16 December 2020

KNF (Polish Financial Supervision Authority) position on the 2021 dividend policy

On 16 December 2020, the Polish Financial Supervision Authority (KNF) unanimously adopted a position on the 2021 dividend policy of commercial banks, cooperative and affiliating banks, insurance companies, reinsurance companies, insurance and reinsurance companies, investment fund companies, universal pension companies and brokerage houses. Each sector will receive recommendations in the form of a letter from the KNF Chairman.

The immediate goal of the KNF's dividend policy is to ensure stability of the Polish financial sector by adjusting the capital base of supervised entities to the level of risk they bear and to protect recipients of those entities' financial services.

Commercial banks

Bearing in mind:

- the significant uncertainty as to further developments related to the COVID-19 pandemic,
- the temporary nature of solutions used by banks to improve their capital situation during the pandemic,
- the continuing cautious regulatory positions within the EU with regard to dividend restrictions and other forms of reducing capital resources,
- revision of the EBA guidelines extending the moratoria

the KNF deems it necessary for commercial banks to suspend dividend payments in the first half of 2021.

The Polish Financial Supervision Authority also expects that banks will refrain from taking other actions, in particular such that fall outside of the scope of ongoing business and operating activity and that may result in the reduction of the capital base without prior consultation with the supervisory body. This also applies to the potential distribution of dividend from retained profit from the previous years and repurchase of own shares. The KNF expects that should such operations be implemented, they would always be preceded by prior consultations with the supervisory authority and be subject to their positive outcome.

At the same time, the Polish Financial Supervision Authority is going to present its position on the dividend policy of commercial banks in H2 2021 in a separate announcement, after it has analyzed the financial situation of the banking sector in the first half.

Cooperative and affiliating banks

The KNF deems it necessary to adopt the following dividend policies for cooperative and affiliating banks in 2021:

1. Affiliating banks should follow the general dividend policy guidelines, the same as other banks operating as joint stock companies.
2. Cooperative banks whose financial situation has deteriorated, i.e. y/y profit decreased by more than 30% or own funds decreased, should refrain from paying dividends.
3. Dividend payments in other cooperative banks should be made on the following terms:

    1) *up to 10% of net profit* – in cooperative banks that meet all the criteria of: not implementing recovery measures, having an aggregate BION score not lower than 2.5 (master scale score 1 or 2), having a leverage ratio (LR) higher than 5%, total TCR capital ratio not lower than 12.0%, T1 capital ratio not lower than 10.0%, CET1 core capital ratio not lower than 8.5% and not exercising the option of reducing the accrual base for specific reserves.
    2) *up to 5% of net profit* – in cooperative banks that meet all the criteria of: not implementing recovery measures, having an aggregate BION score not lower than 2.5 (master scale score 1 or 2), having a leverage ratio (LR) higher than 5%, total TCR capital ratio not lower than 12.0%, T1 capital ratio not lower than 10.0%, CET1 core capital ratio not lower than 8.5%.
    3) *up to 3% of net profit* – in cooperative banks that meet all the criteria of: not implementing recovery measures, having an aggregate BION score not lower than 2.50 (master scale score 1 or 2), having a leverage ratio (LR) higher than 5%, total TCR capital ratio not lower than 10.5%, T1 capital ratio not lower than 8.5%, CET1 core capital ratio not lower than 7.0% – in the case of cooperative banks operating within institutional protection systems.
    4) *up to 2% of net profit* – in cooperative banks that meet all the criteria of: not implementing recovery measures, having an aggregate BION score not lower than 2.50 (master scale score 1 or 2), having a leverage ratio (LR) higher than 5%, total TCR capital ratio not lower than 10.5%, T1 capital ratio not lower than 8.5%, CET1 core capital ratio not lower than 7.0% – in the case of cooperative banks not operating within institutional protection systems.
    5) *up to 1% of net profit* – in cooperative banks that meet all the criteria of: not implementing recovery measures, having an aggregate BION score within (2.51<=BION<=3.25) (master scale score 3), having a leverage ratio (LR) higher than 5%, total TCR capital ratio not lower than 10.5%, T1 capital ratio not lower than 8.5%, CET1 core capital ratio not lower than 7.0%.

4. In addition to the above principles, in connection with the COVID-19 pandemic and a possible deterioration of the economic and financial situation of banks in 2021, cooperative banks that meet the criteria for dividend payments from the 2020 profit should consider retaining their profits in full and allocating them to strengthen the capital base.

5. Individual communications will be addressed to the cooperative banks that do not meet the criteria for dividend payments from the 2020 net profits.

Insurance companies, reinsurance companies, and insurance and reinsurance companies

Having regard to the situation of the insurance sector and the state of the capital base at individual insurance companies, reinsurance companies, and insurance and reinsurance companies, the KNF recommends that dividends could only be paid by those companies which meet:

I. for payments from the 2019 profit – the criteria set out in the KNF communication of 3 December 2019 regarding the regulator's position on guidelines for the 2020 dividend policies of commercial banks, cooperative and affiliating banks as well as insurance companies, reinsurance companies, and insurance and reinsurance companies;

II. for payments from the 2020 profit – all of the following criteria:

- good [1] or satisfactory [2] BION risk rating for 2019;
- in the individual quarters of 2020, no reported shortage of own funds to cover the capital requirement (understood as the maximum of the minimum capital requirement (MCR) and the solvency capital requirement (SCR));
- not covered in 2020 by a short-term financial plan or the recovery plan referred to in Articles 312 and 313 of the Act of 11 September 2015 on insurance and reinsurance activities;
- as at 31 December 2020, own funds, without deduction for anticipated dividends, equal to at least 175% of the capital requirements for Section I insurance companies, reinsurance companies, and insurance and reinsurance companies and at least 150% of the capital requirements for Section II insurance companies, reinsurance companies, and insurance and reinsurance companies.

The insurance companies, reinsurance companies, insurance and reinsurance companies that meet the above criteria may pay dividends at the maximum of 100% of the 2019 profit and 50% of the 2020 profit, provided that capital requirements (after deducting anticipated dividends from own funds) as at 31 December 2020 and for the quarter of dividend payments are covered in at least 175% for Section I insurance companies, reinsurance companies, and insurance and reinsurance companies and at least 150% for Section II insurance companies, reinsurance companies, and insurance and reinsurance companies.

When deciding on the amount of dividends, the insurance companies, reinsurance companies, insurance and reinsurance companies that meet the above criteria should take into account additional capital needs for twelve months after approval of the 2020 financial statements, on account of, for example, changes in the market and legal environment, and in particular the high uncertainty as to further development of the coronavirus pandemic, and hence possible further implications for the insurance company, reinsurance company, or the insurance and reinsurance company in question.

[1] Risk assessment is given based on the macroscale (Good, i.e. 1.00 (1.00 to 1.74); Satisfactory, i.e. 2.00 (1.75 to 2.49); Objectionable, i.e. 3.00 (2.50 to 3.24); Poor i.e. 4.00 (3.25 to 4)).

[2] *ibidem*

Investment Fund Companies (TFI)

The KNF deems it necessary that the 2021 dividends be only paid by those investment fund companies that meet all of the following criteria:

A. Payment of no more than 75% of the 2020 net profit.

I. In 2020 and in the period from the beginning of 2021 until the date of the resolution on 2020 profit distribution the investment fund company did not violate statutory provisions on capital requirements;

II. The investment fund company received the last aggregate BION score of 1 or 2;

III. The actions to be taken, including profit distribution, will not reduce the value of the investment fund company's liquid assets, less the value of own shares held, below 150% of the capital requirement applicable to that company. However, in the case of an investment fund company which manages defined-date funds in accordance with the Act on Employee Capital Plans, profit distribution cannot at the same time reduce the value of its liquid assets, less the value of own shares held, below 150% of the requirement resulting from Article 59.1 (2) of the Act on Employee Capital Plans.

IV. Profit distribution will not result in a reduction of the capital requirement coverage ratio below 1.5, with the capital requirement coverage ratio being calculated as the quotient of the company's equity and the applicable capital requirement.

B. Payment of no more than 100% of the 2020 net profit.

I. The investment fund company meets criteria I-III listed in letter A;

II. Profit distribution will not result in a reduction of the capital requirement coverage ratio below 2, with the capital requirement coverage ratio being calculated as the quotient of the company's equity and the applicable capital requirement.

C. Payment of more than 100% of the 2020 net profit, including undistributed portion of net profit

I. The investment fund company meets criterion I listed in letter B;

II. The investment fund company received the last aggregate BION score of 1;

III. Profit distribution will not result in a reduction of the capital requirement coverage ratio below 2.5, with the capital requirement coverage ratio being calculated as the quotient of the company's equity and the applicable capital requirement.

In addition, when deciding on the amount of payment, investment fund companies should take into account:

A. Additional capital needs within twelve months after approval of the 2020 financial statements so that profit distribution would not affect their ability to meet capital requirements in subsequent months;

B. Current year's financial result;

C. Claims made by participants of investment funds against the company since the date of the last resolution on profit distribution regarding mismanagement of investment funds.

Universal pension companies

The KNF deems it necessary that the 2021 dividends be only paid by those universal pension companies that meet all of the following criteria:

A. Payment of no more than 100% of the 2020 net profit.

I. The company received the last aggregate BION score of 1 (good) or 2 (satisfactory);

II. In 2020 and in the period from the beginning of 2020 until adoption of the resolution on profit distribution, there was no instance of the company not meeting the statutory capital requirements;

III. As at 31 December 2020, the value of the company's equity, increased by the value of the Guarantee Fund attributable to the company, was not less than 1.25% of the net asset value of all the pension funds managed by the company;

IV. As at 31 December 2020, the value of the company's liquid assets[3], increased by the value of the Guarantee Fund attributable to the company, was not less than 1.25% of the net asset value of all the pension funds managed by the company.

B. Payment of more than 100% of the 2020 net profit.

I. The company received the last aggregate BION score of 1 (good);

II. The company meets criteria II-IV listed in letter A;

III. Amounts paid cannot cause the 2021 value of the company's liquid assets, increased by the value of the Guarantee Fund attributable to the company, to be less than 2.00% of the net asset value of all the pension funds managed by the company.

Additional non-numerical criteria applicable to the criteria under letters A and B:

1) dividend payments cannot reduce the value of equity and, as appropriate, liquid assets, increased by the value of the Guarantee Fund assets attributable to the company, below the level specified in criterion III and in criterion IV referred to in letter A over 12 months since approval of the 2020 financial statements, subject to criterion III under letter B,

2) when making the decision on profit distribution, the company should take into account additional capital needs within 12 months after approval of the 2020 financial statements in connection with management of defined-date funds in accordance with the Act of 4 October 2018 on Employee Capital Plans (i.e. Journal of Laws of 2020, item 1342, hereinafter: “Act on Employee Capital Plans”);

3) when making the decision on profit distribution, the company should take into account additional capital needs related to implementation of the solutions resulting from the bill of 13 February 2020 amending certain acts in connection with the transfer of assets from open pension funds to individual pension accounts (hereinafter: “Amending Act”) to enter into force in 2021, in particular additional capital needs related to transformation of the universal pension fund company into an investment fund company, arising from the Act of 27 May 2004 on investment funds and management of alternative investment funds (Journal of Laws 2020, Item 95, hereinafter the “Act on Investment Funds”).

[3]The following are considered liquid assets: securities issued by the State Treasury or the National Bank of Poland, securities guaranteed or backed by the State Treasury or the National Bank of Poland, receivables from OFE under fees on contributions and management fees, cash and other monetary assets, and other short-term financial assets.

Brokerage Houses

The KNF deems it necessary that the 2021 dividends be only paid by those brokerage houses that meet all of the following criteria:

A. Dividends of no more than 75% of the 2020 net profit:

I. for the entities subject to the capital adequacy standards under Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (OJ L 176 of 27/06/2013 as amended, hereinafter: "Regulation 575/2013") as of 31 December 2020:

- core capital Tier 1 ratio of at least 6%;
- capital Tier 1 ratio of at least 9%;
- combined capital ratio of at least 14%;

II. for entities not subject to capital adequacy standards according to Regulation 575/2013 as at 31 December 2020, the ratio which is the share of equity in total assets is at least 50%;

III. the last supervisory grade assigned in the BION process is 1 or 2;

IV. in 2020 and until the date of approval of the financial statements and adoption of the resolution on 2020 profit distribution the entity did not violate the provisions on capital requirements contained in Regulation 575/2013 and the Act of 29 July 2005 on trading in financial instruments (Journal of Laws of 2020, item 89, as amended) and the provisions on large exposure limits, excluding violation of limits related to clients' assets.

B. Dividends of no more than 100% of the 2020 net profit:

I. meets all the criteria listed in letter A;

II. for the entities subject to capital adequacy standards in accordance with Regulation 575/2013, the criteria referred to in letter A (I) are met at the end of each quarter in 2020;

III. for the entities not subject to capital adequacy standards in accordance with Regulation 575/2013, the criterion referred to in letter A (II) is met at the end of each quarter in 2020.

C. Dividends exceeding the 2020 net profit:

I. meets all the criteria listed in letter A and reported a net profit for 2020;

II. the last supervisory grade assigned in the BION process is 1;

III. for the entities subject to capital adequacy standards in accordance with Regulation 575/2013, which resolve to pay dividends before 26 June 2021:

- core capital Tier 1 ratio cannot fall below 12% as a result of the dividends resolution;
- capital Tier 1 ratio cannot fall below 15% as a result of the dividends resolution;
- combined capital ratio cannot fall below 20% as a result of the dividends resolution;

IV. for the entities not subject to capital adequacy standards in accordance with Regulation 575/2013, which resolve to pay dividends before 26 June 2021, the ratio which is the share of equity in total assets cannot fall below 75% as a result of the dividends resolution;

V. for the entities which resolve to pay dividends on or after 26 June 2021 (already subject to Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on prudential requirements for investment firms and amending Regulations (EU) 1093/2010, (EU) 575/2013, (EU) 600/2014 and (EU) 806/2014 (OJ L 314 of 05/12/2019, hereinafter: "Regulation 2019/2033")):

- the ratio defined in Article 9(1)(a) of Regulation 2019/2033 cannot fall below 150% as a result of the dividends resolution;
- the ratio defined in Article 9(1)(b) of Regulation 2019/2033 cannot fall below 187.5% as a result of the dividends resolution;
- the ratio defined in Article 9(1)(c) of Regulation 2019/2033 cannot fall below 250% as a result of the dividends resolution.

The KNF recommends that the conditions referred to in Letter C be met, also when applying for a permit to buy back own shares.

In addition, when deciding on the dividend amount, brokerage houses should take into account additional capital needs within twelve months after approval of the 2020 financial statements, as well as the brokerage house's current financial situation at the time of approval of the financial statements and adoption of the resolution on 2020 profit distribution, in particular, the amount of the current financial result of the brokerage house.

Also, it is recommended that when deciding on the dividend amount, the costs related to preparation by brokerage houses for implementation of solutions arising from the planned entry into force of regulations specifying prudential requirements for investment firms be taken into account (Regulation 2019/2033 and Directive of the European Parliament and of the Council 2019/2034 of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU, 2014/65/UE (OJ L 314 of 05/12/2019)). When deciding on dividend payments, brokerage houses should also take into account the need to ensure the appropriate amount and structure of own funds in relation to the new capital requirements set out in Regulation 2019/2033, which enters into force on 26 June 2021.

At the same time, it should be noted that brokerage houses which are required under applicable laws to maintain additional capital requirements must increase the ratios referred to in letter A.I by the additional capital requirements.