduced growth in lending for housing purposes is the result of reduced demand and high prices for real properties

Slower growth of housing loans as observed in recent periods was caused by:

- changes to the Rodzina na Swoim programme resulting in considerable drop in production of those loans;
- some demand reduction in consequence of rising concerns about the economy outlook resulting in rising concerns of households about their future financial situation; as the result , households are not willing to take out long-term debts;
- continued correction of prices at the real property market which results in restrained demand as the potential buyers wait for more attractive sales prices (which is opposite to what happened in the economic boom of 2005-2008 when the buyers intended to finalize the transaction as soon as possible and the supply was restrained);
- reduced loan demand in terms of value as the result of corrected real property prices (a smaller loan is needed to buy the same real property) – in consequence, the value if new loans is lower (on the other hand, the increased share of loans with LTV>80% in 2010-2012 entails opposite effects);
- tightened loan policy at some banks as the result of growing issuance related to repayment of housing loans, deteriorated economic outlook, limited funding sources and modified strategies of the strategic investors;

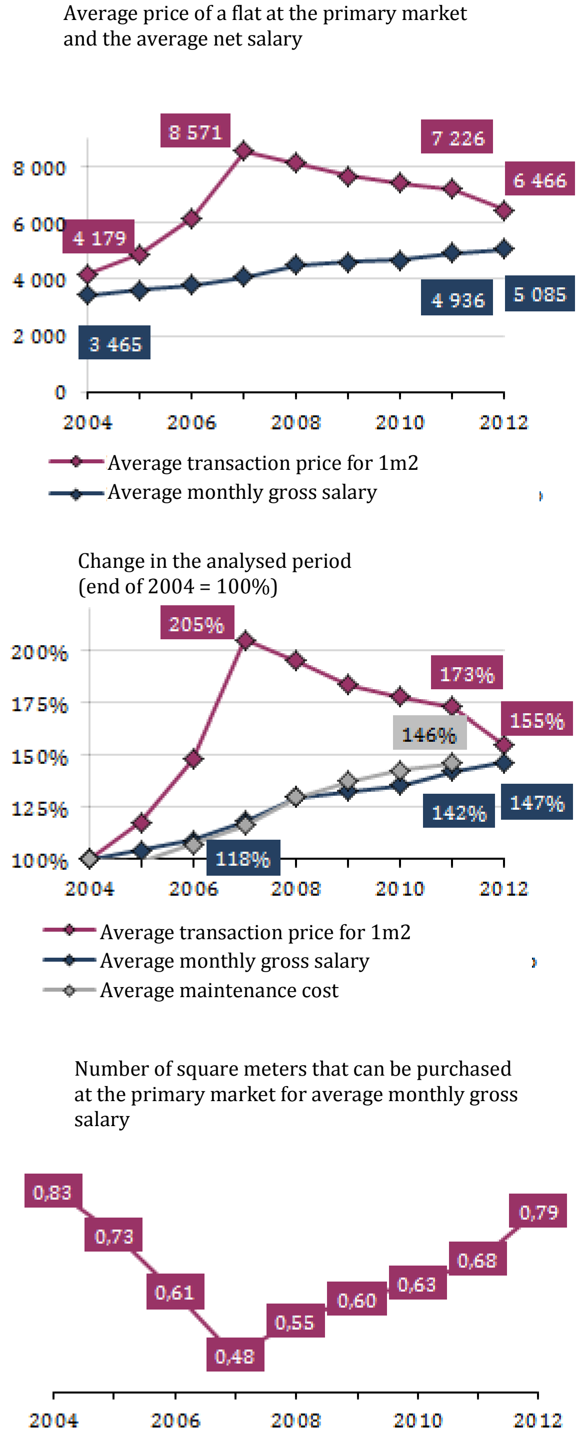
[16] This was the result of lack of fully objective and independent methods for determining the so called conversion ratios for the cost of replacement of 1 m2 of floorage of residence buildings. This led to large disproportions in the maximum price limits in the Rodzina na Swoim Programme per region and/or per city – not reflected in actual construction costs and transaction prices at individual markets. For example, in Q4 2012 the maximum price limit for primary market in Bydgoszcz and Toruń (PLN 5628 for the primary market and PLN 4502 for the secondary market) was similar to Warsaw (PLN 5789 / PLN 4632) and much higher than in Cracow (PLN 4406 / PLN 3525) or in Wrocław (PLN 5182 / PLN 4146). Considering very high limits for Bydgoszcz and Toruń, practically each flat in those cities could be covered by the Rodzina na Swoim Programme (the average transaction price at the primary market was PLN 4615 and at the secondary market PLN 3371); at the same time, the share of flats available under the Rodzina na Swoim Programme was much lower.

[17]among others: the programme was limited, in practice, to cities with developed developer market, lack of full objectivity (as in case of the Rodzina na Swoim Programme) in determining the maximum price limits for flats to be qualified for the Rodzina na Swoim Programme, lack of link between the amount of subsidies and the financial situation of households supported by the State aid. It would be reasonable to link the subsidy system with the obligation to save for buying a flat – this would encourage long-term savings and improved awareness as regards taking out financial debts.

- regulatory changes in years 2010-2011 (the maximum DTI value 50%/65%, 25-years period to calculate the credit capacity, actions aimed at eliminating FX loans); however, according to the UKNF analyses, the regulatory factor is not an actual barrier. It is rather a measure to prevent negative phenomena that generate excessive risk for the customer, the bank and the economy as a whole;
- unfavourable relation of the average flat price to the average salary that causes that a large part of households with average (or lower) incomes is unable to take out a loan or, if taken, it would entail excessive risk, reduced current consumption and limited ability to generate savings. The relation “average prices / average incomes” improves gradually as the result of recent correction of real property prices combined with increasing salaries. The availability of flats (measured as the number of square meters that can be purchased for a monthly salary) is still low[18];
- loan demand has been largely satisfied through extensive lending in previous years; the number of active loan agreements increased from almost 300 thousand at the end of 2002 up to 1.7 million at the end of 2012; the value of loans awarded at that time increased from PLN 20 billion to more than PLN 300 billion; the share of loans in GDP increased from 2% to 20% (similar as in Belgium, Italy and Austria). In consequence, the demand has gradually dropped down and stabilized at a level lower than in the period of the loan boom.

Considering the above, the sales of loans by the banks in 2012 is still satisfactory.

Chart 34.
Selected relationships at the Warsaw real property market



Source: GUS, NBP, own calculations

[18] The availability of flats shown at the diagram (measured based on gross salary) is a large simplification. To present a truly fair view, it would be necessary to use net salary less average maintenance costs.

Reduced portfolio of consumer loans but the lending remains stable

In 2012, the share of consumer loans dropped by PLN 6.9 billion, i.e. by 5.3% (adjusted for FX rates: by approx. PLN 6.2 billion, -4.8%).
Instalment loans saw the highest decline (PLN –4.8 billion; -10.4%) second came the debt under car loans (PLN –1.1 billion; -16.1%) and credit cards (PLN –0.9 billion; -7.0%). Debt under other loans (mainly cash loans) remains stable.

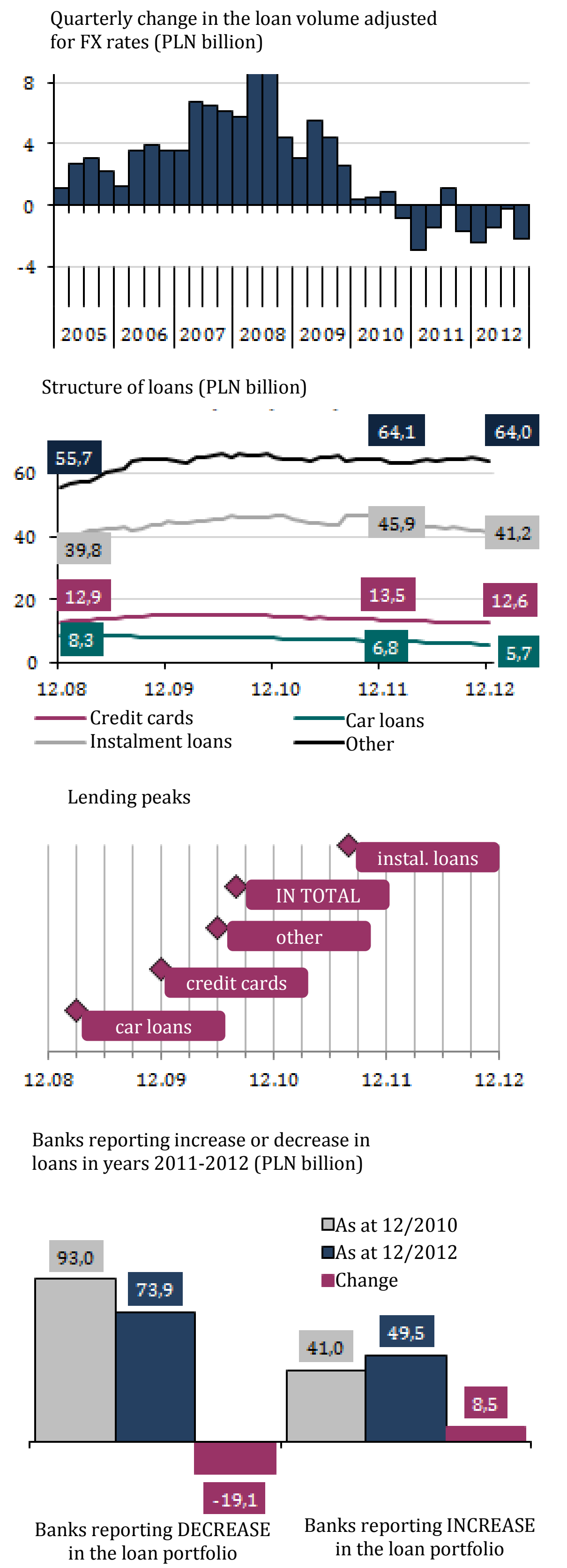
The consumer loans' share in the bank sector balance-sheet has been dropping since the second half of 2010.
The lending peak (defined as the maximum value of portfolio) was in August 2010; peaks for individual products differentiated in time (peak for car loans: 03/2009, peak for debt under credit cards 12/2009, peak for other loans 06/2010, peak for instalment loans: 08/2011).

The decline in loans does not mean that lending drops down as well; the lending remains stable (see herein below).

The situation is not homogeneous

Lending development as per individual banks is strongly differentiated.
Since the end of 2010 until 2012, the consumer loan portfolio had shrunk at 416 banks (by PLN 19.1 billion) and expanded at 214 banks (by PLN 8.5 billion).
The biggest drop is seen for the banks that pursued an aggressive strategy in the past periods, which caused some of them to establish high provisions adversely impacting on their financial results, while others sustained even considerable losses. In consequence, those banks revised their strategies, the fact that affected the loan supply.

Chart 35.
Growth of consumer loans



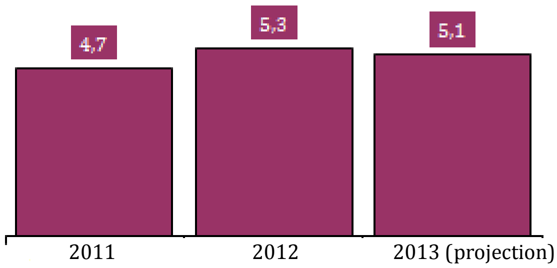
Drop in consumer loans is the effect of "cleaning the portfolio" and not of reduced lending

Drop in consumer loans reported for years 2011-2012 was the consequence of "cleaning the balance-sheet" from low quality assets, through sales (and/or transfer to off-balance sheet items) of a portion of the "bad debts" portfolio. As the result, the portfolio shrank by PLN 10 billion (by PLN 4.7 billion in 2011 and PLN 5.3 billion in 2012).

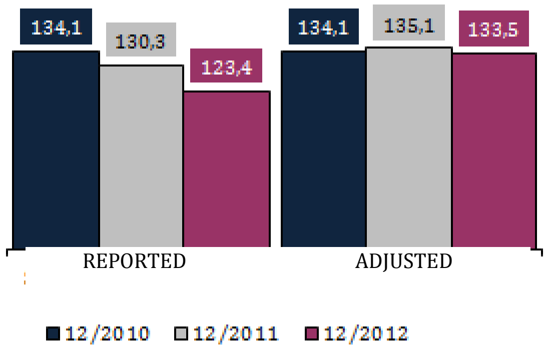
If the reporting data were adjusted (the same as in case of adjustment for FX rates), the consumer loan portfolio 2011-2012 would be similar as at the end of 2010. It means that the lending remains stable, the fact confirmed by analyses based on other data from UKNF and BIK; those analyses show, in addition, that the consumer loans slightly grew in 2012 (see herein below).

Chart 36.
"Cleaning" of the consumer loan portfolio

Sale and transfer of consumer loans to off-balance sheet register (PLN billion)



Reported and adjusted volume of consumer loans (PLN billion)



Transfer of sales of a portion of instalment loans to other entities

The reduction in consumer loans throughout the sector was, to a large extent, caused by transfer of sale of small amount instalment loans by some banks to lending companies, operating under the parent capital group, in order to bypass the regulatory moves. These transfers were particularly large in 2012 and their scale is estimated to be approx. PLN 3-5 billion.

The latter phenomenon is particularly adverse as it results in the credit risk being shifted to yet some other place within the same capital group, further it causes increased compliance and reputation risks and lower transparency of operations as well as stimulates negative competitive pressure. However, for households it is neutral – the loan is still available, but through different sales channel.

Reduced demand and banks' self-regulation are the main reasons for slowdown in consumer lending

The main reasons for slowdown in lending growth (in addition to those specified above) are limited demand from households and banks' self-regulation resulting in selective loan supply.

Decline in demand is the consequence of deteriorated consumer sentiment and raising concerns about future financial situation, the effect of worsened labour market conditions (increased unemployment rate and decline in real salaries) and deteriorated economic outlook. In addition, as the result of intense lending in previous years, some households satisfied their financial needs through loans.

The banks' self-regulatory actions are the effect of material deterioration of the loan portfolio quality in years 2009-2010, increased aversion to take up excessive risk as the consequence of negative phenomena taking place in the banks' external environment, as well as modified strategies of some banks in response to modified strategies of their strategic investors. In particular, in 2009-2010 the consumer loan quality deteriorated considerably, the effect of which was strong rise in non-performing loans and related impairment losses (the value of non-performing loans increased from PLN 9.1 billion as at the end of 2008 up to PLN 23.2 billion at the end of 2010, share of non-performing loans increased from 8% to 17% and the negative balance of impairment losses increased from PLN 3 billion to PLN 7 billion). As the consequence of strong self-regulation, the quality of loans stabilised in 2011-2012 and the impairment losses dropped significantly (it was lower in 2012 as compared to 2008).

Insignificant role of the regulatory factor in slowing down the lending growth

As the analysis of supply and demand show, the actual role of the regulatory factor in slowing down the growth in lending was rather insignificant (see herein below). However, the UKNF reviewed the current regulations and decided to largely amend the existing regulations. In the second half it presented a draft amendment to the Recommendation T (see the Annex).

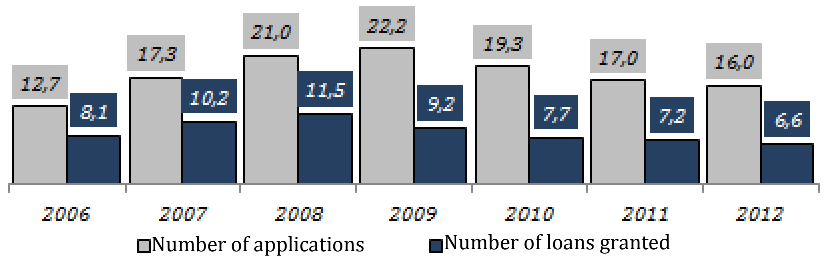
Insignificant/immaterial role of non-banking lending institutions

As the analysis of non-banking lending institutions show (see the Annex), their role is insignificant/immaterial, although they grow at a stable pace. This fact is contrary to the popular opinion that the customers flew from banks to non-banking lending institutions as the result of regulatory actions taken by KNF in the banking sector (this phenomenon was in fact immaterial). At the same time, those institutions experience exactly the same problems and those existing in the banking sector.

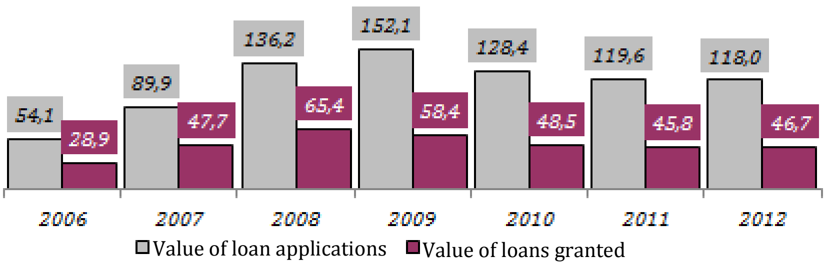
Consumer loans – demand, supply and credit policy

The slowdown in lending was predominantly impacted by demand and supply, as confirmed in the UKNF analyses, the BIK data, analyses of the opinions of the credit committees' chairmen carried out by NBP and the consumer sentiment research. The analyses show that the role of regulatory actions is limited/insignificant.

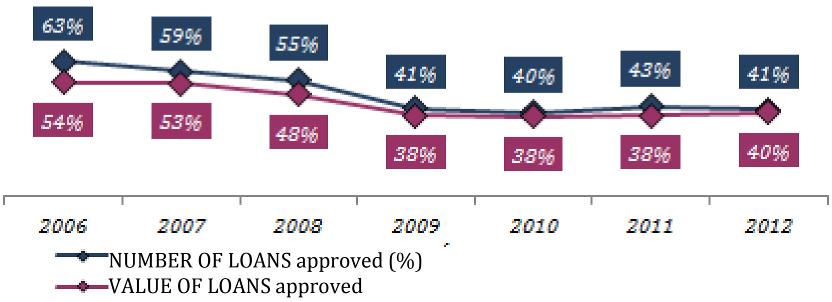
NUMBER of loan applications and consumer loans granted (million pcs)



VALUE of loan applications and consumer loans granted (PLN billion)



Loan applications approved (%)



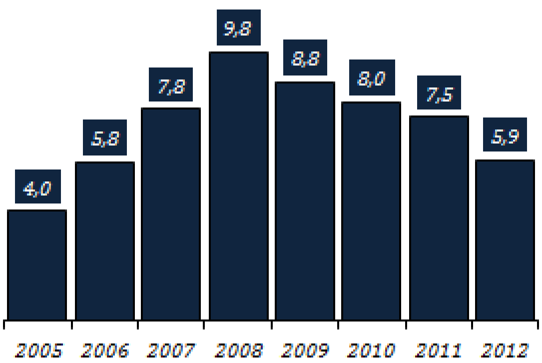
According to the questionnaire research performed by UKNF[19], the consumer loan development peaked in years 2007-2009 (sales peak in 2008, demand peak in 2009). In subsequent years, both the demand and supply dropped. In years 2010-2012 the demand dropped by almost 30% (in quantitative terms) and by approx. 20% (in terms of value) (as compared to 2009).

[19] The research covered 21 entities that, at the end of 2012 held 92.8% of the total consumer loan portfolio. Caution needs to be exercised, however, considering that it was a questionnaire research partly based on expert assessments made by individual banks. Despite that weakness, the results depict the actual situation quite well.
Note: there are large differences between banks as regards the number and the value of loan applications and the number of approvals (the largest number and total value was reported by banks specialised in granting large number of small amount loans).

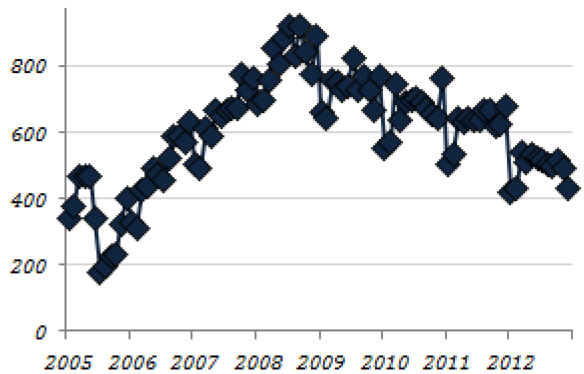
The demand realisation (approval of loan applications) analysis shows that the banks tightened their loan policies in years 2008-2009, the fact reflected in drop in demand realisation from above 50% in years 2006-2007 down to approx. 40% in year 2009. Steep decline in the number of approvals for loan applications was the effect of independent decisions taken by banks and of the crisis after the Lehman Brothers collapse and of strongly deteriorated loan portfolio quality in years 2009-2010. Since 2010 the loan application acceptance level has remained stable.

The research also shows that the role of regulatory actions was rather limited/insignificant. If the regulatory actions were the main reason for slowdown in lending, then considerable reduction in acceptance of loan application would have to be expected in years 2010-2011 (in particular in 2011, when all provisions of Recommendation T started to apply). And it did not happen.

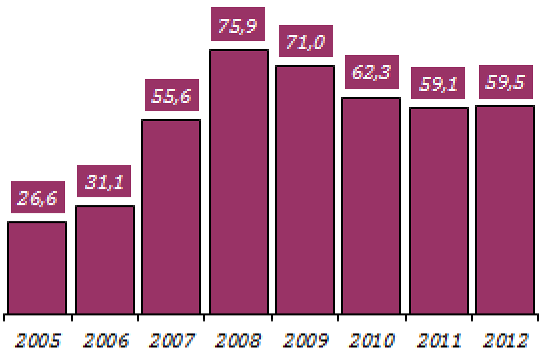
NUMBER of loans granted per year
(million pcs)



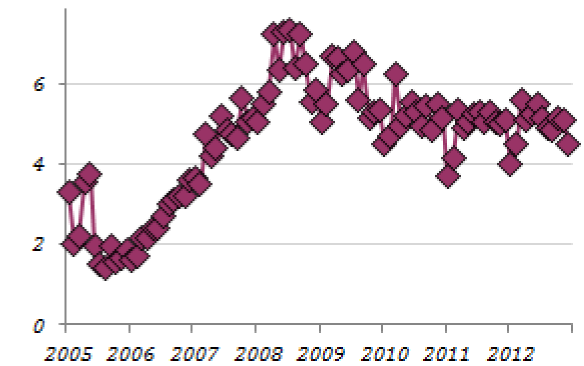
NUMBER of loans granted per month
(thousand pcs)



VALUE of loans granted per year
(PLN billion)



VALUE of loans granted per month
(PLN billion)



Source: BIK

According to data from BIK[20], the loan boom peaked in the middle of 2008 (in Q3 and Q4 loans were granted for the total amount exceeding PLN 20 billion). Lending in subsequent periods dropped. The biggest drop was reported at the end of 2008/beginning of 2009 and at the end of 2009. Since Q4 2009 lending stabilised in terms of value (the value of loans granted in each individual period is approx. PLN 15 billion). The number of loans drops, however, it is a consequence of reduced demand and self-regulatory actions taken by banks reflected, among others, in limited lending for customers with the lowest financial standing.

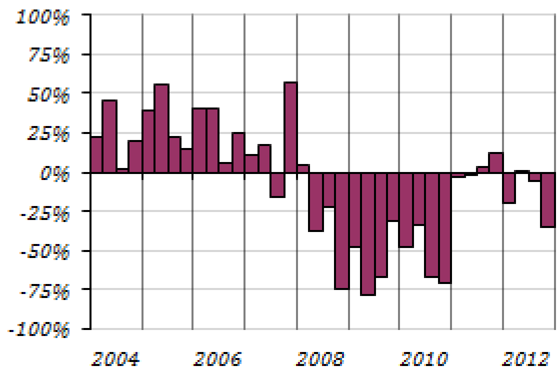
[20] *Note: the data from BIK also include SKOKs and do not include debts in current accounts and under payment cards.*

As the data from BIK show, the resolution and coming into force of the Recommendation T has not resulted in considerable changes as regards the number and the value of loans granted (the key provisions came into force at the end of 2010). The fact is that the value of loans in 2011 was slightly lower as compared to 2010 (correspondingly by 6.7% and 5.1%), however it is difficult to say if it was the effect of regulatory decisions or the effect of self-regulatory actions by banks and limited demand. If the Recommendation T had a strongly negative impact, then a considerable drop in the number and the value of loans granted would have to be expected. And it did not happen.

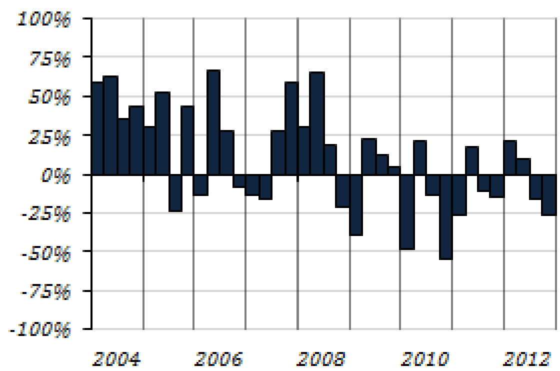
The negative impact of the Recommendation T has been observed since 2012. At that time a portion of sales of small amount instalment loans was transferred by some banks to other entities in order to avoid consequences of regulatory decisions. As the result, the number of loans granted dropped sharply (by 21.0%). In terms of value, however, the lending slightly increased (by 0.6%)[21]. These developments were without impact on households, the loans for which were still available (through a different sales channel). In this context, the Recommendation T proved neutral.

The negative impact of the Recommendation T is also reflected in the reduced number and value of cash loans for up to PLN 10 thousand (in particular up to PLN 2 thousand), this being partially the effect of introducing the DTI limit and requirement to provide a declaration of income.

SUPPLY of consumer loans
Difference in market share of banks which
loosened (+) or tightened (-) the loan policy



DEMAND for consumer loans
Difference in market share of banks which
reported increase (+) or decrease (-) in demand

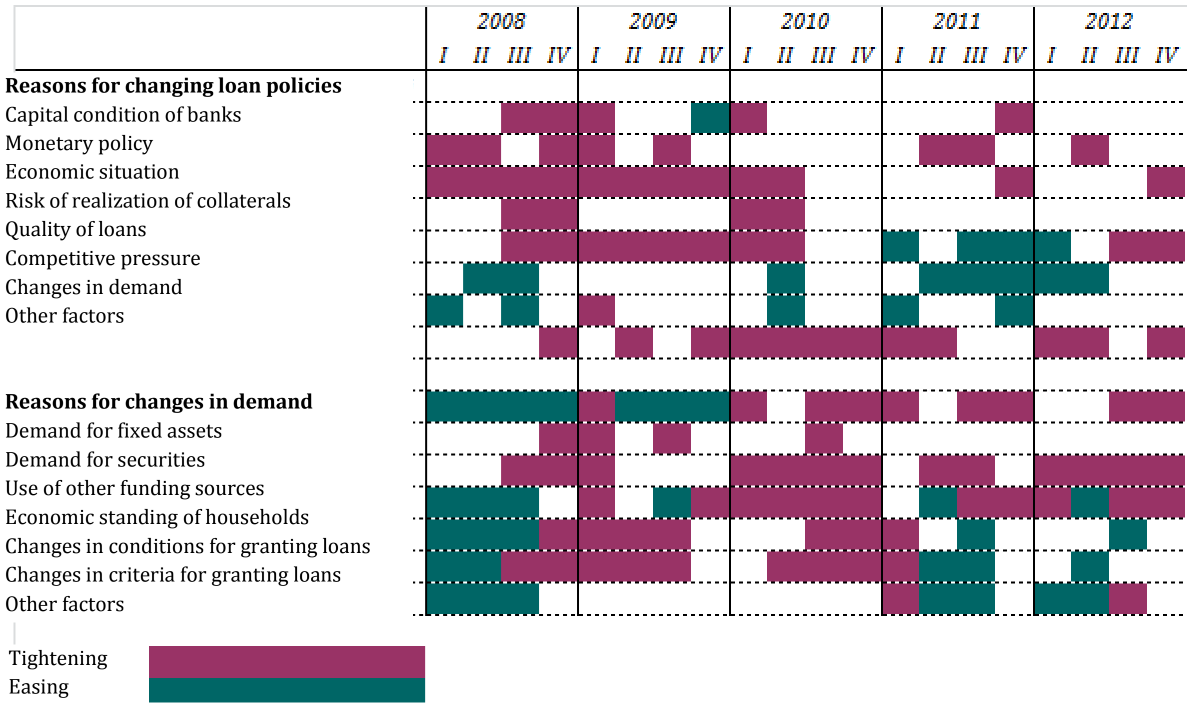


Source: NBP

According to the analyses of the opinions of the credit committees' chairmen carried out by NBP, there are three stages in the consumer loan policies of banks: 2004 – the beginning of 2008: policy loosening; Q2 2008 – Q4 2010: polisy tightening; years 2011-2012: stabilisation of the loan policies (slight adjustments). Q4 2012 saw considerable retightening of the loan policies.

Banks reported the rise in demand in years 2004-2008, then fluctuations in years 2009-2012 with several quarters where the demand dropped considerably.

[21] *The BIK reports focus on quantitative approach which, considering the sales structure (large number of small amount instalment loans) may bias the assessments of ten actual scale of lending.*

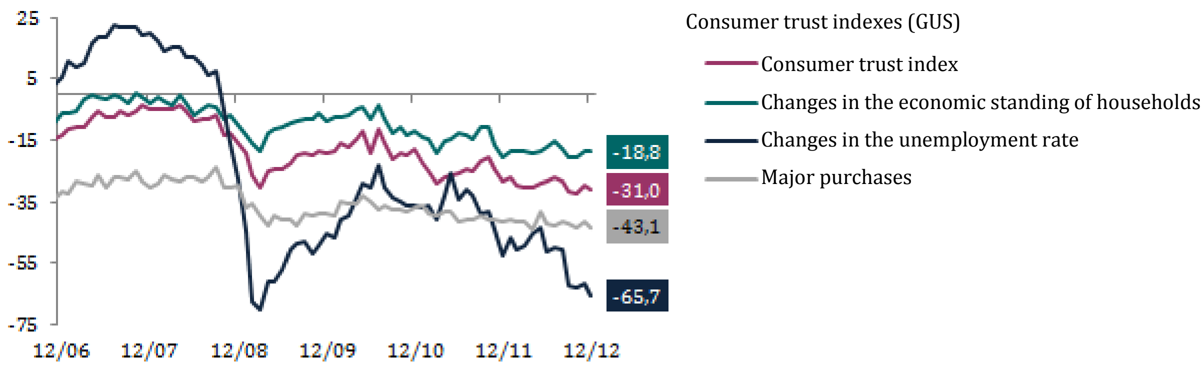


To improve the transparency, only net changes exceeding 10% of the market share were presented

Source: NBP

The main factors affecting the loan supply was the macroeconomic situation (especially in years 2008-2010 and at the end of 2011 and 2012), the loan quality (Q3 2008 – Q2 2010) and the monetary policy. For some periods, banks reported other factors (including the regulatory factor) due to which loan procedures needed to be tightened. The impact of the regulatory factor was particularly large in the second half of 2010 (need to adapt to the T Recommendation).

Important drawback of the NBP research is the lack of weights assigned to individual supply/demand generating factors. Therefore it is not possible to determine the impact of individual factors. Despite that, the research results clearly show the importance of self-regulation (especially in years 2008-2010) in the process of tightening the loan procedures.



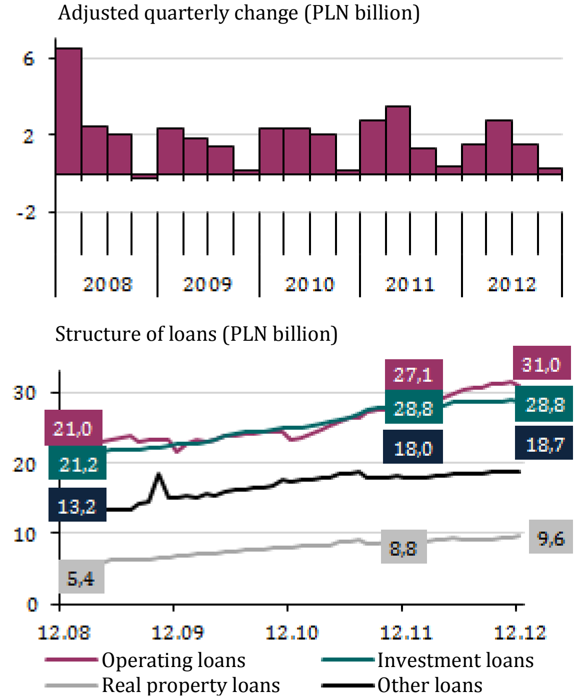
Strong impact of the demand factor has been confirmed in the consumer sentiment analyses (GUS and other research centres). According to those analyses, the customer sentiment has deteriorated considerably and the households are less interested in making large purchases or take out debts.

Stable growth in other household loans

Other household loans (mainly operating and investment loans for small enterprises) has grown at a stable pace in recent periods. The value of those loans increased in 2012 by PLN 5.4 billion, i.e. by 6.5% (adjusted for FX rates: approx. PLN 5.9 billion, i.e. approx. 7.2%).

Negative phenomenon is the slowdown in the investment loan growth, the result of deteriorated economic outlook that translates into limited investments.

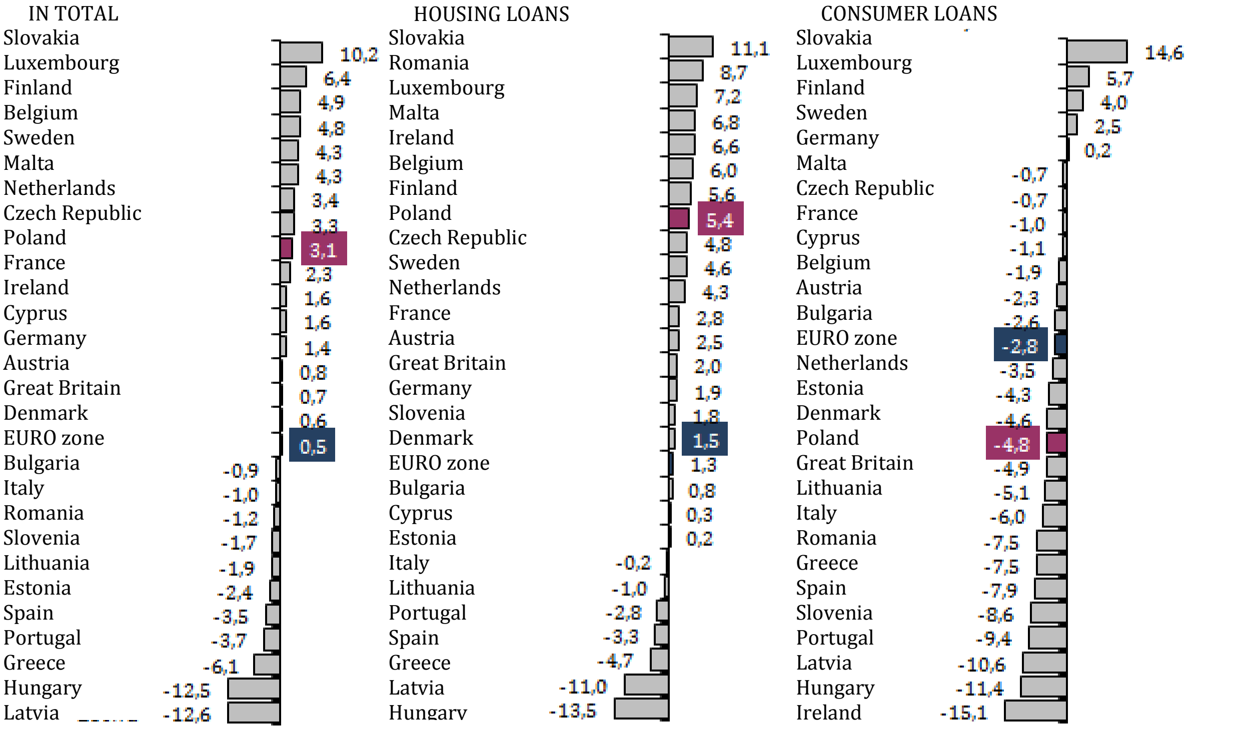
Chart 37.
Other household loans



Low/negative growth of household loans in majority of the European Union countries

Low or negative household loan growth has been reported for the majority of the EU countries. It is the indirect proof that the main reason for slowdown in lending is the long-term financial crisis and related modified attitudes of some households and banks.

Chart 38.
The annual growth in household lending in 2012 as per EU country (%)



Source: ECB, central banks, own calculations

Table 13. Enterprise loans

	Gross balance-sheet value (PLN billion)				Change to 2011			
					nominal		adjusted	
	2010	2011	09/12	2012	PLN bn	%	PLN bn	%
In total	219.7	264.5	276.2	272.3	7.7	2.9%	13.4	5.2%
1/ SME	127.0	159.0	167.2	164.9	5.9	3.7%	8.8	5.6%
- operating loans	46.2	57.5	64.9	62.3	4.8	8.4%		
- investment loans	35.2	47.5	48.3	47.2	-0.3	-0.6%		
- real property loans	35.0	39.9	41.0	42.0	2.2	5.4%		
- other	10.6	14.2	13.0	13.3	-0.8	-5.8%		
2/ Large enterprises	92.7	105.5	109.0	107.4	1.9	1.8%	4.6	4.4%
- operating loans	44.2	47.9	50.5	47.1	-0.9	-1.8%		
- investment loans	30.1	36.5	34.5	34.4	-2.0	-5.6%		
- real property loans	9.2	8.4	9.1	9.2	0.8	9.5%		
- other	9.2	12.7	14.9	16.7	4.0	31.3%		
as per currency								
- PLN	165.1	192.9	211.5	208.8	15.9	8.3%	15.9	8.3%
- foreign currencies	54.6	71.6	64.6	63.5	-8.2	-11.4%	-2.6	-3.9%

Reduced growth in enterprise loans, slowdown in investment loans

The enterprise loan growth slowed down in 2012 (the loan value increased by PLN 7.7 billion, i.e. by 2.9% and, after being adjusted for FX rates, by approx. PLN 13.4 billion, i.e. by approx. 5.2%); in Q4 the debt of enterprises to the banking sector dropped down.

The above is the effect of gradual decline in economic activity, deteriorated economic outlook and increased uncertainty as to future growth – as the result some of the enterprises reduced their demand for loans. It is particularly noticeable in the area of investment loans. It was also caused by tightening the loan policy by some banks (especially as regards loans for sectors which are strongly sensitive to economic slowdown) and slight tightening of the monetary policy in the first half of 2012.

Lending growth was strongly affected by reduction of debt by several large enterprises, in particular from fuel and telecommunication industry (partially, a result of a changed financing structure); as the result, their debt at banks dropped down by approx. PLN 5 billion.

Reduced growth in enterprise loans translated into slight reduction in their share in the balance-sheet total and in total loans; the share of enterprise loans in non-financial sector loans slightly increased.

Chart 39.
Enterprise loans

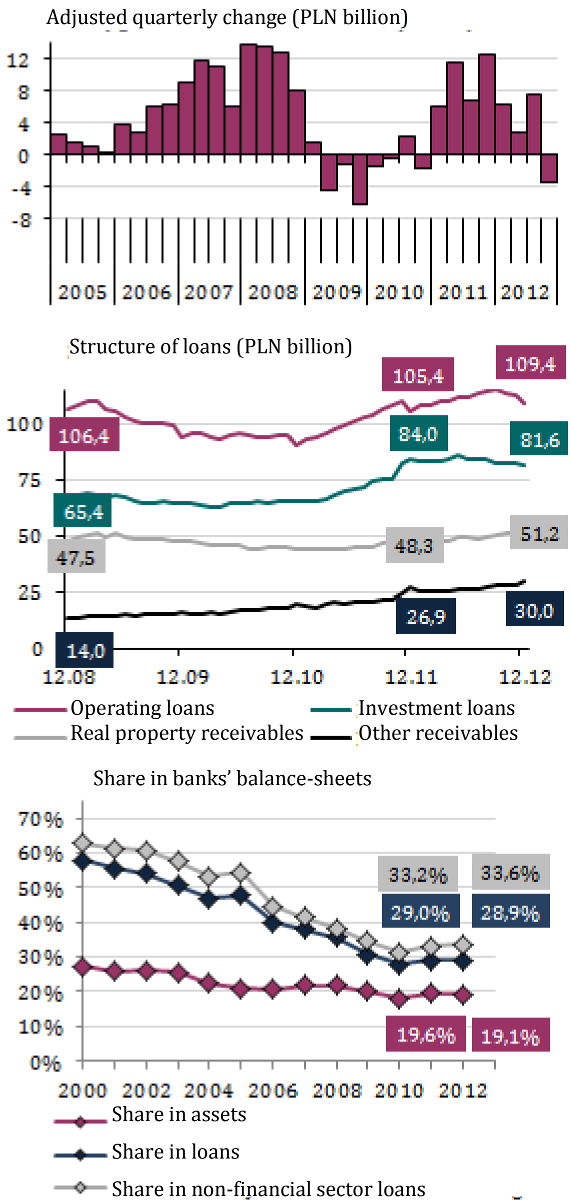
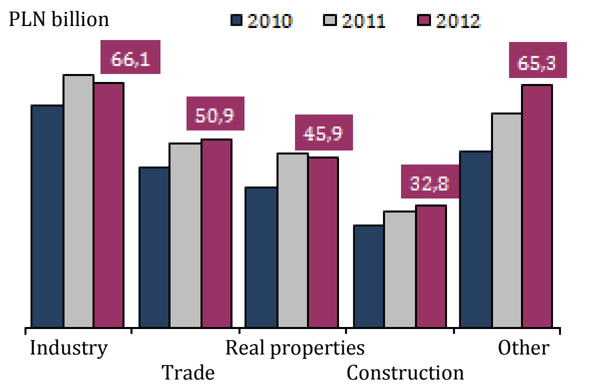


Table 14. Enterprise loans per sector (large commitments)

	Value (PLN billion)				Change to 2011	
	2010	2011	09/12	2012	PLN bn	%
In total	215.9	253.5	266.5	260.9	7.4	2.9%
Industry sector	60.0	67.9	68.4	66.1	-1.8	-2.7%
- food	14.2	15.5	16.3	16.0	0.6	3.6%
- metallurgy	8.0	9.6	9.8	9.8	0.2	2.3%
- chemistry and pharmaceuticals	8.2	9.3	10.0	9.7	0.4	4.3%
- timber and paper-making	7.0	7.3	7.1	7.2	-0.1	-1.4%
- machines	5.7	6.1	6.3	5.8	-0.4	-5.7%
- refineries and coke	6.4	8.2	6.3	5.6	-2.5	-31.1%
- other	10.6	11.9	12.5	11.9	0.0	-0.1%
Trade	43.1	49.6	53.2	50.9	1.3	2.6%
Property management	37.9	46.9	46.6	45.9	-1.0	-2.0%
Construction	27.3	31.4	34.8	32.8	1.4	4.3%
Scientific and technical professional activity	5.7	8.2	9.3	9.6	1.4	16.5%
Rental, lease and services	8.1	8.1	9.0	8.7	0.6	7.4%
Catering and hotel trade	6.6	7.6	8.0	7.9	0.3	3.4%
Power	3.6	5.6	5.8	7.2	1.7	29.8%
Agriculture, forestry and fishing	5.1	6.1	7.1	7.1	1.0	16.3%
Telecommunications and the media	3.6	6.0	6.6	5.9	0.0	-0.5%
Transport and warehousing	5.1	5.3	5.5	5.6	0.3	5.4%
Other industries	9.8	10.8	12.0	13.2	2.4	22.6%

In sectoral terms, the loans extended to industrial processing companies (25.3%), trading companies (19.5%), property market management companies (17.6%) and construction companies (12.6%) prevailed; they accounted for 75% of all loans granted to the enterprise sector.

Chart 40.
Enterprise loan structure



Reduced growth in lending for the public sector

Limited growth in public investments and tightened budgetary discipline translated into reduced growth in lending for the public sector (loans for self-government agencies increased by PLN 2.6 billion, i.e. by 6.0%; loans for central government agencies increased by PLN 4.7 billion, i.e. by 11.4%).

Chart 41.
Loans for public sector

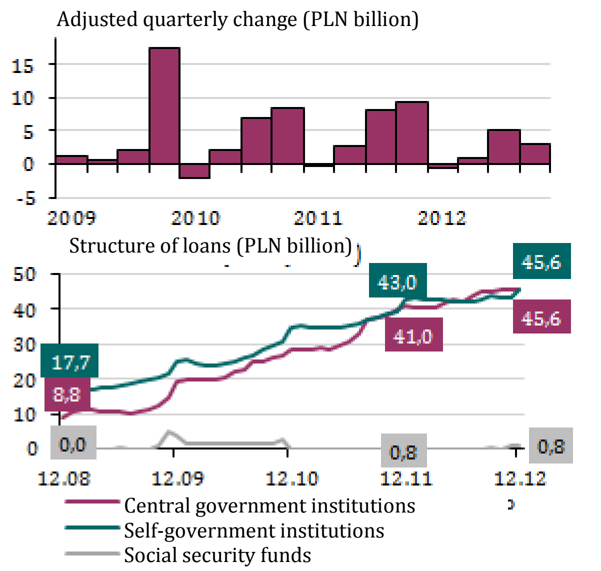


Table 15. Selected liquid assets

	Value (PLN billion)				Change to 2011	
	2010	2011	09/12	2012	PLN bn	%
In total	350.1	355.4	370.7	385.7	30.3	8.5%
1/ Cash in hand, with central banks	50.4	40.3	42.7	71.4	31.1	77.3%
- cash in hand	12.8	13.4	12.5	14.9	1.5	10.9%
- cash with central banks	37.7	26.9	30.2	56.5	29.7	110.4%
2/ Receivables from banks	68.5	71.8	80.4	76.3	4.5	6.3%
- resident	44.4	41.3	49.1	45.4	4.1	9.8%
- non-resident	24.1	30.5	31.3	30.9	0.4	1.4%
3/ Debt and equity instruments	231.2	243.3	247.7	238.0	-5.3	-2.2%
- central banks	74.6	93.3	104.3	98.4	5.1	5.4%
- government securities	143.8	130.8	124.6	120.5	-10.3	-7.8%
- debt instruments from other issuers	10.5	16.3	15.9	16.1	-0.2	-1.0%
- equity instruments	2.3	2.9	2.9	2.9	0.0	1.3%

Increase in most liquid assets and drop in the government securities portfolio

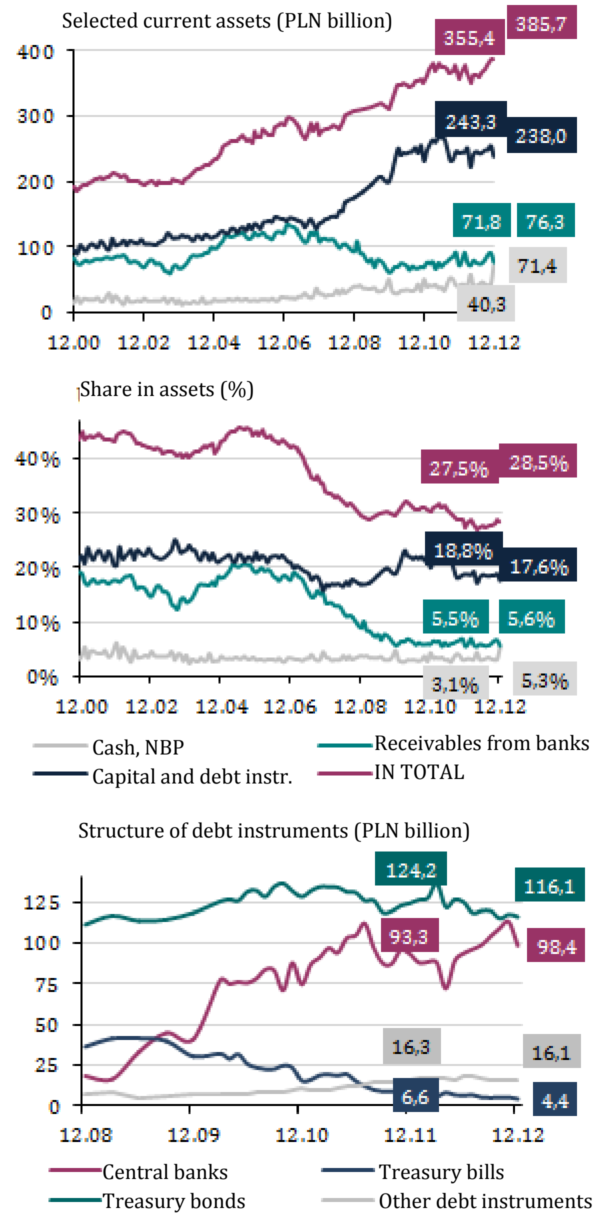
Reduced growth in lending translated into considerable growth in the most liquid assets[22] (by PLN 30.3 billion; 8.5%), including their share in balance-sheet total (27.5% at the end of 2011 up to 28.5% at the end of 2012).

The liquidity surplus was, in majority, invested in government securities and the NBP cash certificates. Some banks benefited from the government securities price hikes and decided to realize profits through sales of a portion of papers. In consequence, the bond portfolio shrunk (by 6.5%). The long lasting trend of marginalization of T-bonds continued.

Stable level of foreign deposits

The deposits of Polish banks at non-resident banks remains stable (within the last years, the value of deposits is between PLN 15-30 billion).

Chart 42.
Liquid assets



[22] Defined herein as the total of: cash in hand, cash with central banks, receivables from banks and the debt and equity instrument portfolio.

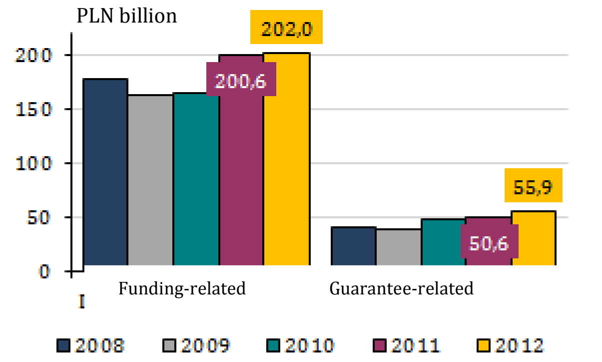
Stability of the off-balance sheet operations

Moderate growth rate of operations' scale, modest changes to interest rates and limited PLN fluctuations caused off-balance sheet operations to stabilise in 2012.

The funding-related liabilities extended has not significantly changed (increase by 0.7%). The liabilities towards the non-financial sector entities accounted for most liabilities (78.4%); they stemmed from the credit lines granted (PLN 144.7 billion).

The amount of guarantees granted by banks went up (by 10.5%). The guarantees granted to the non-financial sector entities accounted for most of them (78.8%; they included PLN 12.6 billion-worth credit repayment guarantees).

Chart 43.
Extended liabilities

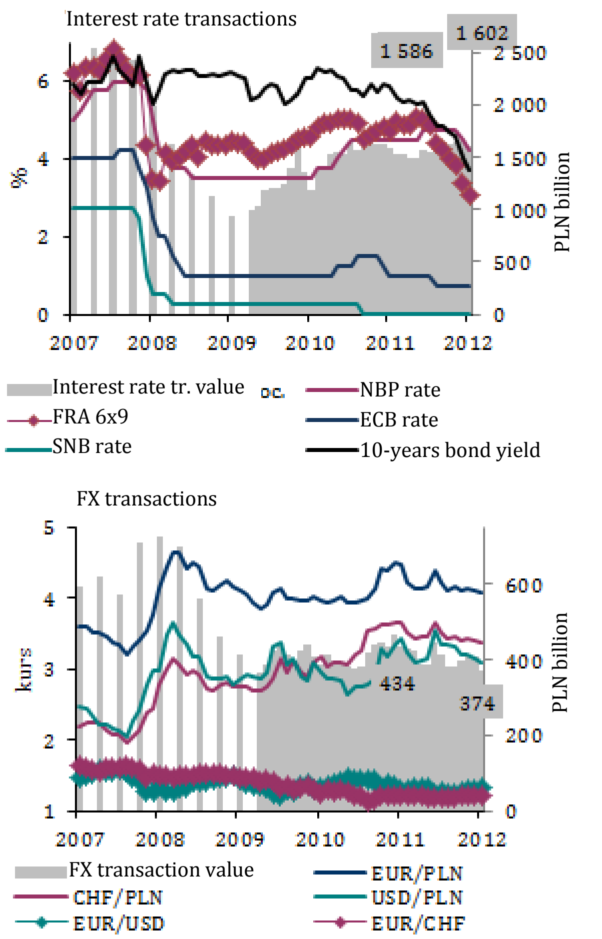


The nominal value of derivative deals remained stable (insignificant drop from PLN 2,019.3 billion down to PLN 1,975.9 billion, i.e. by 2.1%).

Interest rate deals which as at the end of 2012 accounted for 81.1% of all open derivative positions (increase from PLN 1,585.7 billion up to PLN 1,602.3 billion) were prevalent in the structure. Among them, the largest positions were these of IRS, FRA and OIS (47.2%, 30.4% and 2.6% of all open derivative positions respectively); with the most mature market being that of FRA[23].

The value of FX derivatives dropped down (from PLN 433.6 billion down to PLN 373.6 billion); in consequence, their share also dropped (down to 18.9%), while CIRS, FX Swaps and outright forwards were most significant (7.4%, 7.3% and 2.6% respectively).

Chart 44.
Derivative deals (nominal value)



[23] The higher nominal worth of IRS than FRA follows the fact that IRS deals are often made for terms of a few years, whereby they are kept longer in the balance sheet.

6. FUNDING SOURCES

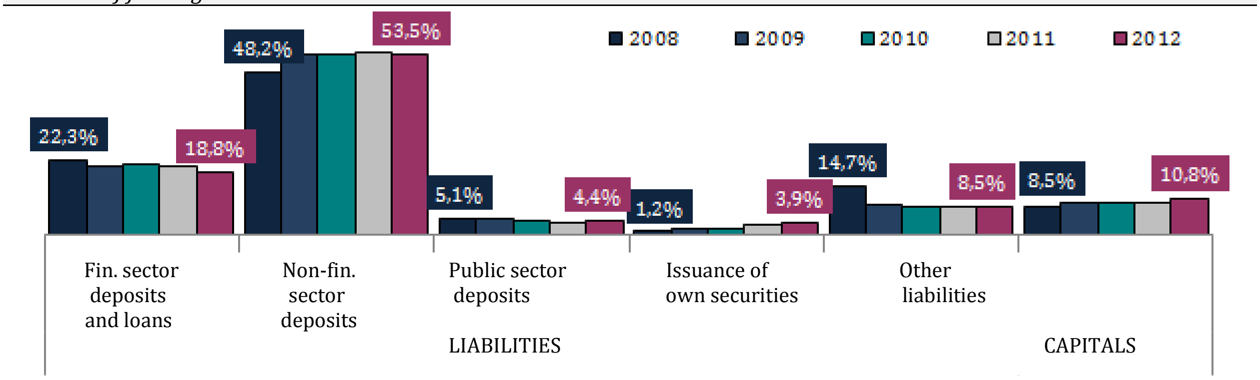
Moderate growth rate of liabilities, significant increase in equities

Moderate growth in scale of operations and PLN appreciation translated into limited growth in liabilities of the banking sector in 2012 (by PLN 40.7 billion, i.e. by 3.5%; adjusted for FX rates: by approx. PLN 62.3 billion, i.e. by 5.4%). Higher public sector and household deposits as well as higher issuance of own securities proved conducive to liabilities growth. On the other hand, lower volumes of enterprise deposits and financial sector deposits and loans (in nominal terms) were reported. The own securities increased considerably (by PLN 17.7 billion; 13.7%). As the consequence of the above changes the stability of funding sources improved.

Table 16. Funding sources

	Value (PLN billion)				Change to 2011			
					nominal		adjusted	
	2010	2011	09/12	2012	PLN bn	%	PLN bn	%
Liabilities	1 043.4	1 165.7	1 192.0	1 206.3	40.7	3.5%	62.3	5.4%
1/ Deposits and loans from the financial sector	244.8	266.6	254.3	254.8	-11.9	-4.5%	0.1	0.1%
2/ Deposits from the non-financial sector	620.4	698.6	695.7	724.0	25.4	3.6%	31.4	4.5%
- households	422.4	477.4	498.9	516.0	38.6	8.1%	41.8	8.8%
- enterprises	182.8	206.0	179.7	191.3	-14.7	-7.1%	-11.9	-5.9%
- non-commercial institutions	15.2	15.3	17.2	16.7	1.5	9.6%	1.5	10.0%
3/ Deposits of the public sector	53.0	49.0	82.9	59.8	10.8	22.1%	11.9	24.9%
4/ Issuance of own securities	24.4	42.8	54.7	52.7	9.9	23.1%		
5/ Subordinated liabilities	9.7	10.1	7.0	8.0	-2.0	-20.1%		
6/ Other	91.2	98.6	97.4	107.1	8.5	8.6%		
Per currency								
- PLN	806.9	880.7	935.3	936.2	55.6	6.3%	55.6	6.3%
- foreign currency	236.5	285.0	256.7	270.1	-14.9	-5.2%	6.7	2.5%
Per country								
- resident	828.6	923.0	977.3	987.6	64.7	7.0%	73.0	8.0%
- non-resident	214.8	242.7	214.7	218.7	-24.0	-9.9%	-10.7	-4.7%
Including: funds from the parent group								
Equities	116.0	128.9	143.3	146.6	17.7	13.7%		

Chart 45.
Structure of funding sources



In the long term, the structure of the banks' funding sources is stable, nonetheless, the issuance of own securities and capitals has been growing in importance in recent years (followed by drop in deposits and loans of the financial sector). Individually, banks differ considerably in terms of funding sources structure.

Slow increase in the non-financial sector deposits – drop in enterprise deposits, reduced growth in households deposits

In 2012, the non-financial sector deposits saw the lowest growth in recent years. The annual deposit growth was only PLN 25.4 billion, i.e. 3.6% (adjusted: approx. PLN 31.4 billion, 4.5%); it was more than half lower than that realised in 2011. It was due to a drop (for the first time since 2004) in enterprise deposits (PLN -14.7 billion, i.e. -7.1%; adjusted: PLN -11.9 billion, -5.9%) and reduced growth in household deposits (PLN 38.6 billion, 8.1%; adjusted: PLN 41.8 billion, 8.8%).

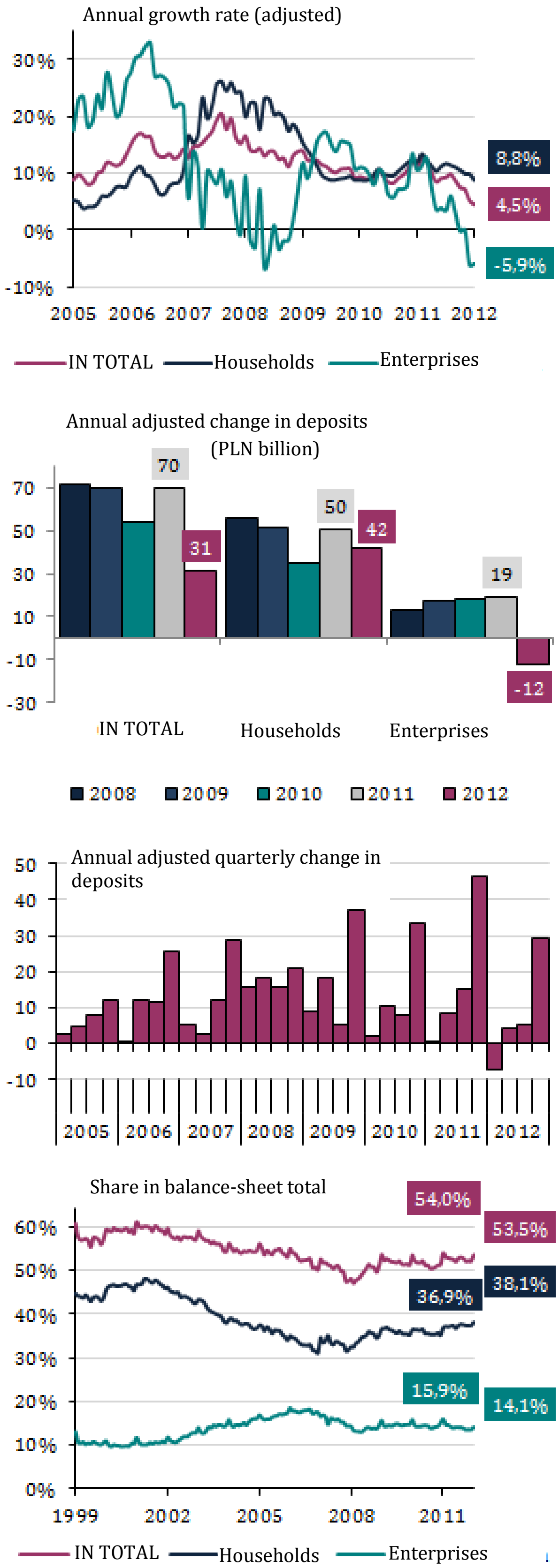
Reasons for the low deposit growth are gradual weakening of the economy (that affects the financial condition of some enterprises) and reduced salaries. Further, RPP started to ease the monetary policy which translated into considerable drop in deposit interest rate at the end of 2012. That, in turn, may negatively affect the customers' propensity to save and reduce the growth of deposits generated by interest accrued on existing deposits. Furthermore, reduction of the enterprise deposits was also the effect of acquisition of the Canadian company Quadra FNX Mining Ltd by KGHM Polska Miedź S.A.

The drop in enterprise deposits was followed by their reduced share in the funding structure (from 15.9% down to 14.1%). On the other hand, the household deposits grew (from 36.9% up to 38.1%) and the change in share of deposits in total was insignificant (drop from 54.0% down to 53.5%).

Low deposit growth may hamper lending

Low deposit growth may seriously hamper lending in the future.

Chart 46.
Non-financial sector deposits

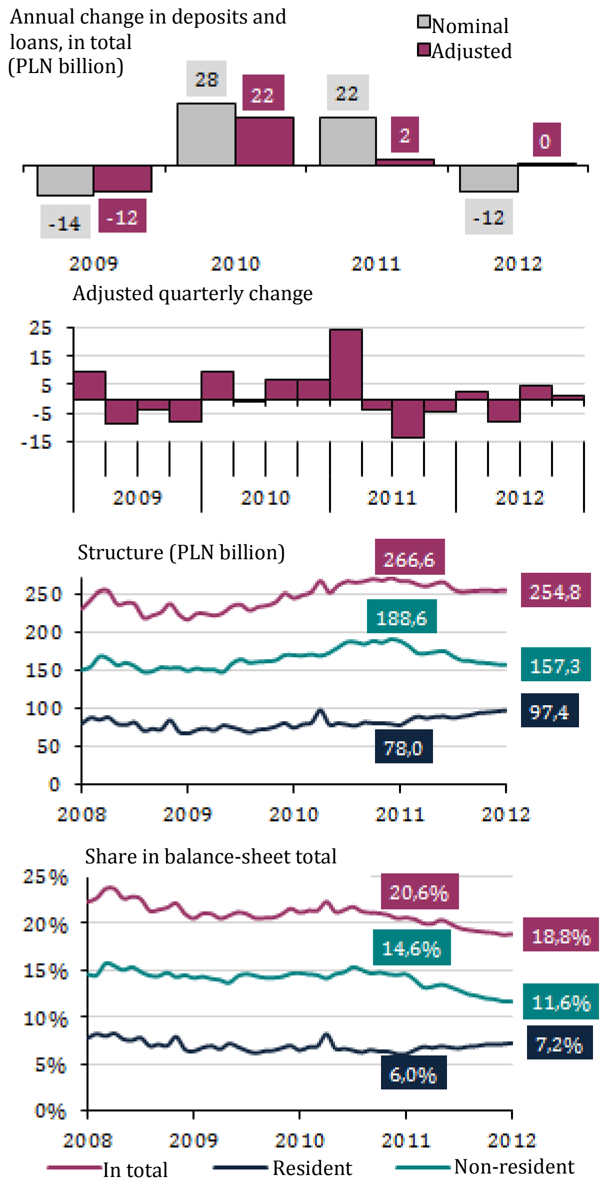


Stable growth in financial sector deposits and loans, reduced funds from non-residents

The financial sector loans and deposits dropped in 2012 (PLN –11.9 billion, -4.5%), however it was the effect of PLN appreciation, which translated into lowered value of funds in foreign currencies (converted into PLN). Upon eliminating the impact of FX rates, the level of those funds was the same as at the end of 2011 r. (PLN 0.1 billion, 0.1%),

Although the financial sector total loans and deposits are stable, noticeable is the reduction of non-resident funds (by PLN –31.3 billion; -16.6%). As already mentioned above, it was the effect of PLN appreciation (majority of the non-resident funds are in foreign currencies) and changes in the operational strategy, including changes of the funding structure at some banks. Reduction of non-resident funds was accompanied by the increase in funds from residents (PLN 19.4 billion, 24.8%).

Chart 47.
Financial sectors deposits and loans

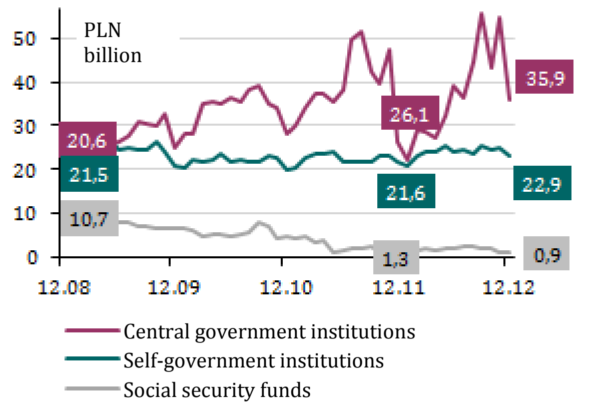


Growth in public sector deposits

Deposits of the public sector grew considerably in 2012 (by PLN 10.8 billion, 22.1%), the combined effect of the increase in deposits from the public sector institutions (outflow of deposits at the end of the year was not so large as in previous years) and of long-term stability of deposits from the local governmental sector.

Despite considerable growth, the role of public sector in financing the banking activities is limited considering relatively low value and strong concentration of funds.

Chart 48.
Public sector deposits



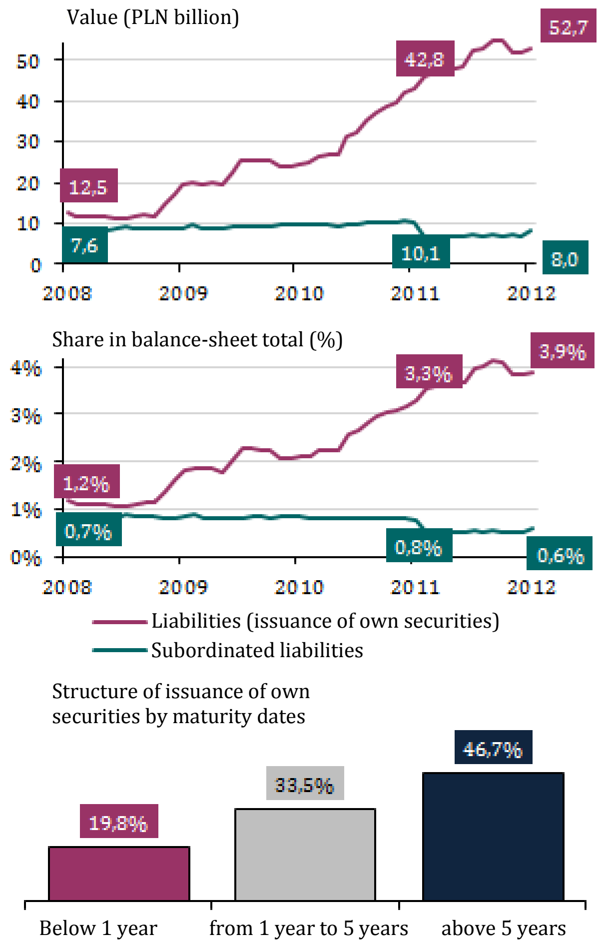
Increase in issuance of own securities

Issuance of own securities grew considerably in 2012 (by PLN 9.9 billion, 23.1%) and their share in funding source structure increased (up to 3.9%). Nonetheless, their role at the majority of banks was still insignificant. In addition, issuance of own securities are strongly concentrated (majority of them was carried out by a single state bank) – although banks tend to use this form of financing more and more (by the end of 2012, the issuance of own securities were carried out by 54 banks; at 10 of them, the value of issuance was PLN 1 billion or higher).

Growing importance of this funding source is a positive phenomenon, in particular considering the long- and medium-term nature of funds acquired through this channel (the maturity date of more than 80% of all funds is above 1 year; the maturity date of approx. 50% of them is above 5 years).

The role of subordinated loans was further marginalised.

Chart 49.
Issuance of own securities and subordinated loans

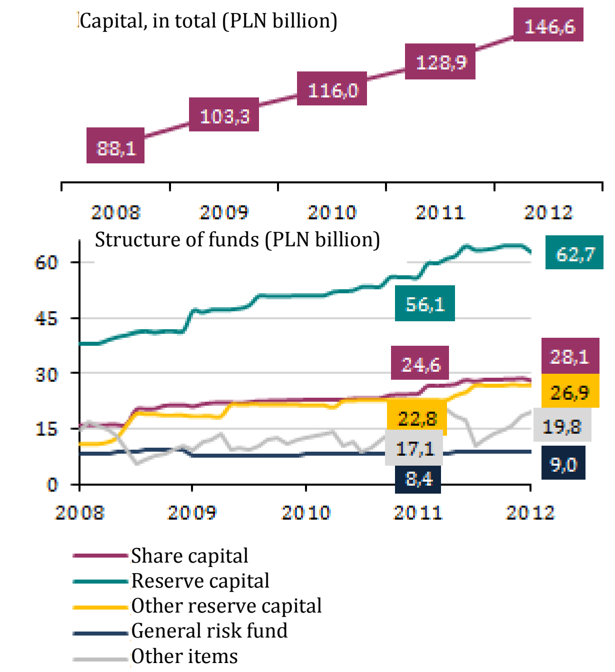


Significant rise in capitals

The banking sector capitals rose considerably in 2012 (by PLN 17.7 billion; 13.7%). This was the effect of the Recommendations from the KNF Chairman regarding the distribution of profit of 2011 (in consequence, the majority of profits was allocated to bank funds), the accumulation of profits of the current year, increased revaluation reserve and acquisition of new capitals by some banks.

The characteristic property of the Polish banking sector capital structure is predominance of the so called highest quality capitals; that translates into stability and safety of the sector.

Chart 50.
Capital structure



Reduced foreign funding as the result of PLN appreciation and changed operational strategies

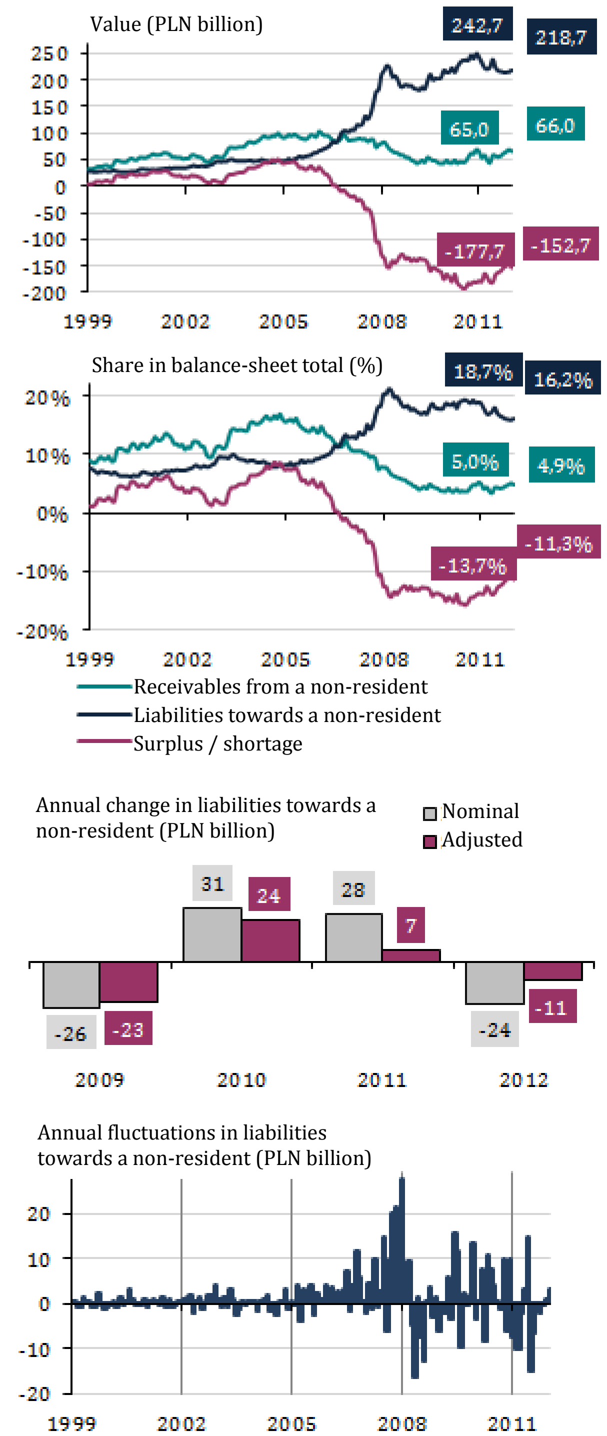
Predominant component of liabilities are the domestic liabilities; at some banks, however, foreign funding plays a significant role.

In 2012 liabilities of the banking sector to non-residents dropped (by PLN 24.0 billion, -9.9%), however the majority of the nominal drop was the effect of PLN appreciation (adjusted for FX changes: drop of PLN 10.7 billion, -4.7%). Reduced foreign funding was the effect of changes in the operational strategies of some banks, which stopped granting FX loans to households and reduced their dependence on funds from parent groups. In consequence, the demand of those banks for foreign funds falls down.

Reduced foreign funding translates into improved stability of the banking sector

Reduction in non-resident funds translated into reduced share of non-residents in the balance-sheet total (from 18.7% at the end of 2011 down to 16.2% at the end of 2012). Combined with the increased balance-sheet total and marginal increase in receivables from non residents, it resulted in reduced negative foreign funding gap (from -13.7% up to -11.3%) and more stable banking sector.

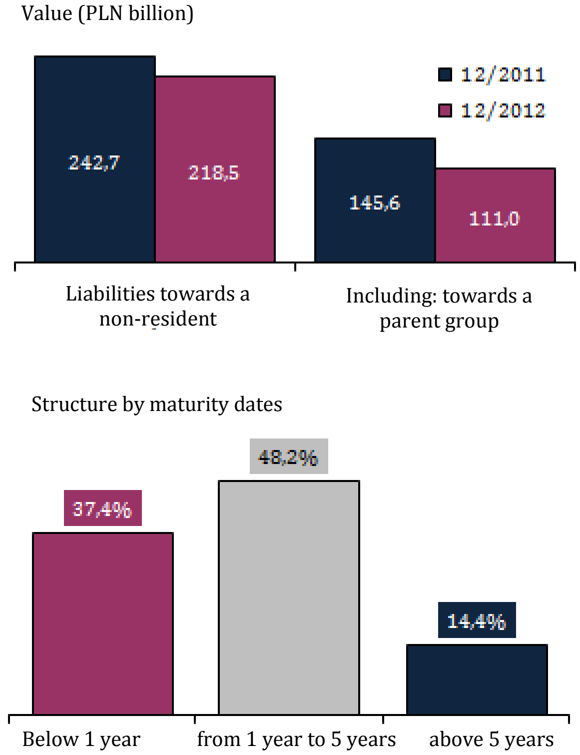
Chart 51.
Receivables and liabilities of non-residents



The biggest share of foreign funding was reported for small banks and loan institution branches controlled by foreign capital (the share usually exceeded 50%). Large share of that funding was also reported for some medium and large banks, controlled by the foreign investors, which were very active in the past in the area of housing lending (and, to the smaller degree, in consumer lending). Considering the lack of adequate deposit base, those banks used the foreign funding from the parent group.

Majority of the foreign funding is from parent groups

Chart 52.
Funds from parent groups



More than a half of all liabilities towards a non-resident is from entities of a parent groups. In 2012, as the result of the above factors, those funds (excluding branches of credit institutions) dropped considerably (PLN –34.6 billion; -23.8%). Those funds declined also due to "closing" of some transactions at the debt instrument market; those transactions have been, at some entities, financed from parent groups (this may be the reason for considerable fluctuations in the non-resident funds, as, for example, in 2011).

The maturity of the majority of funds from parent groups is above 1 year (approx. 60%), while a large portion of them are long-term funds (funds with maturity above 5 years account for approx. 15% of all funds). Others are short-term funds, however they are being successively revolved, if needed, by national banks.

Reduced foreign financing may negatively affect lending

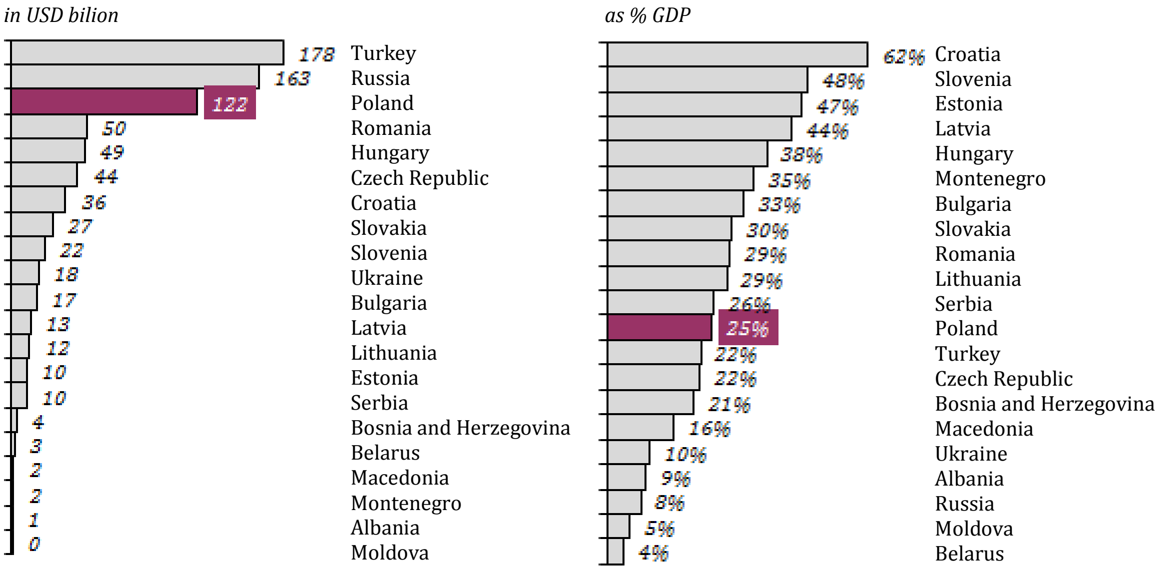
Considering the above, the reduction in funds from non-residents cannot be regarded as directly linked with withdrawal of capital from Poland; such phenomenon does not exist and the reasons for observed changes are different. The above is confirmed by the data regarding the balance of payments; on one hand they show that the Polish foreign debt grows systematically, on the other hand, however, that the foreign debt of Polish banks is stable in the long-term.

The negative aspect of those changes is, however, that, in the light of limited increase in other funding sources (in particular, deposits from the non-financial sector), reduction of foreign funds may negatively affect lending. This may be, to some extent, mitigated by issuance of long-term debt papers at the foreign markets.

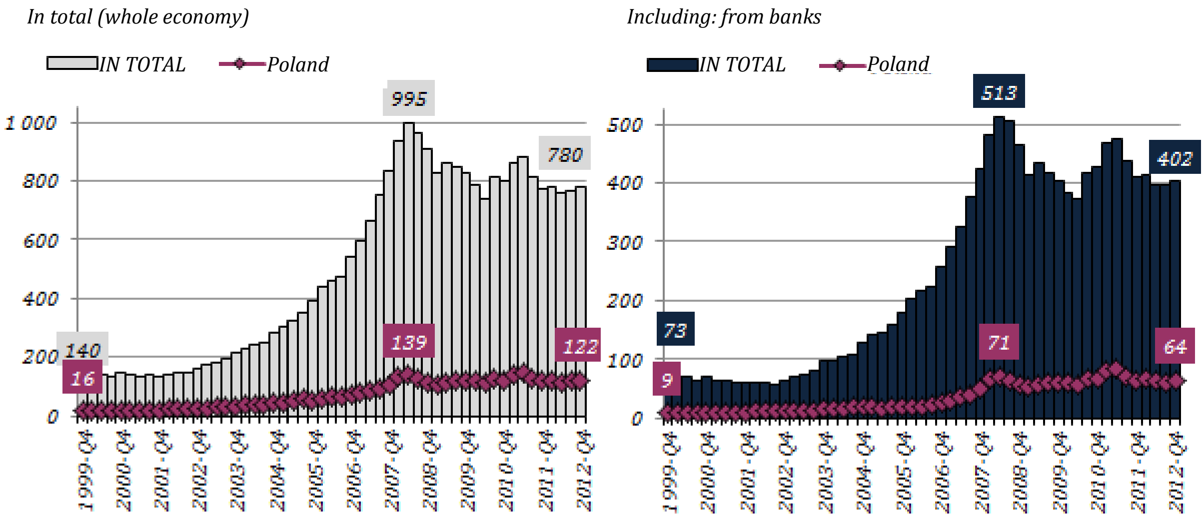
Further, any change in funding structure may result in increased funding costs and increased competition at the deposit market (the latter may be regarded as positive considering rapidly falling deposit interest rates as the result of strong monetary policy easing).

Exposures of foreign banks in the East-Central Europe[24]

Receivables of foreign banks (reporting to BIS) from the East-Central Europe countries at the end of 2012



Receivables of foreign banks from the East-Central Europe countries in years 1999-2012 (USD billion)



Source: BIS, IMF, own calculations

At the end of 2012, receivables of foreign banks[25] *operating at the East-Central Europe markets were USD 780 billion, of which 51.5% were invested in the banking sector (in Poland: 52.8%), and 48.5% in other sectors of the economy (in Poland: 47.2%). Majority of the exposure concerned Turkey, Russia and Poland. Their significance was particularly high for Croatia, Slovenia, Estonia, Latvia, Hungary, Montenegro, Bulgaria, Slovakia, Romania and Lithuania, where they accounted for 30-60% GNP (in Poland: 25%).*

The biggest inflow of funds to the region took place in years 2005-2008 and was one of the reasons of the loan boom. At the peak in Q2 2008 (in USD) the banks reported the regional exposure at the level of USD 995 billion. It dropped graudally in subsequent periods and then stabilised. However, there are still large differences in this regard between individual countries.

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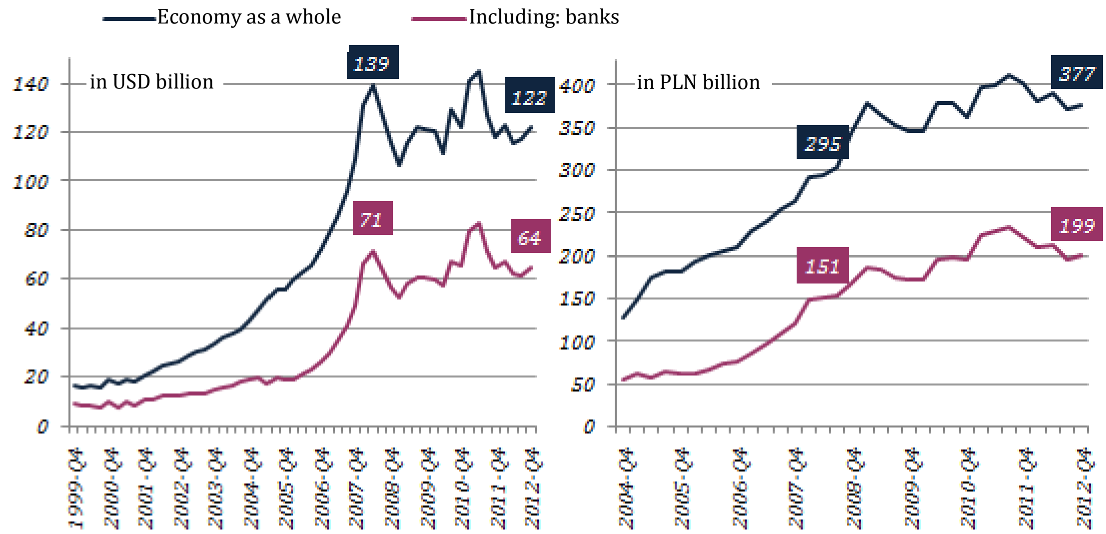
[24] More – see "CESEE Deleveraging Monitor", Vienna Initiative; "Financing Future Growth: The Evolving Role of Banking Systems in CESEE", IMF 2013.
[25] Data presented herein concern the banks reporting to BIS; they concern the so called " external position".

Change in the foreign banks' funds invested in the East-Central Europe countries in years 2008-2012

	In total (economy as a whole) USD billion				Including: banks USD billion			
	2008 Q2	2012 Q4	Change		2008 Q2	2012 Q4	Change	
WHOLE REGION	995	780	-215	-22%	513	402	-111	-22%
Estonia	21	10	-11	-52%	18	8	-10	-57%
Ukraine	37	18	-19	-51%	24	9	-15	-63%
Hungary	98	49	-50	-51%	49	24	-25	-51%
Latvia	24	13	-12	-49%	19	9	-10	-51%
Lithuania	23	12	-11	-47%	14	9	-5	-38%
Slovenia	39	22	-17	-43%	26	9	-17	-65%
Moldova	1	0	0	-35%	1	0	0	-43%
Bosnia and Herzegovina	5	4	-2	-31%	4	2	-2	-46%
Bulgaria	24	17	-7	-31%	13	9	-4	-29%
Romania	72	50	-22	-30%	46	30	-16	-34%
Czech Republic	61	44	-17	-28%	32	19	-13	-40%
Serbia	13	10	-3	-25%	6	5	-1	-10%
Croatia	47	36	-11	-24%	23	18	-5	-22%
Russia	208	163	-44	-21%	105	86	-19	-18%
Poland	139	122	-18	-13%	71	64	-7	-10%
Belarus	3	3	0	-10%	2	2	0	22%
Slovakia	27	27	0	0%	15	12	-4	-23%
Montenegro	1	2	0	4%	1	0	-1	-63%
Turkey	151	178	28	18%	43	84	41	94%
Albania	1	1	0	60%	0	1	0	36%
Macedonia	1	2	1	201%	0	1	1	375%

The largest outflow of funds (in USD, not taking into account fluctuations in the foreign exchange rates) was reported for Estonia, Ukraine, Hungary, Latvia and Lithuania, from which a half of all funds invested at the peak of 2008 were withdrawn. The highest growth in exposure was reported for Turkey.

Exposures of foreign banks (reporting to BIS) in Poland



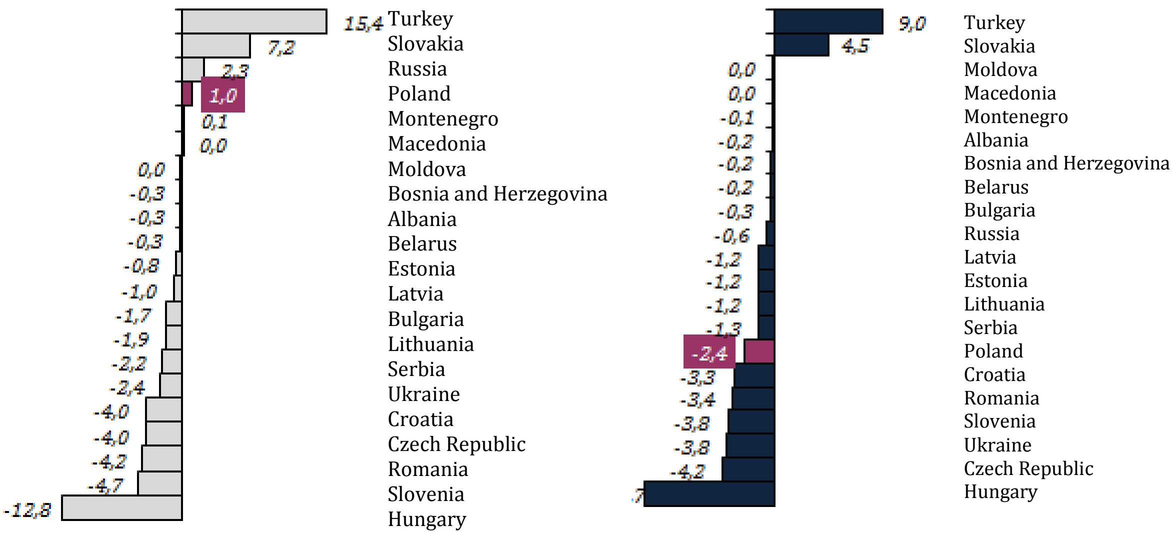
The funds invested in Poland by foreign banks are stable. As for USD, the peak was reported for Q2 2011 (USD 145 billion, including receivables from banks: USD 83 billion). This was the effect of inflow of short-term capital in the first half of 2011, which was withdrawn in subsequent periods. In terms of PLN, the peak was reported for Q3 2011; at that time the total value of funds invested in Poland was PLN 412 billion (including receivables from banks: PLN 232 billion), the effect of the PLN depreciation.

As mentioned above, there is no deleverage in case of Poland; the reduction in funds invested by foreign banks in the banking sector in the recent periods is mainly the result of reduced demand for funds of parent banks considering changed operating strategies and PLN appreciation (plus variability of the scale of operations at the financial market carried out by individual entities financed by, among others, the parent group).

Change in the foreign banks' payables, per country, in 2012

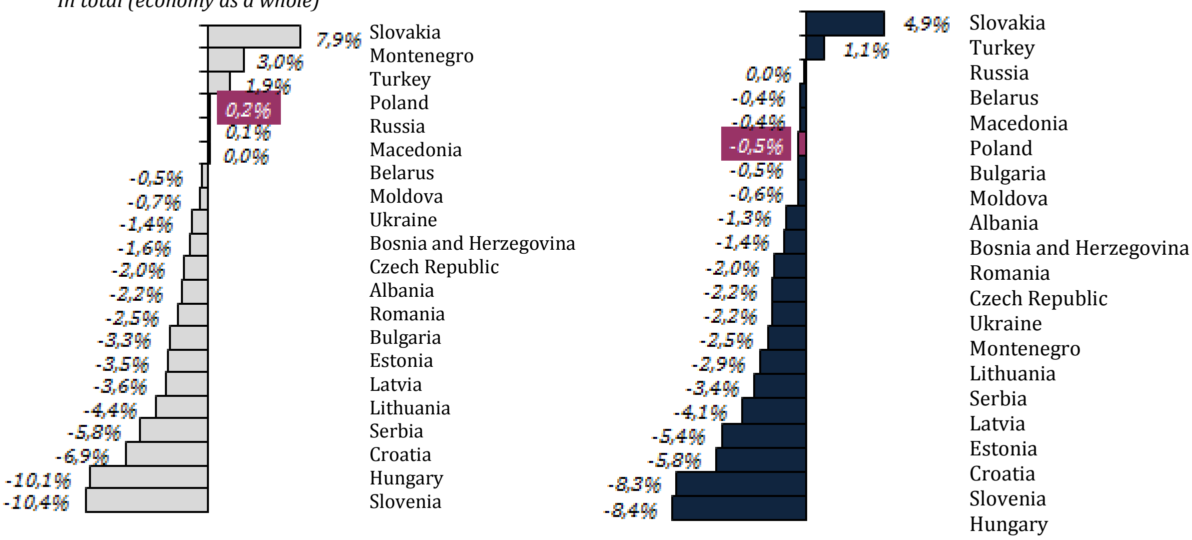
1/ In USD billion (adjusted for FX rates)

In total (economy as a whole) *Including: to banks*



2/ as % GDP

In total (economy as a whole) *Including: to banks*



Source: BIS, MFW, own calculations

In 2012 the foreign banks' exposure towards the whole region dropped by USD 15 billion (adjusted) and was, to a large extent, the effect of limited exposure in Hungary (by USD 13 billion). In terms of GDP, the biggest drop in the foreign banks' funds was reported for Slovenia (the equivalent of –10.4% GDP), Hungary (-10.1%), Croatia (-6.9%) and Serbia (-5.8%). At the same time, Poland reported inflow of funds (0.2%).

7. BALANCE-SHEET FX AND MATURITY STRUCTURE

In the balance sheet structure one may observe some phenomena giving rise to a variety of risks and potentially being a threat. High share of FX assets and excessive dependence of lending on short-term deposits are particularly unfavourable. Some of these phenomena are a natural element of the bank operations and are the consequence of their function in the economy, still the majority of them is the result of excessively expansive business models applied by some banks in the past.

Table 17. The FX structure of the balance-sheet

	Value (PLN billion)				Change to 2011	
	2010	2011	09/12	2012	PLN bn	%
Balance-sheet total	1 159.4	1 294.6	1 335.3	1 352.9	58.4	4.5%
PLN assets	854.9	931.4	1 005.0	1 019.5	88.1	9.5%
FX assets	304.4	363.2	330.3	333.4	-29.7	-8.2%
- EUR	114.6	145.7	135.7	141.1	-4.6	-3.1%
- CHF	164.4	180.3	163.7	160.4	-19.9	-11.0%
- USD and other currencies	25.4	37.2	30.9	31.9	-5.3	-14.2%
PLN liabilities	922.9	1 009.6	1 078.6	1 082.8	73.3	7.3%
FX liabilities	236.5	285.0	256.7	270.1	-14.9	-5.2%
- EUR	109.6	132.7	124.5	138.9	6.2	4.7%
- CHF	89.1	97.0	85.3	82.8	-14.3	-14.7%
- USD and other currencies	37.8	55.3	46.9	48.4	-6.9	-12.4%
FX mismatch in total	-67.9	-78.1	-73.6	-63.3	14.8	
- EUR	-5.0	-13.0	-11.2	-2.2	10.8	
- CHF	-75.3	-83.3	-78.4	-77.6	5.6	
- USD and other currencies	12.4	18.1	16.0	16.5	-1.6	

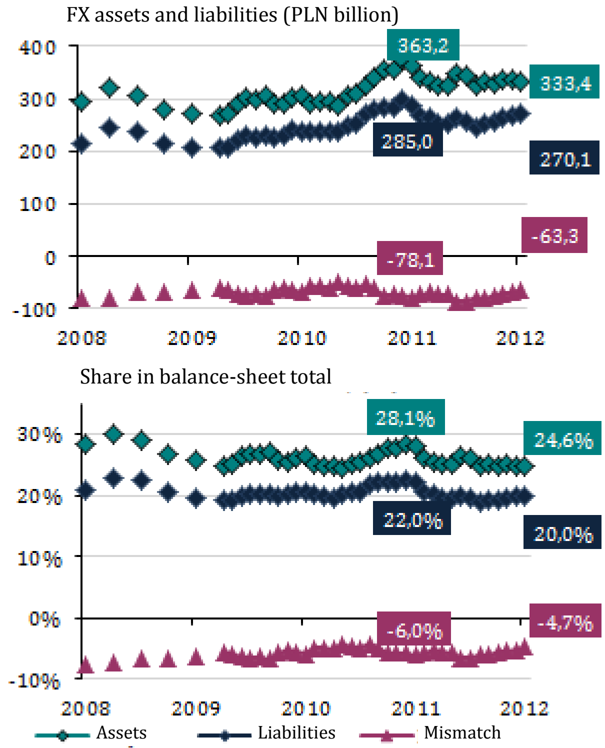
Improved FX structure of the balance-sheet

2012 saw a drop in FX assets and liabilities and their reduced share in the balance sheet total (down to 24.6% and 20.0%). This was the effect of the PLN appreciation, limited offer of new FX household loans (assets) and changed funding structure at some banks (liabilities). As a consequence, one saw a reduction of the negative FX funding gap (down to PLN 63.3 billion) and its share in the balance sheet total (down to -4.7%)[26].

Reduction in the FX liabilities would be even higher, however it was subject of public finance-related transactions performed by the national bank (at the end of the year, large FX deposits from the public sector were made at the bank's bank accounts). Therefore the actual drop in mismatch was slightly smaller.

The high share of FX assets was mainly due to FX loans to households (mainly housing loans), and to a much lesser extent to FX loans to enterprises (as at

Chart 53.
FX assets and liabilities



[26] In individual cases, share of FX assets and liabilities and negative financing gap were considerably much higher.

the end of 2012, the carrying amount of FX receivables from households was PLN 190.0 billion; i.e., 57.5% of all banks' FX receivables; the analogical receivables from enterprises were worth PLN 62.0 billion (18.8%), respectively). High value of FX loans to households indicates the scale of the risk incurred by banks and their clients and contributes to risk growth in the financial system. In particular, one should take into account that the majority of households does not hedge against currency risk in any manner whatsoever. In this context, a positive fact is that lending of new FX household loans was strongly limited in 2012.

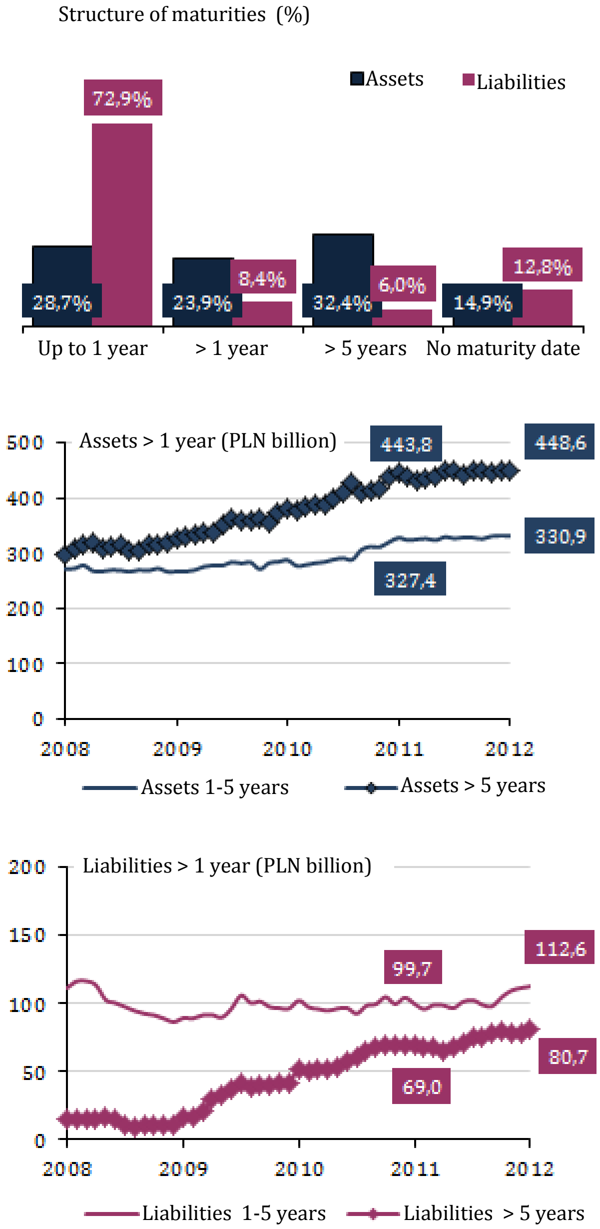
Increase in long-term funding

In 2012 some banks managed to increase the scale of long-term funding (liabilities above 1 year increased from PLN 168.7 billion at the end of 2011 up to PLN 193.3 billion at the end of 2012, 14.6%, despite PLN appreciation that resulted in reduction of long-term FX liabilities; in consequence, their share in the balance-sheet total increased (from 13.1% to 14.4%). The positive fact was that almost a half of the growth concerned funds with maturities above 5 years (increase from PLN 69.0 billion up to PLN 80.7 billion).

Increase in long-term funding concerned liabilities towards the financial sector. The share of long-term liabilities towards the non-financial sector remained marginal (as at the end of 2012, the non-financial sector deposits with maturity over 1 year amounted to PLN 8.4 billion and accounted for 1.2% of liabilities towards this sector while as at the end of 2011 it was PLN 9.3 billion and 1.3%, respectively).

On the other hand, housing lending growth rate slowdown, coupled with PLN appreciation, favoured value stabilisation and reduction in the share of long-term assets (value of assets with maturity over 1 year increased from PLN 771.2 billion up to PLN 779.5 billion, i.e. by 1.1% and their share in the balance sheet total dropped from 58.1% to 56.4%).

Chart 54.
Balance-sheet maturity structure



Necessity to further increase the long term funding

Despite positive changes in 2012, large disproportion in terms of assets and liabilities maturity indicates that long-term lending **relies on short-term deposits, the fact which translates into higher liquidity risk.** The growth in housing lending financed mainly with short-term non-financial sector deposits and funds acquired from foreign parent entities (short-term ones to a great extent but being successively revolved) and only to a small extent by long-term liabilities are the basic drivers of these disproportions. Therefore, **it is necessary for the banks to increase the share of long-term and stable funding sources of lending** through making the long-term deposit offer more attractive, building long-term relationships with clients and issuing long-term debt papers, among other things. It would be profitable to propose systemic incentives for long-term savings.

Aware of certain negative trends in the balance-sheet structure, the KNF Chairman established a working team for development of public market for long-term banking debt instruments. The primary objective of the team is to prepare legal, tax and regulatory solutions that will contribute to development of the public market for long-term banking debt instruments and favouring the change of incorrect banking balance-sheet structure where long-term mortgage loans prevail (financed mainly through short-term deposits of credit lines from the international banking market (see the Annex).

8. LENDING PORTFOLIO QUALITY

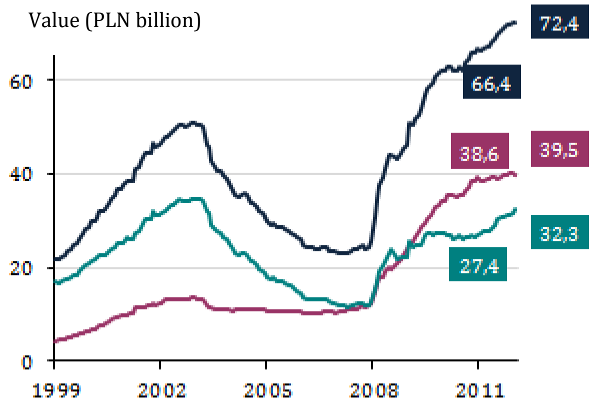
The lending portfolio quality is stable, however, it has deteriorated in certain areas

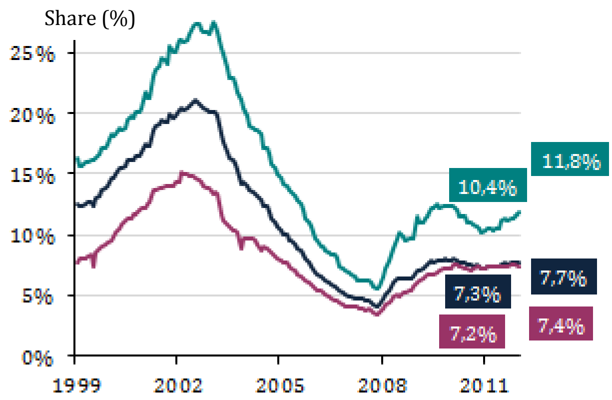
Despite deterioration of the macroeconomic situation in 2012, the lending portfolio quality was relatively stable, with deterioration reported for some areas. In consequence, the non-performing loans increased (from PLN 66.4 billion as at the end of 2011 up to PLN 72.4 billion as at the end of 2012); their share in portfolio rose slightly (from 7.3% up to 7.7%). The main source of difficulties were enterprise loans and, to a smaller extent, small enterprise and housing loans. On the other hand, the quality of consumer loans improved and the quality of financial and public sector loans remained high and stable.

Table 18. Lending portfolio quality

	Non-performing loans (PLN billion)				Change to 2011		Share (%)			
	2010	2011	09/12	2012	PLN bn	%	2010	2011	09/12	2012
Total loans	61.8	66.4	71.8	72.4	6.0	9.0%	7.8%	7.3%	7.7%	7.7%
Financial sector	0.2	0.1	0.1	0.1	0.0	-16.1%	0.7%	0.5%	0.3%	0.3%
Non-financial sector	61.4	66.0	71.3	71.9	5.9	8.9%	8.8%	8.2%	8.8%	8.9%
Public sector	0.2	0.3	0.4	0.4	0.1	38.2%	0.3%	0.3%	0.4%	0.4%
Households	34.1	38.6	40.0	39.5	1.0	2.6%	7.2%	7.2%	7.5%	7.4%
Consumer loans	23.2	23.4	22.5	21.3	-2.1	-9.1%	17.3%	18.0%	17.9%	17.2%
Housing loans	4.9	7.5	8.5	9.0	1.6	21.0%	1.8%	2.3%	2.7%	2.8%
Other	6.0	7.7	8.9	9.2	1.6	20.3%	8.1%	9.3%	10.2%	10.5%
Enterprises	27.2	27.4	31.3	32.3	4.8	17.6%	12.4%	10.4%	11.3%	11.8%
SME	18.5	19.6	20.7	21.7	2.1	10.8%	14.6%	12.3%	12.4%	13.1%
Large enterprises	8.7	7.8	10.6	10.5	2.7	34.9%	9.4%	7.4%	9.7%	9.8%
Defaulted loans										
Consumer loans										
up to 30 DPD	9.1	9.3	8.1	9.4	0.1	0.9%	6.7%	7.0%	6.4%	7.5%
> 30 DPD	25.2	26.1	25.1	23.7	-2.4	-9.3%	18.6%	19.7%	19.6%	18.9%
Housing loans										
up to 30 DPD	9.8	11.4	11.4	13.4	2.0	17.2%	3.7%	3.6%	3.6%	4.2%
> 30 DPD	5.7	9.1	10.7	10.6	1.6	17.3%	2.1%	2.8%	3.3%	3.3%

Chart 55.
Non-performing loans





Loans, in total   Household loans   Enterprise loans

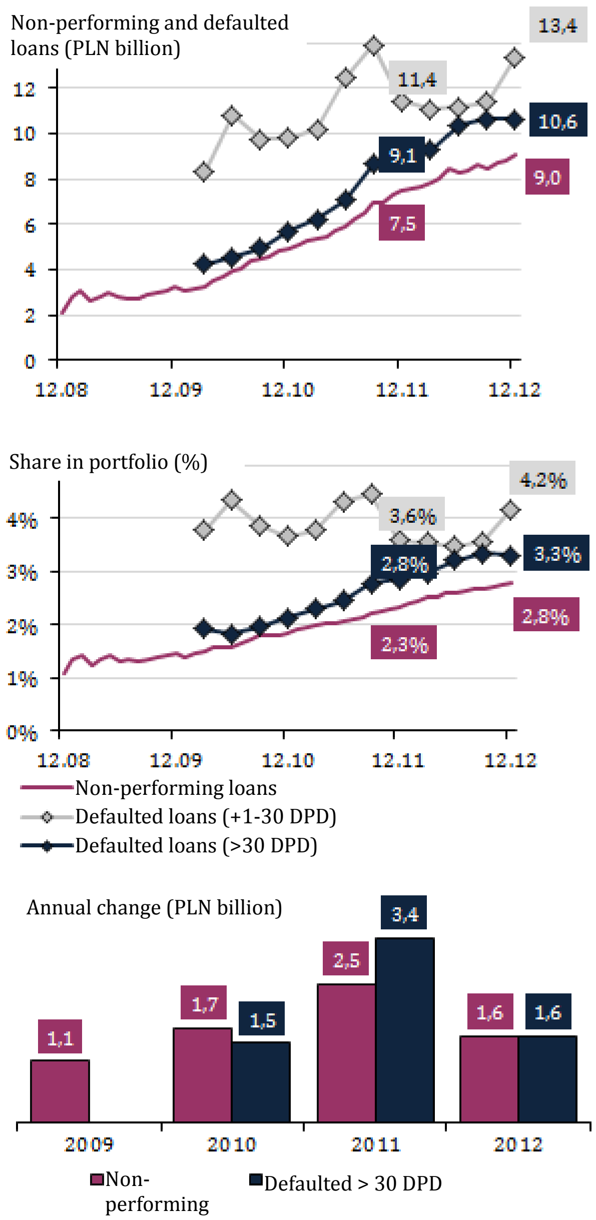
Deteriorated quality of housing loans, first signs of stabilisation

In 2012, the quality of housing loans deteriorated, the fact reflected in the increased number of non-performing loans (by PLN 1.6 billion; 21.0%) or 30+ DPD loans (by PLN 1.6 billion; 17.3%) and their increased share in the portfolio (non-performing: up to 2.8%, 30+ DPD loans: up to 3.3%). At the same time, the large differences in values of non-performing loans and 30+ DPD loans will most likely translate into further increase in the number of non-performing loans in the subsequent periods.

Deterioration of the quality of the housing loans is the natural effect of "maturing" of the portfolio (the history of the majority of loans is relatively short), deteriorated labour market situation and excessively liberal credit policy of some banks and excessive risk taken by some customers (see herein below).

Despite deteriorated quality of the housing loan portfolio, the growth of non-performing and defaulted loans reported for 2012 was significantly lower than that reported for 2011. This positive phenomenon was largely caused by changes of the exchange rates of main currencies against PLN[27]. On the other hand, in the second half of 2012 (in particular in Q4) the growth of 30+ DPD housing loans slowed down and the impairment losses for housing loans dropped. It is difficult to say if this trend is permanent, being the effect of recently changed credit policies and rising awareness of borrowers, or it is only a temporary phenomenon. Therefore, to say that a substantial change in the current trends has actually taken place, one must wait for these positive observations to confirm in the future periods.

Chart 56.
Quality of housing loans

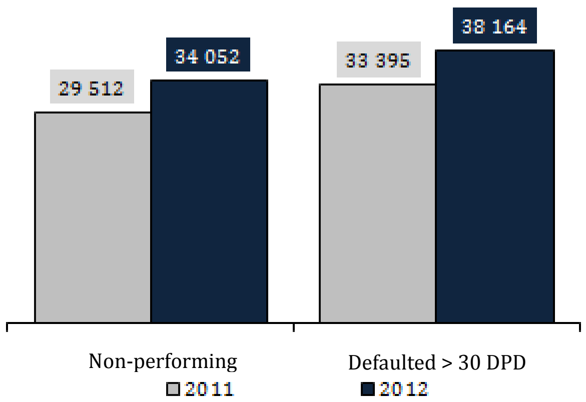


[27] Considering the large share of FX loans, the PLN depreciation of 2011 contributed to the increase in non-performing and defaulted loans in 2011; the PLN appreciation of 2012 resulted in reduction of non-performing and defaulted loans.

Large number of non-performing or defaulted loans

According to the UKNF analyses (see the Annex), as at the end of 2012 the banks' portfolios comprised more than 34.1 thousand non-performing housing loans (increase by 15.4%) and more than 38.2 thousand 30+ DPD loans (increase by 14.3%). Worth noticing is that the banks' portfolios comprised a dozen of non-performing and 30+ DPD loans granted to households for other purposes, mortgaged against a residential unit (see herein below).

Chart 57.
Number of non-performing or defaulted loans



Despite high quality of the housing portfolio, it is still the source of many potential risks

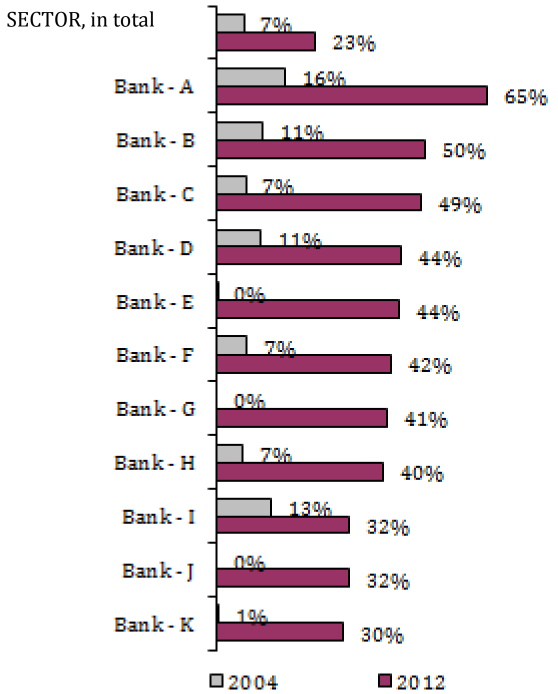
The quality of housing loans (measured with the share of non-performing loans) is high as compared to other types of loans. Nonetheless, considering the risk generated by the housing loan portfolio, one must be aware of the following facts (among others):

- dominant role of the housing loans in the banking sector balance-sheet;
- large number and considerable value of other mortgaged household loans;
- high share of FX loans that generate various types of risks for customers and banks;
- high DTI ratios for a part of the loan portfolio;
- high LTV values for a considerable part of the loan portfolio (effectiveness of collaterals);
- limited liquidity at the real property market (effectiveness of collaterals and the impact of using the collaterals on the real property market);
- risk related to loans granted under the "Rodzina na Swoim" programme (abrupt increase in the value of instalments after 8 years of subsidies);
- strong concentration of housing loan insurances;
- insufficiently good databases regarding the real property market and the financial situation of borrowers;
- lack of proper sources of funding for lending activities.

Strong product-focus at some banks

As mentioned above, as the result of the strong rise in housing loans in recent years, they became the main item in the sector balance-sheet structure. In the period from the end of 2004 (i.e. the beginning of the real property market boom) until the end of 2012, their share in the sector assets increased from 7% up to 23%, and, as regards some loans for the non-financial sector, from 17% to 41%. At some banks, this share rose much higher, the result of a changed business model (change of the assets structure from a model specific for universal or corporate banks to a model specific for mortgage banks). In consequence, the financial condition of those banks was strongly dependent on the quality of housing loans and the real property market situation and, considering the high share of FX loans, on the FX and IR market, the latter being created by foreign monetary institutions.

Chart 58.
Share of housing loans in assets

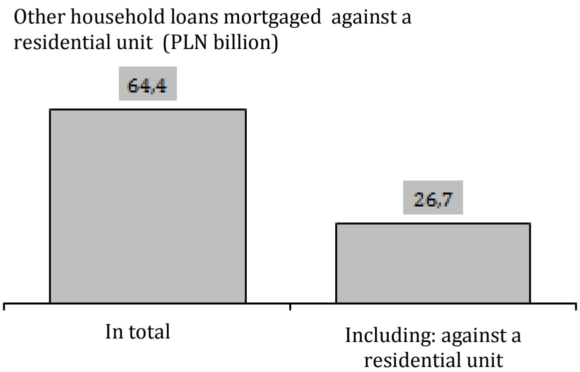


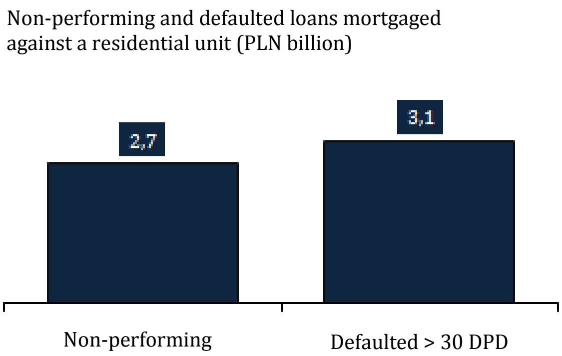
Significant number and value of other mortgaged household loans

Analysing the risks connected with the housing loan portfolio, one must not forget that the bank portfolios comprise mortgaged household loans. As at the end of 2012 their value was PLN 64.4 billion (including PLN 20.9 billion of investment loans, PLN 18.2 billion of consumer loans and PLN 25.1 billion of other loans and receivables).

According to the UKNF analyses, those loans included 249.3 thousand mortgaged loans of the value of PLN 26.7 billion, of which 14.1 thousand loans of the value of PLN 2.7 billion were classified as non-performing and 16.3 thousand loans of the value of PLN 3.1 billion as 30+ DPD loans.

Chart 59.
Other mortgaged household loans





FX household loans cause increased systemic risk

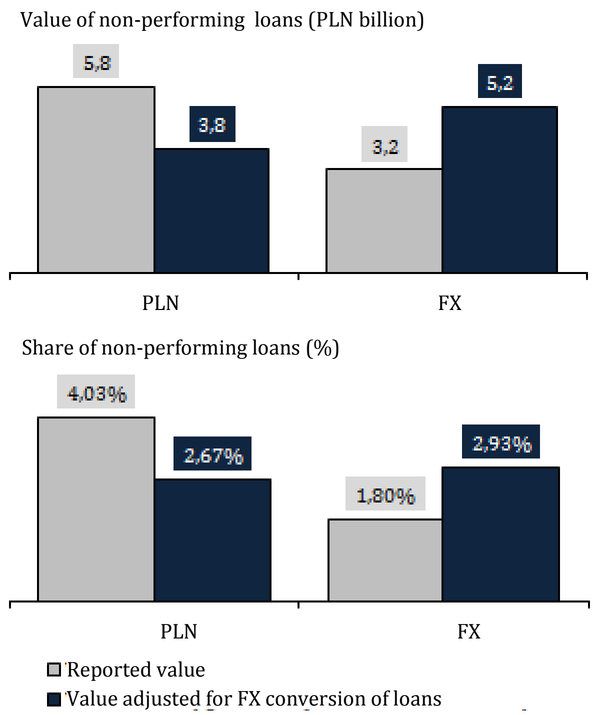
High share of FX loans in the housing loan portfolio contributes to higher risk for borrowers, banks and the economy as a whole, the main reason being that households are not properly hedged against the FX risk[28].

From the borrowers' perspective, the highest risk is generated by adverse changes of FX rates in a situation where they must prematurely terminate the loan agreement. In such situation they must consider a steep increase of their debt which, in case of households with average income, may destabilize them (adverse changes of the FX rates make it more difficult or impossible to sell/change a real property). From the banks' perspective, the risk is that repayability of loans may drop sharply in case of depreciation of PLN and unfavourable market conditions, which, in turn, may result in large losses. There is also a risk connected with financing those loans and related negative opinions from some financial market participants and rating agencies. In case of unstable financial markets, this may considerably hamper re-drawing of loans and increase related costs. From the general economic perspective, the FX loan-related risk is connected with the likelihood that difficulties of households and banks may accumulate. In addition, because of FX loans the Polish Monetary Policy Council loses control over the price of the money in the economy; low interest-bearing FX loans was one of the main reasons of fast increase in the real property prices, the effect of which was limited availability of houses for average households.

The quality of PLN loans is higher than the quality of FX loans

At the same time, the hypothesis regarding better quality of the FX housing loans as compared to loans in PLN has not been confirmed in the analyses carried out by UKNF (more, see the Annex). Higher share of non-performing loans in the PLN loan portfolio is the result of conversion[29] of a part of the non-performing FX housing loans into housing loans in PLN and higher premature repayability of loans in PLN. After the correction (including conversions), the quality of the PLN loans as at the end of 2012 (2.67%) was better than that of FX loans (2.93%). Partially it was the effect of the slowdown in FX lending in recent years, the fact that results in faster "ageing" of loans (this is partially equilibrated by higher premature repayability of the PLN loans, the effect of which being the increased share of non-performing loans in the portfolio).

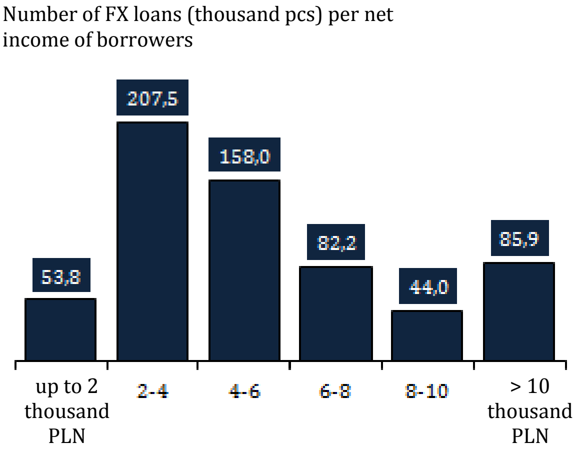
Chart 60.
Quality of PLN and FX loans



[28] More: "Report on condition of banks in 2011", UKNF and "Public consultations for the draft Recommendation S" (website of KNF, archive of 21 December 2012).
[29] This is more precisely described in the "Report on condition of banks in 2011", UKNF.

Majority of FX loans was granted to households with average income

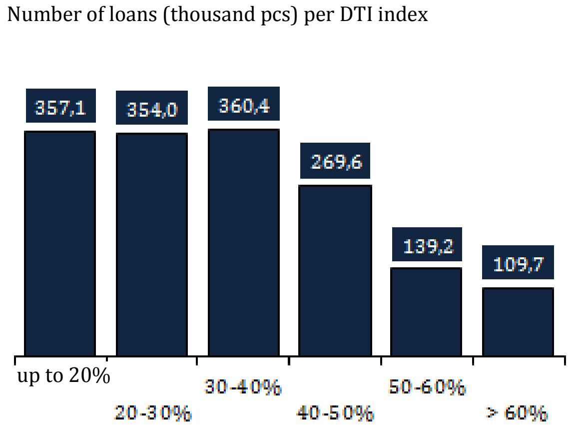
Chart 61.
Distribution of the FX borrowers' income



The results of the UKNF analyses do not confirm the hypothesis of higher incomes of persons with FX loans. The majority of FX loans was granted to households with average (or slightly better than the average) financial condition (261.3 thousand loans were granted to households the net income of which had not exceeded PLN 4 thousand; 158.0 thousand loans were granted to households the income of which was from PLN 4 to 6 thousand; these are average values considering the fact that such loans were usually granted to married couples).

High DTI ratio for some part of borrowers

Chart 62.
Distribution of loans in terms of the DTI ratio



According to the UKNF questionnaire research, the loan repayment burden is high for a large part of households, the fact reflected by the large number of loans where the value of a single loan instalment accounted for 40-50% or even above 50% of the net income of a household (correspondingly, almost 270 thousand loans and almost 250 thousand loans). Even if some of those loans were been granted to persons with high income, it was still risky to burden them with a long–term obligation to repay high loan instalments.

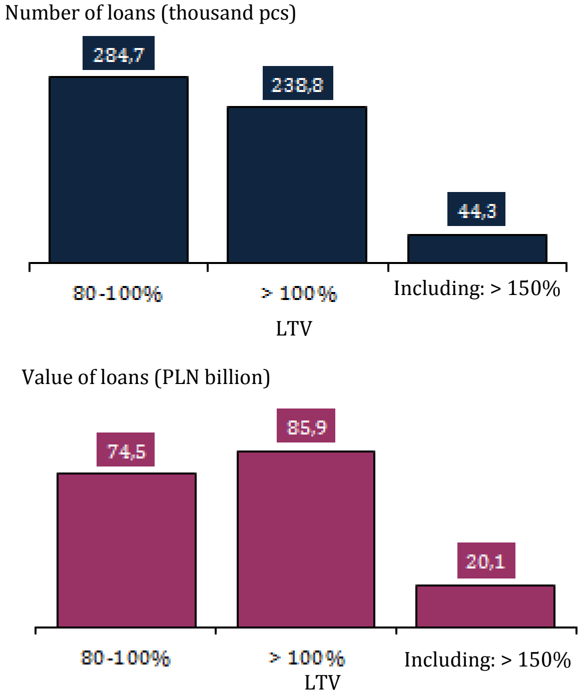
On one hand, the high loan repayment burden results in increased credit risk, on the other hand, negatively affects the current consumption by households and their ability to generate savings. The incomes of the majority of those households will probably rise in the future (this will result in reduced DTI), however one must not forget that the rise in maintenance costs will follow (in case of young married couples, a significant cost will be expenses connected with birth and education of children).

High LTV for a large portion of the loan portfolio

According to the UKNF questionnaire research, at the end of 2012 the banks' portfolios comprised more than 500 thousand loans with LTV > 80%; they accounted for 51.0% of the value of the whole portfolio[30], out of which 238.8 thousand loans with LTV > 100% (they accounted for 27.3% of the value of the whole portfolio). The majority of them were th FX loans (162.3 thousand loans). It is likely that the actual number of loans with high LTV is higher, as the banks not fully took into account the fact that the prices of real properties fell in recent years.

The high LTV ratios raise concerns as to the financial condition of banks in case of worsened repayability of loans (the low repayability scale) and of households covered by the debt enforcement procedures (a portion of them would still have very large debts even if their real properties are sold).

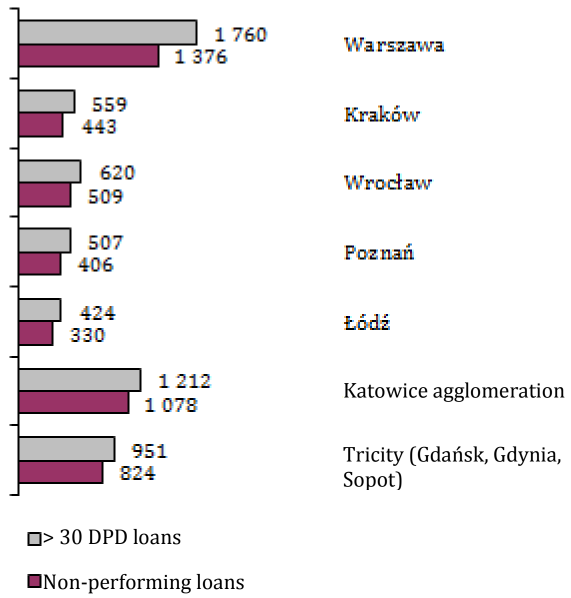
Chart 63.
Loans with LTV > 80%



Growing difficulties in repayment of loans may negatively affect the real property market

In discussions regarding the housing loans, the limited liquidity of the real property market must be taken into account. In case of short-term sales, by banks or other entities, of flats secured with mortgages, one may expect steep decline in prices and in sales levels realized by developers and secondary market players (as at the end of 2012, the number of 30+ DPD loans was close, at some markets, to 10% of the total offer from developers[31]). Realisation of such scenario is unlikely, however it may occur in the future. Therefore it is in the best interest of all market participants to maintain high quality of loans.

Chart 64.
Number of non-performing and 30+ DPD housing loans



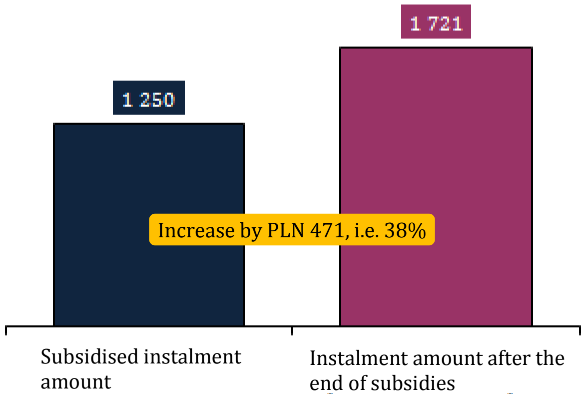
[30] See the Annex.

[31] The view presented at the diagram is not complete. The above calculations should also take into account other non-performing and defaulted housing loans (e.g. house repair) and other non-performing and defaulted loans mortgaged against a residential real property located at those markets (e.g. consumer loans).

Abrupt growth of instalments under the "RnS" Programme

In the context of housing loans, worth mentioning is the abrupt growth of instalments under the "Rodzina na Swoim" Programme after 8 years of subsidies. It is difficult now to guess how it will affect the future repayability of those loans, however it is clear that for some households with relatively low income the growth of instalments will be noticeable (despite very short history and subsidies granted to the borrowers, as at the end of 2012 banks reported 575 non-performing loans under the "Rodzina na Swoim" Programme).

Chart 65.
Value of instalments repaid under the "Rodzina na Swoim" Programme [32]



Large correction of the current housing loan development model is needed

Considering the adverse phenomena regarding the housing loan portfolio, limited funding sources, limited liquidity of the real property market, unsatisfactory quality of databases with data on real property market and the financial condition of borrowers, and weaknesses of banks in management of the credit risk, a large correction of the to-date housing loan development model is needed. This is the objective of actions taken by KNF/UKNF. In this regard, particularly important is the 2012 amendment of the Recommendation J (collection and processing of real property-related data by the banks) and the amendment of the Recommendation S (good practices in management of mortgaged loan exposures) planned for 2013. For the same purposes, the KNF Chairman established a working team for development of public market for long-term banking debt instruments (see the Annex).

In this context, it is a right decision of some banks taken recently to amend their lending policies so as to reduce the banks' and the customers' risk and to improve the stability of funding sources. Positive phenomenon is, in particular, strongly limited FX lending (according to UKNF and NBP those products should be withdrawn from the standard offer and should be available only to customers naturally hedged against the FX risk), gradual shortening of tenors and reduction, by some banks, of the maximum LTV ratios for new loans (below 100%).

[32] Calculated using the loan calculator: http://www.rodzinanaswoim.net.pl/kalkulator-kredytowy.html. Assumptions: loan for a purchase, in Q4 2012, of a 50m2 flat in Warsaw, value of the flat: PLN 289 thousand, a loan for 100% of the flat value; interest rate: 6.72%; reference rate 7.06%; annuity repayment method.

Stabilised / improved quality of the consumer loans

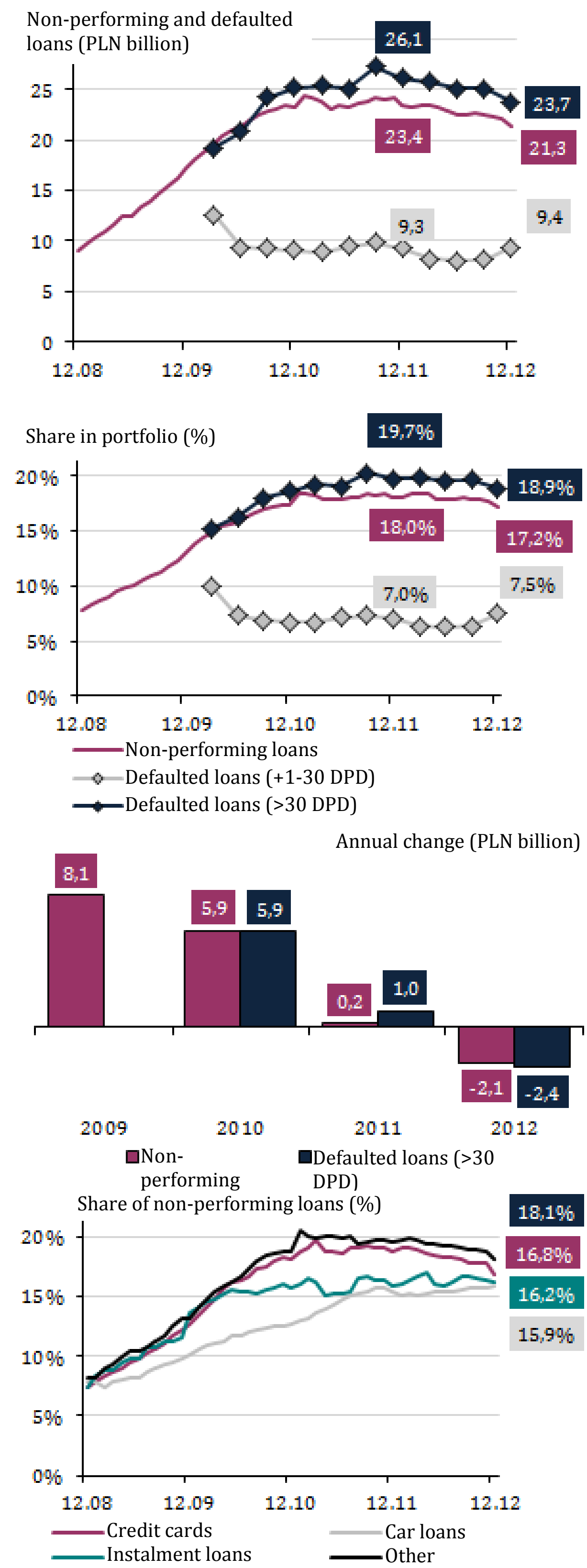
The quality of consumer loans gradually stabilised in 2011 and then improved in 2012 – the volume of non-performing and 30+ DPD loans went down by correspondingly PLN -2.1 billion (-9.1%) and PLN -2.4 billion (-9.3%); their share in the portfolio went down, correspondingly, to 17.2% and 18.9%. The non-performing loan volume was reported for all types of loans; reduced share of non-performing loans was reported for credit card debt (from 18.7% at the end of 2011 down to 16.8% at the end of 2012) and for other loans (from 19.5% down to 18.1%). Increased share of non-performing loans was reported for instalment and car loans (correspondingly, from 15.9% up to 16.2% and from 15.4% up to 15.9%), the effect of large drop in the volume of those two portfolios.

Actual situation is not so optimistic as some part of positive observations takes into account the process of purifying the balance-sheets and removing low quality assets through selling them.

Stabilization and gradual improvement of the consumer loan quality in years 2011-2012 is mainly the effect of self-regulatory actions taken by banks in years 2008-2010 (reflected in the results of the research carried out by UKNF, the interviews with chairmen of the loan committees carried out by NBP and the vintage analysis prepared by BIK, the latter showing that the quality of loans produced in years 2010-2012 is much better[33]). The additional factor is the introduction of the Recommendation T and on-going actions of the supervision authorities aimed at improving the loan management processes both at the industry and individual bank level.

The main threat regarding the quality of the consumer loans in the future is adverse macroeconomic situation that may lead to considerable deterioration of the financial condition of a part of households.

Chart 66.
Quality of the consumer loans

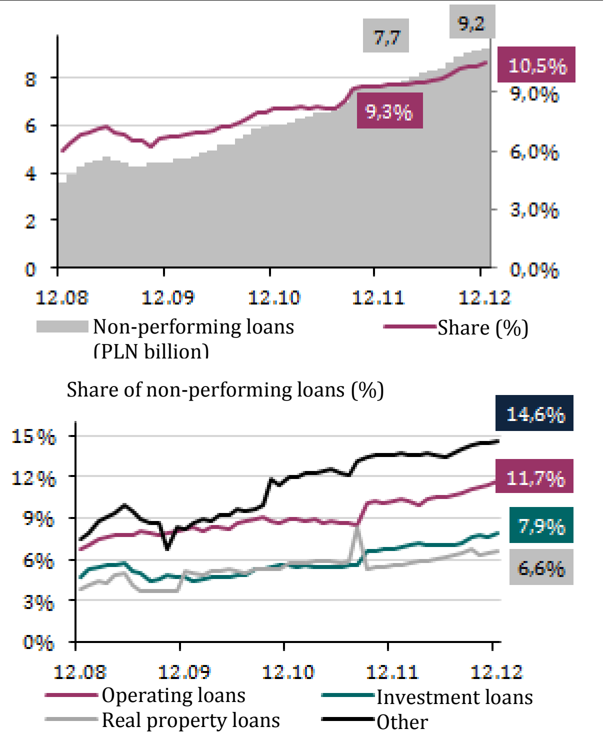


[33] See: "Loan and Trends", BIK.

Deteriorated quality of other household loans

In 2012, the quality of other household loans exponentially deteriorated, the fact reflected in the increased volume of non-performing loans (by PLN 1.6 billion; 20.3%) and the increased share of non-performing loans in the portfolio (from 9.3% at the end of 2011 to 10.5% at the end of 2012). The above was the consequence of deteriorated quality of operating loans granted to small entrepreneurs (increase in non-performing loans: PLN 0.8 billion) and, to a lesser extent, of investment and other loans (increase by approx. PLN 0.3 billion). The main reasons for negative developments are the progressive economic slowdown and deteriorated condition of the construction sector, both of them translating into deteriorated financial condition of some enterprises and their business partners.

Chart 67.
Quality of other household loans



Deteriorated quality of enterprise loans

The enterprise loan quality deteriorated exponentially in 2012, the fact reflected in the significant growth of non-performing loans (by PLN 4.8 billion; 17.6%) and their increased share in the portfolio (from 10.4% at the end of 2011 up to 11.8% at the end of 2012). This affected both the SME (rise in the volume of non-performing loans by PLN 2.1 billion, from 12.3% to 13.1%) and large enterprises (rise in the volume of non-performing loans by PLN 2.7 billion, from 7.4% to 9.8%).

The same as in case of small enterprises, the main reason for deteriorated loan quality was progressive economic slowdown that translated into deteriorated financial condition of some enterprises. That fact was reflected in 2012 by lowered financial results and deteriorated basic economic and financial ratios (including the liquidity ratios). The situation was further negatively affected by deteriorated financial condition of several construction enterprises dealing with large infrastructural contracts.

Chart 68.
Quality of enterprise loans

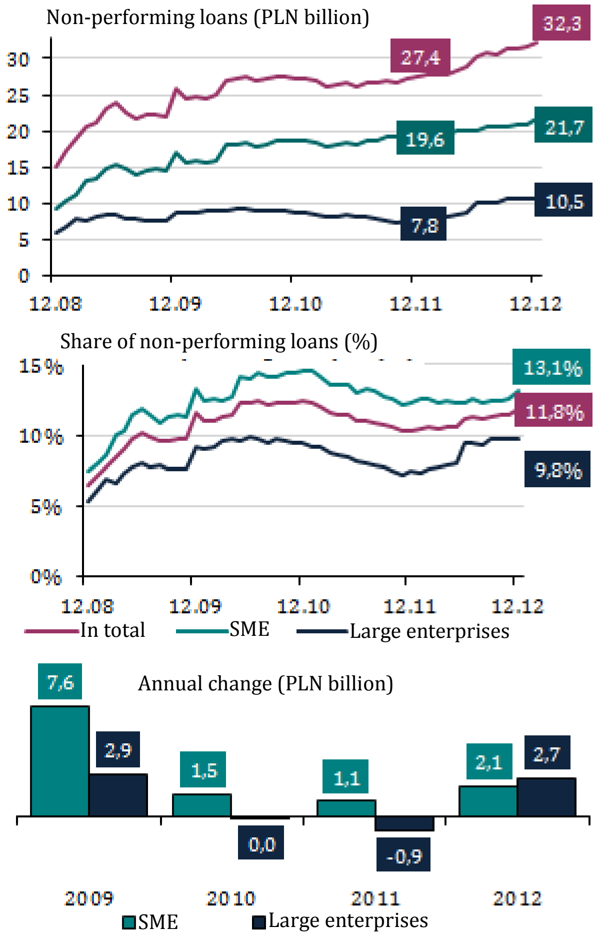
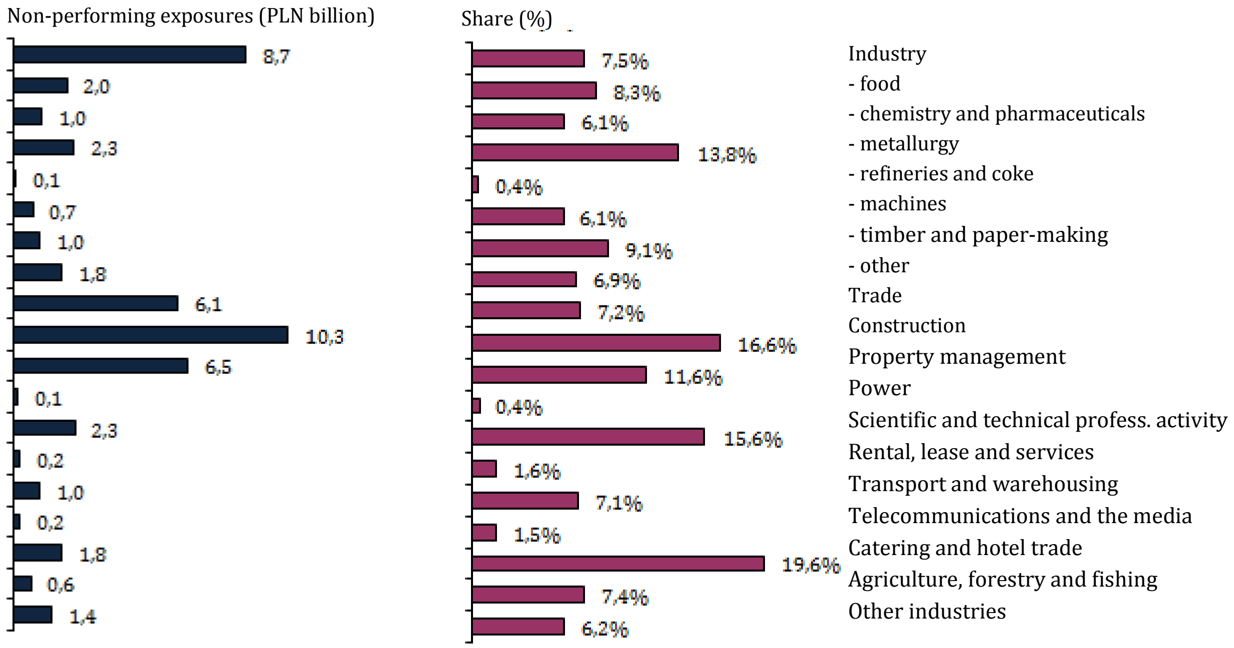


Table 19. Quality of large receivables from enterprises per industry

	Total exposure[34] (PLN billion)			Exposures at risk (PLN billion)			Change to 2011	
	2010	2011	2012	2010	2011	2012	PLN bn	%
Total	375.3	434.8	449.3	30.8	30.2	39.2	9.0	29.8%
Industry sector	106.8	118.4	115.9	9.5	7.8	8.7	0.9	10.9%
- food	22.5	23.5	23.6	2.1	1.8	2.0	0.2	12.0%
- chemistry and pharmaceutical	13.4	15.2	16.4	0.9	0.9	1.0	0.2	17.6%
- metallurgy	14.0	16.4	16.3	1.9	1.9	2.3	0.3	17.1%
- refineries and coke	11.8	14.3	12.2	0.0	0.0	0.1	0.0	34.7%
- machines	11.4	12.1	11.3	0.8	0.7	0.7	0.0	-2.6%
- timber and paper	10.4	11.1	10.6	1.3	0.9	1.0	0.1	7.4%
- other	23.3	26.0	25.5	2.4	1.6	1.8	0.1	6.2%
Trade	72.2	83.0	85.7	5.3	4.9	6.1	1.3	26.1%
Construction	57.0	65.8	61.9	5.1	6.2	10.3	4.0	64.8%
Property management	45.4	57.2	56.1	4.8	5.1	6.5	1.4	28.1%
Power	16.2	23.7	34.9	0.2	0.1	0.1	0.0	10.9%
Scientific and technical professional activity	11.4	13.8	14.5	1.5	1.9	2.3	0.4	20.9%
Rental. lease and services	11.6	12.6	14.3	0.2	0.2	0.2	0.0	-1.1%
Transport and warehousing	10.3	12.0	13.4	0.8	0.8	1.0	0.2	24.7%
Telecommunications and the media	12.4	13.2	12.6	0.1	0.2	0.2	0.0	8.2%
Catering and hotel trade	8.0	9.1	9.2	1.3	1.5	1.8	0.3	21.1%
Agriculture. forestry and fishing	6.0	7.1	8.2	0.5	0.5	0.6	0.1	22.3%
Other industries	18.0	18.9	22.4	1.5	1.0	1.4	0.4	36.9%

Chart 69.
Quality of large receivables from enterprises



In sectoral terms, the deterioration of the quality of enterprise loans was mainly caused by difficulties of the construction sector (increase of non-performing loans by PLN 4.0 billion) and, to a smaller extent, of the real property management (by PLN 1.4 billion) and of trade (by PLN 1.3 billion). The impact from enterprises representing other economy sectors was limited.

The steep increase in the non-performing loans from the construction sector was mainly caused by deteriorated financial condition of several construction enterprises dealing with large infrastructural contracts (reported in items: construction and scientific and technical professional activities), which resulted

[34] Balance sheet and off-balance sheet items

in deteriorated financial condition of their partners. The financial condition of a part of construction sector enterprises was strongly affected by the economic slowdown and gradual limitation of public investments.

Analysing the situation within individual industries, one must take into account that the total receivables in a given industry may deteriorate as the result of a deteriorated condition of individual customers to which banks have large exposures. Therefore reasonable approach is needed when assessing the actual situation in a given industry, so as to avoid generalisation that may, in turn, affect the attitude of investors towards individual sectors (and the willingness of banks to finance them). In this context, it is worth mentioning that the large volume of non-performing loans reported in the real property management item is, to a large extent, the result of transferring, by force of law, the assets of the National Housing Fund (granting preferential loans to TBSs and housing cooperatives) to BGK in 2009.

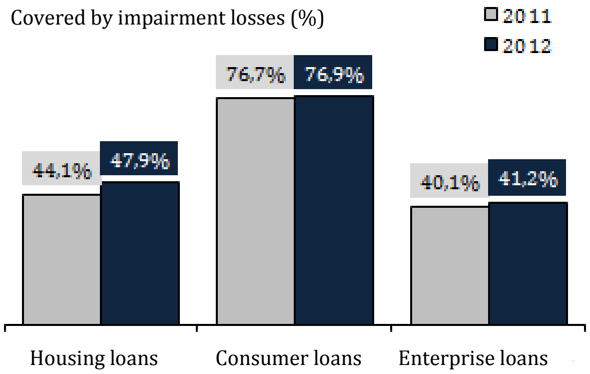
Table 20. Impairment losses and the cost of credit risk

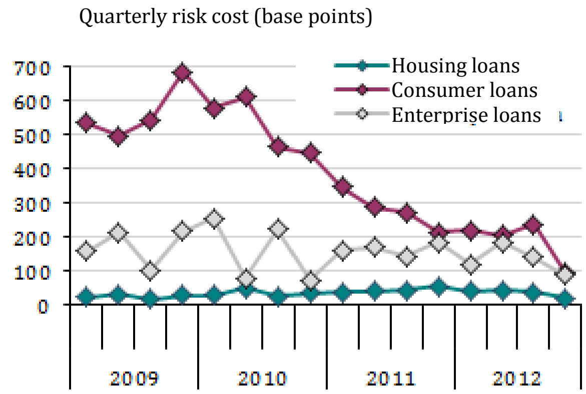
	Impairment loss (PLN billion)			Coverage of non-performing loans with impairment losses (%)			Cost of risk[35] (base points)		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Non-financial sector, in total	33.6	36.4	39.2	54.7%	55.2%	54.5%	158	103	102
Households	23.3	25.4	25.9	68.3%	66.0%	65.4%	203	127	90
Housing loans	2.1	3.3	4.3	42.1%	44.1%	47.9%	36	46	38
Consumer loans	17.8	18.0	16.4	76.9%	76.7%	76.9%	526	282	191
Other	3.4	4.2	5.2	56.7%	54.5%	55.9%	157	167	134
Enterprises	10.3	11.0	13.3	37.8%	40.1%	41.2%	69	53	125
SME	6.0	6.9	8.0	32.4%	35.1%	36.9%	75	50	108
Large enterprises	4.3	4.1	5.3	49.5%	52.6%	50.1%	61	57	152

Stable level of impairment losses for non-performing loans

The increase in impairment losses for loans from the non-financial sector reported for 2012 (PLN 2.8 billion, 7.5%) was lower than the growth rate of non-performing loans (PLN 5.9 billion, 8.9%). That resulted in some reduction in coverage of non-performing loans with impairment losses (from 55.2% at the end of 2011 up to 54.5% at the end of 2012).

Chart 70.
Impairment losses and the credit risk cost





Reduced cost of risk for households, increased cost of risk for enterprises

Despite the increase in impairment losses, the cost of risk did not change (102 base points in 2012, as compared to 103 base points in 103) due to increased lending, although there were still considerable differences with regard to individual products.

[35] Considering some limitations of the reporting system, for simplification it was defined as the relation of the result on impairment losses and provisions to the average volume of loans in a given period, expressed in base points.

Significant increase in cost of risk in enterprise loans was reported, mainly in the first half of 2012, accompanied by reduced cost of risk in household loans.

Quality of loans determined by changing economic conditions

The key factor influencing the quality of the loan portfolio in the future will be the macroeconomic situation. A sharp economic slowdown may negatively affect the financial condition of a part of the borrowers, the fact that will translate into a strong negative pressure on the loan portfolio quality and the banks' results. On the other hand, in consequence of material easing of the monetary policy by the Polish Monetary Policy Council, the loan handling costs (in particular, as regards housing and enterprise loans) are considerably reduced and the financial condition of a part of the borrowers stabilises or even improves.

The banks' financial plans for the year 2013 envisage stabilisation of the loan portfolio quality. The majority of banks expects deterioration of the household loans quality (the effect of deteriorated quality of housing loans accompanied by the improved quality of consumer loans) while, at the same time, improvement of the enterprise loan quality.

LIST OF TABLES

CHART LIST

ANNEX

SITUATION OF THE LARGEST BANKS AND THEIR STRATEGIC INVESTORS

In this annex we present the selected financial data and information regarding the market value of the largest banks operating in Poland, including their strategic investors.
Considering some legal constraints, UKNF cannot publish the reporting data on individual banks. Therefore, the document is based on consolidated data available through Bloomberg information agency.

Banks with the balance-sheet total above PLN 10 billion, including their strategic investors (as at the end of 2012; in PLN million)

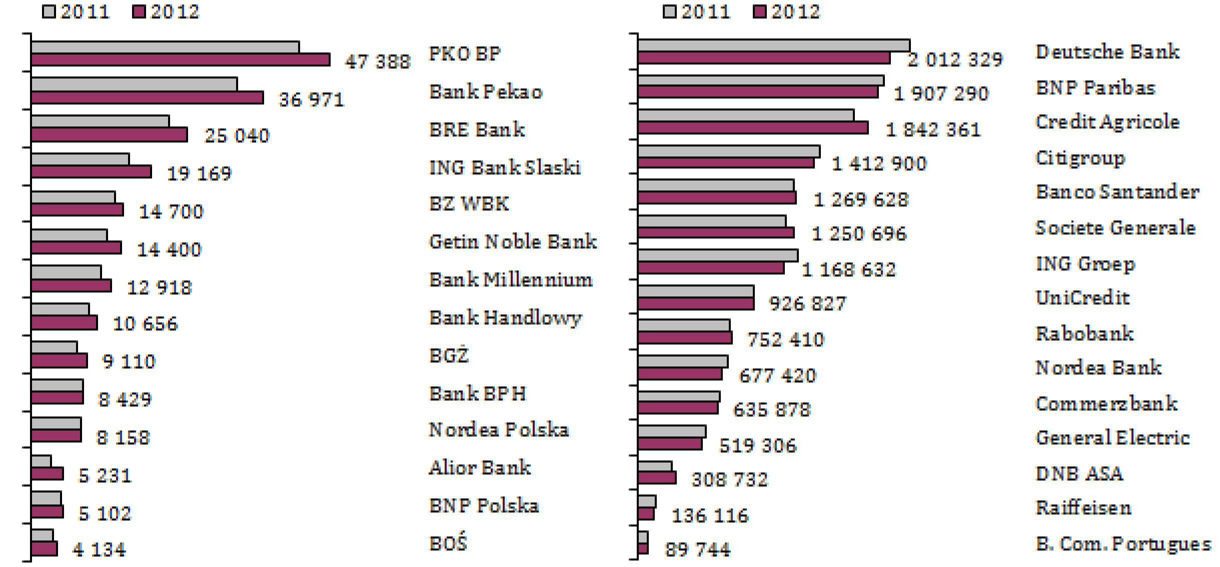
		Balance-sheet total	Net financial result	Market value	Strategic investor
1	Powszechna Kasa Oszczędności Bank Polski	193 480	3 749	46 125	Treasury of State
2	Bank Pekao	150 950	2 956	43 962	UniCredit
3	BRE Bank	102 236	1 203	13 737	Commerzbank
4	Bank Gospodarstwa Krajowego				Treasury of State
5	ING Bank Śląski	78 267	832	11 839	ING Bank
6	Bank Zachodni WBK	60 019	1 434	18 055	Banco Santander
7	Getin Noble Bank	58 794	371	4 744	Leszek Czarnecki
8	Raiffeisen Bank Polska				Raiffeisen Bank International
9	Bank Millennium	52 742	472	5 362	Banco Comercial Portugues
10	Bank Handlowy w Warszawie	43 509	970	12 844	Citigroup
11	Kredyt Bank				Banco Santander
12	Bank Gospodarki Żywnościowej	37 197	130	2 805	Rabobank
13	Bank BPH	34 416	261	3 748	General Electric
14	Nordea Bank Polska	33 310	151	1 382	Nordea Bank
15	Deutsche Bank PBC				Deutsche Bank
16	Alior Bank	21 356	172	3 983	Carlo Tassara
17	BNP Paribas Bank Polska	20 831	31	1 435	BNP Paribas
18	Bank Polskiej Spółdzielczości				Cooperative banks
19	Bank Ochrony Środowiska	16 877	37	686	Treasury of State
20	Santander Consumer Bank				Banco Santander
21	SGB-Bank				Cooperative banks
22	Credit Agricole Bank Polska				Credit Agricole
23	Bank DnB NORD Polska				DNB ASA
24	Euro Bank				Societe Generale

As at the end of 2012, the banking sector comprised 24 banks with reported balance-sheet total above PLN 10 billion; 6 of them was controlled by domestic investors, others by foreign investors.

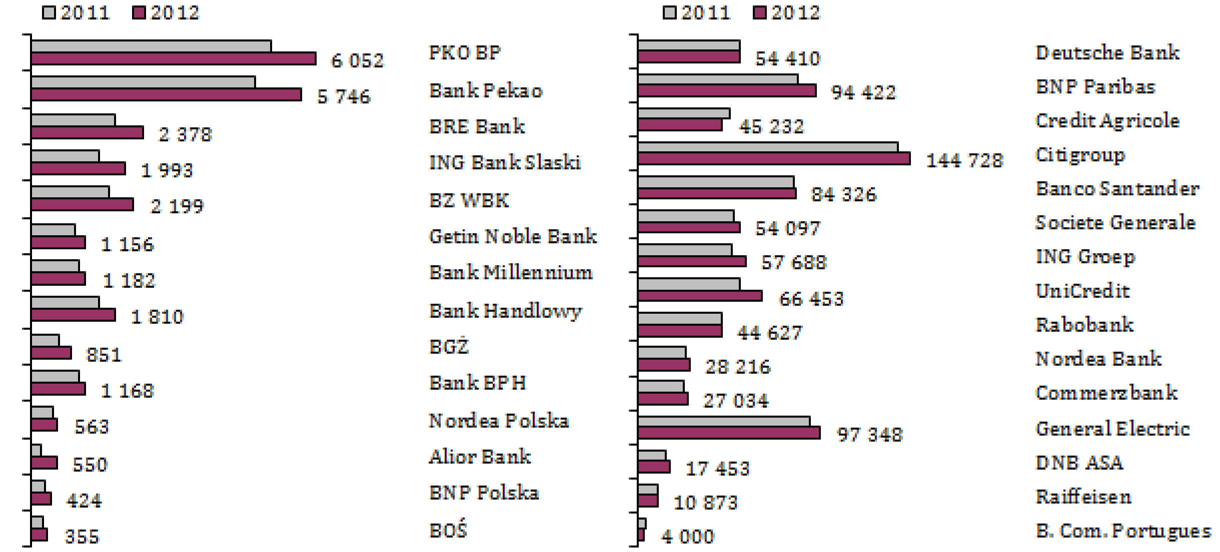
Despite local character, as well as underdeveloped economy and financial markets, and, in consequence, lower scale of operations (measured, among others, by the size of total balance sheet)[36], the current financial condition and the value of Polish banks is good as compared to other European banks (in case of ratings, the restricting/determining condition are ratings of Poland and of the strategic investor). This is the effect of better development perspectives in the long-term and higher operating efficiency (among others: the results generated are more stable, lower C/I, higher ROE).
At the same time, PKO BP and Bank Pekao are among the largest European banks in terms of market value and, particularly in recent years, in terms of profits generated. The latter being, in recent years, the key driver of improved profitability of some strategic investors (this concerns, in particular, Bank Pekao and UniCredit and BRE Bank and Commerzbank).

[36] Disproportions are smaller in terms of value of loans granted, deposits collected and capitals (high balance-sheet totals reported by the European banks are, to a large extent, the effect of a large scale of transactions using other instruments, the effect being the strong increase in their balance-sheet totals).

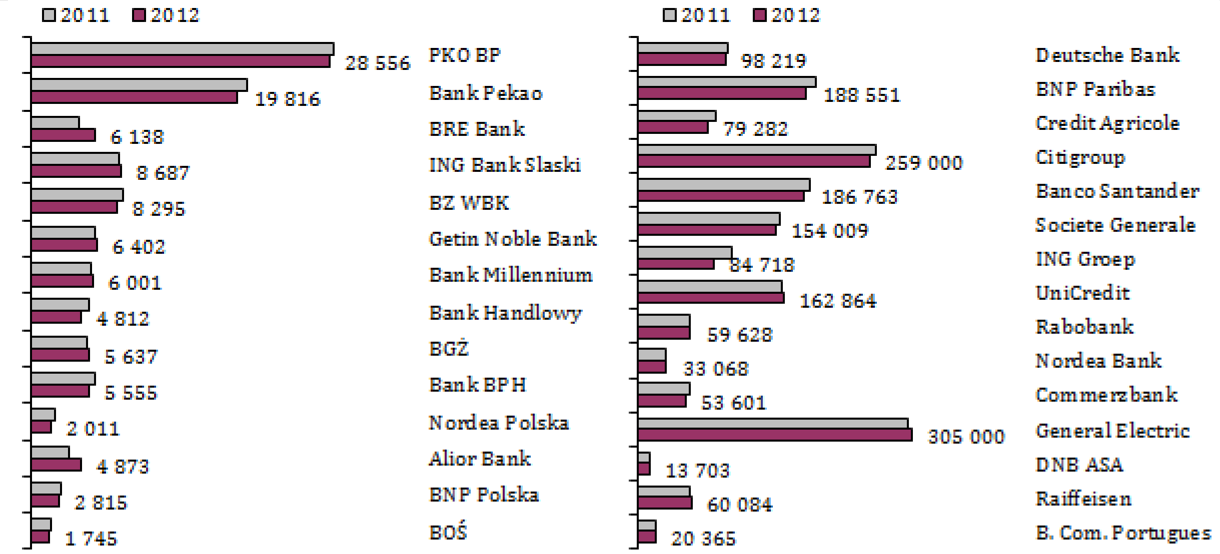
Balance-sheet total (EUR million)



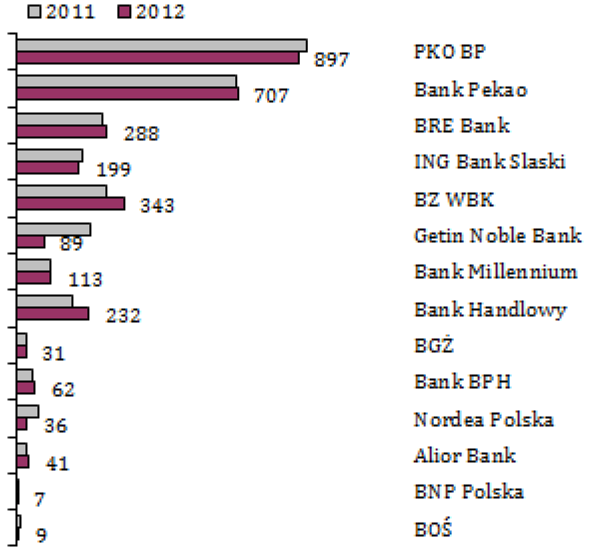
Equity (EUR million)

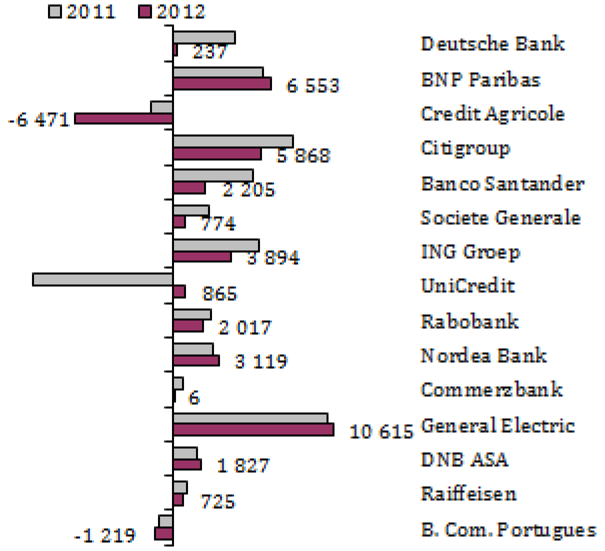


Employment

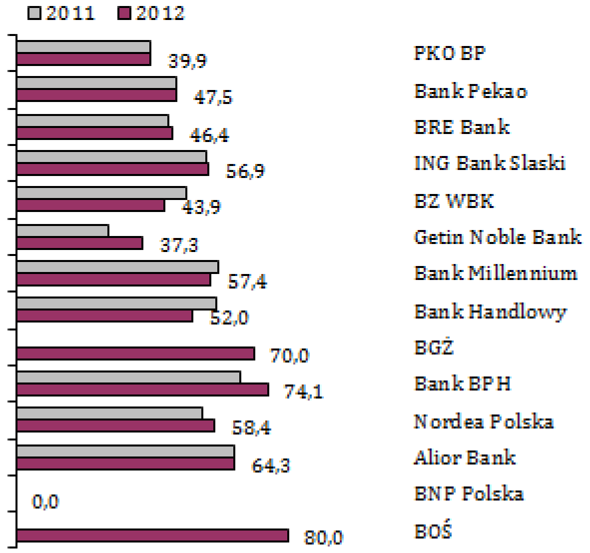


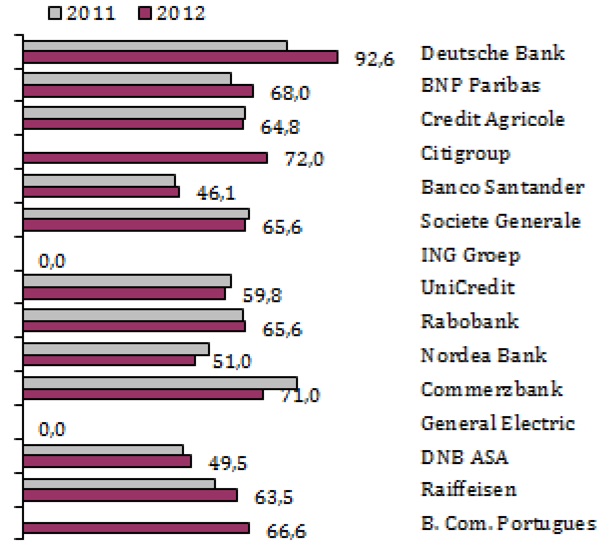
Net financial result (EUR million)



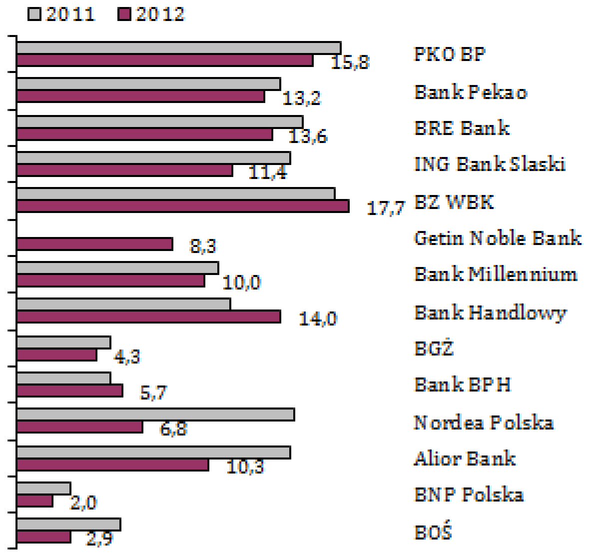


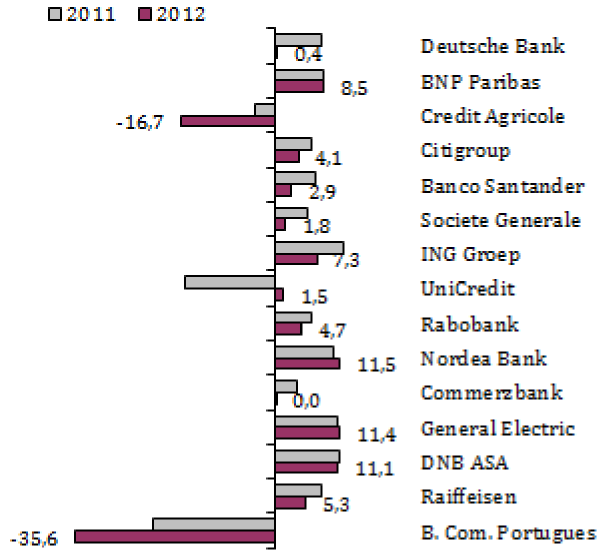
C/I



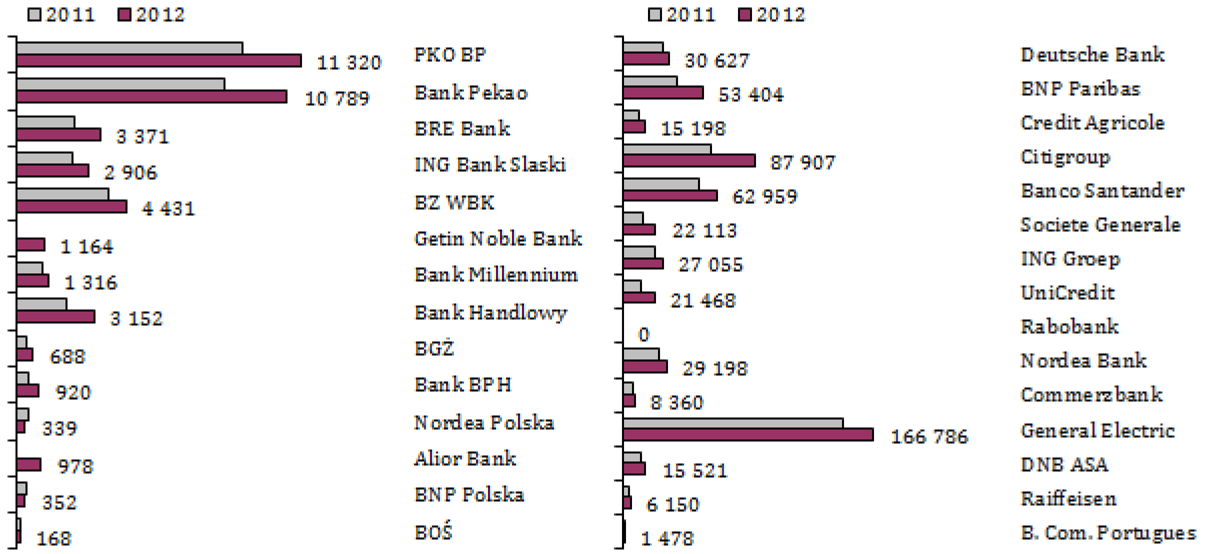


ROE

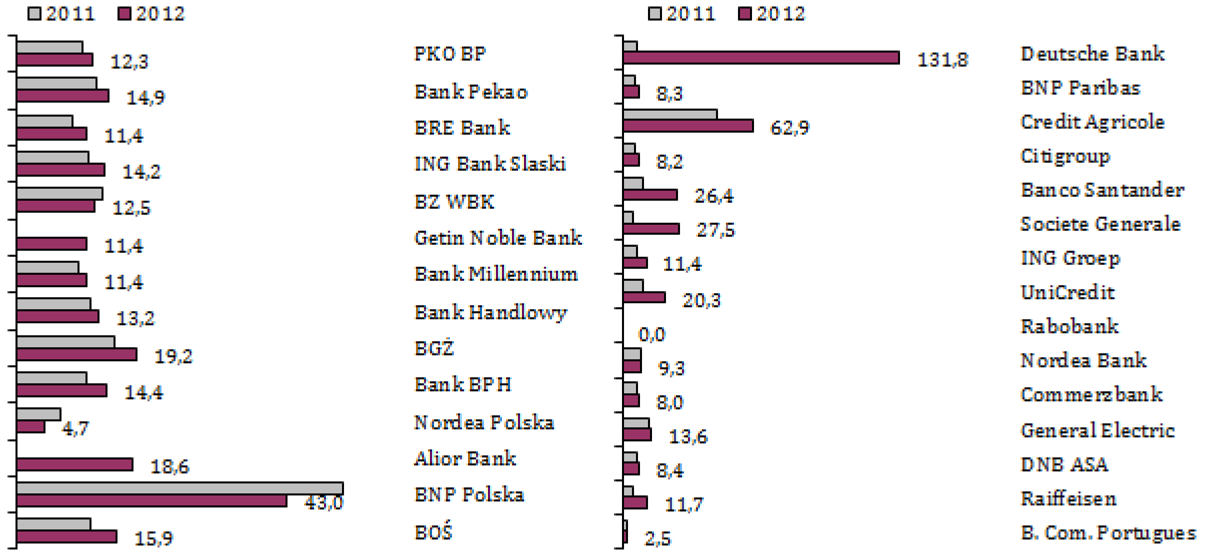




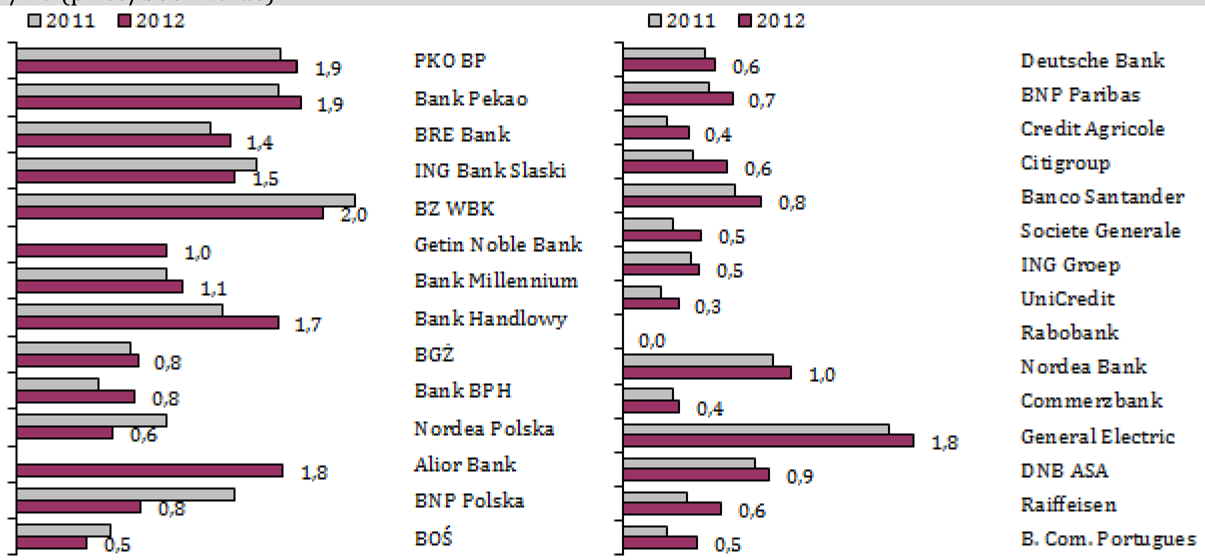
Market value (EUR million)



P/E (price/earnings)



P/BV (price/book value)



Selected data as at the end of 2012 (EUR million)

	Assets	Employ-ment	Equity	Own funds	Solvency ratio	Tier 1 ratio	Net result	ROE	ROA	C/I	Market value	P/E	P/BV	Moody's financial strength
Banks listed at WSE														
PKO BP	47 388	28 556	6 052	5 019	13.1	12.0	897	15.8	2.0	39.9	11 320	12.3	1.9	C-
Bank Pekao	36 971	19 816	5 746	4 824	19.0	18.5	707	13.2	2.0	47.5	10 789	14.9	1.9	C-
BRE Bank	25 040	6 138	2 378	2 832	18.7	13.0	288	13.6	1.2	46.4	3 371	11.4	1.4	D
ING Bank Śląski	19 169	8 687	1 993	1 697	14.8	12.3	199	11.4	1.1	56.9	2 906	14.2	1.5	D+
Bank Zachodni WBK	14 700	8 295	2 199	987	16.5	x	343	17.7	2.4	43.9	4 431	12.5	2.0	D+
Getin Noble Bank	14 400	6 402	1 156	1 322	12.2	x	89	8.3	0.7	37.3	1 164	11.4	1.0	x
Bank Millennium	12 918	6 001	1 182	1 278	13.2	11.6	113	10.0	0.9	57.4	1 316	11.4	1.1	E+
Bank Handlowy w Warszawie	10 656	4 812	1 810	1 573	18.1	x	232	14.0	2.3	52.0	3 152	13.2	1.7	D+
Bank Gospodarki Żywnościowej	9 110	5 637	851	778	11.8	x	31	4.3	0.4	70.0	688	19.2	0.8	D
Bank BPH	8 429	5 555	1 168	1 023	13.9	11.7	62	5.7	0.7	74.1	920	14.4	0.8	D
Nordea Bank Polska	8 158	2 011	563	792	14.2	x	36	6.8	0.4	58.4	339	4.7	0.6	x
Alior Bank	5 231	4 873	550	593	17.0	14.5	41	10.3	0.9	64.3	978	18.6	1.8	x
BNP Paribas Bank Polska	5 102	2 815	424	582	13.8	x	7	2.0	0.1	x	352	43.0	0.8	x
Bank Ochrony Środowiska	4 134	1 745	355	383	15.3	11.6	9	2.9	0.2	80.0	168	15.9	0.5	x
Strategic investors for the largest Polish banks														
Deutsche Bank	2 012 329	98 219	54 410	57 015	17.1	15.1	237	0.4	0.0	92.6	30 627	131.8	0.6	C-
BNP Paribas	1 907 290	188 551	94 422	85 857	15.6	13.6	6 553	8.5	0.3	68.0	53 404	8.3	0.7	C-
Credit Agricole	1 842 361	79 282	45 232	38 600	13.2	11.7	-6 471	-16.7	-0.4	64.8	15 198	62.9	0.4	D
Citigroup	1 412 900	259 000	144 728	127 064	17.3	14.1	5 868	4.1	0.4	72.0	87 907	8.2	0.6	x
Banco Santander	1 269 628	186 763	84 326	72 936	13.1	11.2	2 205	2.9	0.2	46.1	62 959	26.4	0.8	C-
Societe Generale	1 250 696	154 009	54 097	41 308	12.7	12.5	774	1.8	0.1	65.6	22 113	27.5	0.5	C-
ING Groep	1 168 632	84 718	57 688	47 116	16.9	14.4	3 894	7.3	0.3	x	27 055	11.4	0.5	x
UniCredit	926 827	162 864	66 453	62 018	14.5	11.4	865	1.5	0.1	59.8	21 468	20.3	0.3	C-
Rabobank	752 410	59 628	44 627	42 375	19.0	17.2	2 017	4.7	0.3	65.6	x	x	x	B-
Nordea Bank	677 420	33 068	28 216	27 274	16.2	14.3	3 119	11.5	0.4	51.0	29 198	9.3	1.0	C
Commerzbank	635 878	53 601	27 034	37 123	17.8	13.1	6	0.0	0.0	71.0	8 360	8.0	0.4	D+
General Electric	519 306	305 000	97 348	x	x	x	10 615	11.4	1.9	x	166 786	13.6	1.8	x
DNB ASA	308 732	13 703	17 453	18 412	12.6	11.0	1 827	11.1	0.6	49.5	15 521	8.4	0.9	x
Raiffeisen Bank International	136 116	60 084	10 873	12 885	15.6	11.2	725	5.3	0.5	63.5	6 150	11.7	0.6	D+
Banco Comercial Portugues	89 744	20 365	4 000	6 773	12.7	11.7	-1 219	-35.6	-1.3	66.6	1 478	2.5	0.5	E

Scale of operations

	Assets			Loans			Deposits			Employment		
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Banks listed at WSE (PLN million)												
PKO BP	169 661	190 748	193 480	135 525	147 293	150 652	132 981	146 474	145 342	29 780	28 924	28 556
Bank Pekao	134 090	146 590	150 950	84 895	100 102	102 657	99 807	103 821	102 898	20 783	20 783	19 816
BRE Bank	90 039	98 876	102 236	58 486	69 086	67 563	44 443	52 426	56 100	7 023	4 729	6 138
ING Bank Śląski	64 518	69 723	78 267	35 437	43 279	50 415	47 400	52 816	57 858	8 472	8 409	8 687
Bank Zachodni WBK	53 154	59 797	60 019	34 195	39 432	41 397	41 970	46 829	47 077	9 250	8 802	8 295
Getin Noble Bank	x	54 488	58 794	x	44 733	46 510	x	47 217	50 185	x	6 185	6 402
Bank Millennium	46 984	50 838	52 742	37 926	42 550	41 470	35 395	37 428	41 434	6 135	5 886	6 001
Bank Handlowy w Warszawie	37 518	42 278	43 509	13 699	16 004	17 352	23 866	24 096	23 793	6 039	5 646	4 812
Bank Gospodarki Żywnościowej	28 630	33 407	37 197	19 869	25 105	27 394	21 052	22 942	26 942	5 257	5 415	5 637
Bank BPH	37 291	37 031	34 416	30 328	30 438	27 751	15 260	13 417	12 841	6 870	6 162	5 555
Nordea Bank Polska	24 832	35 325	33 310	20 813	27 735	26 770	9 461	13 292	13 467	2 219	2 333	2 011
Alior Bank	9 312	15 408	21 356	5 677	10 434	15 035	7 719	13 532	17 472	x	3 694	4 873
BNP Paribas Bank Polska	18 539	22 479	20 831	14 387	17 932	17 362	8 195	8 829	10 065	2 832	3 011	2 815
Bank Ochrony Środowiska	15 180	15 637	16 877	10 957	11 352	11 429	12 191	11 412	11 816	1 966	1 981	1 745
Strategic investors for the largest Polish banks (EUR million)												
Deutsche Bank	1 905 630	2 164 103	2 012 329	411 025	416 676	401 975	533 984	601 731	577 202	102 062	100 996	98 219
BNP Paribas	1 998 158	1 965 283	1 907 290	694 834	692 371	654 868	553 377	523 124	532 209	205 348	198 423	188 551
Credit Agricole	1 593 529	1 723 608	1 842 361	355 091	362 490	325 294	441 767	453 618	462 162	87 520	87 451	79 282
Citigroup	1 431 900	1 445 900	1 412 900	508 759	520 848	513 718	659 217	699 110	705 130	260 000	266 000	259 000
Banco Santander	1 217 501	1 251 526	1 269 628	743 851	750 598	745 987	570 724	563 692	626 639	178 869	193 349	186 763
Societe Generale	1 132 072	1 181 372	1 250 696	402 628	399 287	372 255	310 636	340 172	337 230	160 704	159 616	154 009
ING Groep	1 247 005	1 279 228	1 168 632	x	x	x	511 362	467 547	455 003	107 106	104 419	84 718
UniCredit	929 488	926 769	926 827	579 108	581 092	553 506	361 761	359 304	368 479	162 009	160 360	162 864
Rabobank	652 536	731 665	752 410	459 955	471 307	489 151	298 761	329 892	334 271	58 714	59 670	59 628
Nordea Bank	580 839	716 204	677 420	297 044	312 891	349 071	176 390	186 723	200 678	33 809	33 068	33 068
Commerzbank	754 299	661 763	635 878	307 864	278 457	252 276	244 721	227 135	233 845	50 489	58 160	53 601
General Electric	559 474	554 158	519 306	x	x	x	x	x	x	287 000	301 000	305 000
DNB ASA	238 784	274 525	308 732	151 545	166 696	178 530	82 336	95 555	110 546	13 021	13 620	13 703
Raiffeisen Bank International	131 173	146 985	136 116	75 657	81 576	83 343	57 633	66 747	66 297	59 782	59 261	60 084
Banco Comercial Portugues	98 547	93 482	89 744	76 411	71 533	66 861	45 515	47 402	49 390	21 370	21 470	20 365

Financial results and the efficiency of operations

	Net financial result			ROE			ROA			C/I			Interest margin		
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Banks listed at WSE (PLN million)															
PKO BP	3 217	3 807	3 749	15.4	17.2	15.8	2.0	2.1	2.0	41.7	39.6	39.9	4.3	4.5	4.4
Bank Pekao	2 525	2 899	2 956	13.1	14.0	13.2	1.9	2.1	2.0	50.6	47.5	47.5	3.5	3.6	3.5
BRE Bank	642	1 135	1 203	11.6	15.2	13.6	0.8	1.2	1.2	50.3	45.1	46.4	2.3	2.5	2.4
ING Bank Śląski	753	880	832	14.3	14.6	11.4	1.2	1.3	1.1	58.3	56.3	56.9	2.8	2.9	3.0
Bank Zachodni WBK	974	1 184	1 434	15.5	16.9	17.7	1.8	2.1	2.4	x	50.2	43.9	3.7	3.9	4.2
Getin Noble Bank	x	980	371	x	x	8.3	x	x	0.7	x	27.3	37.3	x	x	2.2
Bank Millennium	326	466	472	9.5	10.8	10.0	0.7	1.0	0.9	63.1	59.5	57.4	2.1	2.4	2.3
Bank Handlowy w Warszawie	755	736	970	11.9	11.4	14.0	2.0	1.8	2.3	54.0	59.0	52.0	4.6	3.9	3.7
Bank Gospodarki Żywnościowej	112	128	130	4.6	5.0	4.3	0.4	0.4	0.4	x	x	70.0	2.5	2.9	3.1
Bank BPH	-135	218	261	-3.1	5.0	5.7	-0.4	0.6	0.7	x	65.9	74.1	4.1	4.0	4.0
Nordea Bank Polska	259	297	151	17.0	14.8	6.8	1.1	1.0	0.4	x	54.8	58.4	2.1	2.2	2.1
Alior Bank	-104	152	172	-10.1	14.6	10.3	-1.3	1.2	0.9	96.9	64.3	64.3	4.3	4.3	4.1
BNP Paribas Bank Polska	42	39	31	3.1	2.9	2.0	0.2	0.2	0.1	x	x	x	3.1	2.9	2.6
Bank Ochrony Środowiska	63	62	37	6.3	5.6	2.9	0.5	0.4	0.2	x	x	80.0	1.9	1.9	1.9
Strategic investors for the largest Polish banks (EUR million)															
Deutsche Bank	2 310	4 132	237	5.4	8.1	0.4	0.1	0.2	0.0	81.6	78.2	92.6	1.0	0.9	0.8
BNP Paribas	7 843	6 050	6 553	11.8	8.6	8.5	0.4	0.3	0.3	60.4	61.6	68.0	1.3	1.3	1.3
Credit Agricole	1 263	-1 470	-6 471	3.0	-3.6	-16.7	0.1	-0.1	-0.4	65.5	65.5	64.8	1.1	1.0	0.9
Citigroup	8 008	7 958	5 868	6.7	6.5	4.1	0.6	0.6	0.4	x	x	72.0	3.2	2.8	2.8
Banco Santander	8 181	5 351	2 205	11.4	7.1	2.9	0.7	0.4	0.2	43.3	44.9	46.1	2.8	2.9	2.8
Societe Generale	3 917	2 385	774	10.4	5.8	1.8	0.4	0.2	0.1	63.4	66.5	65.6	1.2	1.2	1.1
ING Groep	2 810	5 766	3 894	6.6	12.1	7.3	0.2	0.5	0.3	x	x	x	x	x	x
UniCredit	1 323	-9 206	865	2.1	-15.9	1.5	0.1	-1.0	0.1	58.8	61.4	59.8	1.9	1.9	1.6
Rabobank	2 772	2 549	2 017	7.7	6.4	4.7	0.4	0.4	0.3	x	64.9	65.6	1.5	1.5	1.4
Nordea Bank	2 657	2 627	3 119	11.4	10.4	11.5	0.5	0.4	0.4	52.0	55.0	51.0	1.0	0.9	0.9
Commerzbank	1 430	638	6	14.6	4.0	0.0	0.2	0.1	0.0	69.3	80.8	71.0	0.9	1.0	0.9
General Electric	8 795	10 176	10 615	9.6	11.1	11.4	1.5	1.9	1.9	x	x	x	x	x	x
DNB ASA	1 851	1 665	1 827	14.1	11.3	11.1	0.8	0.7	0.6	47.6	47.1	49.5	1.4	1.5	1.5
Raiffeisen Bank International	1 087	968	725	12.0	8.0	5.3	1.0	0.7	0.5	55.1	57.0	63.5	3.6	2.8	2.6
Banco Comercial Portugues	344	-849	-1 219	5.8	-21.8	-35.6	0.4	-0.9	-1.3	x	x	66.6	1.7	1.7	1.2

Capital adequacy

	Equity			Own funds			Solvency ratio			Tier 1 ratio			CDS (5Y EUR subordinated)		
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Banks listed at WSE (PLN million)															
PKO BP	21 360	22 822	24 708	17 619	18 343	20 491	12.5	12.4	13.1	11.2	11.2	12.0			
Bank Pekao	20 257	21 357	23 459	16 820	17 614	19 694	17.6	17.0	19.0	17.3	17.0	18.5			
BRE Bank	7 077	8 073	9 710	8 971	9 877	11 565	15.9	15.0	18.7	10.8	9.5	13.0			
ING Bank Śląski	5 653	6 416	8 136	4 844	5 482	6 928	13.2	12.3	14.8	x	12.3	12.3			
Bank Zachodni WBK	6 774	7 483	8 978	x	3 697	4 029	15.8	15.1	16.5	x	x	x			
Getin Noble Bank	x	4 227	4 722	x	3 833	5 397	x	10.0	12.2	x	x	x			
Bank Millennium	4 091	4 586	4 824	4 574	4 767	5 218	14.4	13.2	13.2	12.3	11.4	11.6			
Bank Handlowy w Warszawie	6 493	6 444	7 391	4 385	4 355	6 421	18.8	16.4	18.1	x	x	x			
Bank Gospodarki Żywnościowej	2 495	2 638	3 473	x	2 400	3 177	11.1	9.7	11.8	x	x	x			
Bank BPH	4 366	4 598	4 767	3 900	4 024	4 176	13.2	14.0	13.9	11.0	11.6	11.7			
Nordea Bank Polska	1 851	2 148	2 299	x	x	3 233	10.9	9.6	14.2	x	x	x			
Alior Bank	976	1 112	2 245	x	964	2 420	15.4	9.8	17.0	15.3	9.4	14.5			
BNP Paribas Bank Polska	1 334	1 404	1 731	x	1 334	2 375	13.6	11.5	13.8	x	x	x			
Bank Ochrony Środowiska	1 083	1 162	1 451	x	x	1 565	12.4	12.2	15.3	x	x	11.6			
Strategic investors for the largest Polish banks (EUR million)															
Deutsche Bank	50 392	54 660	54 410	48 688	55 226	57 015	14.1	14.5	17.1	12.3	12.9	15.1	187	379	170
BNP Paribas	85 630	85 626	94 422	88 324	85 962	85 857	14.5	14.0	15.6	11.4	11.6	13.6	229	540	225
Credit Agricole	52 149	49 292	45 232	47 400	44 800	38 600	11.7	13.4	13.2	10.3	11.2	11.7	323	572	306
Citigroup	124 038	138 559	144 728	121 367	127 611	127 064	16.6	17.0	17.3	12.9	13.6	14.1	184	404	192
Banco Santander	80 914	82 859	84 326	79 276	76 772	72 936	13.1	13.6	13.1	10.0	11.0	11.2	431	582	372
Societe Generale	50 975	51 112	54 097	40 506	41 428	41 308	12.1	11.9	12.7	10.6	10.7	12.5	295	643	314
ING Groep	46 633	50 440	57 688	x	x	47 116	13.5	13.5	16.9	12.3	11.7	14.4	257	431	191
UniCredit	67 703	54 798	66 453	57 655	56 973	62 018	12.7	12.4	14.5	9.5	9.3	11.4	444	917	489
Rabobank	40 757	45 001	44 627	35 734	39 088	42 375	16.3	17.5	19.0	15.7	17.0	17.2	144	215	119
Nordea Bank	24 538	26 120	28 216	24 734	24 838	27 274	13.4	13.4	16.2	11.4	12.2	14.3	127	268	139
Commerzbank	28 658	24 803	27 034	40 857	36 560	37 123	15.3	15.5	17.8	11.9	11.1	13.1	497	889	391
General Electric	92 921	91 153	97 348	x	x	x	x	x	x	x	x	x			
DNB ASA	14 263	15 212	17 453	16 354	16 388	18 412	12.4	11.4	12.6	12.3	11.3	11.0	114	192	225
Raiffeisen Bank International	10 404	10 936	10 873	12 608	12 858	12 885	13.3	13.5	15.6	9.7	9.9	11.2	337	480	283
Banco Comercial Portugues	5 612	4 374	4 000	6 116	5 263	6 773	10.3	9.5	12.7	9.2	8.6	11.7	1 747	1 680	601

Ratings

	Moody's				Standard & Poor's			FITCH				
	Financial strength	**Long-term**	**Short-term, deposits**	**Perspektywa**	**Long-term**	**Short-term**	**Outlook**	**Viability rating**	**Long-term**	**Short-term**	**Support rating**	**Outlook**
Banks listed at WSE												
PKO BP	C-	A2	P-1	negative	A-	A-2	stable	x	x	x	2	x
Bank Pekao	C-	A2	x	negative	BBB+	A-2	stable	a-	A-	F2	2	stable
BRE Bank	D	Baa3	P-3	stable	x	x	x	bbb-	A	F1	1	stable
ING Bank Śląski	D+	Baa1	P-2	negative	x	x	x	bbb+	A	F1	1	negative
Bank Zachodni WBK	D+	Baa1	x	negative	x	x	x	bbb	BBB	F3	2	stable
Getin Noble Bank	x	x	x	x	x	x	x	bb	x	x	3	stable
Bank Millennium	E+	Ba2	NP	negative	x	x	x	bbb-	BBB-	F3	3	stable
Bank Handlowy w Warszawie	D+	Baa3	x	stable	x	x	x	bbb+	A-	F2	1	stable
Bank Gospodarki Żywnościowej	D	Baa2	x	stable	x	x	x	x	x	x	x	x
Bank BPH	D	Baa2	P-2	stable	x	x	x	x	x	x	x	x
Nordea Bank Polska	x	x	x	x	x	x	x	x	x	x	x	x
Alior Bank	x	x	x	x	x	x	x	x	x	x	x	x
BNP Paribas Bank Polska	x	x	x	x	x	x	x	x	x	x	x	x
Bank Ochrony Środowiska	x	x	x	x	x	x	x	bb	BBB	F3	2	stable
Strategic investors for the largest Polish banks												
Deutsche Bank	C-	A2	x	stable	A+ *-	A-1	x	a	A+	F1+	1	stable
BNP Paribas	C-	A2	x	stable	A+	A-1	negative	a+	A+	F1+	1	stable
Credit Agricole	D	A2	x	stable	A	A-1	negative	a	A+	F1+	1	negative
Citigroup	x	Baa2	x	negative	A-	A-2	negative	a-	A	F1	1	stable
Banco Santander	C-	Baa2	x	negative	BBB	A-2	negative	bbb+	BBB+	F2	2	negative
Societe Generale	C-	A2	x	stable	A	A-1	negative	a-	A+	F1+	1	negative
ING Groep	x	A3	x	negative	A	A-1	negative	x	A	F1	1	negative
UniCredit	C-	Baa2	x	negative	BBB+	A-2	negative	bbb+	BBB+	F2	2	negative
Rabobank	B-	Aa2	x	negative	AA-	A-1+	stable	x	AA	F1+	1	negative
Nordea Bank	C	Aa3	P-1	stable	AA-	A-1+	negative	aa-	AA-	F1+	1	stable
Commerzbank	D+	Baa1	x	stable	A *-	A-1 *-	x	bbb-	A+	F1+	1	stable
General Electric	x	Aa3	x	stable	AA+	A-1+	stable	x	x	x	x	x
DNB ASA	x	x	x	x	x	x	x	x	x	x	x	x
Raiffeisen Bank International	D+	A2	P-1	stable	A	A-1	negative	bbb	A	F1	1	stable
Banco Comercial Portugues	E	B1	x	negative	B+	B	negative	b	BB+	B	3	negative

Market valuation

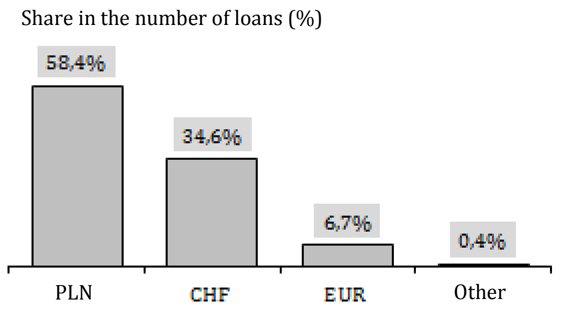
	Market Value			P/E (price/earnings)			P/BV (price/book value)		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Banks listed at WSE (PLN million)									
PKO BP	54 188	40 150	46 125	16.8	10.5	12.3	2.5	1.8	1.9
Bank Pekao	46 963	37 046	43 962	18.6	12.8	14.9	2.3	1.7	1.9
BRE Bank	12 792	10 357	13 737	17.4	9.1	11.4	1.9	1.3	1.4
ING Bank Śląski	11 631	10 226	11 839	15.4	11.6	14.2	2.1	1.6	1.5
Bank Zachodni WBK	15 704	16 515	18 055	16.1	13.9	12.5	2.4	2.2	2.0
Getin Noble Bank	x	x	4 744	x	x	11.4	x	x	1.0
Bank Millennium	5 944	4 610	5 362	17.4	9.9	11.4	1.5	1.0	1.1
Bank Handlowy w Warszawie	12 217	8 872	12 844	16.2	12.0	13.2	1.9	1.4	1.7
Bank Gospodarki Żywnościowej	x	2 019	2 805	x	15.8	19.2	x	0.8	0.8
Bank BPH	5 443	2 430	3 748	101.6	11.1	14.4	1.3	0.5	0.8
Nordea Bank Polska	2 225	2 158	1 382	7.7	7.3	4.7	1.2	1.0	0.6
Alior Bank	x	x	3 983	x	x	18.6	x	x	1.8
BNP Paribas Bank Polska	3 134	2 044	1 435	75.4	51.8	43.0	2.3	1.5	0.8
Bank Ochrony Środowiska	1 257	737	686	43.0	11.8	15.9	1.3	0.6	0.5
Strategic investors for the largest Polish banks (EUR million)									
Deutsche Bank	36 343	27 360	30 627	12.7	6.6	131.8	0.7	0.5	0.6
BNP Paribas	57 056	36 655	53 404	7.5	6.3	8.3	0.9	0.5	0.7
Credit Agricole	22 825	10 891	15 198	17.6	45.3	62.9	0.5	0.3	0.4
Citigroup	102 804	59 354	87 907	13.3	5.6	8.2	0.8	0.4	0.6
Banco Santander	66 033	50 290	62 959	8.4	9.7	26.4	0.9	0.7	0.8
Societe Generale	30 021	13 352	22 113	8.1	5.4	27.5	0.7	0.3	0.5
ING Groep	27 894	21 303	27 055	12.8	6.7	11.4	0.6	0.4	0.5
UniCredit	29 883	12 396	21 468	24.2	10.0	20.3	0.5	0.2	0.3
Rabobank	x	x	x	x	x	x	x	x	x
Nordea Bank	32 984	24 165	29 198	12.3	9.2	9.3	1.3	0.9	1.0
Commerzbank	6 561	6 663	8 360	4.6	7.2	8.0	0.6	0.3	0.4
General Electric	145 799	145 897	166 786	16.0	12.9	13.6	1.6	1.6	1.8
DNB ASA	17 056	12 314	15 521	9.5	7.3	8.4	1.2	0.8	0.9
Raiffeisen Bank International	8 016	3 923	6 150	9.0	5.1	11.7	0.9	0.4	0.6
Banco Comercial Portugues	2 732	980	1 478	10.2	2.5	2.5	0.7	0.3	0.5

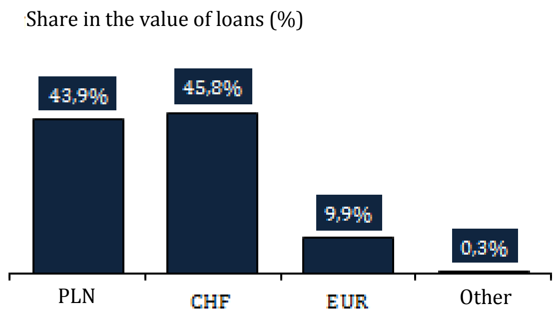
RESULTS OF THE ANALYSIS OF THE HOUSEHOLD HOUSING LOANS[37]

As at the end of 2012 the banks' portfolios comprised 1.7 million loans, including 58.4% of PLN loans and 41.6% of FX loans. In terms of value, the majority were FX loans (in average, the value of an FX loan (PLN 253.0 thousand) was twice higher than the value of a PLN loan (PLN 141.5 thousand).

The loan portfolio structure by the loan currency

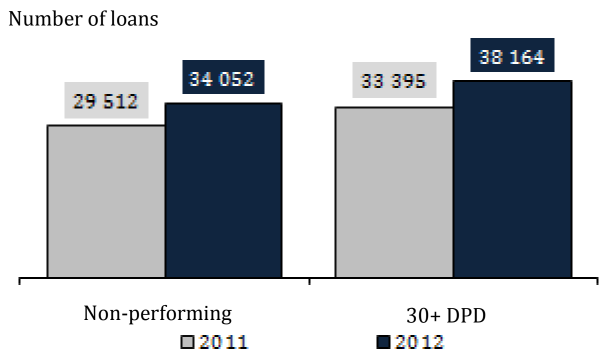
	IN TOTAL	PLN	FX	CHF	EUR	Other
Number of loans (pieces)	1 679 980	980 298	699 682	580 489	113 163	6 030
Value of loans (PLN million)	315 765	138 727	177 038	144 664	31 285	1 089
Average value of a loan (PLN thousand)	188.0	141.5	253.0	249.2	276.5	180.5

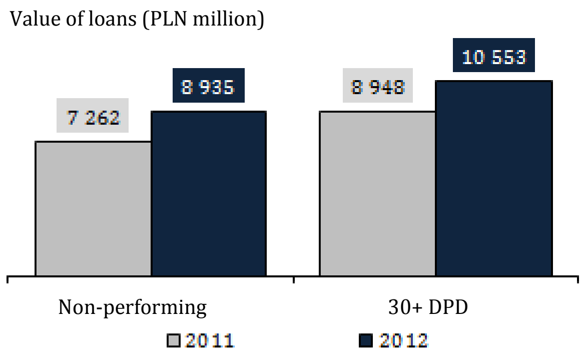




Non-performing and defaulted loans

	Number of loans (pieces)			Value of loans (PLN million)		
	2011	2012	Change	2011	2012	Change
Non-performing loans	29 512	34 052	4 540	7 262	8 935	1 672
30+ DPD loans	33 395	38 164	4 769	8 948	10 553	1 605
31-90 days	11 466	11 730	264	3 497	3 346	-151
91-180 days	4 477	4 383	-94	1 243	1 175	-68
> 180 days	17 452	22 051	4 599	4 207	6 032	1 825





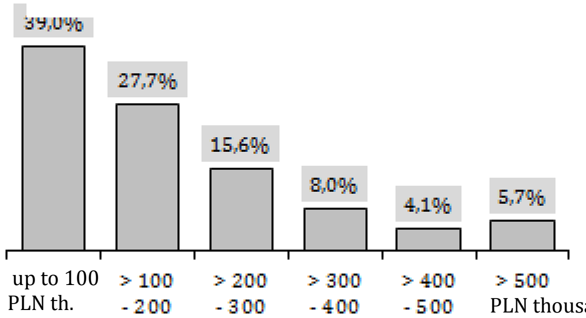
The portfolio comprised 34.1 thousand non-performing loans and 38.1 thousand 30+ DPD loans; in the context of the credit risk, one must take into account the large number of other non-performing and defaulted loans mortgaged against residential units (see herein below).

[37] The analysis covered 29 entities which, as at the end of 2012, held 96.8% share in the household housing loan market. Interpreting the results, one must take into account that some part of data provided by the banks were expert estimations. In addition, not all banks provided complete data, or, if yes, then they were not coherent (this is the reason for discrepancies as to the number and the value of loans in total, as presented in individual tables). Despite that, the results of the analysis is a good picture of the actual situation.

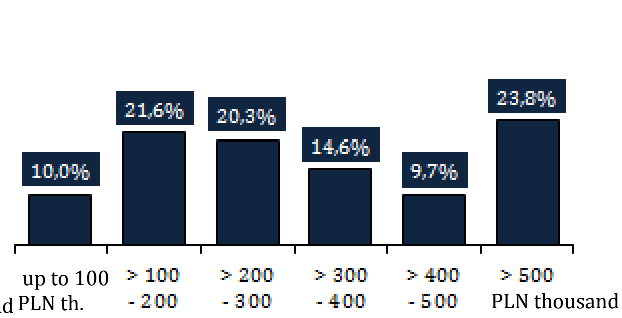
Structure by the loan value

	Number of loans (pcs)			Value of loans (PLN million)		
	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX
IN TOTAL	1 679 980	980 298	699 682	315 765	138 727	177 038
up to PLN 100 thousand	654 593	463 692	190 901	31 506	21 694	9 812
> 100 - 200	465 111	292 426	172 685	68 067	42 475	25 592
> 200 - 300	261 301	134 191	127 110	63 982	32 638	31 344
> 300 - 400	134 239	50 335	83 904	46 223	17 211	29 011
> 400 - 500	69 152	19 113	50 039	30 695	8 426	22 269
> PLN 500 thousand	95 584	20 541	75 043	75 293	16 284	59 009

Share in the number of loans (%)



Share in the value of loans (%)

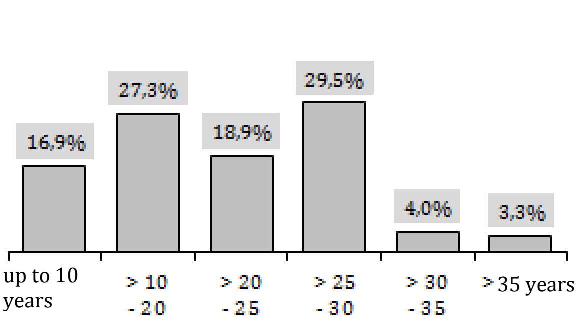


In terms of a loan value, loans up to PLN 200 thousand prevail. They account for 66.7% of the total number of loans. Their share in the total value of loans is, however, only 31.6%. On the other hand, loans of above PLN 500 thousand account for only 5.7% of all loans and, at the same time, for as much as 23.8% of their total value.

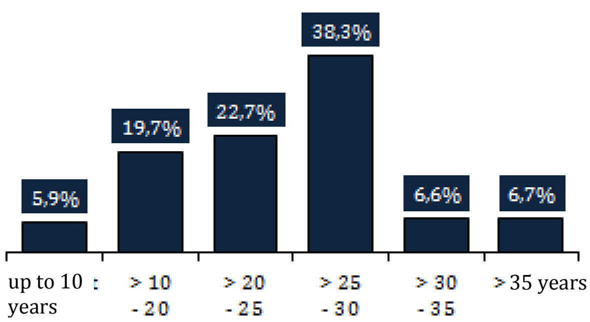
Structure by loan maturity

	Number of loans (pcs)			Value of loans (PLN million)		
	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX
IN TOTAL	1 679 977	980 297	699 680	313 765	138 727	175 038
up to 10 years	284 478	209 257	75 221	18 608	12 503	6 105
> 10 - 20	458 729	277 684	181 045	61 866	31 113	30 753
> 20 - 25	317 989	139 450	178 539	71 368	22 025	49 343
> 25 - 30	494 930	303 002	191 928	120 289	60 185	60 104
> 30 - 35	67 904	30 429	37 475	20 723	7 328	13 395
> 35 years	55 947	20 475	35 472	20 911	5 573	15 338

Share in the number of loans (%)



Share in the value of loans (%)

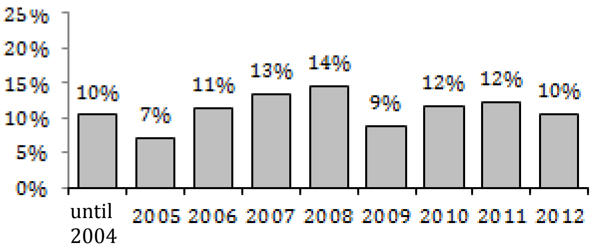


In terms of maturity, loans with maturities between 20 and 30 years prevail. They account for 48.4% of all loan agreements and 61.0% of their total value.

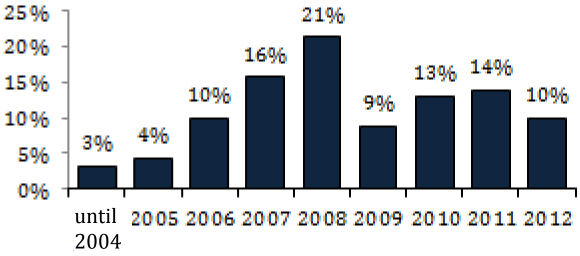
Structure by the year when a loan was granted

	IN TOTAL	2012	2011	2010	2009	2008	2007	2006	2005	until 2005
Structure										
Number of loans (pcs)										
In total	1 679 979	174 954	205 842	197 239	148 525	243 085	223 192	191 952	120 413	174 777
PLN	980 297	166 964	168 268	149 734	111 638	75 668	124 353	72 470	32 560	78 642
FX	699 682	7 990	37 574	47 505	36 887	167 417	98 839	119 482	87 853	96 135
Value of loans (PLN million)										
In total	315 765	31 061	43 896	40 791	28 040	67 300	49 554	31 542	13 457	10 125
PLN	138 727	28 111	30 662	25 130	17 195	10 325	16 164	6 194	1 840	3 106
FX	177 038	2 950	13 234	15 661	10 845	56 975	33 390	25 348	11 617	7 019
Average value of a loan (PLN thousand)										
In total	188.0	177.5	213.3	206.8	188.8	276.9	222.0	164.3	111.8	57.9
PLN	141.5	168.4	182.2	167.8	154.0	136.5	130.0	85.5	56.5	39.5
FX	253.0	369.2	352.2	329.7	294.0	340.3	337.8	212.1	132.2	73.0
Quality of loans										
Number of loans (pcs)										
Non-performing	34 139	168	868	2 201	3 195	8 138	6 528	4 346	3 001	5 694
30+ DPD	38 156	263	1 267	2 679	3 568	9 197	7 182	4 819	3 225	5 956
Value of loans (PLN million)										
Non-performing	9 006	41	287	685	923	3 159	1 996	862	458	594
30+ DPD	10 590	69	423	869	1 091	3 624	2 321	1 039	532	623
Share (%)										
Non-performing	2.9%	0.1%	0.7%	1.7%	3.3%	4.7%	4.0%	2.7%	3.4%	5.9%
30+ DPD	3.4%	0.2%	1.0%	2.1%	3.9%	5.4%	4.7%	3.3%	4.0%	6.2%

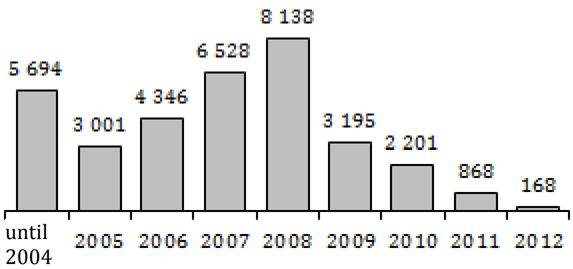
Share in the number of loans (%)



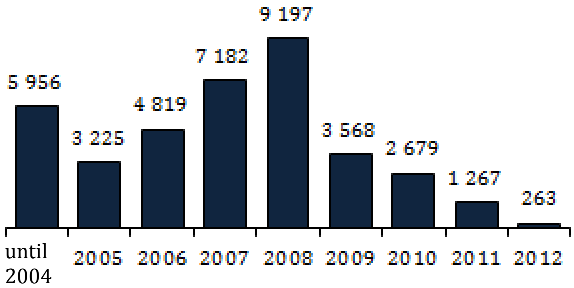
Share in the value of loans (%)



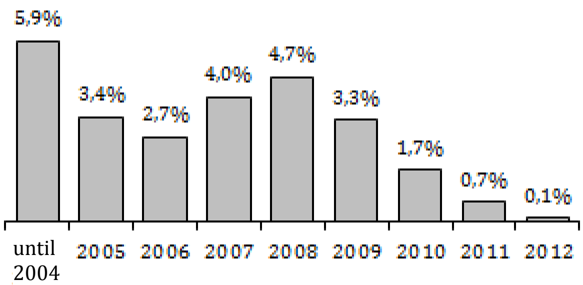
Number of non-performing loans



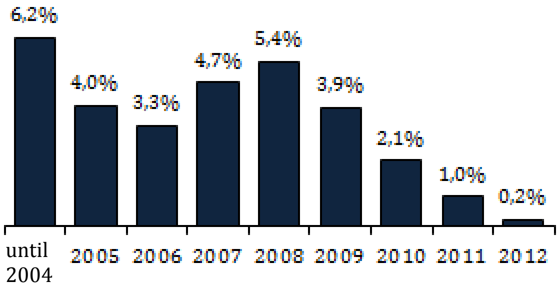
Number of 30+ DPD loans



Quality of loans (per year when granted)
Share of non-performing loans



Quality of loans (per year when granted)
Share of 30+ DPD loans



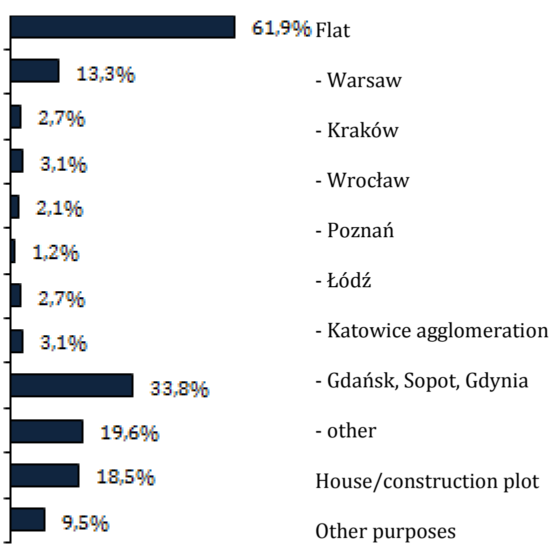
The number of loan agreements entered into as per individual year is equilibrated (large number of loans granted in years 2011-2012 can be explained by changes of the financing bank or major changes in parameters of the existing agreements). In terms of value, loans granted in years 2007-2008 prevail.

The portfolio of 2007-2008 has the lowest quality, the fact reflected by the highest number and the highest value of non-performing and defaulted loans (partially it is due to record-high lending in those years) and by the highest share of non-performing and defaulted loans. Although the quality of loans granted before 2005 is lower, it is the result of the portfolio ”maturing” and a large number of loans repaid prematurely. Noticeable is the quick deterioration of the quality of loans granted in years 2009-2010 (share of non-performing and defaulted loans granted in 2009 is higher than those granted in 2006 and comparable to those granted in 2005).

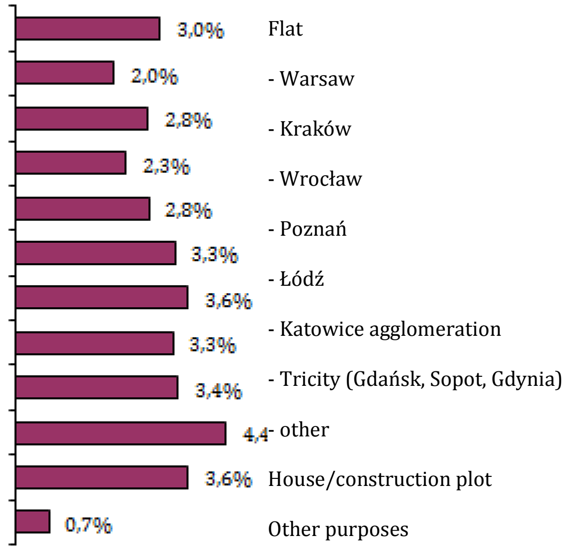
Structure by the loan purpose

	Number of loans (pcs)			Value of loans (PLN million)		
	IN TOTAL	Non-performing	30+ DPD	IN TOTAL	Non-performing	30+ DPD
In total	1 677 801	34 069	38 156	315 492	8 961	10 622
1/ Purchase of a flat	1 017 712	18 231	20 641	195 158	5 038	5 823
- Warszawa	126 559	1 376	1 760	42 064	693	860
- Kraków	35 123	443	559	8 458	192	233
- Wrocław	40 327	509	620	9 721	183	221
- Poznań	29 304	406	507	6 469	148	178
- Łódź	22 108	330	424	3 678	99	121
- Katowice agglomeration	59 104	1 078	1 212	8 393	271	301
- Tricity (Gdańsk, Gdynia, Sopot)	42 189	824	951	9 761	277	318
- other	662 998	13 265	14 608	106 614	3 174	3 590
2/ Purchase of a house/constr. plot	285 190	6 305	7 681	61 829	2 118	2 693
3/ Other purposes (e.g. repair, etc.)	374 899	9 533	9 834	58 505	1 805	2 083
Additional information: loans under the ”Rodzina na Swoim” Programme	176 612	575	576	29 866	103	202

Share in the total value of loans



Share in 30+ DPD loans



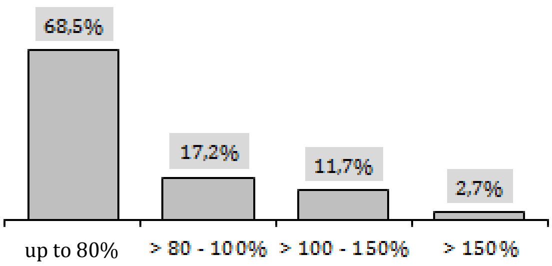
The housing loans prevail in the loan structure; they account for 61.9% of the total loan value (28.1% was granted at the ”main markets”, including 13.3% in Warsaw). Loans for purchase of a flat / construction plot accounted for 19.6%. Loans for other purposes accounted for 18.5%.

Loans with the lowest quality were those granted for purchase of a house / construction plot (share of non-performing and defaulted loans was, correspondingly, 3.4% and 4.4%) and for other purposes (3.1% and 3.6%). The quality of housing loans was slightly higher than the average (2.6% and 3,0% - the highest quality for Warsaw, the lowest quality for the Katowice agglomeration). Noticeable is that, at some markets, the number of 30+ DPD loans accounted for almost 10% of the developer's offer[38].

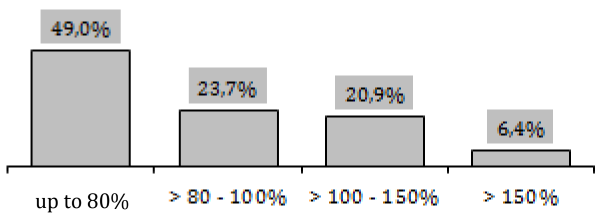
Structure by the current LTV ratio

	Number of loans (pcs)			Value of loans (PLN million)			Average value of a loan (PLN thousand)		
	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX
IN TOTAL	1 659 948	964 752	695 196	314 516	137 867	176 649	189.5	142.9	254.1
up to 80%	1 136 375	707 683	428 692	154 163	81 004	73 160	135.7	114.5	170.7
> 80% - 100%	284 744	180 584	104 160	74 502	38 368	36 134	261.6	212.5	346.9
> 100%	238 829	76 485	162 344	85 851	18 495	67 355	359.5	241.8	414.9
including									
up to 50%	737 197	477 107	260 090	67 663	38 260	29 403	91.8	80.2	113.0
> 50% - 80%	399 178	230 576	168 602	86 501	42 744	43 756	216.7	185.4	259.5
> 80% - 90%	136 284	81 159	55 125	35 642	17 262	18 380	261.5	212.7	333.4
> 90% - 100%	148 460	99 425	49 035	38 860	21 106	17 754	261.8	212.3	362.1
> 100% - 110%	96 558	59 042	37 516	27 772	13 540	14 233	287.6	229.3	379.4
> 110% - 120%	36 360	9 707	26 653	13 010	2 553	10 457	357.8	263.0	392.3
> 120% - 130%	24 775	2 529	22 246	9 636	680	8 956	388.9	268.9	402.6
> 130% - 140%	19 921	1 128	18 793	8 186	320	7 866	410.9	283.6	418.6
> 140% - 150%	16 892	767	16 125	7 174	234	6 940	424.7	305.3	430.4
> 150% - 200%	40 646	1 932	38 714	18 312	720	17 592	450.5	372.7	454.4
> 200%	3 677	1 380	2 297	1 759	448	1 311	478.5	325.0	570.7

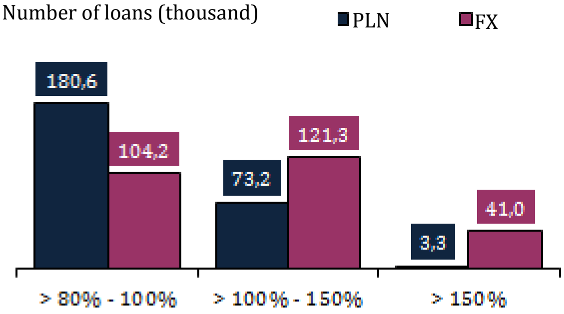
Share in the number of loans (%)



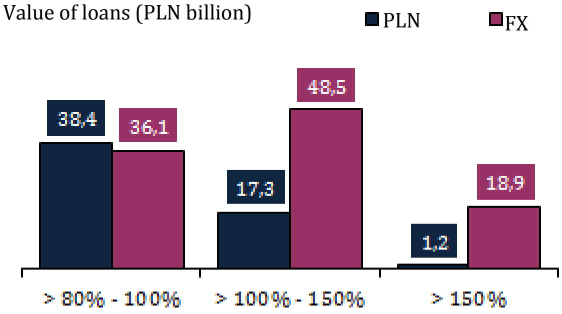
Share in the value of loans (%)



Number of loans (thousand)



Value of loans (PLN billion)



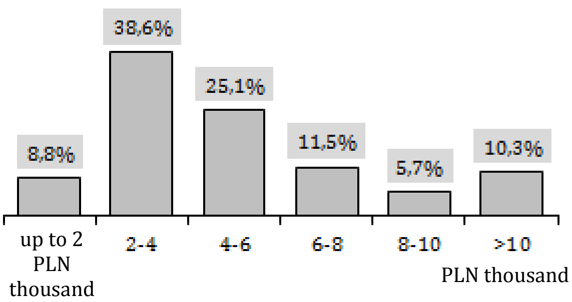
As at the end of 2012, the banks' portfolios comprised 523.6 thousand loans (31.5%) with LTV > 80%, i.e. 51.0% of the value of the whole portfolio. Those included 238.8 thousand loans (14.4%) with LTV > 100%, i.e. 27.3% of the value of the whole portfolio (majority of those loans were FX loans – 162.3 thousand). It is likely that the actual number of loans with high LTV is larger as, most probably, banks did not take into account the drop in real property prices in recent years.

[38] The picture presented at the diagram is not complete. The calculation should include other non-performing and defaulted housing loans (e.g. loans for a flat repair) and other non-performing and defaulted loans mortgaged against residential units located at those markets (e.g. consumer loans).

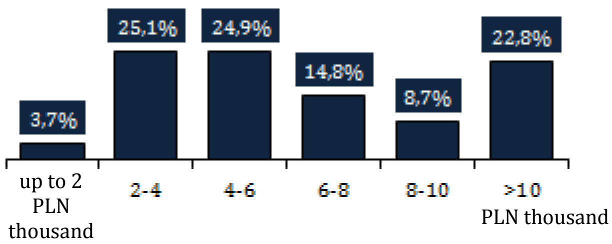
Structure by the borrowers' current net income

	Number of loans (pcs)			Value of loans (PLN million)			Average value of a loan (PLN thousand)		
	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX
up to PLN 2000	139 104	85 262	53 842	11 073	5 547	5 527	79.6	65.1	102.6
> 2000 – 4000	607 712	400 168	207 544	75 193	41 492	33 701	123.7	103.7	162.4
> 4000 – 6000	394 812	236 835	157 978	74 847	36 170	38 677	189.6	152.7	244.8
> 6000 – 8000	181 339	99 158	82 181	44 424	18 421	26 003	245.0	185.8	316.4
> 8000 – 10000	89 248	45 226	44 022	26 238	9 678	16 560	294.0	214.0	376.2
> PLN 10000	162 754	76 863	85 891	68 328	23 626	44 702	419.8	307.4	520.4
In total	1 574 969	943 511	631 458	300 104	134 935	165 169	190.5	143.0	261.6

Share in the number of loans (%)



Share in the value of loans (%)

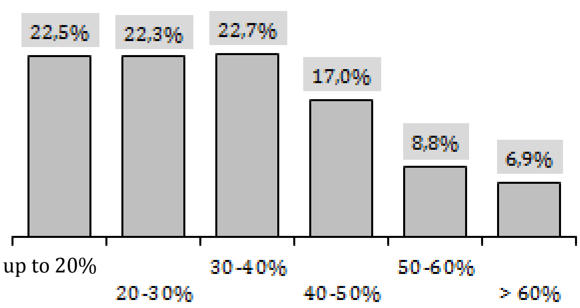


The loans granted to households with average or slightly better than average financial standing prevail in the loan portfolio (72.5% of all loan agreements were entered into with households with incomes not exceeding PLN 6 thousand).

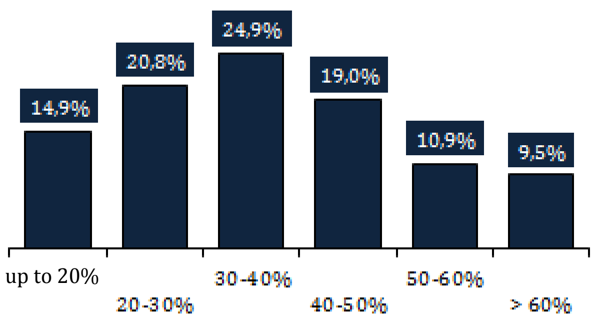
Structure by the current DTI ratio

	Number of loans (pcs)			Value of loans (PLN million)			Average value of a loan (PLN thousand)		
	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX	IN TOTAL	PLN	FX
up to 20%	357 126	198 981	158 145	45 008	17 715	27 293	126.0	89.0	172.6
> 20% - 30%	354 044	188 459	165 585	62 833	22 256	40 577	177.5	118.1	245.1
> 30% - 40%	360 385	211 334	149 051	74 988	30 606	44 382	208.1	144.8	297.8
> 40% - 50%	269 646	176 303	93 343	57 164	29 009	28 155	212.0	164.5	301.6
> 50% - 60%	139 243	91 302	47 941	32 941	18 280	14 661	236.6	200.2	305.8
> 60%	109 690	75 997	33 693	28 553	16 704	11 849	260.3	219.8	351.7
In total	1 590 133	942 376	647 757	301 487	134 569	166 918	189.6	142.8	257.7

Share in the number of loans (%)



Share in the value of loans (%)



In the loan structure presenting the loan repayment burden on the borrowers' incomes the loans with DTI not exceeding 40% prevail (they account for 67.4% of all loan agreements). This is a positive fact considering the long terms for which the loan agreements were entered into. Noticeable is the considerable share of loans with DTI > 40% (and, in particular, with DTI > 50%), which, in case of the majority of borrowers, is a large burden affecting their consumption level and ability to generate savings.

Structure of lending in 2012 r.

	IN TOTAL	Q1	Q2	Q3	Q4
Structure by the loan currency					
Number of loans (pcs)					
In total	179 823	44 289	45 819	44 853	44 862
PLN	171 401	38 496	44 331	44 077	44 497
FX	8 422	5 793	1 488	776	365
Value of loans (PLN million)					
In total	35 451	9 438	9 291	8 733	7 989
PLN	32 140	7 311	8 634	8 372	7 822
FX	3 311	2 126	657	360	167
Structure by the LTV value at the time when the loan was granted					
Number of loans (pcs)	179 823	44 289	45 819	44 853	44 862
up to 80%	102 189	24 904	26 898	26 266	24 121
> 80% - 90%	22 892	5 833	5 601	5 617	5 841
> 90% - 100%	50 081	12 222	12 032	12 036	13 792
> 100%	4 661	1 331	1 288	935	1 108
Value of loans (PLN million)	35 451	9 438	9 291	8 733	7 989
up to 80%	17 709	4 601	4 771	4 540	3 797
> 80% - 90%	5 729	1 558	1 468	1 408	1 295
> 90% - 100%	10 934	2 929	2 708	2 582	2 715
> 100%	1 079	349	344	203	183
Structure by the loan maturity					
Number of loans (pcs)	178 896	43 669	45 715	44 755	44 757
up to 10 years	24 838	5 172	6 519	6 537	6 610
> 10 - 20	43 631	10 201	11 237	11 221	10 972
> 20 - 25	26 140	5 943	6 770	6 641	6 786
> 25 - 30	74 070	18 791	18 609	18 269	18 401
> 30 years	10 217	3 562	2 580	2 087	1 988
Value of loans (PLN million)	35 411	9 413	9 283	8 737	7 978
up to 10 years	2 327	556	624	603	543
> 10 - 20	7 135	1 718	1 876	1 857	1 684
> 20 - 25	5 461	1 333	1 460	1 372	1 296
> 25 - 30	17 453	4 656	4 599	4 290	3 908
> 30 years	3 036	1 150	724	615	547
Structure by the loan value					
Number of loans (pcs)	180 050	44 361	45 904	44 901	44 884
up to PLN 100 thousand	45 593	9 941	11 640	11 684	12 328
> 100 - 200	66 176	15 875	16 285	16 524	17 492
> 200 - 300	38 648	9 823	9 964	9 651	9 210
> 300 - 400	15 958	4 538	4 292	3 712	3 416
> 400 - 500	6 636	2 011	1 772	1 597	1 256
> PLN 500 thousand	7 039	2 173	1 951	1 733	1 182
Value of loans (PLN million)	35 526	9 466	9 312	8 755	7 993
up to PLN 100 thousand	2 775	635	718	702	720
> 100 - 200	9 760	2 350	2 412	2 438	2 560
> 200 - 300	9 407	2 419	2 447	2 352	2 189
> 300 - 400	5 433	1 552	1 473	1 261	1 148
> 400 - 500	2 932	894	787	706	545
> PLN 500 thousand	5 219	1 614	1 476	1 296	832

Noticeable in the structure of lending of 2012 is a steep reduction in production of FX loans (in Q1 5.7 thousand loans were granted, and only 0.4 thousand in Q4) and gradual reduction in loans with tenors exceeding 30 years. Both these facts are positive. The negative fact is that there is still a large share of loans with LTV > 80%, including above 100%, in sales.

Loan conversion

	until 2005	2005	2006	2007	2008	2009	2010	2011	2012	IN TOTAL
FX loans converted into PLN										
- number of loans	1 573	921	869	1 070	1 791	257	644	399	201	7 725
including non-performing	749	722	707	970	1 674	242	295	269	198	5 826
- value of loans (PLN million)	162	168	227	543	920	51	186	89	22	2 369
including non-performing (PLN million)	112	138	189	520	886	48	46	45	21	2 005
PLN loans converted into FX										
- number of loans	1 208	474	1 812	5 054	918	475	1 040	316	6	11 303
including non-performing	0	2	5	22	5	1	3	2	0	40
- value of loans (PLN million)	128	77	468	1 687	376	181	281	85	2	3 287
including non-performing (PLN million)	0	1	2	10	5	2	1	0	0	19

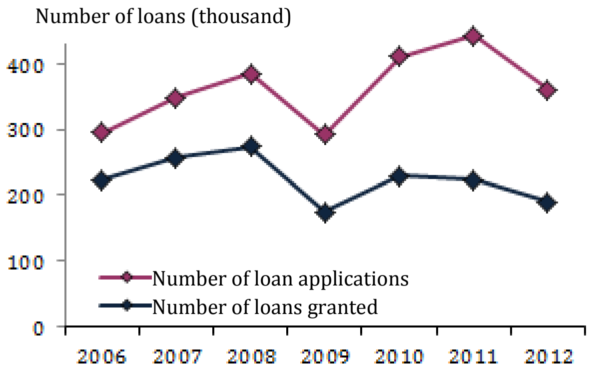
Reported and actual quality of loans per currency

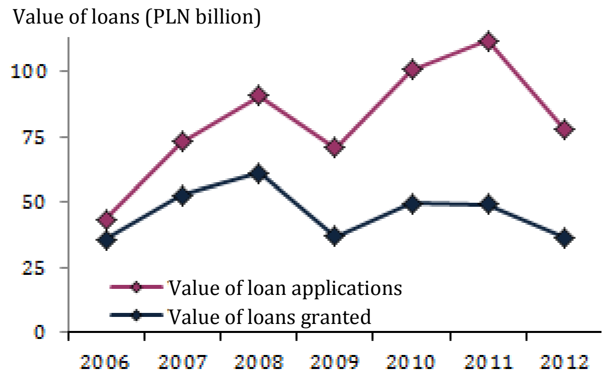
PLN LOANS	
1/ REPORTED data	
- loans in total	138 727
- including non-performing loans	5 738
- share of non-performing loans	**4.14%**
2/ ADJUSTED reported data	
Increase (conversion of PLN loans into FX loans)	
- loans in total	3 287
- including: non-performing loans	19
Decrease (conversion of FX loans into PLN loans)	
- loans in total	-2 369
- including: non-performing loans	-2 005
3/ ADJUSTED data	
- loans in total	139 645
- including: non-performing loans	3 751
- share of non-performing loans	**2.69%**
FX LOANS	
1/ REPORTED data	
- loans in total	177 038
- including non-performing loans	3 268
- share of non-performing loans	**1.85%**
2/ ADJUSTED reported data	
Increase (conversion of FX loans into PLN loans)	
- loans in total	2 369
- including: non-performing loans	2 005
Decrease (conversion of PLN loans into FX loans)	
- loans in total	-3 287
- including: non-performing loans	-19
3/ ADJUSTED data	
- loans in total	176 120
- including: non-performing loans	5 254
- share of non-performing loans	**2.98%**

Higher reported quality of FX loans is the result of conversion of a part of non-performing FX loans into PLN and higher rate of premature repayment of PLN loans. The reported data (adjusted for currency conversions) show that, as at the end of 2012, the quality of PLN loans was slightly higher as compared to FX loans.

Demand and supply of loans[39]

	2006	2007	2008	2009	2010	2011	2012	1Q	2Q	3Q	4Q
Loan applications											
Number of applications (thousand)	296	349	385	292	411	443	360	81	91	93	95
Value of loan applications (PLN billion)	43	73	91	71	101	112	78	19	20	20	19
Loans granted											
Number of applications (thousand)	224	257	273	175	230	224	190	47	49	46	47
Value of loan applications (PLN billion)	35	52	61	37	49	49	36	10	10	9	8
Loan acceptance											
Number of loans	76%	74%	71%	60%	56%	51%	53%	58%	54%	49%	50%
Value of loans	82%	72%	67%	52%	49%	44%	47%	54%	49%	43%	42%





As the analysis shows, the demand dropped considerably in 2012 (by approx. 20%).

Other loans/mortgaged household loans[40]

	IN TOTAL	Non-performing	30+ DPD
Number of loans (pcs)	352 676	25 159	26 483
- consumer loans	163 202	12 568	14 685
- investment loans	46 163	4 100	3 254
- other real property loans	36 543	961	1 137
- other	106 768	7 530	7 407
Value of loans (PLN million)	50 806	5 981	6 173
- consumer loans	14 888	2 182	2 579
- investment loans	13 349	1 601	1 332
- other real property loans	5 903	478	512
- other	16 666	1 720	1 750
Supplementary information: **including mortgaged against a residential real property**			
- Number of loans (pcs)	249 331	14 051	16 318
- Value of loans (PLN million)	26 665	2 710	3 146

In the context of the housing loans-related risk, one must take into account that the banks' portfolios also include other mortgaged household loans. Among them there were 249.3 thousand loans of the total value of PLN 26.7 billion mortgaged against a residential unit, of which 14.1 thousand loans of the total value of PLN 2.7 billion was classified as non-performing and 16.3 thousand of the total value of PLN 3.1 billion was classified as 30+ DPD.

[39] The actual demand in years 2006-2010 was higher but not all banks had data available regarding that period and were able to carry out an expert estimation.
[40] For the whole sector, the value of those loans was PLN 64.4 billion (including PLN 20.9 billion of investment loans, PLN 18.2 billion of consumer loans and PLN 25.1 billion of other loans and receivables).

AMENDMENT OF RECOMMENDATION T AND RECOMMENDATION S

In 2012 UKNF reviewed the current regulatory provisions. The effect of that review were the following amendments:

- Amendment to Recommendation T concerning good practices in management of the retail loan exposures risk,
- Amendment to Recommendation S concerning good practices in management of the mortgaged loan exposures.

The basic objectives of the above changes:

- to separate the subject scope of Recommendation T and S,
- to attenuate the regulatory approach, or to make it more flexible, in the areas where, according to the regulators, it would not affect the risk management and the banks' stability,
- to introduce new solutions that, according to regulators, are necessary to ensure long-term stability of banks and security of deposits and borrowers,
- to strengthen the customers' position in relations with banks,
- to align the competitive position of banks and branches of credit institutions.

The main assumptions for amendments were discussed by KNF and then draft Recommendations were referred for public consultation.

Amendment to Recommendation T

The Recommendation T was adopted by the Polish Financial Supervision Authority at its session of 26 February 2013. The key amendments to Recommendation T are as follows:

- separation of the subject scope of Recommendation T and S,
- addressing the Recommendation T directly to all banks operating under the Polish law and to branches of credit institutions operating in Poland,
- withdrawal from determining the maximum values for the DTI ratio (relation of expenses connected with loan handling to average net income) by KNF; the DTI ratio value should be determined by the bank's management board and incorporated into the bank's risk management strategy approved by the bank's supervisory board,
- simplified rules for assessing the customer's creditworthiness; banks can apply those rules to:
    - instalment loans for retail customers, where the value of the loan does not exceed the four times the average salary in the enterprise sector,
    - loans for retail customers:
        - where a given customer has at least six months history at the bank, where the value of the loan does not exceed the six times the average salary in the enterprise sector,
        - where a given customer has at least twelve months history at the bank, where the value of the loan does not exceed the twelve times the average salary in the enterprise sector,
        - other customers: where the value of the loan does not exceed the average salary in the enterprise sector,
- unconditionally obliging the banks to use the external databases to assess the creditworthiness of a retail customer, such external databases being, in particular, the interbank databases created by institutions that, pursuant to Article 105.4 of the Banking Law, are authorised to collect, process and make available the information regarding, among others, the level and the history of loan repayments by retail

customers; the recommendation also emphasizes the importance of using the information from the commercial information agencies,
- increase the requirements as regards granting and management of FX loan exposures,
- emphasizing that, in the area of customer relationship, the bank must dispose of written internal procedures specifying the form and the scope of information provided to each customer applying for a retail loan in accordance with the Law on Consumer Loan; in case of FX loans – continuation of the recommendation specifying that the bank must provide the customer with relevant information on risk and related consequences connected with such exposure and on the impact of the bid-offer spread on the amount of loan and related burden of repayment; in addition, a new recommendation was introduced according to which, in case of a customer applying for a retail loan exposure, the bank must obtain the customer's written statement specifying that:
  - the bank provided the customer with the information necessary to take a decision regarding the loan,
  - the bank provided the customer with explanations of the customer's doubts,
  - the customer is aware of the risk connected with the loan.

KNF expects that the recommendations will be implemented by no later than 31 July 2013. The effects of the recommendation will be monitored for its impact on the situation of the banking sector.

Draft amendment to Recommendation S[41]

The reason for drawing up the amendment is the experience regarding the development of household housing loans in recent years. Apart from a number of positive effects, it generated an excessive risk for customers, banks and the economy as a whole. The expansion of housing loans and the excessive easing of loan standards was one of the main reasons for steep increase in prices of real properties in 2005-2008 (lack of supply and competition, large flow of foreign investors and speculative capital) that was only partially justified by increased production costs; at the same time, the prices rose several times faster than the salaries. The fast rise in real property prices was further driven by low interest-bearing FX loans and excessively lengthened tenors, both these factors contributing to artificially improved creditworthiness. The phenomenon was further strengthened by high LTV ratios of loans granted. In consequence, the availability of real property market was strongly limited for average households that were either unable to take high value loans or, if taken, it would entail excessive risk that may materialize in case of even small deterioration of their financial condition.

The necessity of introducing regulatory changes was also a consequence of experiences and conclusions drawn from the financial crisis that affected the global economy in recent years, the reasons for which were: excessive easing of loan standards for housing loans and excessive debt of a part of households. The Recommendation also takes into account the recommendations from the National Bank of Poland, the European Systemic Risk Board and the Basel Committee on Banking Supervision, as well as recommendations from other organisations and bodies responsible for the stability of the global financial system. When drafting the regulatory changes, regulatory solutions and international practices were reviewed – some of those were taken into account when drawing up the final version of the Recommendation. In the context of international experiences, noticeable is the widespread application of the rule of granting loans in the same currency as the income currency of the borrower, lower LTV for newly granted loans, shorter tenors and more widespread financing of lending through long-term debt instruments based on relatively uniform loan portfolios.

For the draft regulatory solutions, UKNF took into account the weaknesses/inefficiencies of the risk management processes at banks that result, among others, from incomplete databases on real properties and/or the customers' debts.

[41] Detailed explanation for the UKNF position: see the KNF website: "Publiczne konsultacje projektu Rekomendacji S" (archive of 21 December 2012).

The regulatory actions take also into account the fact that banks, focused on their own operations, are unable to consider the systemic risk generated by their activities. It is a natural fact that their strategies are short or medium term and that such strategies are prepared for their own interest (not for the interest of the whole banking sector or the whole economy). There is also a negative pressure from competing banks, the effect of which is that the banks using more conservative development models may be ousted from the market by the banks accepting higher risk levels. At the same time, the risk generated by those banks can be transferred to banks managed by conservative standards. Therefore regulatory actions by supervisory institutions are necessary – on one hand, they should not restrict the development of the sector, on the other hand they must ensure safety and stability in the long-term, the key factor for security of deposits and stable development of the economy as a whole.

The main proposals of changes in the area of household housing loans:

- separation of the subject scope of Recommendation T and S and adjustment and adding more precision to the current provisions;
- limited FX lending – the retail customers should be granted loans in the currency of their income, regardless of their financial condition;
- extended period for calculation of creditworthiness – up to 30 years; the recommended maximum tenor should be 25 years (this period can be extended, but the customer must be fully aware of the increased risk and loan cost) and the maximum tenor: 35 years;
- withdrawal from determining the maximum DTI ratio values by regulators; the maximum DTI ratio values should be internally determined by banks. The DTI-40% was specified for customers with the income not exceeding the average salaries in a given region, the DTI-50% was specified for other customers, as requiring special attention – they can be exceeded, however it must be a fully aware acceptance of the increased risk, both by the bank and the customer;
- the maximum LTV value for exposures mortgaged against residential units at the level of 80% or 90% if the part of exposure exceeding 80% LTV is properly insured. Those requirements concern the new loans; at the same time, transitory periods were defined (until the end of 2013 – 100%; 2014 – 90%; since 2015 – 80/90%);
- improved customer's security – regulations regarding the relationship with customers, the loan currency, LTV, creditworthiness assessment procedures.

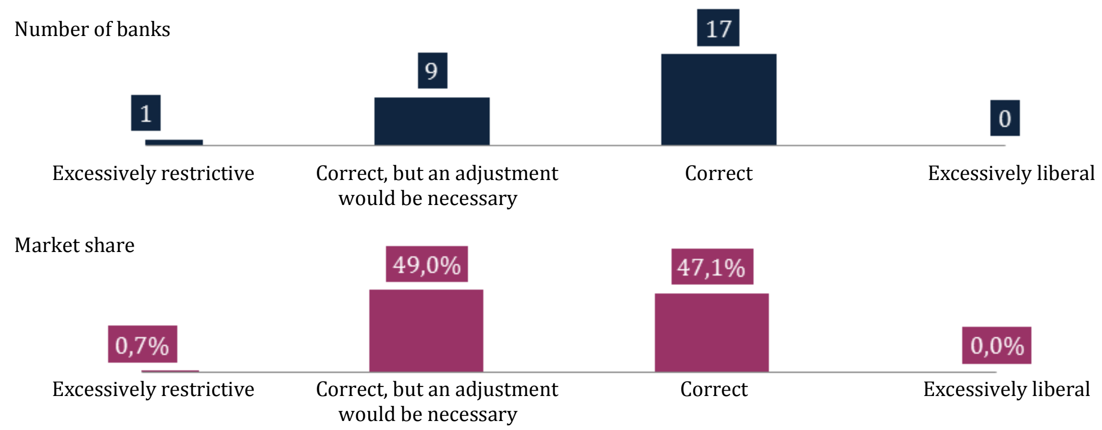
Under the consultation procedure, UKNF requested for the opinions from, among others, the National Bank of Poland, the Polish Bank Association, the National Association of Cooperative Banks, selected auditing companies and banks being the main participants at the household housing loan market.

The key provisions of the Recommendation received a positive feedback. Noticeable is the strong acceptance for key provisions from the key market participants.

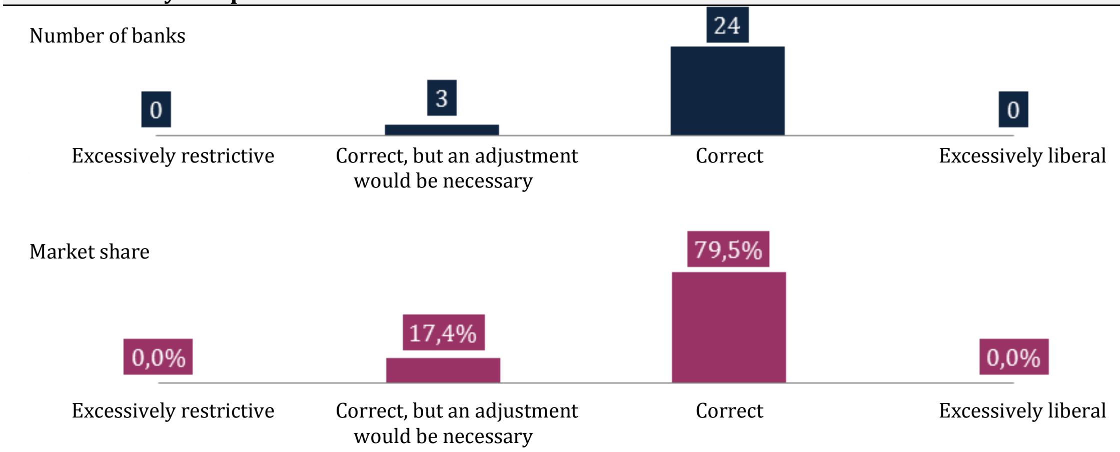
Opinion of the banks' Management Boards on the key provisions of the draft Recommendation S (main market participants)

	Excessively restrictive	Correct, but an adjustment would be necessary	Correct	Excessively liberal
Compliance of the loan currency and the borrower's income (Recommendation 6)				
Number of banks	1	9	17	-
Market share	0.7%	49.0%	47.1%	-
Maximum 30-years period for calculation of creditworthiness (Recommendation 7)				
Number of banks	-	3	24	-
Market share	-	17.4%	79.5%	-
Maximum 35-years period for a duration of a loan agreeement (Recommendation 7)				
Number of banks	2	2	20	3
Market share	9.6%	9.8%	75.4%	2.1%
Own contribution requirement (Recommendation 10)				
Number of banks	4	7	16	-
Market share	18.9%	42.6%	35.3%	-
80/90% LTV limit at the moment of granting a loan (Recommendation 15.7)				
Number of banks	4	9	14	-
Market share	25.8%	44.6%	26.4%	-
Liquidation of the regulatory DTI limit				
Number of banks	-	5	19	3
Market share	-	24.1%	62.8%	9.9%

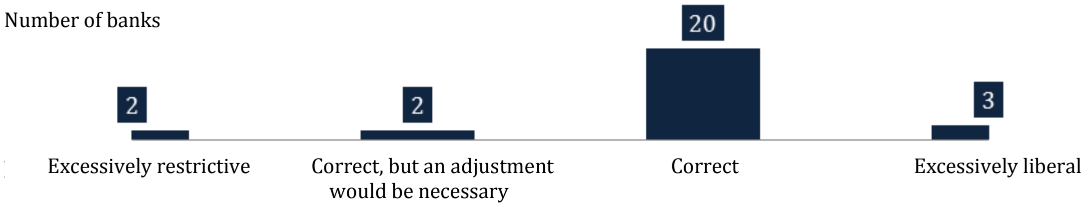
Compliance of the loan currency and the borrower's income

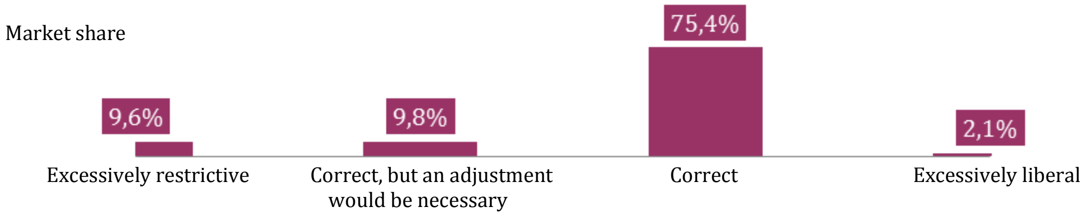


Maximum 30-years period for calculation of creditworthiness

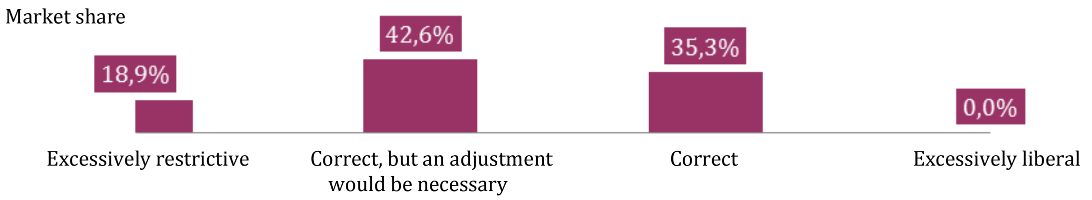


Maximum 35-years period for a duration of a loan agreeement

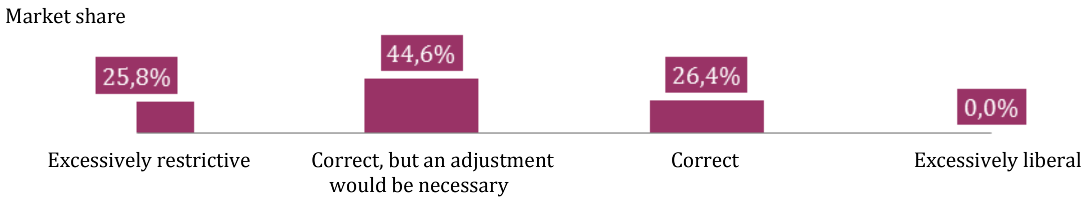




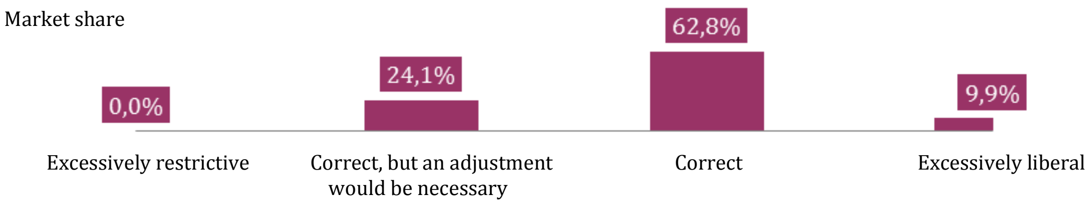
Own contribution requirement



80/90% LTV limit at the moment of granting a loan



Liquidation of the regulatory DTI limit

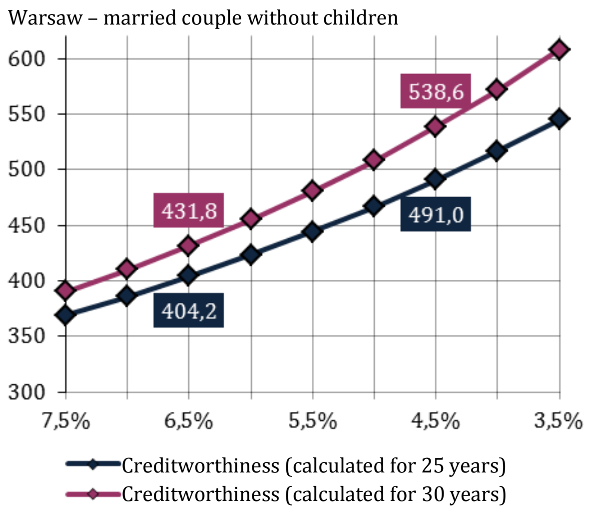


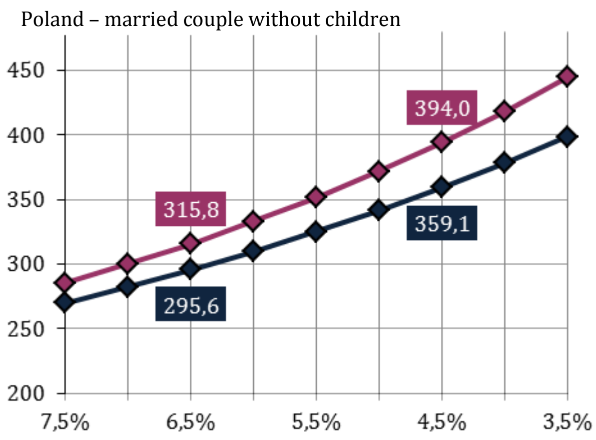
When drafting the regulatory changes, one must take into account that the basic barrier for satisfying the housing needs by households with average income is the unfavourable relation between the average flat price to average salaries. This relation improves gradually as the salaries grow and the prices of real properties drop in recent years.

According to the analysis from UKNF, the regulatory factor is not a material barrier as regards the access to loans. The regulatory decisions do not translate into increased income of households, they only contribute to loosening the rules for calculating the borrower's creditworthiness. The larger impact on the loan availability is from the interest rates and the loan policies of individual banks (including the amount of commissions, fees and margins). The creditworthiness strongly increased in recent months as the result of easing of the monetary policy.

Creditworthiness of households with average income[42]

	Maximum available loan (PLN thousand) depending on the interest rate level and the period taken for calculation of creditworthiness									**Change in creditworthiness**
	7.5%	7.0%	6.5%	6.0%	5.5%	5.0%	4.5%	4.0%	3.5%	
Warsaw										
Married couple with no children										
25 years	369.3	386.1	404.2	423.6	444.4	466.8	491.0	517.0	545.1	21%
30 years	390.3	410.2	431.8	455.2	480.7	508.4	538.6	571.6	607.8	33%
Married couple with one child										
25 years	237.6	248.4	260.0	272.5	285.9	300.3	315.8	332.6	350.7	21%
30 years	251.1	263.9	277.8	292.8	309.2	327.0	346.5	367.7	391.0	33%
Poland										
Married couple with no children										
25 years	270.1	282.4	295.6	309.8	325.1	341.5	359.1	378.2	398.7	21%
30 years	285.5	300.0	315.8	332.9	351.6	371.8	394.0	418.1	444.5	33%
Married couple with one child										
25 years	181.7	190.0	198.9	208.4	218.7	229.7	241.6	254.4	268.2	21%
30 years	192.0	201.8	212.4	224.0	236.5	250.1	265.0	281.3	299.0	33%





[42] The analysis covers married couples with no children (or with one child), where both spouses are employed and whose salaries are, in average, PLN 3400 (for Poland) or PLN 4936 (for Warsaw) (as at 2011), and where each spouse settles its tax separately. The average monthly expenses (according to GUS, 2011) for a married couple with no children: PLN 2875 (for Poland), PLN 4283 (for Warsaw), and for a married couple with one child: PLN 3528 (for Poland) , PLN 5257 (for Warsaw). The loan is granted as a fixed instalment loan and the maximum instalment is the difference between the net income and the expenses.

Excessive regulatory easing may bring effects opposite than expected. In particular, if combined with a strong easing of the monetary policy, it may result in considerable increase in the real property prices that will translate into deteriorated situation of the average households at the real property market; in this case, they will have to take a higher loan to buy the same real property.

Completion of works on Recommendation and submitting it for a KNF decision is expected in the mid-2013.

NON-BANKING LOAN SERVICES MARKET

Loans for natural persons are granted by banks, branches of credit institutions, Cooperative Credit Unions (SKOK), loan companies affiliated to banks (specializing in consumer loans, mainly instalment loans for goods and services), independent loan companies (specializing in short-term cash loans) and natural persons (family members, friends, unrelated persons).

LOANS FOR NATURAL PERSONS

Commercial banks
Cooperative banks
Branches of credit institutions

SKOK

Loan companies affiliated to banks

Independent loan companies

Natural persons

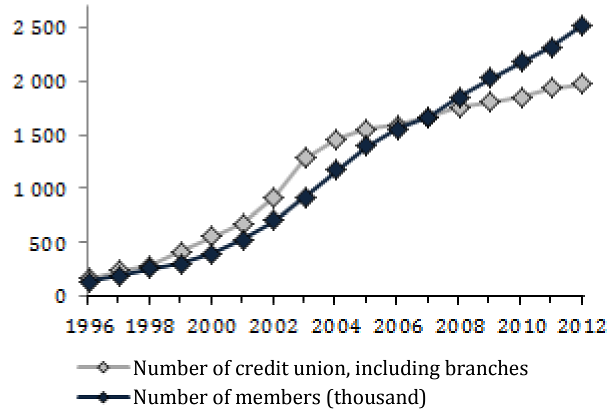
Considering the lack of full data, it is not possible to estimate the scale of financing the natural persons. The main problem in this regard are incomplete data on the scale of activity of loan companies (both affiliated to banks and independent) and on loans from natural persons.

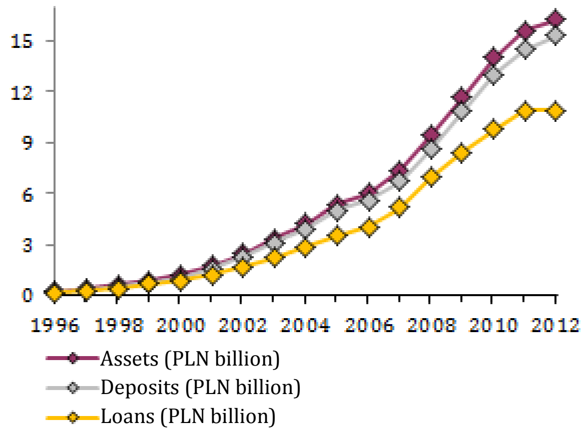
Another difficulty in describing the market is the problem of how data are presented. In case of banks and SKOKs, usually balance-sheet items are reported; in case of loan institutions, the value of loans granted within a given period is provided. The effect is that data regarding the scale of operations of banks and SKOKs are underestimated as compared to data regarding the scale of operations of the loan institutions (for example, if a customers repays an overdraft or a payment card debt in full at the end of a reporting period, then the bank does not report any commitment despite the fact that, within the analysed period, the scale of financing could have been large).

Despite some reservations mentioned above, the general conclusion is that the lending services for natural persons are mostly provided by banks; the scale of operations of non-banking loan institutions is small/marginal as compared to the banking sector. Another conclusion is that, despite commonly held perception, the regulatory actions carried out by KNF in the banking sector did not translate into considerable development of non-banking loan institutions. As the analyses show, SKOKs and loan institutions grow in a constant and stable manner and the scale of customer transfer, if any, was insignificant/marginal. A significant migration of the banks' customers took place only in case of transferring, by some banks, the small instalment loan sales operations to other entities of the same group (the estimated scale of that transfer is PLN 3-5 billion). However, both for the households and the economy, those transfers remain neutral (loans are still provided, but through another sales channel).

SKOK system in years 1996-2012[43]

	Number of credit unions and branches	Change y/y	Number of members (thousand)	Change y/y	Assets (PLN million)	Change y/y	Deposits (PLN million)	Change y/y	Loans (PLN million)	Change y/y
1996	168	x	138	x	219	x	190	x	161	x
1997	237	69	194	56	368	149	313	122	281	120
1998	290	53	259	65	590	222	528	216	412	132
1999	420	130	306	47	883	292	740	212	668	256
2000	560	140	394	88	1 199	317	995	255	866	197
2001	680	120	525	131	1 752	553	1 558	563	1 236	370
2002	923	243	703	178	2 455	703	2 254	695	1 660	424
2003	1 285	362	924	221	3 344	889	3 112	858	2 213	553
2004	1 461	176	1 169	245	4 229	885	3 938	826	2 856	643
2005	1 553	92	1 395	226	5 329	1 100	4 990	1 052	3 503	647
2006	1 589	36	1 551	156	5 970	641	5 553	563	4 047	544
2007	1 663	74	1 669	118	7 325	1 355	6 705	1 152	5 147	1 100
2008	1 757	94	1 856	187	9 447	2 122	8 604	1 899	6 933	1 785
2009	1 801	44	2 026	170	11 637	2 190	10 842	2 238	8 411	1 479
2010	1 851	50	2 177	151	14 014	2 377	13 028	2 186	9 793	1 381
2011	1 934	83	2 315	138	15 598	1 584	14 518	1 490	10 907	1 114
2012	2 131	x	2 568	x	16 884	x	15 730	x	10 250	x





Source:
SKOK – data for years 1996-2011
UKNF – data as at the end of 2012

In the long-term, the SKOK system grows in a stable manner. The SKOKs' lending peaked in 2008 where the highest loan portfolio growth was reported (PLN 1.8 billion). In subsequent years, the SKOKs' lending grew at a slower pace.

Increased scale of operations in 2010-2012 (expressed, among others, with the increased number of members and volume of assets, deposits and loans) is not such that it can be associated with regulatory activities in the banking sector. The growth in the scale of the SKOKs operations within the above period was similar to that reported for previous periods. It is possible that, due to regulatory decisions and self-regulatory actions taken by banks, some customers might have switched to SKOKs but, even if it was the case, then the scale of that transfer was rather small.

[43] Presentation of data for 2012 was abandoned as databases of SKOK and UKNF are non-compatible. The data from SKOK show that the value of loans did not increase in 1H 2012. Reduced lending in 2012 is also reflected in data resulting from comparison of data from UKNF (year end 2012) and from GUS (year end 2011).

Considering the lack of full data, it is difficult to estimate the scale of operations of loan institutions not affiliated to banks:

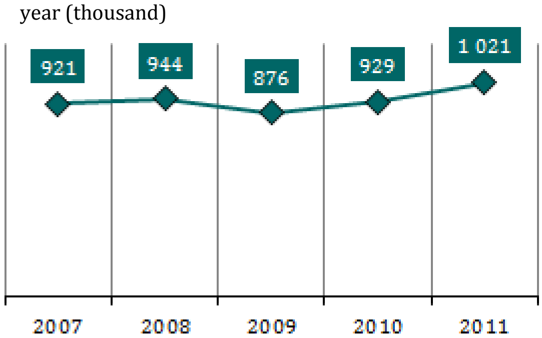
- according to Białowolski[44] the market value is approx. PLN 2.3-2.5 billion, and data from Konfederacja Przedsiębiorstw Finansowych (KPF) cover approx. 80-90% of that market,
- according to the information obtained by UKNF from GUS, in 2011 16 loan institutions granted, from their own capitals, loans for the total amount of PLN 2.4 billion.

Knowing that these data are incomplete and that the shadow economy exists, the scale of operations of those companies is estimated at the level not exceeding PLN 3-4 billion of loans per year.

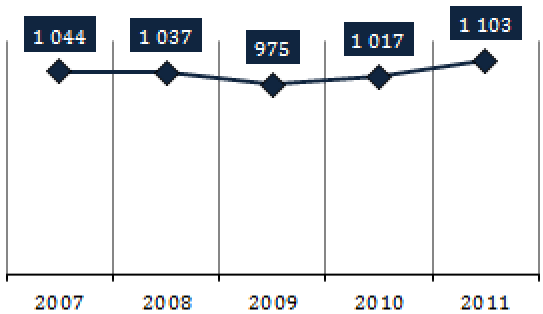
Activity of loan institutions not affiliated to banks in years 2007-2011

	Number of loans granted (thousand)	Change y/y	Value of loans granted (PLN million)	Change y/y	Number of customers at the end of the year (thousand)	Change y/y	Value of loans at the end of the year (PLN million)	Change y/y
2007	1 044	x	1 511	x	921	x	1 282	x
2008	1 037	-7	1 673	162	944	23	1 482	200
2009	975	-62	1 503	-170	876	-68	1 574	92
2010	1 017	42	1 569	66	929	53	1 718	144
2011	1 103	86	1 798	229	1 021	92	2 008	290

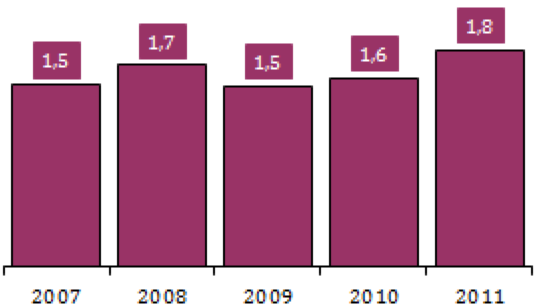
Number of customers as at the end of the year (thousand)



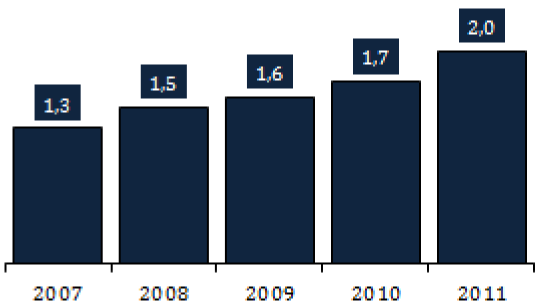
Number of loans granted (thousand)



Value of loans granted, per year (PLN billion)



Value of the loan portfolio as at the end of each year (PLN billion)



Source: Konfederacja Przedsiębiorstw Finansowych (KPF)

As the data from KPF show, the loan institution market grows in a stable and limited manner, with a clear slowdown in 2009. The market growth observed in 2010 was the effect of "revival" after the considerable downturn in 2009. Slightly accelerated growth in 2011 might be, to some extent, connected with adoption of Recommendation T, however, this growth was marginal and the observed increase in scale of operations was mainly organic (the total value of loans increased in 2011 by approx. PLN 200 million and the number of loans increased by less than 100 thousand). Additionally, the transfer of a part of the banks' customers to the loan institutions was more likely due to self-regulatory decisions taken by banks in 2008-2010, the effect of

[44] See "Rynek firm pożyczkowych w Polsce", KPF 2012.

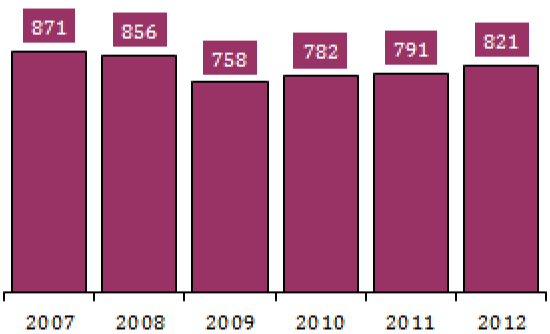
which was limited lending to customers with the lowest credit rating and tightened loan procedures (due to steep deterioration in the loan portfolio quality in 2009-2010, excessive loan burden in case of some customers, reduced risk appetite as the result of deteriorated economic outlook and growing incertitude as to future developments).

Considering the above, the conclusion is that the mass media exaggerated the role of loan institutions. In fact, growth potential of this financial services market sector is limited and its role for the economy is insignificant/marginal. The high growth reported by some loan institutions is due to the fact that their history is short (low base effect); in H2 2012 some of them reported deteriorated growth perspectives (including withdrawal of 2012 projections by SMS Kredyt Holding S.A. i Marka S.A.).

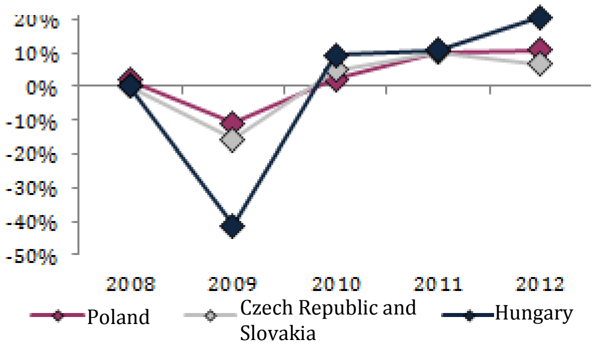
Activities of IPF plc in years 2007-2012

	2007	2008	2009	2010	2011	2012
Group, in total						
Number of customers (thousand)	1 937	2 029	2 056	2 211	2 323	2 415
Value of loans granted (GBP million)	621	791	710	765	845	882
Gross financial result (GBP million)	51	76	62	92	101	95
Poland						
Number of customers (thousand)	871	856	758	782	791	821
Value of loans granted (GBP million)	271	345	280	296	319	327
Change y/y (adjusted for FX rates)	10.8%	2.0%	-10.9%	2.1%	10.4%	11.0%
Gross financial result (GBP million)	b.d.	b.d.	46	49	66	62
Czech Republic and Slovakia						
Number of customers (thousand)	402	397	383	386	385	383
Value of loans granted (GBP million)	153	195	178	185	210	207
Change y/y (adjusted for FX rates)	N/A	-0.2%	-15.8%	4.8%	10.2%	6.8%
Gross financial result (GBP million)	b.d.	b.d.	38	42	38	29
Hungary						
Number of customers (thousand)	319	321	227	238	244	268
Value of loans granted (GBP million)	130	150	89	95	104	114
Change y/y (adjusted for FX rates)	19.7%	-0.6%	-41.2%	9.3%	11.0%	20.7%
Gross financial result (GBP million)	b.d.	b.d.	-7	9	8	10
Romania						
Number of customers (thousand)	33	85	164	207	241	260
Value of loans granted (GBP million)	9	34	64	75	88	86
Change y/y (adjusted for FX rates)	N/A	244.1%	99.7%	20.5%	17.2%	10.1%
Gross financial result (GBP million)	-4	-8	-2	2	4	2

IFP – number of customers in Poland (thousand)



IFP – annual lending growth (%)



Source: International Personal Finance plc

The limited growth of the loan institutions is reflected in the IPF's financial statements (owner of Provident Polska); the number of the IPF customers is lower than in 2007 and the value of loans granted is lower than that reported for 2008. At the same time, the basic trends at the Polish market are similar to those reported by IPF at other markets; it is an indirect proof that the regulatory decisions of KNF were neutral from the company's growth perspective.

SKOKs and loan institutions as compared to the banking sector (as at the end of 2011)

Source: UKNF, SKOK, KPF, BIK

Currently, SKOKs and loan institutions are not real competitors or a threat for the banking sector which operates at a much greater scale. A gradual growth of that sector may however be a source of pressure on the banking sector. This may be positive for the customers and the economy provided that law, ethical standards and fair competition rules are observed.

It must be emphasized that loan institutions are a long established element of the economy. They are present in all developed free market economies. Their history is longer than that of banks, although forms and methods of operation changed over time. To some extent, the loan institutions' offer is complementary to the banks' offer. The loan institutions offer loans for low amounts, short-term and using simple procedures and usually operate in small cities and towns and in rural areas, i.e. outside the main area of banks' activities. In this context, the loan institution market is complementary to the banking services market.

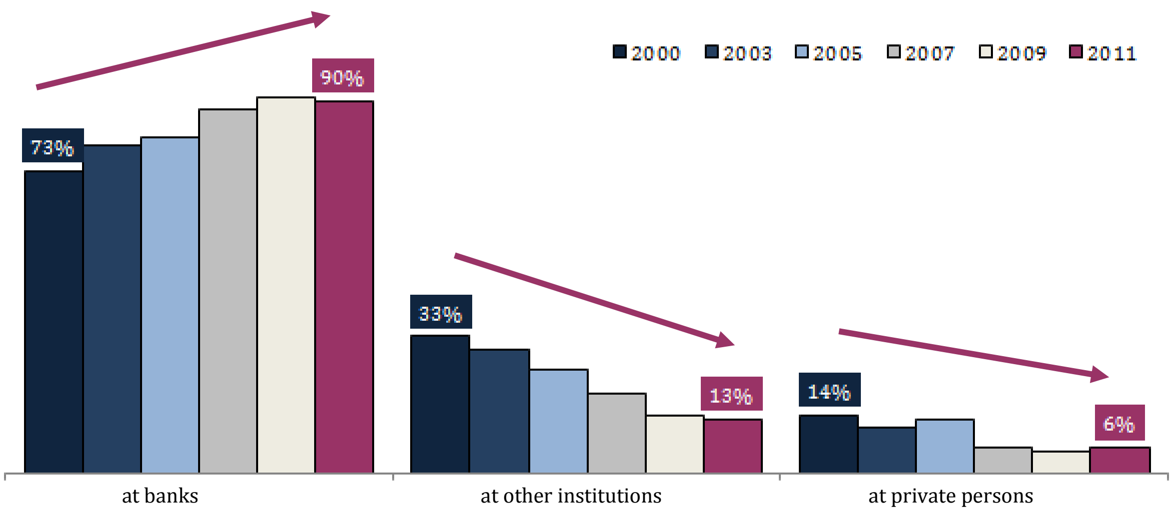
Regarding high interest rates charged on loans granted by loan institutions, one must remember that those companies deal with higher risk (as compared to banks) and their cost of capital is higher as well (among others, loan institutions are not entitled to collect deposits). Another factor with considerable impact on the product prices is salaries for the agent network and the costs in connection with providing services at the customer's home. At the same time, relatively constant additional costs of loans concern lower amounts and much shorter tenors (as compared to typical bank loans), the result being strong increase in RRSO [*annual percentage rate*]. Therefore one must be cautious when analysing the RRSOs for those types of loans as these are not the proper measure for loans granted for very short tenors.

Analysing the competitive pressure on the banking sector from loan institutions, one must remember that the main reason for households to take out debts at loan institutions is how the banks operate. Banks, willing to attract new customers, must increase the competitive pressure through:

- simplifying the loan procedures and developing the banking services access channels, taking into account the existing regulatory requirements and risk management rules,
- reaching a larger set of potential customers through offering a current bank account and/or a credit card (proper advertisement), both of them being more attractive than short-term loans (in particular, for customers that use loan institutions frequently),
- creating products dedicated for customers with low income or living outside the area covered by the banking sales network,
- reducing the loan costs that remain practically unchanged in recent years (reflected in stable RRSO) – this could translate into higher demand for bank loans (interest rate is indicated as the main obstacle for taking out debts).

In this context, one must remember that the amended Recommendation T enables the banks to apply a simplified method for assessing the creditworthiness of customers without a loan history at the bank up to the amounts which are higher than the average loans granted by loan institutions (this strongly improves the competitive position of banks).

Entities at which households take debts (regarding households that declare debts)



Source: "Diagnoza Społeczna 2011"

The predominant role of banks has been indirectly confirmed by the results of the research on households (see ”Diagnoza Społeczna 2011”[45]). As the results of the research show, among the households that declare debts, the share of households indebted at banks rose sharply (from 73% up to 90%) within the last ten years; at the same time, the share of households indebted at non-banking institutions or private persons dropped (correspondingly, from 33% to 13% and from 14% to 6%). The above results show that, during the last ten years, banks ”ousted” other lending providers.

[45] Reports describe the conditions and the quality of life of Polish citizens. The research, performed every second year, is directed by Rada Monitoringu Społecznego, whose members are representatives of economic and social sciences (the research is carried out by Polskie Towarzystwo Statystyczne, GUS surveyors, main sponsor of ”Diagnoza Społeczna 2011”: Ministry of Labour and Social Policy and the National Bank of Poland).

ACTIONS TO SUPPORT THE DEVELOPMENT OF THE BANKING DEBT INSTRUMENT MARKET

Considering unfavourable trends in the balance-sheet structure, the KNF Chairman established a team for development of the banking long-term debt instrument market. The basic objective of the Team was to work out legal, tax and regulatory solutions supporting the development of the long-term banking debt instrument market and favouring the modification of the banks' balance-sheet structure, where long-term mortgaged loans prevail financed mainly from short-term deposits or credit lines from the international banking market.

The team members included the UKNF employees, as well as the representatives of the Ministry of Finance, Ministry of Justice, the National Bank of Poland, the Polish Bank Association, the Warsaw Stock Exchange, the Chamber of Commerce for Pension Institutions, the Polish Insurance Chamber and the Funds and Assets Managers' Chamber.

Individual working teams established within the Team prepared three reports[46] comprising the diagnosis and proposals in the following fields:

- issuance of long-term own bonds by banks, both in PLN and in FX,
- securitisation of bank receivables, including mortgaged receivables using the subparticipation method,
- mortgage bond market development and using the mortgage banks to ensure long-term funding based on homogeneous mortgage loan portfolio.

Group for issuance of long-term own bonds by banks

Proposals for mitigating actions presented in the Group's report:

1. Regarding the unfavourable tax provisions on the foreign issues (as regards the lump sum income tax):

- by operation of law, no taxation of interest on long-term bonds issued by banks (through amendment to Article 17 of the CIT Law and Article 21 of the PIT Law), or
- withdrawal from collecting the lump sum income tax on long-term bonds issued by banks pursuant to the Minister of Finance Regulation (the same as in case of eurobonds issued by the Polish Government or some bonds issued by self-government institutions, e.g. by the self-government of Warsaw);

If the above proposals are not taken into account, or if taken into account partially, the following is proposed:

- the same taxation rules for foreign investors (non resident legal persons) and for residents – through extending the rule of taxation of net interest to non-residents. In case of domestic investor, the tax base can be reduced by the cost of acquiring funds (income interest less cost interest in connection with acquisition of funds). Foreign investors obliged to pay a lump sum income tax are not allowed to reduce the tax base for funding costs.
- unified lump sum income tax rate for foreign legal and natural persons (19%). The lump sum income tax rate on interest is 19% for foreign natural persons and 20% for foreign legal persons;

As regards other issues related to the lump sum income tax, the following is proposed:

- unification and transparent rules for collection of lump sum income tax on interest/discount generated by domestic and foreign natural persons and foreign legal persons;
- rule for collection of lump sum income tax according to which the tax is collected by entities providing those services to taxpayers, i.e. investment companies or banks holding securities accounts;

[46] More, see: http://www.knf.gov.pl/o_nas/komunikaty/dlugoterminowe.html.

- withdrawal of the obligation to have a residence certificate by an issuer in a situation where the original certificate is in the possession of a brokerage house, a trust bank or any other entity responsible for registering securities at securities accounts held by them;
- introduction of procedures (or making them more efficient) for refund of overpaid tax (a standard and a quick refund procedure), in accordance with the Commission Recommendations of 19 October 2009 on withholding tax relief procedures and the Commission Recommendation ”Quick and standard refund procedures”.

2. Regarding the lack of tax provisions encouraging the development of the banks' own bond market:

- Introduction of temporary tax provisions based on which the tax on interest from bonds issued by banks is not collected for a period of 2-3 years.

3. Regarding the unfavourable tax provisions for domestic individual investors:

- the base for calculating the income tax on income from the interest coupon is proportional to the period of maintaining a given debt instrument (amendment to the PIT Law.

Additional proposals as regards tax settlements by natural persons:

- simplification of tax base calculation, through combining, under money capital incomes, interest from coupons (paid from a given instrument) with profits (losses) from selling securities;
- option to settle the incomes from investment in securities by entities holding securities accounts for natural persons.

4. Regarding issues related to licensing and organisational separation of brokerage activities:

- proposal from the Polish Bank Association to remove the obligation to have a separate license for brokerage activities by banks; according to UKNF, such separate licenses are needed for various supervisory purposes (referred to in the law on financial instruments and the Banking Law), the subject matter of procedures and the scope of licenses differ, the legal and regulatory requirements towards banks differ as well;
- proposal from the Polish Bank Association to remove the obligation to organisationally separate the brokerage activities as regards the issuance of own bonds by banks; according to UKNF, such organisational separation is needed in order to ensure protection of confidential and professional information referred to in the law on financial instruments and, in addition, to ensure separation of banking and investment (brokerage) areas of banking activities.

5. Regarding the transparency of criteria of classification of banks as admitted to enter into repo transactions with NBP:

- proposal from the Polish Bank Association to define a set of criteria that must be complied with to be entered in the NBP list and to ensure working consultations with a competent NBP department regarding entry of a given issue to the NBP list (template – standards applied by ECB); according to NBP: entry in the list by a discretionary decision of the central bank taken using publicly announced minimum criteria and the credit risk assessment for a given security based on non-public internal standards, determination of whether a given instrument can be used as a collateral is possible only after the issuance of such instrument is finalised and after the instrument is deposited at the National Depository of Securities (KDPW); the final position of NBP in this regard will be announced upon completion of internal negotiations.

Group for securitisation of bank receivables

Potential barriers in development of the bank receivables securitisation market identified by the Group:

- Lack of definition of a securitisation transaction in tax law – if more precision is given, then the ambiguity in interpretation of applying VAT provisions to securitisation transactions could be avoided; Now, the VAT or PCC tax (tax on civil-law transactions) rate depends on individual interpretation by tax chambers.
- Lack of regulations regarding the cooperation between the bank selling a given loan portfolio with a buyer of that portfolio (as regards the portfolio handling); that would ensure effective and profitable

handling of loans, e.g. handling of a loan portfolio by a transferring bank is exempt from VAT (as an outsourced service).

- No tax neutrality in case of transferring assets to SPV or a bank in order to refinance them with debt securities.
- Lack of a provision in Article 12.4.15 letter c of the CIT Law enabling the bank to recognise a portion of price repaid by a debtor as a taxable income at the time when a given principal instalment becomes mature (”accrual-based approach”). The tax deductible cost would be recognised at the time the repayment is transferred to the securitisation fund (”cash-based approach”).
- Lack of a general interpretation from the Minister of Finance: are the services provided under the agreements entered into by banks and securitisation funds for bank’s handling of securitised receivables (acquired by a fund) exempt from VAT (pursuant to Article 43.13 of the VAT Law) as services auxiliary to financial services (or, are they considered as other services taxed with VAT rate 23%)?
- Provisions on the banking secret may make it more difficult to carry out transactions – according to the current law, banks may provide information which is a bank secret only if it is necessary to enter into and implement a contract for a transfer of receivables or subparticipation exclusively to a securitisation fund.
- It is not possible for banks to carry out a subparticipation transaction with an entity different than a securitisation fund (i.e. with a SPV, in the form of a commercial law company).
- Lack of regulations on change of creditor under the mortgaged loans transferred from a bank to an issuer, regulations ensuring effective and profitable transfer of assets.
- Lack of detailed regulations as regards the mortgaged receivables portfolio transferred during the transitory period (e.g. rules for determining the price of a receivable/portfolio, rules for a return transfer in case of a rejection of a request to change mortgage entries by a land and mortgage register court, tax conditions regarding the repayment of a loan during the mortgage transfer) resulting from statutory nature of entry of a receivable transfer to a loan and mortgage register.
- Lack of regulations regarding reorganisation procedures and compulsory management in case of bank bankruptcy (which is important for securitisation transactions); lack of regulations regarding maintenance of liquidity of register of receivables traded under a securitisation transaction, after such register is separated from the bankruptcy estate.

Group for mortgage bond market development

The following amendments have been proposed by the Group:

a) Provisions directly concerning the issuance of mortgage bonds:

- giving more precision to the bankruptcy law provisions in the context of what is happening after bankruptcy is announced by an issuer of mortgage bonds;
- resolving tax issues – now, the issuance of debt instruments is not profitable for Polish banks (thin capitalization, withholding tax);
- transparency as regards the security of invested funds – rating of issues, demand for issues; potential improvement of rating through an entry of a statutory NBP liquidity reserve (in case of mortgage banks) to the register of collaterals for mortgage bonds;
- regulatory changes – Recommendation F (appraisal of real properties by mortgage banks) and Recommendation K (register of collaterals);
- LCR and NSFR ratios – important matter is whether mortgage bonds can be reported as liquid assets (liabilities); according to the latest version of Basel III, covered bonds are defined as a high liquid asset item in LCR; issued mortgage bonds (covered bonds) can also be classified as NSFR as stable funding available provided that they match the definition of the NSFR measure;

b) Provisions regarding the transfer of real properties from a universal bank to a mortgage bank:

- simplification of a transfer of portfolios between banks; clarification of matters related to the bank secret in case of a transfer of mortgages between banks for the purposes of refinancing through mortgage bonds (the Banking Law Act, the personal data protection act);
- resolving tax issues – settlement of trading in receivables in terms of tax costs and incomes; approach to recognising provisions for receivables taken over (when they are not repaid) as tax deductible cost;
- lack of provisions regarding reserves for non-performing loans after selling a portfolio; as the result, the mortgage banks cannot be an institution that – by purchasing the mortgage receivables portfolio – can be an issuer of mortgage bonds for parent banks (Hungarian model) or for bank groups (Swiss or French model);
- lack of regulations regarding the cooperation between a mortgage bank and a parent bank; the banks' business model would be more effective if procedures of both these institutions are more closely integrated.

COMPOSITION OF THE LOAN PORTFOLIO – METHODOLOGY APPLIED BY UKNF

Financial sector (excluding banks and branches of credit institutions)

Non-financial sector

- Enterprises
  - SME
    - Operating loans
    - Investment loans
    - Real property loans
    - Other loans and receivables
  - Large enterprises
    - Operating loans
    - Investment loans
    - Real property loans
    - Other loans and receivables
- Households
  - Housing loans
    - PLN
    - FX
  - Consumer loans
    - Credit cards
    - Car loans
    - Instalment loans
    - Other
  - Other
    - Operating loans
    - Investment loans
    - Real property loans
    - Other loans and receivables
- Non-commercial institutions providing services for households

Government and self-government institution sector

- Central government institutions
- Self-government institutions
- Social security funds

Operating loans – for financing the operations of a company, a farm, e.g. for repayment of debts to suppliers, remunerations, current expenses. This item also include discount loans, export loans and overdraft loans (except for overdraft loans for private persons).

Investment loans – loans for financing new (or for increasing the existing) production and service capabilities of a borrower and for other undertakings of joint or accompanying nature, for reproduction, modernisation or enlargement of fixed assets, except for car loans and real property loans (reported as a separate item). If a loan is granted for various purposes (purchase of a land, construction of a plant, purchase of machines and equipment), then such loan should be classified according to the purpose to which the largest portion of the loan was allocated.

Housing loans – by convention, these are loans granted to households for: purchase, reconstruction, enlargement or extension of a house or a flat (being a separate real property) or for adaptation works (conversion of non-residential units into residential units), purchase of a cooperative title to a residential unit or a separate ownership right to a residential unit from a housing cooperative, for a repair of a house or a flat referred to above, for purchase of a construction plot (or of its part) for construction of a single-family house or an apartment building comprising a given residential unit, for other purposes connected with satisfying housing needs, in particular for covering costs of participation in costs of flat construction by social construction societies.

Real property loans – other housing loans (granted to entities other than households), loans for commercial real properties and loans for other real properties.

Consumer loans – loans for private persons for purposes other than business activity or farm management. Those loans include:

- **credit card** loans – funds used under a credit limit granted by a bank for a given credit card, with no restrictions as to purpose of a loan and form of repayment;
- **car** loans;
- **instalment** loans – loans repaid in instalments (usually during 1-3 years), granted for consumption-related purposes (e.g. purchase of household appliances) or for financing current expenses of a households (e.g. holiday loans, etc.). This category also include baloon loans. **This category does not include car loans** and **single repayment loans**;
- **other** – loans repaid in a **single repayment transaction**. This item also include **overdraft loans** for households, for purposes other than business activity or farm management.

Other loans and receivables – other loans (not allocated to any group listed above) and other receivables.

COMPOSITION OF THE ECONOMY BY SECTORS[47]

Financial sector

- Monetary financial institutions
    - Central banks
        - NBP
        - Central banks – non-residents
    - Other monetary financial institutions
        - Banks and branches of credit institutions
        - Another monetary financial institutions
            - SKOK
            - Monetary market funds
- Other financial sector institutions
    - Insurance institutions
    - Pension funds
    - Other financial brokerage institutions
        - Investment funds (except for monetary market funds)
        - Another financial brokerage institutions (except for investment funds)
    - Auxiliary financial institutions
    - International financial organisations (only non-residents)

Non-financial sector

- Enterprises
    - SME
    - Large enterprises
- Households
    - Individual entrepreneurs
    - Private persons
    - Individual farmers
- Non-commercial institutions providing services for households

Government and self-government institution sector

- Central government institutions
- Self-government institutions
- Social security funds

[47] This is a slightly modified extract from ”Instrukcja uzupełniająca do pakietu FINREP”, NBP.

FINANCIAL SECTOR – entities whose main business objective is the financial brokerage, i.e. purchase of financial assets and taking debts, for their own account, through financial transactions, as well as any entities providing services auxiliary to financial brokerage.

Central banks – the National Bank of Poland – operating under the Law of 29 August 1997 on the National Bank of Poland (Journal of Laws of 2005, no. 1, item 2, as amended). **Central banks – non-resident** – an institution in the non-resident's country of origin acting as a monetary authority the basic objective of which is domestic currency issuance and maintenance of full (or a part of) national FX reserves. Central banks may provide other services, such as control over the money and loan supply for the economy, exchange rate policy, financial services for the public sector, supervision over the banking system, maintenance of banks' reserves and refinancing, organising the money settlements. Some of the above services can be provided by other institutions. This category also includes the European Central Bank.

Other monetary financial institutions – financial institutions the objective of which is to accept deposits and/or close substitutes of deposits from entities other than monetary financial institutions and to grant loans and/or invest in securities for their own account. In case of EU countries, those institutions are classified in accordance with regularly updated list published in the Internet (www.nbp.pl) at the ECB's website (www.ecb.int). As for other countries, other monetary financial institutions mean banks (excluding central bank).

Banks (excluding banks in bankruptcy, liquidation or organisation) – entities created and operating in accordance with the Banking Law Act of 29 August 1997 (Journal of Laws no. 140, item 939, as amended), or (as regards cooperative banks) in accordance with the Cooperative Law Act of 16 September 1982 (Journal of Laws of 1995, no. 54, item 288, as amended), or (as regards affiliating banks) in accordance with the Act of 28 December 2000 on the operation and association of cooperative banks and on affiliating banks (Journal of Laws no. 119, item 1252, as amended), or (as regards mortgage banks) in accordance with of Act of 29 August 1997 on mortgage bonds and mortgage banks (Journal of Laws no. 140, item 940, as amended).

Branches of credit institutions – organisational units of a loan institution performing, for and on its behalf, all or any actions specified in a license granted to such loan institution; all such organisational units of a given loan institution established in Poland are deemed to be a single branch.

Cooperative Credit Unions – units created and operating in accordance with the Act of 14 December 1995 on cooperative credit unions (Journal of Laws of 4 January 1996, no. 1, item 2, as amended)

Monetary market funds – funds created in accordance with the Act of 27 May 2004 on investment funds (Journal of Laws 146/04, item 1546).

Insurance institutions – institutions that provide insurance services (insurance products) and that implement their objectives and tasks through an insurance undertaking (insurance company), in the form of a joint stock company or a mutual insurance company, operating under the Insurance Activity Act of 22 May 2003 (Journal of Laws no. 124, item 1151, as amended). The term "insurance institution" does not include entities operating in the social security area (Zakład Ubezpieczeń Społecznych [*the Polish Social Security Institution*], Kasa Rolniczego Ubezpieczenia Społecznego [*the Farmers' Social Securiy Fund*], Narodowy Fundusz Zdrowia [*the National Health Fund*], Fundusz Pracy [*the Labour Fund*]) and entities supervising the insurance institutions and pension funds (Komisja Nadzoru Finansowego [*the Polish Financial Supervision Authority*]), all of them classified as government and self-government institutions.

Pension funds – institutions whose business objective is to collect funds and to invest them, in order to pay old-age pension to the pension fund members after they reach the old-age pension age; pension funds operate in accordance with the Act of 28 August 1997 on organisation and operation of pension funds (Journal of Laws of 2004, no. 159, item 1667, as amended).

Other financial brokerage institutions – financial institutions whose key business objective is the financial brokerage through taking debts in forms other than cash, deposits and/or deposit substitutes at institutional units other than monetary financial institutions.

Investment funds (except for monetary market funds) – legal persons listed in the Act of 27 May 2004 on investment funds (Journal of Laws no. 146/04, item 1546), whose the exclusive business objective is to invest cash collected through public (or, in certain cases expressly specified in the Act, non-public) offering of shares of investment certificates in securities, money market instruments of other property rights listed in the Act. This category also includes the National Investment Funds.

Another financial brokerage institutions (except for investment funds) - financial institutions whose key business objective is the financial brokerage through taking debts in forms other than cash, deposits and/or deposit substitutes at institutional units other than monetary financial institutions. This subsector includes: financial lease companies (companies providing operating lease services must be reported in non-financial sector, enterprise item), factoring companies, brokerage houses, Private Equity/ Venture Capital companies, companies created for the purposes of securitisation of assets, banks in bankruptcy, in liquidation or in organisation.

Auxiliary financial institutions – financial institutions which do not provide financial brokerage services on their own behalf, but which create environment for providing such services. This subsector includes, among others: brokers, insurance and pension agents and advisers, investment advisers, exchange offices, stock exchanges, commodity exchanges, institutions that create infrastructure for financial markets (e.g. settlement chambers and centres, e.g. Polcard), securities depositories (e.g. Krajowy Depozyt Papierów Wartościowych SA), guarantee institutions (e.g. Bankowy Fundusz Gwarancyjny), funds and foundations (including: the Cooperation Fund), investment fund companies, pension fund companies, instalment sales institutions, asset management companies, the Polish Bank Association, the National Cooperative Credit Union, representative offices of foreign banks.

International financial organisations – financial organisations dealing with multilateral cooperation and providing aid to member states and third countries, e.g. the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (the World Bank), the Bank for International Settlements (BIS), the European Bank for Reconstruction and Development (EBRD). This category also includes the international financial institutions within the meaning of Article 4.3 of the Banking Law Act of 29 August 1997 (Journal of Laws of 2002, no. 72, item 665, as amended).

NON-FINANCIAL SECTOR – entities whose main business objective is production and trading in goods and providing non-financial services (including the operating lease), the entities with non-financial function and natural persons. The non-financial sector **includes enterprises, households and non-commercial institutions**.

Enterprises – all entities whose main business purpose is production, trading in goods or provision of non-financial services. This category also includes natural persons running businesses for their own account, provided that the number of their employees was, at the end of the last closed financial year, more than 9.

Small and medium enterprises (SME) – entities where the number of employees at the end of the last closed financial year was less than 250 persons and natural persons running businesses for their own account provided that the number of their employees was, at the end of last closed financial year, more than 9 and less than 250. This category also includes microenterprises (the enterprises where the number of employees at the end of the last closed financial year was up to 9). Natural persons running businesses for their own account and having, at the end of last closed financial year, not more than 9 employees, are categorised as individual entrepreneurs (households).

Large enterprises – entities where the number of employees at the end of the last closed financial year was at least 250 persons and natural persons running businesses for their own account provided that the number of their employees was, at the end of last closed financial year, at least 250.

Households – persons or groups of persons being consumers and/or persons or groups of persons who produce goods and non-financial services intended for their own use.

Individual entrepreneurs – natural persons running businesses for their own account, for which a reporting bank provides services connected with their business, where the number of their employees was, at the end of the last closed financial year, up to 9 (e.g. liberal professions, provided that the above conditions are met). Loans for persons running businesses (for their consumer or own housing needs) should be reported as loans for private persons. The same concerns deposits of those persons: if they are opened separately and for private purposes, then they must be reported as deposits of private persons. This category also includes non-public health centres, non-public schools run by natural persons, provided that, at the end of the last closed financial year, the number of employees was up to 9.

Private persons – natural persons, except for persons running businesses and/or farms (i.e. persons qualified as individual entrepreneurs or individual farmers). This category also includes: employee savings and loans scheme run by employers, school savings scheme, parents' councils at schools, kindergartens and other institutions.

Individual farmers – natural persons whose main source of income is agriculture and whose business has not been registered as an enterprise, company, cooperative or producers' groups. Loans for individual farmers (for their consumer or own housing needs) should be reported as loans for private persons. The same concerns deposits of those persons: if they are opened separately and for private purposes, then they must be reported as deposits of private persons.

Non-commercial institutions providing services for households – non-commercial institutions being individual legal entities providing services for households. Their basic income is, in addition to income from occasional sales, voluntary cash or in-kind contributions from households, subsidies from government and self-government institutions and income from ownership titles. This category includes: trade unions, professional and scientific societies and associations, consumer associations, political parties, churches and religious association, voluntary fire service, funds and foundations acting for households, social clubs, culture clubs, recreation and sports clubs, housing cooperatives, non-public health centres and non-public schools, provided that they are run by churches and religious associations, foundations acting for households, trade unions, professional self-governing bodies ant other entities classified as non-commercial institutions, charities, humanitarian aid institutions financed from voluntary cash or in-kind contributions from other institutional bodies.

GOVERNMENT AND SELF-GOVERNMENT INSTITUTION SECTOR – this sector includes public authorities and subordinated organisational units, state legal persons and other state organisational units not entered in the National Court Register, financed (fully or in prevailing part) from public funds, except for state enterprises, state banks and commercial law companies.

Central government institutions – all ministries and other central institutions, whose scope of responsibility is, typically, the whole economic area of Poland, except for social security fund management. This subsector includes central government management authorities and subordinated organisational units, whose activities are financed, to certain extent, from the state budget.

Self-government institutions – self-government management bodies (at the gmina, poviat and voivodship level) and subordinated organisational units, whose activities are financed from self-government institutions' budgets, except for local branches of social security funds. The scope of responsibility of self-government institutions is local parts of the economic territory of Poland.

Social security funds – include all central and local institutions, whose basic purpose of activity is to ensure social security, provided that two following criteria are jointly met: by force of law (or pursuant to relevant regulations) specific groups of people are obliged to participate in a scheme (e.g. pension scheme) or to pay contributions and the government is responsible for management of that institution in terms of determining and approving the amount of contributions and types of benefits. This subsector includes: Zakład Ubezpieczeń Społecznych [*the Polish Social Security Institution*] and Kasa Rolniczego Ubezpieczenia Społecznego [*the Farmers' Social Securiy Fund*] and funds managed by them (Social Security Fund, the

Demographic Reserve Fund, the Contribution Fund, the Prevention and Rehabilitation Fund, the Old-Age and Disability Fund, the Administration Fund, the Incentive Fund, the Reserve Fund and the Labour Fund), Narodowy Fundusz Zdrowia [*the National Health Fund*] and its regional branches.

GLOSSARY OF SELECTED TERMS[48]

Nominal value of financial instruments – value of a receivable, a liability, an off-balance sheet liability or a security corresponding to the amount of principal (including capitalised interest) at the reporting day, that a debtor must repay to the creditor in accordance with a contract. In case of debt liabilities, such as bonds or promissory notes, that value corresponds to the amount that will become payable at the time of redemption (including capitalised interest). In case of shares, the nominal value is the value specified in a memorandum of association and entered in a court register.

Balance-sheet value – it is a value that corresponds to the value as at the balance-sheet date, i.e.:

- financial assets are valued by amortised cost using the effective interest rate, less impairment losses / special purpose reserves, or by fair value, and, in case of financial assets classified as "for sale" portfolio, fair value should be reduced by impairment losses or by cost less impairment losses,
- shares in subordinated entities are valued using the purchase price less impairment loss or in accordance with IAS 39,
- shares in other entities: banks which prepare financial statements in accordance with IAS – valuation in accordance with IAS 39, banks which prepare financial statements in accordance with the Polish Accounting Standards – valuation of financial assets by purchase price less impairment losses,
- financial liabilities are valued using fair value or amortised cost using the effective interest rate,
- tangible fixed assets are valued using the purchase price or production cost less depreciation and impairment losses or by revaluated value that corresponds to their fair value less depreciation and impairment losses,
- investment real properties are valued using fair value or purchase price less depreciation and impairment losses,
- intangible fixed assets are valued using the purchase price or production cost less amortisation and impairment losses or by revaluated value that corresponds to their fair value less amortisation and impairment losses,
- non-current assets for sale are valued in lower of the following values: balance-sheet value or fair value less cost of sale (IFRS 5)
- inventories are valued using the purchase price or production cost or by net realisable value, whichever is less.

Net balance-sheet value – the balance-sheet value.

Gross balance-sheet value – the balance-sheet value not reduced for amortisation/depreciation, impairment losses, special purpose reserves.

Net assets – assets of an entity less liabilities; in terms of value, it corresponds to equity.

[48] This is a slightly modified extract from "Instrukcja uzupełniająca do pakietu FINREP", NBP.

Portfolio A – other receivables from the Financial Assets portfolio valued using fair value or through the profit and loss account and the Financial Assets for sale.

Portfolio B – other receivables from the Financial Assets for Sale portfolio and Investments Held until Maturity Date and the whole Loans and Other Receivables portfolio.

Receivables without impairment (for banks using IAS) – financial assets without impairment. The receivables subject to IBNR must be reported in columns ”without impairment”. Receivables without impairment **for banks using the Polish Accounting Standards** – credit exposures classified as: performing or watch-list.

Receivables with impairment (for banks using IAS) – financial assets as to which objective evidence of loss of value referred to in Article 59 of IAS 39 was provided and they were classified as impaired assets in accordance with IAS 39. Receivables with impairment **(for banks using the Polish Accounting Standards)** – credit exposures classified as non-performing.

Gross balance-sheet value of exposure without recognised impairment – banks applying the Polish Accounting Standards report performing and watch-list receivables; banks applying the IAS report exposures without impairment and exposures, in case of which impairment conditions occurred but an impairment loss was not recognised. **Gross balance-sheet value of exposure with recognised impairment** – banks using the Polish Accounting Standards report non-performing receivables; banks using the IAS should recognise exposures with impairment, for an impairment loss was recognised.

Impairment write-downs recognised for assets assessed individually - banks applying the Polish Accounting Standards report special purpose reserves for credit exposures, except for special purpose reserves for exposures linked with retail loans classified as ”performing”; banks applying the IAS report impairment write-downs for individual items. **Impairment write-downs recognised for financial assets assessed by portfolio method** – banks applying the Polish Accounting Standards report special purpose reserves for credit exposures linked with retail loans classified as ”performing”; banks applying the IAS report impairment write-downs for credit exposures that were jointly assessed for impairment loss.

Impairment loss / special purpose reserve is a surplus of the balance-sheet value of a given asset over its recoverable value. **Recoverable value** –corresponds to fair value less cost of sale or a useful value of an asset or a cash-generating center, whichever is higher (IAS 36.6) or current value of estimated future cash flow discounted using the effective interest rate (IAS 39.63).

Original term – period for which a contract with a customer was concluded. The contractual period is also the period as amended by an annex constituting an integral part of the contract. In case of deposits, it is the period for which a deposit was opened at a bank. In case of loans, the original term is the period for which a loan was granted taking into account the date of repayment of the last instalment. In case of securities, the original term is the period from issuance to redemption of those securities. In case of deposits where the date of depositing funds differs from the date of the contract (e.g. interbank deposits T/N, S/W), the original term starts on the date of opening a deposit (i.e. reclassification from a bank’s off-balance sheet item to a balance-sheet item) and ends on the date when funds are returned.

Maturity date (receivables) – period from the reporting date to the date of repayment of a receivable specified in the contract; receivables repaid as a one-time repayment – date of repayment of the whole debt specified in the contract; receivables repaid in instalments – date of repayment of each individual instalment as specified in the contract.

Maturity date (liabilities) – period from the reporting date to the date of repayment of a liability specified in the contract.

Year of commitment by a bank – the year when a bank receivable accrued.

Non-defaulted receivables – receivables that are repaid in accordance with the agreement, the repayment schedule, i.e. there have been no delays in repayment of capital or interest.

Defaulted receivables – receivables with unpaid, on the dates specified in the agreement, interest or principal instalments. The delay period is the period from the maturity date specified in the agreement (the agreed date for repayment of an instalment, an interest or the whole receivable) until the balance-sheet date. In case of receivables repaid in instalments, the length of the delay period counts from the date of maturity of the first instalment with delayed repayment.

Non-handled receivables – receivables in case of which the contractual repayment date (from the repayment date specified in the agreement until the reporting date) has been exceeded by more than 3 months. Non-handled receivables must be reported in full, even if the delay concerns an individual principal instalment or a repayment of interest. This item also includes the receivables with a delay of repayment of interest (by more than 3 months), where there is no delay in repayment of principal instalments.

Deposit – a bank's liability linked with funds deposited at the customer's accounts (except for liabilities resulting from cash collaterals accepted).

Current deposits – funds deposited by entities at the current accounts kept with a reporting institution, payable on request.

Term deposits – funds deposited with a reporting institution for a predefined period of time.

Deposits with period of notice – funds deposited with a reporting institution for indeterminate period of time, that cannot be withdrawn without notifying the reporting institution in advance on the intention to withdraw that deposit in full or in part. The period of notice is defined in the agreement. Withdrawal of a deposit without period of notice is impossible or results in a loss of a considerable part or of all interest accrued.

Restricted deposits – funds deposited with a reporting institution that cannot be freely disposed of by a depositor considering the fact they are intended for a specific purpose, including settlement of letters of credit or a hedge instrument for the reporting institution (e.g. hedge against the risk linked with a loan granted, payment card transactions, etc.). If it is possible to determine the original realisation date, then such deposit should be allocated to a given time interval defined for term deposits. If it is not possible to determine the original realisation date, then such deposit should be qualified as ”Restricted deposit”.

Loans recognised as liabilities – liabilities of a reporting institution connected with loans received (liabilities related to securities issued are excluded).

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