A look at the problem of safety of the polish banking sector examined through the perspective of the monetary policy conducted

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The problem of the banking sector functioning in the market economy conditions inclines to raise a general question regarding the place and functions of the central bank in the market economy. The question is so significant as the central bank (the National Bank of Poland) is not a typical financial institution. On the one hand, it has significant features allowing for the classification thereof as an institution of public nature. On the other hand, functioning thereof to a great extent is related to the market economy banking system. Nevertheless, it is fundamental that in each of these functions it closely interacts with the financial (banking) sector providing specific goods which assume the shape of either monetary policy parameters or regulations, e.g. with respect to payment settlements, or supervisory regulations. It would be extremely interesting to investigate into the interpenetration of these functions of the central bank as well as into the development of the monetary policy of the National Bank of Poland during the system transformation which had occurred in Poland since 1989. From a time perspective, the most important appears to be the fact that the National Bank of Poland has gained thorough autonomy with respect to determining the inflation objective and selecting the instruments of accomplishment thereof. This results from the fact that the statutory objective of the National Bank of Poland is to maintain a stable price level which in common understanding means stabilisation of inflation at a low level.

At the same time it ought to be emphasised that currently the National Bank of Poland accomplishes its statutory objective through the strategy of direct inflation objective which was adopted in 1998 by the Monetary Policy Council. As part of the strategy, the National Bank of Poland determines the inflation objective (determining the range of acceptable deviations quantitatively) which then is to be accomplished through shaping appropriate level of interest rates. This approach, quite common in the current practice of central banks, requires from the bank accurate diagnosis of the monetary impulse transmission mechanism occurring in the economy, for which the primary impulse is the decision of the central bank on the level of interest rates. Selection of a strategy of direct inflation objective not only did and does require monitoring monetary impulse transmission channels but also a significant change with respect to selecting a set of data describing the economy. First of all, attention is focused on the information which describes and explains inflation processes.

In general, attention ought to be focused on a problem which has a significant impact on the effectiveness of the monetary policy as well as on the safety of the banking sector functioning. Most of all, it is the stability of the banking sector. What justifies the interest? The role of the banking sector in the process of transmission of policy signals to the real sector. Our considerations have been deliberately limited to the banking sector although the role ought to be discussed with respect to the entire financial sector. The limitation is justified by the fact that the financial system in Poland has been dominated by the banking sector concentrating approximately 67% of the assets of the financial sector and the fact that vast majority of banks perform the role of a financial broker at the financial market between savers and investors. If we assume that the banking sector is an important, one might say – fundamental market of monetary impulse transmission to the real sector, then any disturbances in the functioning thereof will affect the impact of the monetary policy instruments on the economy. This fact is a sufficient premise for the central bank to be interested in activities aimed at the stability of the banking sector, stability defined as a condition in which the 'sector performs all its functions in a continuous and effective manner even in the event of occurrence of unexpected and disadvantageous disturbances (shocks) of significant scale[1]'.

The problem of stability is the field of interest of central banks which has assumed particular importance in recent years. The interest does not at all times translate into disseminating the fact among economists. As it has already been mentioned, the interest is rooted in the role of the banking sector in the process of monetary impulse transmission to the economy and also in the fact that banks are subject to the very same market rules as any other entity but differ from them in being public confidence institutions due to performing the functions thereof regarding the acceptance of public deposits. Due to the nature of the system in which they function, destabilisation thereof tends to affect the stability of the economy as a whole. The statement is substantiated by the experiences which the global economy has undergone. Interest in the stability (meaning the strive to maintain it) has gained additional importance in the situation of a very high increase of transborder financial transactions, what results in instability at one market being likely to 'be transferred' to other markets, thus seriously impairing the effectiveness of the monetary policy. Awareness of results of these risks both for the monetary policy and the safety of the banking system has resulted in more or less formalised actions being undertaken at the international forum and aimed at developing standards which will allow for stabilising activities undertaken by national and international financial systems. In the light of international experience, striving to increase the level of safety of the financial sector is common and in most countries there are being developed institutionalised systems aimed at protecting the financial system against destabilisation, referred to as the financial safety net. The system has not been assumed to be identical with the supervision over individual segments of the financial market. This is an important observation as the role of the safety net is not to replace the cautionary supervision the purpose

[1] cf. ' Raport o stabilności systemu finansowego w 2006r' (Report on the stability of the financial system in 2006) the National Bank of Poland, Warsaw, May 2007.

whereof is to reduce the possibilities of financial entities conducting too aggressive a policy and thus securing the interests of clients of these institutions, e.g. in case of banks it is supposed to serve depositary protection.

International experience with respect to the safety network organisation allows for the formulation of recommendations which ought to be respected in the event of development of national systems. It is important that it be capable of ensuring effective operation of the ‘safety net’ at three stages of events within the banking (financial) system, namely: a) crisis prevention stage, b) crisis management stage, and c) crisis resolution stage. Existence of the ‘safety net’ does not mean that it eliminates from the life of the banking (financial) sector insolvency of those institutions. Exclusion of such cases would in principle disturb the principle of market responsibility for the institution management process; what is more, it would encourage banking entities to take too high a risk, going beyond acceptable standards developed by the cautionary supervision systems. Such activities would result in moral hazards. The aim of the institutionalised safety system has not been assumed to be the protection of an individual institution as these tasks rest with other institutions of, inter alia, banking supervision or deposit guarantee institutions, but the protection of the stability of the entire system. In consequence, activities undertaken within the ‘safety net’ are conducted when there is a system risk of crisis spreading onto the entire banking system and consequently infecting other sectors. As it can be observed, good justification for organising the ‘safety net’ system is the reduction of adverse results of individual events within the financial sector for the entire economy. Underlying it is also the motive of minimising potential disturbances with respect to the monetary policy.

The foregoing justifications for organising the ‘safety net’ system are sufficient a premiss for the National Bank of Poland to actively engage in the organisation thereof and participation therein. However, it is not a sufficient condition for such a system to be organised. Organisation thereof needs to be a joint undertaking of the institutions decisive authorities and legal powers whereof allow for influencing the principles of operation and activity of the financial sector. In Polish conditions this means that at least four institutions ought to actively participate in both the establishment and the functioning of the ‘safety net’, i.e. the National Bank of Poland, the government represented by the Ministry of Finance, the Bank Guarantee Fund (Bankowy Fundusz Gwarancyjny – BFG) and the Financial Supervision Authority (Komisja Nadzoru Finansowego – KNF). This solution disregards the position of the cautionary supervision over the banking sector. The fact does not affect actual participants in the system but the division of the tasks of these institutions at individual stages of the safety net operation.

What does the analysis of the experiences of other countries in this domain from the point of view of the optimal financial safety net organisation model suggest?

It ought to fulfil such requirements as:

firstly – the central principle ought to be the assumption that the existence of the ‘safety net’ ought not to result in moral hazards among market participants. This means that the potential scope of the system operation and its inclination to provide aid ought not to be publicly known. Market awareness of the system existence and operation is one thing, and the decreed level of aid is something different. Here, one ought also to distinguish well-known principles of operation within the Bank Guarantee Fund and what the ‘safety net’ system may use and be vested with;

secondly – the central bank, here the National Bank of Poland, ought to be provided with (unlimited) access to the information both quantitatively and qualitatively describing the situation of the banking system. The need is obvious as in a period when the system is functioning faultlessly the central bank ought to monitor and assess the stability of the system and publicise the results of these observations, which will increase the transparency of the sector functioning, while in the event in which it is supposed to actively engage in crisis resolution process it ought to have most recent data on, for instance: financial condition of a given entity, decision of the bank strategic investor concerning the level of their involvement in the reorganisation process;

thirdly – inclusion in the system of the government represented by the institution which is the disposer of public resources and has been vested with decisive authorities with respect to the financial (banking) sector. In the case of Poland, it is the Ministry of Finance which may decide on the level of any support in the form of capital funding, granting guarantees in the case of issue of securities or contracting credits to improve liquidity. In extreme cases, the Minister of Finance will also provide opinions on to what extent the state ought to participate in covering the crisis costs if there are sufficiently important macroeconomic premises not to allow, for instance, downfall of a bank important to the system, i.e. a bank results of the crisis (insolvency) whereof would result in the domino effect within the system;

fourthly – involvement of the Bank Guarantee Fund and the Financial Supervisory Authority in the ‘safety net’ due to the statutory authorities thereof to control the functioning of the financial sector or, in the case of the BFG, statutorily allowed cooperation in the process of reorganisation of banking institutions. This is to ensure that the process of preventing crises and crises management will involve the institutions which are capable of promptly diagnosing the situation causing threats, assessing the crisis risk level and undertaking activities limiting the results thereof;

fifthly – safety net institutions ought to cooperate with one another and exchange information; this statement is so obvious that there arises the question why to formulate it all. The reason is that in different countries there are different models of supervision over the banking sector and that there occur different functions of central banks when it comes to monitoring the financial sector. This results in the need to formalise the principles of cooperation and legal regulation of the flow of information between the institutions involved in the crisis management process. From the point of view of the central bank, the cooperation is extremely important not only when the institutions find themselves at the stage of solving the problems of a given banking institution but also when the sector is functioning faultlessly. This is to recommend new solutions regarding various regulations, for instance supervisory regulations, assessment of the risk level within the financial system for the purposes of the deposits guaranteed as well as to enable national banks to conduct research into financial stability which, through the dissemination of the results thereof, may be used to adjust the behaviour of the financial (banking) entities;

sixthly – activities undertaken by individual safety net institutions as well as the course of cooperation between them ought not to be subject to excessive formalisation so as not to impede the effectiveness of the entire crisis management and crisis resolution process. Organisation of cooperation between safety net institutions ought to provide for keeping the right proportions between flexibility and formalised elements thereof. This assumption results from the fact that despite numerous common features each crisis is different. Formalised elements of cooperation ought to serve improvement of the organisation of activities and reduction of the information noise and organisational chaos to the minimum. However, they may not reduce the operation speed as in the event of crises decisions ought to be taken within hours, not days. If we are talking about observing the rules, it means that the participants in the process act within their statutory competence;

seventhly – banks ought to be the area of special interest of safety net organisations in Poland. This results from numerous factors previously discussed, i.e. the dominant role of the sector in the entire financial sector, acting as a public confidence institution and the fact that transactions realised by banks are of fundamental importance to the correct functioning of cash settlements within the entire economy, from a household to state budget operations;

eigthly – if in Polish conditions this so important a role of the ‘safety net’ is assigned to banks, then it would be logical if the National Bank of Poland were the leading institution of the ‘safety net’ organisation and functioning. It is important as in the countries where such systems operate the leading institution has been expressly indicated. Indication of the leading institution does not mean releasing others from responsibility for the safety of the banking sector. What will differentiate involvement and responsibility of other participants in the process is their legal capability of reacting at various levels of crisis resolution. And so, for instance, the government will have the decisive vote in a situation in which a decision on the level of involvement of budgetary resources in the sector reorganisation processes is to be taken.

Summary

The outlined concept of the ‘safety net' based on the existing models and recommended standards does not officially function in Polish conditions, one may only talk about certain elements thereof, but the awareness of the need for such a system to be developed and activities to be undertaken by the National Bank of Poland ensures that such a system will operate in the near future. Development thereof will be an important step towards the increase of safety standards of the Polish financial system as well as institutional support to increase the effectiveness of the monetary policy. Effective monetary policy may only be conducted in a financial system that is stable and resistant to external shocks.

Bibliography

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Abstract

The article discusses the problem of safety of the banking system in Poland examined through the perspective of the monetary policy. First of all, an outline of the banking system safety network in the context of the monetary policy has been outlined. Further in the article, issues related to the problem in the international scale have been discussed. The final part of the article presents the requirements which the organisation of a financial safety net ought to comply with.

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