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The issues of regulatory environment of Bank Gospodarstwa Krajowego operation with reference to European standards for public development banks. Current situation and own proposals for changes

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The purpose of this article is to point out the BGK's exemption from the CRDIV/CRR package regulations and propose an idea for amending the Bank Gospodarstwa Krajowego Act of March 14, 2003 with a view to the proportionality of solutions related to prudential and supervisory standards and the priority of tasks entrusted to the Bank Gospodarstwa Krajowego by the Polish State. In the article, the Author attempts to demonstrate that introducing changes in BGK's regulatory environment would be of advantage from the point of view of the Bank itself, its customers and economic development. The Author proposes two systemic solutions related to amending the BGK Act, i.e. the statutory determination of zero risk weight and separate limits of concentration per capital group

Keywords: public development bank, Bank Gospodarstwa Krajowego, risk weight, large exposure, regulatory environment.

Problematyka otoczenia regulacyjnego funkcjonowania Banku Gospodarstwa Krajowego w odniesieniu do standardów europejskich państwowych banków rozwoju. Stan obecny i autorskie propozycje zmian

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Celem niniejszego artykułu jest zwrócenie uwagi na wyłączenia Banku Gospodarstwa Krajowego spod regulacji pakietu CRDIV/CRR oraz przedstawienie koncepcji projektu nowelizacji ustawy z dnia 14 marca 2003 r. o Banku Gospodarstwa Krajowego w kontekście proporcjonalności rozwiązań w zakresie norm ostrożnościowych i nadzorczych oraz priorytetów zadań stawianych Bankowi Gospodarstwa Krajowego przez Państwo. W artykule autor podejmuje się próby wykazania, że wprowadzenie zmian w otoczeniu regulacyjnym BGK byłoby korzystne z punktu widzenia samego Banku, jego klientów oraz rozwoju gospodarczego. Autor proponuje dwa systemowe rozwiązania w zakresie nowelizacji ustawy o BGK, tj. ustawowe ustalenie zerowej wagi ryzyka oraz odrębne limity koncentracji na grupę kapitałową.

Słowa kluczowe: państwowy bank rozwoju, Bank Gospodarstwa Krajowego, waga ryzyka, duże ekspozycje, otoczenie regulacyjne.

JEL: K220, G210, G280

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Introduction

During works on the 2003 Treaty of Accession, a concept was developed of placing the Bank Gospodarstwa Krajowego ("BGK" or "Bank") on the list of credit institutions exempted from the EU banking law (i.e. the then effective Directive 2000/12/EC of the European Parliament and the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions). The above position was based on that, during the pre-Treaty negotiations (Olszówka, Skuza, 2003):

1) the BGK was primarily the State's financial policy instrument, focused mostly on the performance of tasks entrusted to it by the Polish government;
2) due to the kind and scope of its activities, the BGK was not a competitor for other banking entities;
3) the BGK was not treated as part of the public finances sector but instead as an institution supporting the implementation of Polish economic policy by market methods;
4) the main tasks entrusted to BGK by the government included servicing funds established by means of statutory instruments;
5) in the future, the BGK was to remain a state-owned bank;
6) the tasks related to financing specific government programmes were performed in line with UE-approved principles of supporting economic development;
7) the exemption would allow the BGK to be used for performing general economic and social tasks outlined by the State (such as promoting exports, implementing the State policy with respect to selected sectors of the economy, supporting large investment projects).

As a consequence of the above, pursuant to Article 2(5)(18) of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("CRDIV"), the BGK has been subjectively exempted from the application of the directive. By reference to the provisions of the said directive, the BGK is also exempted from the need to comply with standards and regulations found in the provisions of Regulation 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 ("Regulation no 575/2013" or "CRR"), without the need to implement that regulation in domestic law.

The purpose of this article is to point out the BGK's exemption from the CRDIV/CRR package regulations and propose an idea for amending the Bank Gospodarstwa Krajowego Act of March 14, 2003 with a view to the proportionality of solutions related to prudential and supervisory standards

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and the priority of tasks entrusted to the Bank Gospodarstwa Krajowego by the Polish State. The draft proposal would be based on experience obtained during BGK operations and on standards commonly applied to European public development banks. In the article, the Author attempts to demonstrate that introducing changes in BGK's regulatory environment would be of advantage from the point of view of the Bank itself, its customers and economic development. To this end, existing literature on the issue, in particular regulatory solutions, has been subjected to analysis (including comparative analysis) and critique. During works on the BGK's case the Author noticed the virtual absence of existing literature on this topic, so the Author decided to fill this gap with his own publications.

I. Specialized solutions (*lex specialis*) with respect to the Banking Act in the context of the Bank Gospodarstwa Krajowego operations

The special protection afforded to the BGK derives from the legal instruments establishing that entity. Article 3(3) of the Bank Gospodarstwa Krajowego Act of March 14, 2003 stipulates that the minister responsible for public finances provides the BGK with own funds at a level that ensures the performance of BGK tasks, as well as with means for maintaining the cash flow liquidity standards referred to the in the Banking Act provisions. It needs to be emphasized that the above obligation refers to all tasks of the BGK, not just those entrusted by the State. To meet this obligation, the minister responsible for financial institutions disposes of an appropriate set of means specified in Article 3a (liquidity guaranteed by the Treasury), Article 5c (recapitalization with Treasury bonds) and Article 5c (possibility of granting a subordinate loan from state budget funds) of the Bank Gospodarstwa Krajowego Act of March 14, 2003. On the other hand, Article 3(4) of the Bank Gospodarstwa Krajowego Act suggests overtly that when the BGK is liquidated, its obligations are taken over by the Treasury.

The BGK has been classified as an entity that cannot become bankrupt. Pursuant to Article 6(4) of the Bankruptcy and Reorganization Act, institutions and legal persons established by statute cannot be declared bankrupt, unless otherwise stipulated in the Act; neither can entities established in fulfillment of a statute-imposed obligation. A confirmation of the BGK's subjective exemption from bankruptcy is the current wording of Article 3(2) of the Bank Gospodarstwa Krajowego Act, which definitively states that Article 6(4) of the Bankruptcy and Reorganization Act does apply to the BGK (Skuza, 2013). This is because the Treasury, local government units, public autonomous health care centers, institutions and legal persons established by statute, natural persons running an agricultural farm, institutes of higher learning etc. cannot be declared bankrupt. The BGK was (expressly)

classified as an "institution and legal person established by statute". Apart from BGK, examples of such institutions and legal persons include the Bank Guarantee Fund, Krajowy Depozyt Papierów Wartościowych S.A. and the BGK-owned company Krajowy Fundusz Kapitałowy S.A. (Opinion of the Ministry of Justice, 2009).

BGK's exemption from bankruptcy was confirmed in the opinion of the Ministry of Justice of August 25, 2009, ref. no. DL-P III 4290-30/09. Pursuant to Article 6(4) of the Bankruptcy and Reorganization Act, institutions and legal persons established by statute or in fulfillment of a statute-imposed obligation cannot be declared bankrupt, unless otherwise stipulated in the Act. While the Bank Gospodarstwa Krajowego was actually established by a regulation of the President of the Republic of Poland of May 30, 2014 concerning the merger of State Credit Institutions (entities established by statute) into the Bank Gospodarstwa Krajowego, the hierarchy of legal sources prevailing in the Second Polish Republic allowed the President to issue regulations having the force of statute (Landau, 1998). For this reason, the statutory provenance of the BGK cannot raise any doubts, and consequently the bank is exempted from bankruptcy under Article 6(4) of the Bankruptcy and Reorganization Act (Opinion of the Ministry of Justice, 2009). This means that the Bank Gospodarstwa Krajowego cannot become bankrupt, it can however be liquidated (by means of a separately enacted regulation) (Piotrowska, 2014).

As regards prudence standards, the current domestic solutions found in the Banking Act do not contain any essential exemptions or special provisions for the BGK in comparison with norms applicable to commercial banks. An optional exception for state-owned banks (in practice solely for the BGK) is Article 128b of the Banking Act that grants the Polish Financial Supervision Authority("FSA") the possibility to exempt, on request of a state-owned bank, some or all activities of that bank related to servicing funds established, entrusted or transferred to the bank under separate statutes or for the purpose of implementing government programmes, from the need to comply with certain requirements and norms referred to in the Banking Act. Additionally, the FSA may, on request of a state-owned bank, issue a permit that entrusts another bank with assessing the ability to pay obligations and analyzing the risk of defaulting on payments in the following cases (Skuza, 2009):

1) the other bank has received from the state-owned bank a guarantee or surety with respect to a loan portfolio, understood as a set of individual loans granted by the former, with the total limit of guarantees or sureties in a specific period being defined in an agreement between the other bank and the state-owned bank;
2) the other bank has received a guarantee or surety with respect to proper performance of other obligations, understood as a set of individual civil law agreements, with the total limit of guarantees or sureties in a

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specific period being defined in an agreement between the other bank and the state-owned bank.

II. Examples of principles of regulatory environments of other European public development banks[1]

The Author would like to review the public development banks regulations in two areas: the statutory determination of zero risk weight and *lex specialis* solutions for these banks (some special exemptions from the obligations of the general banking law). The research group consists of the public development banks from the oldest countries of the UE (Germany, France, Italy), the middle-age members (Denmark, Spain, Finland) and the "youth" (Hungary, Slovenia, Croatia).

II.1. Kreditanstalt für Wiederaufbau

At the Community level, the German Kreditanstalt für Wiederaufbau ("KfW") has been exempted from the CRDIV under Article 2(5)(6) of the directive and from the supervision of the European Central Bank ("ECB") in the Single Supervisory Mechanism ("SSM"). KfW has also been granted a number of other privileges, such as exemption from Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("EMIR").

At the national level, KfW operates on the basis of a dedicated statute ("Gesetz über die Kreditanstalt für Wiederaufbau"), which entitles it to call itself a "bank" and "bank group". Until 2013, KfW was not subject to the German banking law. In July 2013, an amendment of the KfW Act was adopted, granting the body supervising the entity (i.e. the Minister of Finance) the authority to specify by means of a regulation the cases in which specific provisions of the Banking Act and Regulation No 575/2013 may be applied to KfW. Such a regulation was issued by the Minister of Finance in September 2013, and Article 6 thereof stipulated that KfW was to be covered by BaFin supervision (the German FSA). Article 7 of Regulation No 575/2013, providing for a possibility of the regulatory body to waive certain requirements with respect to specific institutions on an individual basis, is also applicable to KfW. Additionally, in accordance with the said regulation of the Minister of Finance, most provisions of Regulation No 575/2013 and the banking law do apply to KfW itself and the KfW banking group. KfW, and the KfW group as a whole, is subject to provisions in areas such as consolidation, own funds, capital requirements, large exposures, exposures to transferred credit risk and financial leverages. On the other hand, regulations concerning liquidity do not apply to KfW.

[1] On the basis of legal acts and BGK's materials.

II.2. Caisse des dépôts et consignations

At the Community level, the French Caisse des dépôts et consignations ("CDC") has been exempted from the CRDIV under Article 2(5)(11) of the directive and from the supervision of the ECB in the SSM.

In Article L 518-2 of the Monetary and Financial Code (*Code monétaire et financier*), CDC and its subsidiary companies have been defined as a group serving general interests of the State and economic development, while supporting the public policies of the government and regional authorities. The article also states the CDC mission, that is management of court deposits and pension funds, financing the construction of residential housing, and supporting national economy and regional development. Until 2014, CDC was not subject to any provisions of the French banking law. In February 2014, a decree was issued that made the CDC group subject to several provisions of the Monetary and Financial Code. The most important of these seems to be the obligation to maintain appropriate levels of liquidity and solvency.

CDC is not subject to the supervisory authority regulating the financial market ("AMF"), but only to the supervisory authority monitoring financial institutions, the Authorité de Contrôl Prudenciel ("ACP") affiliated with the Bank of France (CDC together with its subsidiary companies has been defined as a public group serving public interest and economic development).

CDC is not *explicite* fully guaranteed by the State, but pursuant to L 631-2 and L 640-2 of the Monetary and Financial Code cannot be declared bankrupt or liquidated. Its solvency does fall under State guarantees. These safeguards are treated as an *implicite* guarantee and treated (by rating agencies as well) as a proof of strong ties between the French government and CDC, with the consequence that the most important rating agencies award scores that are identical to the ratings of France. The strong ties with the French State are also reflected in the composition of the Supervisory Board that brings together, among others, members of parliament, judges of the Supreme Administrative Court, the president of the Central Bank and the Minister of Treasury. CDC has therefore a 0% risk weight for its obligations as a result of recognizing the indirect guarantee of the State and its classification as a Public Sector Entity ("PSE").

II.3. Cassa depositi e prestiti

The Italian Cassa depositi e presiti has been exempted from the CRDIV under Article 2(5)(12) of the Directive. CDP was founded in 1850 in Turin as a public trust fund for public funds and private deposits. In 2003, it was transformed into a joint stock company. CDP operates under a 2003 statute entitled "The urgent dispositions to support the development and improve the situation of public finances". According to that statute, CDP is subject to the provisions of title V of the banking law statute that deal

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with supervision over non-banking financial intermediaries. CDP is also subject to supervision by the Parliament Supervisory Committee and the Court of Accounts. In 2006, the Italian Central Bank decided to apply to CDP the requirement of holding appropriate foreign currency reserves.

The scope of CDP operation has been specified in its bylaws. In 2009, it was extended by direct financing of projects implemented in the public interest, financing of export, construction of social housing and support for the SME sector.

Under Article 5(8) of the 2003 statute, the organization and accounting of activities of the CDP conducted in general public interest and other activities have been separated. Introducing such separation was necessary to ensure compliance with the EU regulations concerning public support and competition law, especially since most sources of CDP financing are fully guaranteed by the State. This is because CDP has no full State guarantee for its activities (the State only guarantees mail assets, such as saving passbooks and mail bonds), resulting in a risk weight of 20% for CDP's obligations. Other activities of CDP that are financed from funds not covered by the guarantee may potentially be pursued in competition with other market participants.

II.4. Slovenska izvozna in razvojna banka, d.d. Ljubljana

The Slovenian development bank, Slovenska izvozna in razvojna banka, d.d. Ljubljana ("SID Bank"), is exempted from the CRDIV under Article 2(5)(20) of the directive. SID Bank is fully and irrevocably guaranteed by the State (however, pursuant to Article 13(2) of the SID Bank Act, the guarantee amount has been limited to 50 times the share capital). Thanks to this guarantee, SID Bank obligations have a 0% risk weight. According to Article 14(1) of the SID Bank Act, its activities are regulated by the Slovene Export and Development Bank Act, the Banking Act and the Commercial Code.

Article 14(3) of the SID Bank Act establishes the following exemptions in applying the banking law to the SID Bank:

1) for the calculation of large exposures, the SID Bank balance of assets which are guaranteed by the Republic of Slovenia according to Article 13 of the SID Bank Act is used as the basis for calculation instead of the share capital;
2) Article 14(4) of the SID Bank Act obliges the minister responsible for State finances to apply the procedure exempting the SID Bank from relevant EU directives;
3) the capital requirements applied to the SID Bank are one half the capital requirements normally applied to banks;
4) the SID Bank is exempted from mandatory application for a license to establish a branch in the territory of the Republic of Slovenia, a EU Member State or any other State;

5) regulations concerning guaranteed deposits do not apply to the SID Bank;
6) SID Bank is not entitled to accept deposits from natural persons;
7) according to Article 16 of the SID Bank Act, the Bank's activities are supervised by the Slovenian Central Bank, Insurance Supervision Agency and the Ministry of Finance as part of their competences.

II.5. Magyar Fejlesztési Bank Zártkörűen Működő Részvénytársaság

The legal status, duties and scope of activities of the Magyar Fejlesztési Bank Zártkörűen Működő Részvénytársaság are specified in Act XX of 2001 on Hungarian Development Bank Ltd. MFB has the status of a "specialized credit institution" that holds a banking license. The license restricts MFB activities both by territory (only operations in Hungary) and by function (only mandated activities).

MFB is subject to supervision of the Hungarian Financial Supervision Office. Because of the Community directive, some capital requirements specific to commercial banks are not applied to it.

Chapter IV of the MFB Act lists the following exemptions concerning the application of Act CXII of 1996 on credit institutions and financial enterprises to the MFB:

1) pursuant to Article 76 of the Act on credit institutions and financial enterprises that deals with capital requirements, paragraphs 2–5 of that article do not apply to the MFB, which means that the MFB has only the obligation to maintain an appropriate level of capital, but does not need to comply with additional capital requirements and notify each instance in which own funds drop below the level of 120% of required capital;
2) as regards large exposures (Article 79 of the Act on credit institutions and financial undertakings), paragraphs 2 and 3 concerning concentration limits are not applied, and in their place the following method of calculating large exposures is proposed by the MFB Act:
   a) the size of MFB exposure with respect to individual customers or groups of customers that are credit institutions cannot exceed 200% of MFB own funds,
   b) in the case of customers that are not credit institutions, aggregated exposure with respect to individual customers or groups of customers cannot exceed 35% of MFB own funds.

MFB explicitly enjoys the direct and irrevocable guarantee of the State pursuant to Article 5(1)(a) of the MFB Act. The guarantee covers all obligations of the MFB due to taken loans and credits and issued bonds. The guarantee limit is specified each year in the state budget. Due to the above solutions being in place, MFB has a 0% risk weight for its obligations.

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II.6. Finnvera Oyj/Finnvera Abp

The Finnish Finnvera Oyj/Finnvera Abp has been exempted from CRDIV under Article 2(5)(21) of the directive. Finnvera acts as a specialized credit agency that provides financing to venture capital undertakings, as well as credits for SMEs. The bank acts under statute no. 443/1998 (*Act on the State-Owned Specialized Financing Company*). Finnvera Oyj/Finnvera Abp is not subject to the provisions of the banking law. Supervision over Finnvera is conducted by the Minister of Economy and Employment.

Finnvera is a specialized credit institution whose obligations are explicitly guaranteed by the State as the owner (with a EUR 5 billion limit). The obligations of Finnvera have a 0% risk weight.

II.7. KommuneKredit

The Danish KommuneKredit is exempted from CRDIV under Article 2(5)(10) of the directive and its operations in Denmark are regulated solely by the KommuneKredit Act. Supervision over KommuneKredit is conducted directly by the Minister of Economy and Internal Affairs.

KommuneKredit is not a typical development bank but a financial agency owned by local government units that guarantee its obligations fully and irrevocably, resulting in 0% risk weight for the obligations. KommuneKredit finances only projects of local government units and their non-commercial subsidiary companies. The share of KommuneKredit in this market sector is about 90%.

II.8. Instituto de Crédito Oficial

The Spanish Instituto de Crédito Oficial ("ICO") conducts its activities under Royal Decree no. 706 of April 30, 1999 that adjusts ICO to operate in accordance with Act no. 6 of April 14, 1997 on the organization and functioning of State General Administration. ICO is subject to the same requirements as commercial banks (including prudential requirements) and the same tax provisions. It holds a banking license and is supervised by the Spanish central bank. At the Community level, ICO has been exempted from CRDIV under Article 2(5)(10) of the directive and from the supervision of the ECB in the SSM.

The risk related to ICO activities has the same weight as the risk related to activities of state administration, while risk borne for ICO by financial institutions is not subject to concentration limits.

II.9. Hrvatska Banka za Obnovu i Razvitak

The Croatian Hrvatska Banka za Obnovu i Razvitak ("HBOR") operates under the HBOR Act as a specialized financial institution with a public mandate.

According to Article 8 of the HBOR Act, the bank enjoys the full (i.e. unconditional, irrevocable and first demand) guarantee of the Republic

of Croatia. HBOR cannot be declared bankrupt, but only liquidated by a separate statute. Strong ties with the State are also reflected by the composition of the supervisory board which includes 6 members of the government, 3 members of parliament and the President of the Croatian Chamber of Commerce.

The main objective of HBOR actions is not the maximization of profit, but preserving its value. The annual report on bank activities must be approved by the parliament. HBOR generally acts in accordance with the banking law (but with some exceptions). At the Community level, it is not exempted from the CRDIV/CRR package (Croatia has been an EU member since 1 July 2013).

III. Own proposals of amendments in the Bank Gospodarstwa Krajowego Act

As conclusions drawn from the above examples showing the operation of European development banks and the review of regulations, the Author proposes two systemic solutions related to amending the BGK Act, i.e. the statutory determination of zero risk weight and separate limits of concentration per capital group.

III.1. Proposal to recognize zero risk weight for obligations of the Bank Gospodarstwa Krajowego

The foreign examples discussed in section II and the specialized solutions found in the BGK Act point towards a conclusion that the currently effective risk weight (50%) need not be maintained and that a reduced risk weight (0%) can be assigned to all BGK obligations in domestic currency.

Following are two proposals to amend the wording of the Bank Gospodarstwa Krajowego Act.

Proposal 1:

Amendment of Article 3 of the Bank Gospodarstwa Krajowego Act by adding paragraph X:

"X. BGK exposures denominated or financed in the Polish currency shall be assigned the risk weight specified for the Treasury.".

Proposal 2:

Amendment of Article 3 of the Bank Gospodarstwa Krajowego Act:

"3. The minister responsible for public finances shall provide the BGK with means to maintain:

1) the amount of own funds at a level guaranteeing the performance of BGK tasks referred to in Article 5;
2) the cash flow liquidity standards referred to in the provisions of the Banking Act of August 29, 1997 and of Regulation no 575/2013, and the timely settlement of obligations related to the fund disbursement referred to in Article 158(2) of the Banking Act of August 29, 1997

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– having in mind the need to cover the banking activity risk borne by BGK.

3a. The conditions and manner of providing the means referred to in paragraph 3 shall be specified in an agreement concluded between the minister responsible for public finances and the BGK.".

The above proposals seem to comply with the position taken by the Financial Supervision Authority in a letter of May 7, 2012, no. DRB/BRB 1/7111/9/5/12.

In that letter, the FSA approved the proposal of the Bank Gospodarstwa Krajowego to treat BGK's obligations related to guarantees or sureties granted in government programmes as obligations with a 0% risk weight (Piotrowska, 2014). In a justification for the above proposal, it was stated that *(...) provisions that are key for resolving the issue of assigning the resulting risk weight to BGK exposures are found in appendix no. 17 concerning the recognition of credit protection instruments. Based on the provisions of pars. 39–41 of appendix no. 17 to resolution 76/2010 of the FSA that concern guarantees and re-guarantees, it should be analyzed whether considering the credit protection granted to the Bank by the Treasury as a re-guarantee is acceptable under the provisions of the BGK Act and the Guarantees and Sureties Granted by the Treasury and Certain Legal Persons Act. Final authority should here be given to the wording of par. 40(1)(3) of appendix no. 17 to resolution 76/2010 of the FSA which states that a re-guarantee issued for a specific entity provides effective credit protection. Historical experience shows that the effectiveness of such protection is not lower than the effectiveness of protection provided by a direct guarantee issued by the re-guarantor. The solution found in Article 34d(1) of the Guarantees and Sureties Granted by the Treasury and Certain Legal Persons Act has been deemed sufficient. The article's wording is as follows: "For the purpose of implementing government programmes, the minister responsible for public finances shall provide means to increase the statutory fund of the Bank Gospodarstwa Krajowego". Of particular importance is the possibility of using this provision to conclude an appropriate civil law agreement with the Minister of Finance to regulate the manner of providing those means to the Bank (...). The Financial Supervision Commission expressed a view that "(...) the solutions found in the BGK Act and the Guarantees and Sureties Granted by the Treasury and Certain Legal Persons Act should be considered as meeting the conditions for re-guarantee found in appendix no. 17 of resolution 76/2010 of the FSA with respect to BGK activities related to implementing government programmes, and consequently, after CRM (Credit Risk Mitigation) is applied, allowing to use the resulting risk weight of the re-guarantor (i.e. the Treasury)".* (FSA, 2012).

III.2. Separate concentration limits due to involving entities with identical risk profile in the group

Given the tasks imposed on BGK and having in mind the circumstances in which the BGK operates, it appears reasonable to set up separate debt concentration standards. An example of such tasks and the possible resulting

difficulties in complying with certain prudential standards currently specified in the Banking Act while fully performing an entrusted task may currently be the Polish Investments Programme.

The objective of the Polish Investments Programme is to maintain in the economy the desired dynamics of investments in infrastructural projects with an extended time frame, while simultaneously using long-term financing and capital involvement.

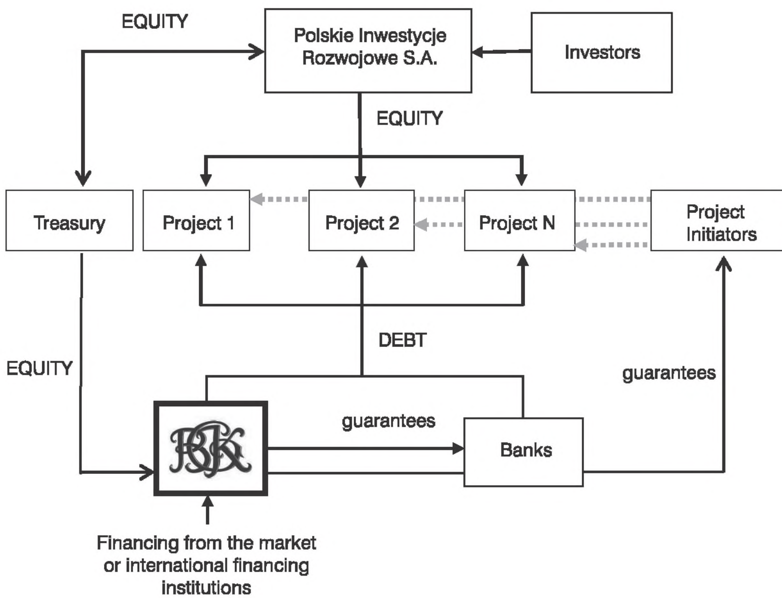

Figure 1. BGK instruments in the Polish Investments Programme. Source: www.bgk.com.pl, 2013.

Carrying out the Polish Investments Programme rests on two pillars that are supposed to ensure the financing of investment undertakings:

1) BGK – providing debt financing for investment undertakings;
2) the Polskie Inwestycje Rozwojowe S.A. company ("PIR") – capital investments in special purpose vehicles ("SPV") that undertake the investments, and *mezzanine* financing.

The activity of the BGK consists in particular in acting as an entity offering on market terms services complementary with respect to those of other commercial entities (providing the "last penny" necessary to finance the project) (www.bgk.com.pl, 2013; Skuza, 2013).

If the relationships between the BGK and PIR were restricted by involvement concentration limits at the affiliated entity group level pursuant to Article 71(1) of the Banking Act (involvement of PIR in SPVs), the

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effectiveness of the entire PIR scheme would be severely handicapped. It does not appear possible for PIR to become involved in SPVs (actually, in projects implemented by those entities) that would be classified as non-essential from the point of view of risk (i.e. if PIR did not have the decisive voice in managing the SPV), resulting in lack of necessity to recognize such involvement at the group level.

In assessing the affiliations between entities for the purpose of calculating the concentration of involvement, two basic kinds can be distinguished:

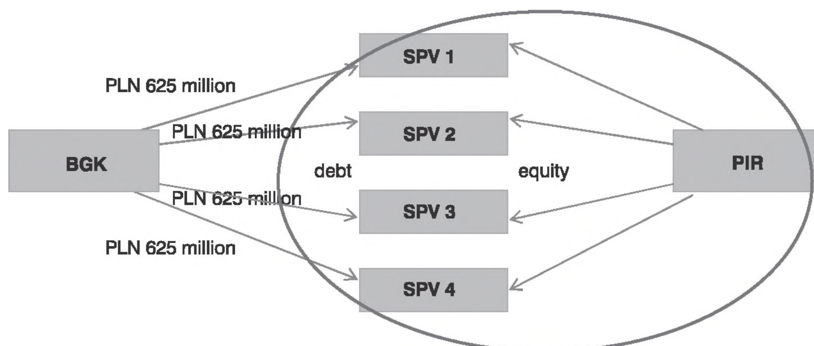
1) capital affiliations – when the affiliation is evidenced by a specific level of shares that one company holds in another;
2) other affiliations – such as economic, organizational and personal affiliations which are evidenced by the impact that the condition of one company has on another, not necessarily because of direct relationships (the companies are a joint risk for the Bank).

Following are simulations of projects that could have been carried out as part of the Polish Investments Programme, taking into account:

1) the currently effective provisions (maximum involvement in a group at the level of 25% of own funds);
2) proposed amendments to regulations (maximum involvement in a group at the level of 100% of own funds);
3) the currently effective provisions with the assumption that BGK own funds are increased to PLN 30,000 million;
4) the Hungarian model (maximum involvement in a group at the level of 35% of own funds);
5) in each project, BGK in tandem with PIR undertakes four SPV investments that together with PIR make up a concentration group. Calculations of the concentration ratio for specific projects have been presented with the assumed level of BGK own funds equal to about PLN 10,000 million.

Example 1.

Maximum possible BGK involvement per group is 25% of own funds.

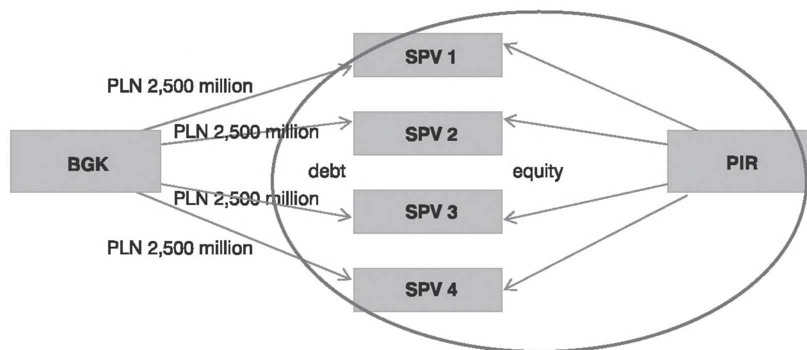


Source: BGK's materials and own calculations.

BGK in tandem with PIR undertakes four SPV investments that together with PIR make up a concentration group. Each SPV is financed directly by the BGK with an amount of PLN 625 million. The total involvement of BGK in the group is PLN 2,500 million, i.e. 25% of BGK's own funds.

Example 2.

The maximum possible involvement of BGK per group is 100% of own funds.



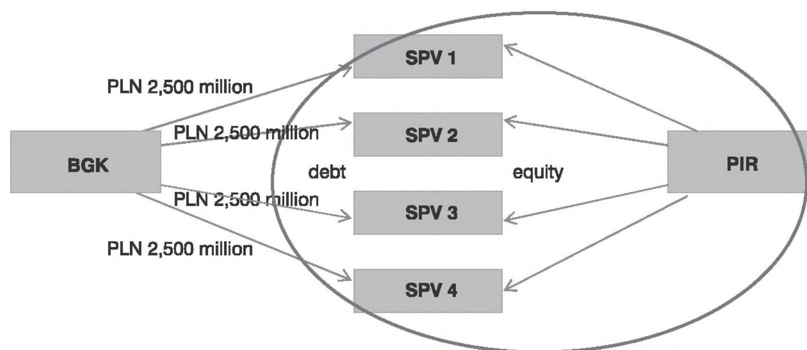
Source: BGK's materials and own calculations.

BGK in tandem with PIR undertakes four SPV investments that together with PIR make up a concentration group. Each SPV is financed directly by the BGK with an amount of PLN 2,500 million. The total involvement of BGK in the group is PLN 10,000 million, i.e. 100% of BGK's own funds.

In the above scenario, BGK's maximum possible involvement was increased by PLN 7,500 million (PLN 1,875 million per each SPV 1–4 investment) in comparison with Example 1.

Example 3.

Conditions necessary to reach the PLN 10,000 million involvement threshold with currently effective provisions. Maximum possible BGK involvement per group is 25% of own funds.



Source: BGK's materials and own calculations.

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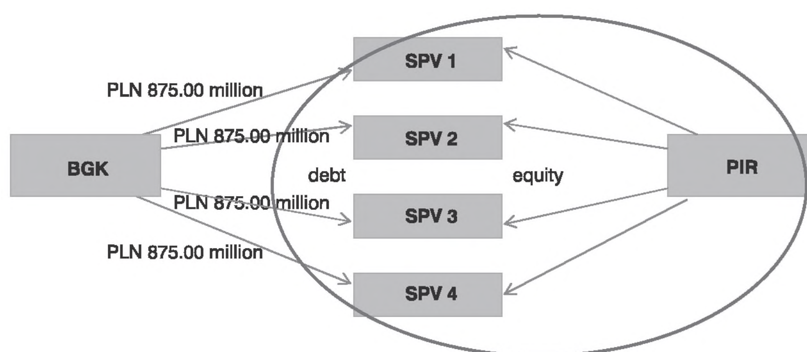
BGK in tandem with PIR undertakes four SPV investments that together with PIR make up a concentration group. Each SPV is financed directly by the BGK with an amount of PLN 2,500 million. The total involvement of BGK in the group is PLN 10,000 million, i.e. 100% of assumed BGK's own funds. SPV financing is not possible with the above figures.

Reaching the level of financing in Example 2 would require the bank to be recapitalized with an amount of PLN 20,000 million, i.e. raising its own funds to the level of PLN 30,000 million.

Example 4.

BGK's maximum possible involvement per group and single entity is 35% of own funds (example based on solutions adopted for MFB).



Source: BGK's materials and own calculations.

BGK in tandem with PIR undertakes four SPV investments that together with PIR make up a concentration group. Each SPV is financed directly by the BGK with an amount of PLN 875.00 million. The total involvement of BGK in the group is PLN 3,500 million, i.e. 35% of BGK's own funds.

In this scenario, BGK's maximum possible involvement was increased by PLN 1,000 million (PLN 250 million for each SPV 1–4 investment) in comparison with Example 1.

Summary

With respect to BGK's counterparts, the specialized credit institutions exempted at the Community level from the CRDIV, and hence from Regulation no 575/2013, a common practice is to exempt them from domestic banking law. The exemption can be total, partial, or allowing for considerable exceptions.

The development of the flagship Polish Investments Programme without taking the proposed changes into account may reach the barrier of concentration limit per PIR group; such a limit is not adequate for activities of the BGK as a development bank. In the view of the Author, adopting the solutions proposed in section III of this article would have the following benefits for:

1) financial risks and the economy (a 0% risk weight for all BGK obligations would cause an estimated decrease in the level of required capital in the Polish and foreign banking sector and increasing the potential of supporting programmes implemented in the financial perspective of 2014–2020, involving the utilization of Community funds, with particular emphasis on infrastructural investments and SME segment support);
2) the BGK (obtaining a 0% risk weight would allow the BGK to more easily obtain means for financing its activities, including means from the international market, which would be of considerable importance for costs of BGK financing and the BGK could more easily access long-term financing).

Failure to adopt the proposed solutions, i.e. to assign a weight risk of 0% to BGK's obligations, may as a result limit BGK's capability of procuring long-term financing for Polish economy from financial institutions at lower costs, as well as BGK's activities in the Polish Investments Programme, leading to incomplete utilization of BGK's credit, guarantee and surety potential.

Works are ongoing to transpose the provisions of the CRDIV/CRR package into Polish law. In the view of the Author, the specific character of legal solutions and BGK activities, as well as the objectives set for the Bank, including safe operation guaranteed by the Treasury, form a reasonable argument in favor of amending the BGK Act. Amending this statute should be a priority for legislative authorities so as to ensure an appropriate tool to support development and anti-cycle processes.

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