KNF | KOMISJA NADZORU FINANSOWEGO

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KNF's stance on the dividend policy in 2021

On 16 December 2020, the Polish Financial Supervision Authority (KNF) unanimously approved its stance on the dividend policy of commercial banks, cooperative banks and affiliation banks, insurance undertakings, reinsurance undertakings, insurance-and-reinsurance undertakings, mutual fund management companies, universal pension fund management companies and brokerage houses in 2021. Each one of these sectors will receive recommendations in the form of a letter from the Chairman of KNF.

The direct aim of KNF's dividend policy is to ensure stability of the Polish financial sector through adaptation of the capital base of the supervised entities to the level of their risk and protection of the recipients of the financial services provided by such entities.

Commercial banks

Considering:

- significant uncertainty regarding further developments related to the COVID-19 pandemic,
- temporary nature of the solutions applied by banks to improve their capital standing during the pandemic,
- continuing cautious EU regulatory stances regarding dividend limitations and other forms of reduction of capital resources,
- change of EBA's guidelines extending the moratoria

KNF considers it necessary for commercial banks to withhold the payment of dividend in H1 2021.

The Polish Financial Supervision Authority also expects that no other actions will be taken, in particular, actions falling outside the scope of their ongoing business and operating activity that could lead to lowering their capital base, without consultation with the regulatory authority. This applies also to dividend payment from retained earnings from prior years and repurchase of treasury shares. KNF expects that each such operation will be preceded by a prior consultation with the regulatory authority and will be subject to its positive outcome.

The Polish Financial Supervision Authority's stance on the dividend policy of commercial banks in H2 2021 will be presented separately after analyzing the financial standing of the banking sector in the first half of the year.

Cooperative banks and affiliation banks

KNF considers it necessary to adopt the following principles of the dividend policy of cooperative banks and affiliation banks in 2021:

1. Affiliation banks should 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.
2. Cooperative banks whose financial standing deteriorated, i.e. the y/y profit dropped by more than 30% or own funds decreased, should refrain from dividend payment.
3. Dividend payment in other cooperative banks should be effected on the following principles:
    1. up to 10% of net profit in cooperative banks that simultaneously meet the following criteria: banks that are not implementing remedial actions, whose final SREP score is no lower than 2.5 (master scale score of 1 or 2), banks that have a leverage ratio (LR) higher than 5%, a total capital ratio (TCR) no lower than 12.0%, a T1 capital ratio no lower than 10.0%, a CET1 common equity tier ratio no lower than 8.5% and that are not utilizing the option to reduce the basis for setting up special-purpose provisions.
    2. up to 5% of net profit in cooperative banks that simultaneously meet the following criteria: banks that are not implementing remedial actions, whose final SREP score is no lower than 2.5 (master scale score of 1 or 2), banks that have a leverage ratio (LR) higher than 5%, a total capital ratio (TCR) no lower than 12.0%, a T1 capital ratio no lower than 10.0%, a CET1 common equity tier ratio no lower than 8.5%.
    3. up to 3% of net profit in cooperative banks that simultaneously meet the following criteria: banks that are not implementing remedial actions, whose final SREP score is no lower than 2.50 (master scale score of 1 or 2), banks that have a leverage ratio (LR) higher than 5%, a total capital ratio (TCR) no lower than 10.5%, a T1 capital ratio no lower than 8.5%, a CET1 common equity tier ratio no lower than 7.0% – in respect of cooperative banks operating under institutional systems of protection,
    4. up to 2% of net profit in cooperative banks that simultaneously meet the following criteria: banks that are not implementing remedial actions, whose final SREP score is no lower than 2.50 (master scale score of 1 or 2), banks that have a leverage ratio (LR) higher than 5%, a total capital ratio (TCR) no lower than 10.5%, a T1 capital ratio no lower than 8.5%, a CET1 common equity tier ratio no lower than 7.0% – in respect of cooperative banks not operating under institutional systems of protection,
    5. up to 1% of net profit in cooperative banks that simultaneously meet the following criteria: banks that are not implementing remedial actions, whose final SREP score is in the range (2.51<=SREP<=3.25) (master scale score of 3), banks that have a leverage ratio (LR) higher than 5%, a total capital ratio (TCR) no lower than 10.5%, a T1 capital ratio no lower than 8.5%, a CET1 common equity tier ratio no lower than 7.0%.
4. Regardless of the foregoing principles, in connection with the COVID-19 pandemic and the possibility of deterioration of the banks' economic and financial standing in 2021, cooperative banks satisfying the criteria for dividend payment from the 2020 profit should consider retaining the profit in entirety and earmarking it to strengthen the capital base.
5. The KNF will individually address those cooperative banks that do not meet the criteria to pay a dividend from their 2020 net profit.

Insurance undertakings, reinsurance undertakings and insurance-and-reinsurance undertakings

Considering the standing of the insurance sector and the status of the capital base of individual insurance undertakings, reinsurance undertakings and insurance-and-reinsurance undertakings, KNF recommends that only undertakings which meet the following criteria may pay a dividend:

I. for distributions from the 2019 profit – the criteria defined in KNF's communiqué pertaining to the regulatory authority's stance on the assumptions underlying the dividend policy of commercial banks, cooperative banks and affiliation banks, insurance undertakings, reinsurance undertakings and insurance-and-reinsurance undertakings in 2020 dated 3 December 2019;
II. for distributions from the 2020 profit – all of the following criteria:
   - they have received a good or[1] satisfactory SREP risk score for 2019[2];
   - in the various quarters of 2020 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));
   - in 2020 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;
   - as at 31 December 2020, the level of own funds, without deducting the expected dividends, was at the level of at least 175% of the capital requirements for insurance undertakings, reinsurance undertakings, insurance-and-reinsurance undertakings operating in section I and at least 150% of the capital requirements for insurance undertakings, reinsurance undertakings, insurance-and-reinsurance undertakings operating in section II.

Insurance undertakings, reinsurance undertakings, insurance-and-reinsurance undertakings satisfying the above criteria may pay a dividend in the maximum amount of 100% of the profit generated in 2019 and 50% of the profit generated in 2020, however the coverage of capital requirements (after deducting the expected dividends from own funds) as at 31 December 2020, and for the quarter in which the dividend was paid, will be at the level of at least 175% for insurance undertakings, reinsurance undertakings, insurance-and-reinsurance undertakings operating in section I and at least 150% for insurance undertakings, reinsurance undertakings, insurance-and-reinsurance undertakings operating in section II.

Insurance undertakings, reinsurance undertakings, insurance-and-reinsurance undertakings satisfying the above criteria, when deciding on the level of dividends, should take into account their additional capital needs within the period of 12 months from the approval date of the 2020 financial statements, which may result, among others, from changes in the market and legal environment, in particular from the high degree of uncertainty about the future evolution of the coronavirus pandemic, hence the possible further adverse consequences for the insurance, reinsurance and insurance-and-reinsurance undertakings.

Mutual fund management companies

KNF considers it necessary recommend that a dividend to be paid in 2021 solely by those mutual fund management companies that meet all of the criteria below:

A. Disbursement of no more than 75% of their 2020 net profit

[1]The risk score was given according to the micro scale (good score, i.e. 1.00 (from 1.00 to 1.74); satisfactory score, i.e. 2.00 (from 1.75 to 2.49); score raising concerns, i.e. 3.00 (from 2.50 to 3.24); unsatisfactory score, i.e. 4.00 (from 3.25 to 4)).

[2]*ibidem*

I. in 2020 and during the period from the outset of 2021 up to the date of adopting the resolution on distributing the 2020 profit, the mutual fund management company did not breach the regulations on statutory capital requirements;
II. the mutual fund management company obtained the final SREP score of 1 or 2;
III. the measures taken, including the method of profit distribution, will not lead to a reduction in the mutual fund management company's liquid assets 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 manages defined date funds 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 minus the value of treasury shares, below the level of 150% of the requirement stemming from Article. 59 sec. 1 item 2 of the Employee Capital Accumulation Schemes Act.
IV. the profit distribution will not cause the capital requirements coverage ratio to fall below 1.5, where the capital requirements coverage ratio is computed as the quotient of the management company's equity and the capital requirements level in force.

B. Disbursement of no more than 100% of the 2020 net profit
   I. the mutual fund management company satisfies criteria I-III listed in letter A;
   II. 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.

C. Disbursement of more than 100% of the 2020 net profit taking into account the unpaid part of the net profit
   I. the mutual fund management company satisfies criterion I listed in letter B;
   II. the mutual fund management company obtained the final SREP score of 1;
   III. the profit distribution will not cause the capital requirements coverage ratio to fall below 2.5, where the capital requirements coverage ratio is computed as the quotient of the management company's equity and the capital requirements level in force.

Additionally, when making the decision pertaining to the amount of the distribution, mutual fund management companies should take into account:

A. their additional capital needs within a 12 month outlook from the time of approving the 2020 financial statements such that the method of profit distribution does not exert an influence on the ability to meet capital requirements in subsequent months;
B. the amount of the financial result from the current year;
C. claims reported by participants of the mutual funds against the management company in connection with improper management of mutual funds during the period from the date of adopting the last resolution on profit distribution.

Universal pension fund management companies

KNF considers it necessary recommend that a dividend to be paid in 2021 solely by those pension fund companies that meet all of the criteria below:

A. Disbursement of no more than 100% of the 2020 net profit
   I. the management company has received a final SREP score of 1 (good) or 2 (satisfactory);

II. in 2020 and during the period from the outset of 2020 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;

III. as at 31 December 2020 the equity of a management company plus the value of the Indemnity Fund attributable to the management company represents no less than 1.25% of the net asset value of all pension funds managed by the management company;

IV. as at 31 December 2020 the liquid assets[3] of the management company plus the value of the Indemnity Fund attributable to the management company represents no less than 1.25% of the net asset value of all pension funds managed by the management company;

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

I. the management company has received a final SREP score of 1 (good);

II. the management company satisfies criteria II-IV listed in letter A;

III. the disbursement amount may not cause that in 2021 the amount of liquid assets of the management company plus the value of the Indemnity Fund attributable to the management company represents less than 2.00% of the net asset value of all pension funds managed by the management company.

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

1) the payment of a dividend may not 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 specified in letter A within the 12 month outlook from the time of approving the 2020 financial statements, subject to criterion III in letter B,
2) when making the decision pertaining to the distribution of profit, the management company should incorporate its additional capital needs within a 12 month outlook from the time of approving the 2020 financial statements associated with the management of defined date funds in accordance with the Employee Capital Accumulation Schemes Act of 4 October 2018 (consolidated text in Journal of Laws of 2020, Item 1342, hereinafter referred to as the "Employee Capital Accumulation Schemes Act"),
3) when making the decision pertaining to the distribution of profit, the management company should incorporate its additional capital needs associated with implementation of solutions arising from the bill of the Act of 13 February 2020 amending certain acts in connection with the transfer of funds from open-end pension funds to individual retirement accounts (hereinafter referred to as the "Amendment Act"), whose provisions are expected to enter into force in 2021, in particular additional capital needs associated with transformation of a pension fund management company into a mutual fund management company, following from the Act on Mutual Funds and Management of Alternative Mutual Funds of 27 May 2004 (Journal of Laws of 2020, Item 95, hereinafter referred to as the "Act on Mutual Funds").

Brokerage houses

KNF considers it necessary recommend that a dividend to be paid in 2021 solely by those brokerage houses that meet all of the criteria below:

[3] The following are deemed to be liquid assets: securities issued by the State Treasury or National Bank of Poland, securities guaranteed or secured by the State Treasury or National Bank of Poland, 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.

A. A dividend totaling no more than 75% of their 2020 net profit:

I. for entities subject to the capital adequacy norms in accordance with 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 referred to as "Regulation No 575/2013") as at 31 December 2020:
- the Tier 1 common equity ratio is at least 6%;
- the Tier 1 equity ratio is at least 9%;
- the total capital ratio is at least 14%;

II. in respect of entities that are not subject to the capital adequacy standards in accordance with Regulation No 575/2013 as of 31 December 2020, the ratio of equity to total assets is at least 50%;

III. the last regulatory assessment assigned in the SREP process is 1 or 2;

IV. in 2020 and up to the date of approving the financial statements and adopting the resolution on profit distribution for 2020 the entity in question has not violated the regulations regarding capital requirements set forth in regulation 575/2013 and the Financial Instruments Trading Act of 29 July 2005 (Journal of Laws of 2020, Item 89 as amended) and the regulations pertaining to large exposure limits, excluding limit breaches pertaining to clients' cash.

B. A dividend totaling no more than 100% of their 2020 net profit:

I. the entity 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 were met at the end of each quarter in 2020;

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 was met at the end of each quarter in 2020.

C. A dividend totaling more than their 2020 net profit:

I. the entity meets all the criteria enumerated in letter A and recorded a net profit for 2020;

II. the last regulatory assessment assigned in the SREP process is 1;

III. entities that are subject to the capital adequacy standards in accordance with Regulation No 575/2013, which adopt a resolution to pay a dividend before 26 June 2021:
- the Tier 1 common equity ratio may not, as a result of adoption of the resolution to pay a dividend, drop below 12%;
- the Tier 1 equity ratio may not, as a result of adoption of the resolution to pay a dividend, drop below 15%;
- the total capital ratio may not, as a result of adoption of the resolution to pay a dividend, drop below 20%;

IV. entities that are not subject to the capital adequacy standards in accordance with Regulation No 575/2013, which adopt a resolution to pay a dividend before 26 June 2021 the ratio being the percentage of equity in total assets, may not, as a result of adoption of the resolution to pay a dividend, drop below 75%;

V. for entities which adopt a resolution to pay a dividend on 26 June 2021 or later (are subject to already prevailing Regulation (EU) No 2019/2033 of the European Parliament and of the Council of 27 November 2019 on prudential requirements for investment firms and amending Regulation (EU) No 1093/2010, (UE) No 575/2013, (UE) No 600/2014 and (UE) No 806/2014 (OJ L 314 of 05.12.2019, as amended, hereinafter referred to as "Regulation No 2019/2033")):

- the ratio specified in Article 9(1)(a) of Regulation No 2019/2033 may not, as a result of adoption of the resolution to pay a dividend, drop below 150%;
- the ratio specified in Article 9(1)(b) of Regulation No 2019/2033 may not, as a result of adoption of the resolution to pay a dividend, drop below 187.5%;
- the ratio specified in Article 9(1)(c) of Regulation No 2019/2033 may not, as a result of adoption of the resolution to pay a dividend, drop below 250%.

KNF recommends satisfaction of the conditions referred to in condition C also in the case of applying for a permit to purchase treasury shares.

In addition, when making the decision concerning the dividend amount brokerage houses should take into account additional capital needs within the twelve month outlook from the time of approving the 2020 financial statements, and the current financial standing of the brokerage houses at the time of approval of the financial statements and adoption of the resolution on distribution of the 2020 profit, in particular the amount of the recorded financial result of the brokerage house.

In addition, it is recommended that when making the decision concerning the dividend amount brokerage houses should take into account the costs associated with preparation of the brokerage houses for implementation of the solutions following from the planned entry into force of the regulations defining the prudential requirements for investment firms (Regulation No 2019/2033 and Directive (EU) 2019/2034 of the European Parliament and of the Council 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 and 2014/65/EU (OJ UE L 314 of 05.12.2019)). When making the decision to pay a dividend brokerage houses should take into account the necessity to ensure an appropriate level and structure of own funds in relation to the new capital requirements specified in Regulation No 2019/2033, which enters into effect on 26 June 2021.

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