15 January 2019

Communique published by the Polish Financial Supervision Authority pertaining to the regulatory authority's assumptions underlying the dividend policy of commercial banks, cooperative banks and affiliation banks, insurance and reinsurance undertakings, brokerage houses, mutual fund management companies and universal pension fund management companies in 2019

At its meeting of 15 January 2019, the Polish Financial Supervision Authority (KNF) unanimously approved its stance on the dividend policy of commercial banks, cooperative banks and affiliation banks, insurance and reinsurance undertakings, brokerage houses, mutual fund management companies and universal pension fund management companies in 2019. The purpose of the dividend policy pursued by financial institutions in accordance with KNF's recommendations is to procure the financial system's safe and sustainable development. The standing of the Polish financial system is stable. KNF constantly monitors the capital ratios of the various entities belonging to this system and, if necessary, it takes the pertinent growth-focused and preventive measures. Each one of these sectors will receive recommendations in the form of a letter from the Chairman of KNF.

Commercial banks

It is recommended for a dividend from the profit in the previous year to be paid solely by banks that simultaneously satisfy the criteria below:

- banks that are not implementing a remedial program[1];
- banks that have a positive score (final BION score no lower than 2.5 – master scale assessment of 1 or 2 [*The Polish abbreviation BION means Test and Regulatory Assessment*]);
- banks that have a leverage ratio (LR) higher than 5%;
- banks that have a Tier I (CET1) capital ratio no lower than the required minimum plus 1.5 p.p.[22]: 4.5% + 56%*add-on + merged buffer requirement[3] + 1.5%;
- banks that have a Tier I (T1) capital ratio no lower than the required minimum plus 1.5 p.p.[3]: 6% + 75%*add-on + merged buffer requirement[4] + 1.5%;
- banks that have a total capital ratio (TCR) no lower than the required minimum plus 1.5

[1] Remedial proceedings program / implementation of a remedial plan
[2] 1.5 p.p. - according to art. 142 section 4 of the Banking Law Act: when assessing the financial standing of a bank, the Polish Financial Supervision Authority may give consideration to that bank's adherence to the own funds requirement prescribed by section 1 item 1 plus 1.5 percentage points.
[3] Merged buffer requirement in force as of 2019

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p.p.[3]: 8% + add-on + merged buffer requirement[4] + 1.5%;

It is recommended for banks that simultaneously meet the foregoing criteria to be able to pay up to 75% of their earnings in the year preceding the decision.

In addition, the ability for banks to pay up to 100% of their earnings in the year preceding the decision provided that they meet all the foregoing criteria while taking into account a given bank's sensitivity to an unfavorable macroeconomic scenario[4] under the capital criteria is recommended.

In the case of banks with FX loan exposure[5], the dividend yield should additionally be adjusted according to the criteria below:

Criterion 1 - based on the percentage of FX-denominated household mortgage loans in the overall portfolio of receivables from the non-financial sector:

- banks whose percentage exceeds 10% - adjust the dividend yield by 20 p.p.
- banks whose percentage exceeds 20% - adjust the dividend yield by 30 p.p.
- banks whose percentage exceeds 30% - adjust the dividend yield by 50 p.p.

Criterion 2 - based on the percentage of FX-denominated household mortgage loans extended in 2007 and 2008 in their portfolio of FX-denominated household mortgage loans:

- banks whose percentage exceeds 20% - adjust the dividend yield by 30 p.p.
- banks whose percentage exceeds 50% - adjust the dividend yield by 50 p.p.

The adjustment criteria will become less significant as the FX loan portfolio is amortized.

Banks should satisfy the foregoing criteria referring to a payout from their earnings in the year preceding the decision at the standalone and consolidated level alike.

Cooperative banks and affiliation banks

The recommendation is given to cooperative banks to apply the general assumptions of the dividend policy – the same ones as in the case of other banks operating in the form of a joint stock company.

[4] A bank's sensitivity to an unfavorable macroeconomic scenario measured using the results of regulatory stress tests defined as the difference between TCR in the benchmark scenario and TCR in the stress scenario at the end of the forecast period (2020) while giving consideration to regulatory adjustments minus the hedging buffer in its target amount (2.5%).

[5] Banks that have in their portfolio receivables from the non-financial sector with the percentage of FX-denominated household mortgage loans exceeding 5%.

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It is recommended that a dividend:

A. up to 100% of earnings may be paid out only by cooperative banks that simultaneously meet the following criteria: banks that are not implementing a remedial program, whose final BION score is no lower than 2.5 (master scale score of 1 or 2 under the test and regulatory assessment [*Polish abbreviation: BION*], banks that have a leverage ratio (LR) higher than 5%, a total capital ratio (TCR) no lower than 15.0%, a T1 capital ratio no lower than 13.0%, a CET1 common equity tier ratio no lower than 11.5% and that are not utilizing the option to reduce the basis for setting up special-purpose provisions.
B. up to 75% of earnings may be paid out only by cooperative banks that simultaneously meet the following criteria: banks that are not implementing a remedial program, whose final BION score is no lower than 2.5 (master scale score of 1 or 2 under the test and regulatory assessment [*Polish abbreviation: BION*], banks that have a leverage ratio (LR) higher than 5%, a total capital ratio (TCR) no lower than 15.0%, a T1 capital ratio no lower than 13.0% and a CET1 common equity tier ratio no lower than 11.5%.
C. Taking into consideration the pro rata rule and the legal and organizational distinctiveness of cooperative banks, a dividend payment with restrictions is recommended for two groups of cooperative banks:

1. Cooperative banks that are not implementing remedial programs, that meet the criterion of having a leverage ratio (LR) above 5%, that have a total TCR capital ratio no lower than the required minimum, i.e. 13.5%, a T1 capital ratio no lower than the required minimum, i.e. 11.5% and a BION score <= 2.50 will be able to designate the following to be paid as a dividend:
    - no more than 10% of their net earnings - in respect of cooperative banks operating under institutional protection schemes,
    - no more than 5% of their net earnings - in respect of other cooperative banks.

2. Cooperative banks that are not implementing remedial programs, that meet the criterion of having a leverage ratio (LR) above 5%, that have a total TCR capital ratio no lower than the required minimum, i.e. 13.5%, a T1 capital ratio no lower than the required minimum, i.e. 11.5% and a BION score within the range (2.50<BION<= 3.25) will be able to designate the following to be paid as a dividend:
    - no more than 2% of their net earnings.

Just as in previous years the KNF Office will individually address those cooperative banks that do not meet the criteria to pay a dividend from their 2018 net earnings.

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Insurance and reinsurance undertakings

It is recommended for a dividend to be paid solely by those undertakings that meet all of the criteria below:

I. they have received a good (1.00) or satisfactory (2.00) BION risk score for 2017;
II. in the various quarters of 2018 they reported no shortage of own funds to cover the capital requirement (defined as the maximum of the minimum capital requirement (MCR) and the solvency capital requirement (SCR));
III. in 2018 they were not covered by a short-term financial plan or the remedial plan referred to in Articles 312 and 313 of the Insurance and Reinsurance Activity Act of 11 September 2015;
IV. as at 31 December 2018, the level of own funds, without deducting the expected dividends, was at the level of at least 175% of the capital requirements for undertakings operating in section I and at least 150% of the capital requirements for undertakings operating in section II.

Those undertakings that satisfy the above criteria should limit their dividend payments to 75% of the profit earned in 2018, while the coverage of the capital requirements in the quarter in which the dividend is paid out should be maintained at no less than 110%.

At the same time, it is permitted to pay out a dividend equal to the entire profit earned in 2018 (which means that payment from other equity components is not permitted), provided that the coverage of capital requirements (after expected dividends are deducted from own funds) at the end of 31 December 2018 and for the quarter when the dividend is paid, is at least 175% for undertakings operating in section I and at least 150% for undertakings operating in section II.

Those undertakings that satisfy the above criteria, when deciding on the level of dividends, should take into account their additional capital needs within the period of twelve months from the approval date of the 2018 financial statements, which may result, among others, from changes in the market and legal environment.

Brokerage houses

It is recommended for a dividend to be paid in 2019 solely by those brokerage houses that meet all of the criteria below:

A. A dividend totaling no more than 75% of their 2018 net profit:

I. entities that are subject to the capital adequacy standards in accordance with regulation 575/2013 as of 31 December 2018:

- the Tier 1 common equity ratio is at least 6%;
- the Tier 1 equity ratio is at least 9%;
- the total equity ratio is at least 14%;

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II. in respect of entities that are not subject to the capital adequacy standards in accordance with regulation 575/2013 as of 31 December 2018, the ratio of equity to total assets is at least 50%;

III. the last regulatory score assigned in the BION process is 1 or 2;

IV. in 2018 and up to the date of approving the financial statements and adopting the resolution on profit distribution for 2018 the entity in question has not violated the regulations regarding capital requirements set forth in regulation 575/2013 and the Financial Instruments Trading Act (Journal of Laws of 2017, Item 1768 as amended) and the regulations pertaining to large exposure limits.

B. A dividend totaling no more than 100% of their 2018 net profit:

I. the entity in question meets all the criteria enumerated in letter A;

II. in respect of entities that are subject to the capital adequacy standards in accordance with regulation 575/2013, the criteria referred to in letter A item I are met at the end of each quarter in 2018;

III. in respect of entities that are not subject to the capital adequacy standards in accordance with regulation 575/2013, the criterion referred to in letter A item II is met at the end of each quarter in 2018.

In addition, when making the decision concerning the dividend amount brokerage houses should take into account additional capital needs within a twelve month outlook from the time of approving the 2018 financial statements.

At the same time, attention is drawn to the fact that brokerage houses obligated by the currently binding law to maintain additional capital requirements should increase the ratios referred to in letter A.I by the amount of their additional capital requirements.

Mutual fund management companies

On the basis of the analysis of the situation on the mutual fund management company market, giving consideration to the regulations in force, it is recommended for the following criteria to be incorporated jointly when making the decision on distributing profit for 2018 and its allocation in 2019:

I. in 2018 and during the period from the outset of 2019 up to the date of adopting the resolution on distributing profit, no situation has transpired in which the statutory capital requirements would not be met;

II. when making the decision pertaining to the distribution of profit, a management company should incorporate its additional capital needs within a twelve month outlook from the time of approving the 2018 financial statements such that the method of profit distribution does not exert an influence on the ability to meet capital requirements in

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subsequent months, and it should also take into account the needs related to the planned establishment of defined date funds and their management in accordance with the *Employee Capital Accumulation Schemes Act* of 4 October 2018 (Journal of Laws of 2018, item 2215, hereinafter referred to as the "Employee Capital Accumulation Schemes Act");

III. the decision on the method of profit distribution should take into account whether during the period from the date of adopting the last resolution on profit distribution any claims have been reported by participants of mutual funds against the management company in connection with improper management of mutual funds;

IV. mutual fund management companies meeting the conditions referred to in items I – III that at the same time received a final BION score of 1 or 2 during the most recent Test and Regulatory Assessment [*Polish abbreviation: BION*] may allocate - in some other way than by designating net profit to set up or increase supplementary capital and other reserve capital or cover retained losses:

1. a maximum of 75% of their net profit earned in 2018 insofar as the profit distribution will not cause the capital requirements coverage ratio to fall below 1.5;
2. more than 75% but no more than 100% of their net profit earned in 2018 insofar as the profit distribution will not cause the capital requirements coverage ratio to fall below 2;

- where the capital requirements coverage ratio is computed as the quotient of the management company's equity and the capital requirements level in force.

V. the measures taken, including the method of profit distribution, cannot lead to a reduction in the management company's assets that have the highest level of liquidity and safety specified as the sum total of cash, securities issued by the State Treasury or the National Bank of Poland, participation units of money market mutual funds and mutual funds that invest at least 85% of their assets in securities issued, guaranteed or backed by the State Treasury, the National Bank of Poland or local governments minus the value of treasury shares below the level forming 150% of the capital requirement binding upon the management company. In turn, in respect of a mutual fund management company that plans to set up defined date funds and manage them in accordance with the Employee Capital Accumulation Schemes Act, the profit distribution cannot at the same time lead to a reduction in the liquid assets held by that management company, as defined above, below the level of 150% of the requirement stemming from art. 59 section 1 item 1 of the Employee Capital Accumulation Schemes Act referring to the minimum level of liquid funds.

Universal pension fund management companies

A necessary prerequisite and something that is recommended by the regulatory authority is for a universal pension fund management company that makes a decision to pay a dividend in 2019 to meet concurrently all of the criteria enumerated below:

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criterion I	the management company has received a final BION score for 2017 of 1 (good) or 2 (satisfactory);
criterion II	in 2018 and during the period from the outset of 2019 up to the date of adopting the resolution on distributing profit, no situation has transpired in which the management company would fail to satisfy statutory capital requirements;
criterion III	as at 31 December 2018 the equity of a management company plus the value of the Indemnity Fund attributable to the management company represents at least 1.25% of the net asset value of the open-end pension fund managed by the management company;
criterion IV	as at 31 December 2018 the value of the liquid assets of a management company[6] plus the value of the Indemnity Fund attributable to the management company represents at least 1.25% of the net asset value of the open-end pension fund managed by the management company;
criterion V	the management company has received a partial BION score for 2017 regarding capital adequacy of 1 (good) or 2 (satisfactory).

A universal pension fund management company meeting the foregoing criteria should curtail the amount of the dividend paid in 2019 from the profit originating from 2018 or from other components of equity to a level not to exceed 100% of the profit earned in 2018. Nor can the payment of a dividend lead to a reduction in equity and the value of liquid assets, respectively, plus the value of the funds in the Indemnity Fund attributable to the management company below the level specified in criterion III and criterion IV.

Moreover, when making the decision pertaining to the distribution of profit, a management company should incorporate its additional capital needs within a one year outlook from the time when the shareholder meeting approves the management company’s 2018 financial statements, in particular, the needs related to the establishment of defined date funds and their management in accordance with the *Employee Capital Accumulation Schemes Act* of 4 October 2018 (Journal of Laws, item 2215). A pension fund management company that is already managing a voluntary pension fund should also incorporate the risk associated with that portion of its business and its possible impact on its financial result and capital position.

[6]The following may be deemed to be liquid assets: securities issued by the State Treasury or NBP, receivables from an open-end pension fund by virtue of the fee charged to the contribution and the management fee, cash and other cash assets and other current financial assets.

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