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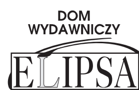

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A word from the Editor

Dear Readers,

Traditionally, the turn of the old and new year is conducive to reflections, both personal and professional, as well as some more general reflections on the immediate and distant environment. The war in Ukraine, as well as other conflicts and tensions between countries in various regions of the world (including the Middle East, Sub-Saharan Africa, tensions in the US-China relations) have increased the significance of geopolitical risk for the economies of many countries. In the case of the Polish economy, 2023 was the year of peak inflation, followed by its reduction, the freezing of energy prices, favorable judgments of the Court of Justice of the Europe Union for Swiss franc borrowers and the introduction of an embargo on Ukrainian grain. The war taking place just across the Polish border was associated with a series of consequences and difficulties in conducting business activities and, for many domestic business entities, with uncertainty about development prospects. The consequences of the war had an impact on the low level of investor confidence in financial markets, as well as on the functioning of banks. In these conditions, the European Green Deal strategy was implemented, with the most important task being the energy transformation. Achieving climate neutrality in Europe in 2050 requires much greater involvement of the financial sector.

With the end of 2023, marking the 26th year of publishing *Safe Bank*, we are pleased to propose some interesting studies to our readers. We start with an article devoted to the deposit guarantee schemes in the European Union. A significant part of it is dedicated to the critical assessment of the new proposals presented by the European Commission in 2023 as part of the reform of the crisis management and deposit insurance framework (CMDI). The following text concerns the impact of digital technology on traditional banking and the financial results of banks in the context of the new competition conditions within the EU financial market, including FinTech's. The development of digital technologies was undoubtedly accelerated by the COVID-19 pandemic, which is highlighted in the next study on the Turkish banking sector. The study focuses on the identification of the common aspects of anti-COVID measures and sustainable banking principles in Turkey. Sustainability issues are also at the core of sustainable investing considerations in the US. The article

presents the performance of 10 actively managed sustainable investment funds in the US and indicates the lack of justification for the basis of the anti-ESG movement, as well as the anti-ESG regulations introduced in multiple states. Sustainable investing is reinforced by the development of financial instruments that incorporate ESG standards. European Secured Notes, which are discussed in the following article, may become such an instrument. This article deals with the concept of European Secured Notes and presents both the feasibility study and assessment of their development potential. We close the *Problems and Opinion* section with an article on new EU regulations in the field of consumer credit and their implementation into the national legal order (Directive 2023/2225 of the European Parliament and of the Council on credit agreements for consumers and repealing Directive 2008/48/EC).

In the *Miscellanea* section, we present three studies related to the activities of the European Financial Congress. The first two were based on the presentations and debates during the 11th Corporate and Investment Banking Congress, which took place in Warsaw on November 7 and 8, 2023. The first study is the presentation of selected fragments of the Bank Pekao S.A. Report "*Corporate banking in Poland – trends and prospects*." The results of this report serve as an introduction to the debate on the future of corporate banking through the eyes of bankers, which is the subject of the next text. This text also contains a summary of the second debate: "*The future of corporate banking through the eyes of entrepreneurs*." The 93/2023 issue of Safe Bank concludes with the study of the 12th edition of the "*Forecast Consensus of the European Financial Congress*." The Consensus was prepared following two consultation stages, with the participation of 27 experts, prominent Polish macroeconomists.

Enjoy reading

Ewa Kulińska-Sadłocha
Issue Editor

Problems and Opinions

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Towards the enhanced role of deposit guarantee schemes in the European Union crisis management framework

Abstract

Deposit guarantee schemes constitute an important but relatively new element of the financial safety net. Prior to the Global Financial Crisis deposit guarantee schemes in the European Union acted mainly as payboxes with their mandate mostly limited to payout of covered deposits. The crisis experience unveiled many weaknesses in the area of deposit insurance and prompted European lawmakers not only to increase the level of harmonization of regulations in this respect but also to extend the mandate of deposit guarantee schemes. The aim of this article is to present and analyze the evolution of financial regulation related to deposit insurers in the European Union, taking into account their role in crisis management, in particular as regards interventions other than payout. An important part of the article is focused on the critical assessment of the new proposal put forward in 2023 by the European Commission to reform the crisis management and deposit insurance framework (CMDI). The article discusses the potential positive effects of the proposed changes under the CMDI reform as well as

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All opinions expressed in this article belong to author and do not represent the official stance of the institution in which she is employed.

possible difficulties and challenges related to their introduction. Results of the analysis indicate that the proposed reform would strengthen deposit guarantee schemes giving them a more prominent role in crisis management. Nevertheless, this new broadened mandate might require strengthening financial capacity of deposit guarantee funds.

Keywords: deposit guarantee schemes, crisis management, resolution, financial stability

JEL Codes: G01, G21, G28, H12

W kierunku większej roli systemów gwarancji depozytów w unijnych ramach zarządzania kryzysowego

Streszczenie

Systemy gwarancji depozytów stanowią ważny, ale stosunkowo nowy element sieci bezpieczeństwa finansowego. Przed globalnym kryzysem finansowym, systemy gwarancji depozytów w Unii Europejskiej funkcjonowały głównie w formule paybox, tzn. ich mandat był ograniczony do wypłaty środków gwarantowanych. Doświadczenia kryzysowe ujawniły wiele słabości w obszarze gwarancji depozytów i skłoniły unijnych legislatorów nie tylko do zwiększenia poziomu harmonizacji w tym obszarze, ale także do rozszerzenia mandatu systemów gwarancji depozytów. Celem niniejszego artykułu jest przedstawienie i analiza ewolucji regulacji finansowych związanych z gwarantami depozytów w Unii Europejskiej, z uwzględnieniem ich roli w zarządzaniu kryzysowym, w szczególności w zakresie interwencji innych niż wypłata depozytów. Istotna część artykułu poświęcona jest krytycznej ocenie nowych propozycji przedstawionych przez Komisję Europejską w 2023 r. w ramach reformy ram zarządzania kryzysowego i gwarancji depozytów. Artykuł omawia potencjalne pozytywne skutki proponowanych zmian, jak również możliwe trudności i wyzwania związane z ich wprowadzeniem. Wyniki analizy wskazują, że proponowana reforma wzmocni systemy gwarancji depozytów, nadając im bardziej znaczącą rolę w zarządzaniu kryzysowym. Niemniej, ten nowy rozszerzony mandat, może wymagać zwiększenia zdolności finansowych funduszy gwarantowania depozytów.

Słowa kluczowe: systemy gwarancji depozytów, zarządzanie kryzysowe, przymusowa restrukturyzacja, stabilność finansowa

Kody JEL: G01, G21, G28, H12

Introduction

Deposit guarantee schemes (DGS) constitute an important but relatively new element of the financial safety net. The key aim of DGS is to protect depositors and in that way to contribute to maintaining financial stability (Gortsos 2019). In the European Union (EU) deposit insurance has long been perceived as the main and only function of DGS. However, with subsequent episodes of financial instability and in particular the experience of the Global Financial Crisis (GFC), the perception of DGS has changed. Deposit insurers started to be perceived as important and active participants of the crisis management process. Moreover, with the establishment of the banking union in

2014, discussions on the centralization of DGS function have begun. Initial intensive works on the European Deposit Insurance Scheme[1] (EDIS) as a third pillar of the banking union, has gradually slowed down as there seems to be lack of political will to the "Europeanisation" of DGS.

At its June 2022 meeting the Eurogroup sketched an overall action plan for strengthening and completing the banking union. Although no consensus on EDIS was reached, the Eurogroup agreed on directions for reforms in other areas. Accordingly, the focus has been shifted from EDIS itself to the overall crisis management and deposit insurance (CMDI) framework. In order to strengthen the current EU regulations in that area, the Eurogroup agreed that the reform of the CMDI framework should cover (Avgouleas et al. 2023):

- clarification and harmonization of public interest assessment (PIA);
- enhancement of the resolution framework to include also medium-sized banks;
- further harmonization of national deposit guarantee schemes, in particular as regards their functions other than payout;
- harmonization of certain elements of national insolvency laws in order to facilitate crisis management.

What is striking, is the fact that Eurogroup put a strong emphasis on national deposit guarantee schemes, the role of which is about to be increased. The experience gathered so far in the European Union, and in particular in the banking union, suggests that indeed, the current EU regulatory framework does not allow to use the full potential of DGS as key institutions in crisis management in the banking sector.

The aim of this article is to present and analyze the evolution of financial regulation related to deposit insurers in the European Union, taking into account their role in the crisis management, in particular as regards interventions other than payout. An important part of the article is focused on the critical assessment of the new proposal put forward in 2023 by the European Commission to reform the crisis management and deposit insurance framework. The article discusses the potential positive effects of the proposed changes under the CMDI reform as well as possible difficulties and challenges related to their introduction. The article is composed of four sections. Section 1 discusses the rationale, the role and the evolution of deposit guarantee schemes as an element of the financial safety net. Section 2 presents European deposit insurance regulations from a historic perspective, pointing out to the gradual increase in harmonization and expansion of DGS mandate. Section 3 diagnoses the problems which currently limit a more enhanced use of DGS funds in crisis management in the EU and shows which elements of the CMDI reform could

[1] The proposal for the establishment of EDIS was put forward by the European Commission in 2015. The original idea was that EDIS would be introduced gradually, in three stages: re-insurance, co-insurance and full insurance (Gortsos 2016). However, the European Commission proposal for EDIS turned up to be too controversial and in 2018 Austrian Presidency presented an alternative compromise proposal of a "hybrid model", in which national DGS coexist with EDIS. Nevertheless, due to political deadlock no further progress has been made on establishing EDIS. For more on national preferences and positions regarding EDIS see: (Tümmler 2022).

address them. Section 4 provides a critical assessment of the proposed changes, indicating possible difficulties and challenges related with their implementation. The final section concludes.

1. The evolution of the role of deposit insurers within the financial safety net

There are several reasons speaking for the establishment of a deposit guarantee scheme at the national level. The most important ones relate to the specificity of the banking business and the existence of market imperfections/externalities. Any bank, whether weak or strong, does not have sufficient liquid resources to finance at once the payout of all deposits. Bank clients are also conscious about that and once they start losing confidence in a bank, they are susceptible to run on a bank to withdraw their funds, in accordance with a rule "first come first served"[2]. This, however, aggravates the financial problems of the bank concerned and might even trigger contagion in the banking system as clients of other banks might also start to question the financial condition of other lenders.

The rationale behind establishing deposit guarantee scheme is to contain the incentive for massive withdrawals and in that way contribute to maintaining financial stability (Gortsos 2016). It is assumed that the existence of DGS should prevent banking panics which has the potential to cause systemic banking crisis[3]. This reasoning is related to the characteristic of the banking business which is based on trust and confidence. Loss of confidence quickly spreads within the banking system which risks not only massive withdrawals of deposits by clients but also freezes interbank market. The resulted liquidity problems experienced by a bank might lead to more severe insolvency problems or even its failure.

Having said that, it is important to note that the role of DGS does not limit only to preventing collective withdrawals. It is normal that banks as any other enterprises may face financial problems and in a consequence fall. The failure of a bank is, however, different from a failure of a typical enterprise, in particular, in terms of the impact a bank failure could have on the financial system, depositors and other creditors, and the economy at large. In such situations DGS could play also an important role by preventing bank failures or eventually by mitigating

[2] The March 2023 confidence crisis in the US, in particular the bank run on, and subsequent failure of Silicon Valley Bank, Signature Bank and First Republic Bank, have reminded us how fragile the confidence in the banks can be. Moreover, it also showed that bank runs in a digital era could unfold extremely fast and result in bank failures within hours.

[3] Of course apart from benefits related to setting up DGS, some drawbacks and costs could also be indicated. Two issues should be mentioned here. First, one of the most important side-effects of general deposit insurance is a possible increase in moral hazard. Second, DGS are financed from contributions paid in by banks. Regardless, of whether the financing arrangement is based on *ex-ante* or ex-*post* model, DGS contributions constitute cost for banks. Furthermore, the *ex post* financing model is also considered to be more procyclical.

the financial distress and potential contagion[4] which could be caused by a bank's failure (Brescia Morra et al. 2023). To that end, DGS might be viewed as a measure to indirectly contain systemic risk and proactively manage banking crisis.

Looking at the history of deposit insurance[5], it shows that DGS were set up or reformed as a result of significant external shocks such as financial crises (Kerlin 2015). This is because financial instability periods usually undermine the trust in the financial sector, with particularly painful consequences if consumer mistrust touches banks and causes devastating bank runs. It seems that a particularly significant impact on the development of regulatory approach towards DGS had the GFC. It should also be reminded that prior to the GFC there had not been any international standards on deposit insurance (Arda & Dobler 2022). Only in 2009, the International Association of Deposit Insurers (IADI) adopted Core Principles for Effective Deposit Insurance Systems, which were then revised in 2014. The Core Principles constitute an international standard for deposit insurance, thus on the one hand they provide some harmonized features in order to enhance the deposit insurance worldwide, but on the other hand they are sufficiently flexible to cater for national specificities (Gortsos 2016). This led to the development of different models of DGS with varied tasks and functions. The four main DGS categories could be distinguished (FSB 2012):

- paybox model – DGS mandate is the narrowest and covers only reimbursement of covered deposits which is activated when a bank fails, its license is withdrawn and deposits become "unavailable";
- paybox plus model – DGS mandate includes not only the payout of insured deposits but also some additional functions like providing financial support or some specific resolution functions;
- loss-minimizer model – DGS mandate enables it to actively engage in a range of activities in accordance with least cost principle;
- risk minimizer model – DGS mandate is the widest and covers comprehensive functions that allow it to reduce the risk within financial system, such as early intervention or resolution powers as well as supervisory responsibilities.

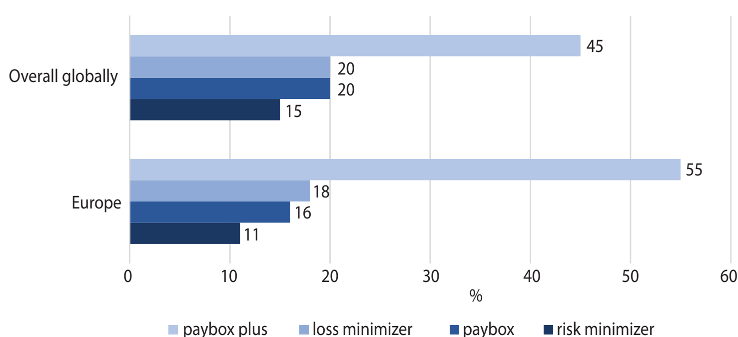
The 2021 IADI annual survey shows that currently the most popular model in the world is "paybox plus", while less common – the most advanced risk minimizer model. Similar trends are also visible in Europe (Chart 1). Following the GFC the mandates of deposit insurers in many jurisdictions have been expanded giving them a more prominent role in crisis management which is in stark contrast to the pre-GFC

[4] The contemporary financial system is characterized by a dense network of interconnections and interlinkages which could result in so called contagion effect, i.e. a quick and wide "spilling over" of problems from one institution to others. For more on the contagion effect and systemic risk in the banking sector see e.g. (Freixas et al. 2015) or (de Bandt & Hartmann 2000).

[5] Over the last decades the perception of the role of DGS has changed substantially which is reflected also in the literature. As pointed by Pruski and Kerlin (2015), there could be distinguished five different periods of research related to DGS, starting with analyses of the mere rational for the existence such institutions, through different elements of their design, and most recent studies on the need for redefining the role of DGS in crisis management and resolution.

period when DGS played rather a minor role in the financial safety net (FSB 2012). Kerlin (2015) notes that the simplest DGS model (i.e. paybox) is slowly disappearing from the financial safety net landscape, while more developed models are being more widely adopted.

Chart 1. Mandate of deposit insurers overall globally and in Europe



Source: Own work based on IADI (2021).

Those changes are taking place due to a growing consensus that the benefits from a more active involvement of DGS in crisis management and resolution outweigh their usage as mere payout boxes only. In a paybox model only covered depositors are protected, while DGS support for non-payout measures could offer wider benefits for financial stability (Costa et al. 2022). The shift in attitude towards DGS started to be clearly visible after the GFC when the resolution framework, which aims to restructure failed banks in an orderly and cost efficient manner, have begun to be widely adopted[6]. As noted by IADI (2022) the abandonment of the paybox model is related to a greater involvement of DGS in resolution. Although the role played by DGS in resolution varies across jurisdictions, a majority of DGS participate in resolution by, at least, contributing to relevant decision making processes. Furthermore, around 40% of deposit insurers worldwide act also as a bank resolution authority[7] and housing deposit insurance and resolution functions in one authority is becoming more popular (IADI 2022).

[6] An important role in popularization of the idea of resolution played the FSB which in 2011 released Key Attributes of Effective Resolution Regimes for Financial Institutions setting out the essential elements necessary for an effective resolution framework.

[7] This is the case in Poland where the Bank Guarantee Fund is not only a deposit guarantee scheme but also an authority responsible for resolution of banks.

2. The evolution of European Union regulations on deposit insurance

In Europe first deposit guarantee schemes were established starting from 1960s, primary as voluntary private-initiative systems. The most intensive period of setting-up such institutions occurred between 1991–2003 (Kerlin 2015). Currently all Member States have in place harmonized deposit guarantee schemes which is a consequence of a legislative action taken at the EU level. The current status is, however, a result of more than 35 years of EU regulations in the area of deposit insurance. Nevertheless, the work does not seem to be completed and continued efforts are still being taken to ensure adequate role of these institutions in the financial safety net.

At the European level works on establishing deposit insurance started in late 1980s, first with the European Commission (EC) recommendation 87/63/EEC concerning introduction of deposit guarantee schemes in the Community. Although this recommendation was legally non-binding and had rather advisory character, its issuance by the European Commission signaled clear support for the setting-up of DGS at the national level. The wording of the EC recommendation was very general and included only four tips to be taken into account by Member States with regard to deposit insurance:

- deposit guarantee should cover depositors who are not capable of properly assessing the financial condition of a bank in which they deposited their funds;
- deposit guarantee should cover depositors of all authorized banks, including branches;
- there should be a clear division between DGS intervention prior to winding-up a bank and deposit payout as a result of bank insolvency;
- there should be clear and transparent criteria specifying conditions for receiving compensation.

Nevertheless, a mere recommendation turned up to be insufficient, in particular it started to be obvious that more issues related to deposit insurance required harmonization. To that end, Directive 94/19/EC was a first legal act that introduced harmonized rules on deposit guarantee schemes, yet also only to some extent (so called minimum harmonization). The adoption of this directive in 1994 pushed Member States to establish DGS at the national level. The key issues regulated by Directive 94/19/EC were the introduction of:

- the requirement to set up at least one officially recognized DGS in each Member State;
- a harmonized minimum coverage of 20 000 EUR;
- the possibility of co-insurance[8];

[8] Co-insurance meant that only a defined percentage (e.g. 90%) of a deposit was insured. However, co-insurance was a national option which meant that there was not uniform approach to this, with some Member States applying co-insurance and other not using this option. This clearly led to differences in depositor protection across the EU. For more information see: (Cariboni et al. 2007).

- certain minimum aspects regarding the scope of protection (i.e. definition of a deposit and broad categories of deposits covered and excluded from the protection);
- payout period (set at three months with possible two extensions of max. three months each[9]);
- information requirements for bank customers on their deposit insurance.

It is also worth mentioning what was not regulated by Directive 94/19/EC. The most important lacking element were provisions on the funding of DGS, which resulted in the adoption of varied DGS funding mechanisms across the EU, either via ex ante or ex post contributions or a combination thereof (Cariboni et al. 2007). This in turn had impact on the financial capacity of DGS and consequently on depositor confidence. Furthermore, Directive 94/19/EC was based on minimum harmonization which led to divergent approaches across the EU Member States as for the coverage level or payout period. In times of financial stability these differences seemed not to be important but once the global financial crisis broke out, it turned out that the adopted solutions were neither sufficient nor effective.

Directive 94/19/EC did not stand the test of the global financial crisis which revealed that there was a substantial room for improvement in the area of deposit protection. The financial turmoil of 2008 pushed many EU Member States to unilaterally increase coverage level or introduce blanket guarantees to restore depositor confidence in their countries[10]. Such uncoordinated actions by the EU national authorities threatened the Single Market and added fuel to the fire. The EU needed to act swiftly. As a consequence of the crisis events, a quick amendment to Directive 94/19/EC was adopted. Directive 2009/14/EC (which amended Directive 94/19/EC) increased the coverage limit from minimum of 20 000 EUR to 50 000 EUR and then finally to 100 000 EUR in order to maintain trust in the banking sector. Furthermore, co-insurance was abandoned and payout period shortened. All these measures could be considered, however, a “quick-fix”, and a more thorough review of DGS regulations was needed (Terták & Szeląg 2010).

The global financial crisis prompted European regulators not only to rethink the main parameters of deposit guarantees but also the role deposit insures play within the financial safety net. It became more evident that DGS should play a more active role in crisis prevention and crisis management. It should be noticed that the de Larosière Report (2009), which impacted EU lawmakers to a large extent, stated that EU regulations should not prohibit additional functions of DGS which goes beyond a mere paybox model, but it did not recommend any further harmonization either.

[9] This meant that in extreme cases the Directive allowed the payout to take max. 9 months.

[10] Low coverage might negatively influence trust of depositors in safety of their deposits and thus contribute to sudden bank runs which could destabilize the whole banking sector. This is especially the case during periods of financial instability. The real-life cases were seen during the global financial crisis with one of the most famous example of classic bank run on Northern Rock in September 2007 which was first such episode in the United Kingdom since over a century.

The next Directive 2014/49/EU (so called Deposit Guarantee Schemes Directive, DGSD) adopted in 2014, and which is still in force, took into account lessons learnt from the GFC by introducing further harmonization of the payout function of DGS and by recognizing the additional role that such institutions could play in ensuring financial stability (see Box 1). Importantly DGSD provided for a more active role of DGS via so called preventive and alternative measures, which, however, are not uniformly applied across the EU but constitute so called national options. This is enshrined in Article 11 of DGSD.

Box 1. Main elements of Directive 2014/49/EU

Directive 2014/49/EU harmonizes the main elements of the functioning the deposit guarantee schemes in a comprehensive manner. The directive aimed to reach two important goals: (1) to improve depositor protection and (2) to strengthen DGS as an element of the financial safety net.

The main changes that enhanced the depositor protection and confidence are:

- a harmonized coverage level of 100 000 EUR per depositor per bank;
- a shorter payout period (7 working days);
- clarification on the payout process in the cross-border context (host country DGS acting as "paying agent" on behalf of home country DGS);
- increased information requirements for the DGS in order to raise depositor awareness.

The directive also strengthens deposit guarantee schemes by extending their mandate and increasing their financial capacity by introducing:

- a requirement to finance DGS via *ex ante* risk-based contributions supported by *ex post* contributions and mutual borrowing between DGS;
- a harmonized target level of DGS funds of 0.8% of covered deposits (to be reached by 3 July 2024);
- possibility to use DGS funds also for preventive and alternative measures and within resolution.

Source: Own work.

More specifically, under Article 11(3) it is allowed to use DGS funds for preventive measures to avoid the failure of a bank, so these measures could be taken prior to the state of insolvency. There might be different types of preventive measures and DGSD leaves this topic open and to the discretion of Member States. Possible preventive measures include subsides to the acquiring bank, capital support, loans or guarantees. However, DGSD specifies conditions under which preventive measures could be undertaken[11]. It should be noticed, that on the ground of the current regulations preventive measures could be considered "extraordinary public support" (Mecatti 2022). This in turn, requires authorities to deem such a bank

[11] The most important ones are that the ailing bank is not under resolution, the DGS has appropriate systems and procedures to select and implement those preventive actions and also exercises more stringent risk monitoring of the bank concerned and finally, the cost of such intervention does not exceed the cost of deposit payout.

failing or likely to fail (FOLTF)[12]. Consequently, banks that could be restored via preventive measures are automatically declared FOLTF and in case they don't meet public interest assessment (PIA), they are subject to insolvency proceedings.

Whereas under Article 11(6) it is allowed to use DGS funds for alternative measures taken in order to preserve access to covered deposits once a bank has been declared insolvent. Thus, alternative measures could be taken once a bank has been found FOLTF but there is no public interest in putting it under resolution. This applies mostly to smaller banks, with little significance for financial stability. Alternative measures could include for example transfer of all or selected assets and liabilities (in particular deposit portfolio) to another healthy bank. What is important, least cost test should be applied.

As preventive and alternative actions are national options, only several Member States have implemented them. As of 2020, preventive measures (Article 11(3) DGSD) were available only in nine Member States[13], while alternative measures (Article 11(6) DSGD) were available in twelve Member States[14] (Eule et al. 2022). Only five Member States[15] transposed into national law both national options, giving their DGS possibility to undertake both kind of interventions. The actual cases in which these measures have been applied are even scarcer (Brescia Morra et al. 2023; Ramos-Muñoz et al. 2023). This shows that actually the role of majority of EU DGS is limited.

It should also be mentioned that in 2015 together with the introduction of Directive 2014/59/EU (so called Bank Recovery and Resolution Directive, BRRD) and resolution framework in the EU, DGS have been engaged also in an additional type of activity, namely participation in resolution financing. According to Article 11(2) DGSD and Article109 BRRD DGS funds should be used to finance resolution. As one of the resolution objectives is to protect depositors, the activation of resolution procedure aims at ensuring depositors have continued access to their deposits. In such situations DGS funds do not have to be used for the payout. However, EU legislators decided that DGS should instead contribute to the financing of resolution. The amount of DGS financial contribution depends on which resolution tool is used. In case bail-in is applied, DGS should contribute with the amount by which covered deposits[16] would have been written down, had covered deposits been included in the scope of bail-in and taking into account their position in the creditor hierarchy of national insolvency law. In case other resolution tool is used, then the amount contributed by DGS corresponds to the amount of losses that covered depositors

[12] Conditions for declaring bank failing or likely to fail are provided in Art. 32 (4) BRRD.

[13] Article 11(3) DGSD was transposed in Austria, Croatia, France, Germany, Ireland, Italy, Malta, Poland and Spain.

[14] Article 11(6) DGSD was transposed in Belgium, Croatia, Denmark, Finland, Greece, Ireland, Italy, Luxembourg, Lithuania, Malta, Poland, Slovenia.

[15] These are: Croatia, Ireland, Italy, Poland and Malta.

[16] In accordance with Article 44(2)(a) BRRD covered deposits are excluded from the application bail-in tool.

would have suffered, had they not benefitted from DGS protection but covered losses to the same extent as creditors with the same level of priority under national insolvency law.

In addition BRRD provides for important safeguards which are meant to protect DGS from depleting its funds. According to Article 109(5) BRRD deposit insurer's liability is capped at the 50% of its target level. This limit might, however, be increased by Member States, if they deem it necessary taking into account characteristics of the domestic banking sector. In any case, the financial engagement of DGS towards resolution financing may not be higher than losses it would have suffered in a hypothetical scenario of winding up a failed bank under national insolvency proceedings (i.e. in a situation where there would be a payout event).

In case of DGS interventions other than payout so called least cost test (LCT) applies. This rule has been inserted in the regulations to minimize the losses for the DGS fund. According to the least cost test DGS funds could be used only if this will not result in losses for the DGS higher that in case of payout. Currently there are no detailed rules on the LCT which means that it is applied heterogeneously across the EU.

The amount that DGS could contribute for preventive or alternative measures or towards resolution depends on many aspects, including direct and indirect cost and recoveries. Costa et al. (2022) distinguish five elements which could be included in the LCT methodology[17]:

- cost of reimbursing covered deposits (which is treated as a default option);
- operational expenses of DGS related to the insolvency proceedings;
- recoveries (which reduces the net cost of insolvency);
- consequential expenses of deposit payout (such as borrowing expenses or opportunity costs);
- systemic costs (related to e.g. the impact on banks of the increased contributions to replenish the DGS funds or possible contagion effect).

An important factor which also impacts the results of LCT computation is a recovery rate in insolvency which in turn depends on the DGS ranking in the creditor hierarchy. Currently, DGS in the EU enjoy the super-preference status as they subrogate into the rights of covered depositors. The high ranking of the DGS was introduced to shield DGS from losses connected with reimbursing of deposits as super-preference status usually means a high recovery rate for deposit insurer, and thus finally very low costs in the event of bank liquidation. As a consequence, this automatically decreases the amount which could be contributed towards interventions other than payout (Mecatti 2022; Costa et al. 2022; Ramos-Muñoz et al. 2023). As rightly pointed by Avgouleas et al. (2023) it is illogical that DGSD provides for additional functions (i.e. preventive and alternative measures) while at the same time having in place rules which hinder their application by DGS.

[17] It should be noted that many of those elements require judgement as authorities possess incomplete information and must make assumptions. For more on the different approaches applied in LCT calculation in practice see (Costa et al. 2022).

Table 1. DGS functions and their character under current EU regulations

DGS functions	Character	Legal basis
Payout of covered deposits in case of their unavailability (so called paybox)	mandatory	Article 11(1) DSGD
Contribution to resolution financing	mandatory	Article 11(2) DGSD and Article 109 BRRD
Preventive measures	optional	Article 11(3) DGSD
Alternative measures	optional	Article 11(6) DGSD

Source: Own work based on (Gortsos 2019).

To sum up, the current European regulations provide for four DGS functions, among which two are mandatory and two are facultative (see Table 1). The facultative functions are, however, not commonly used and one could even say their application is constrained by the regulations. Nevertheless, those facultative functions would enable deposit insurers to take active part in crisis management, in case resolution procedure does not apply.

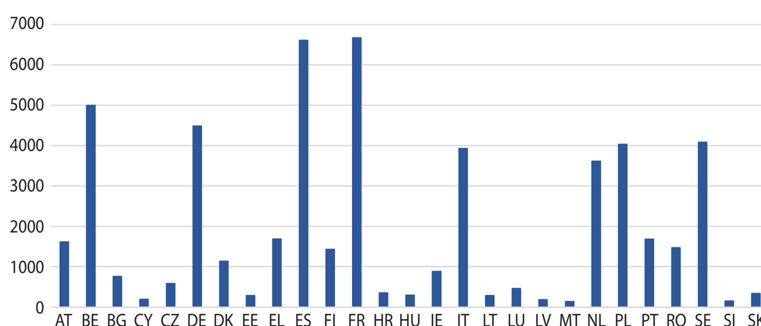
3. New EU proposals to enhance deposit insurers' role in crisis management

The 2023 European Commission proposal[18] to amend the crisis management and deposit insurance framework could be perceived as a continuation of the reform begun after the GFC. Indeed, the presented package of new regulations tries to fix the weaknesses of the current crisis management framework. It has been noticed that in order to be effective resolution framework should be applied to a wider set of banks. Resolution has so far been applied only to a limited extent, in particular in the banking union. During almost 10 years of its existence, the Single Resolution Board (SRB) has initiated resolution only twice, in 2017 towards Spanish Banco Popular and in 2022 towards two subsidiaries of Sberbank Europe A.G., while directing the parent bank for insolvency proceedings. In many cases, however, national authorities decided to resolve the problematic banks with the use of public funds within the State aid framework as laid out in the 2013 Banking Communication which imposes less strict requirements than BRRD. Since 2015 more than 58 billion EUR was spent to bail-out banks (European Commission [EC] 2023). The overwhelming majority of banks in distress have been dealt with outside resolution, using alternative paths. According to EC data, since 2015 around 60% and since 2016 (when bail-in tool came into force) 75% cases were managed

[18] The EC proposal contains three legislative proposals: amendments to Directive 2014/59/EU, amendments to Directive 2014/49/EU and amendments to Regulation 806/2014.

outside resolution in the EU. These numbers are even higher for the banking union. At the same time, large amounts of money are kept idle not only in resolution funds but also in national deposit guarantee funds. Total available funds of all national DGS amounted to 52 billion EUR as of 2022 (Chart 2).

Chart 2. DGS available funds as of 2022 (in million EUR)



For AT the figure represents cumulative available funds for all three recognized Austrian DGS. For IT the figure represents cumulative amount of two recognized Italian DGS.

Source: Own work based on (EBA 2022).

It is generally recognized that DGS financial capacity is sufficient to finance the payout of covered deposits in case of a failure of a medium-sized bank, but it would be too small to cope with a reimbursement of guaranteed deposits in case a systemically important bank fails (Dijmărescu 2011; Spitzer 2022). J. Eule et al. (2022) using data covering 2 455 European banks show that in each Member State in the banking union at least one bank operates the failure of which could deplete national DGS. Nevertheless, even in case of a medium-sized banks more cost efficient is to arrange, with assistance of DGS, a deposit portfolio transfer to a healthy buyer than to pay out covered deposits. Thus, there is a growing consensus that a more flexible use of DGS funds for interventions other than payout would be more effective than putting banks under a piecemeal liquidation (Brescia Morra et al. 2023). However, the current DGS regulations combined with BRRD and 2013 Banking Communication on state aid rules provide a complex framework which restricts using DGS resources for preventive or alternative measures, which traditionally had been their functions in managing banking crisis (Mecatti 2020). In particular, as advocated by Ramos-Muñoz et al. (2023) with regard to small and medium-sized banks transfer strategies supported by DGS would be mostly relevant.

The CMDI framework reform aims to enhance the role DGS play in crisis management by facilitating the use of DGS funds for interventions other than payout. To that end, several changes have been proposed. The most important ones are the following:

a. Permission to use DGS financing to meet 8% TLOF[19] requirement for access to resolution fund, but only in case of transfer strategies with market exit.
b. Introduction of general depositor preference and removal of DGS super-preference status in the creditor hierarchy.
c. Harmonization of the least cost test for all DGS interventions.
d. Clarifications as regards preventive and alternative measure.

Ad a. In order to widen the scope of resolution and include also small and medium-sized banks it is proposed to allow for DGS bridge financing in case a bank does not have sufficient funds to meet 8% TLOF requirement for accessing resolution fund. This might be particularly relevant for banks with a high prevalence of deposits as there is a risk that in order to meet 8% TLOF requirement some categories of uncovered deposits might need to be bailed-in which would have negative consequences for depositors trust and financial stability. Nevertheless, to constrain potential moral hazard several conditions are proposed. First, before DGS financing would be used, the internal loss absorbing capacity of a bank would have to be used to the maximum extent, and the exclusion of uncovered deposits from bail-in should be justified by financial stability reasons. Second, DGS would contribute only the missing amount that is necessary to reach 8% TLOF requirement. Third, the DGS bridge financing would only be possible in case of transfer strategies with market exit. And finally, DGS intervention would be allowed only if according to the least cost test the amount provided by the deposit insurer is not greater than in case of deposit payout.

Ad b. As already noted, the amount DGS is allowed to contribute towards interventions other than payout depends on the determination of the least cost test, the result of which is dependent on the DGS ranking in the creditor hierarchy. Strict application of the LCT together with a super-preference status of DGS ranking limit the possibilities of DGS to contribute to interventions other than payout (Avgouleas et al. 2023). In order to unlock the DGS funds it is proposed to introduce a general depositor preference under which all deposits (and as a consequence DGS too) would rank higher than ordinary unsecured claims. At the same time all deposits, whether covered or not, would be at the same level, i.e. pari passu. In its Impact Assessment Report, the EC (2023) provides that the introduction of single depositor preference would unlock on aggregate almost 1 billion EUR which is 20 times more DGS funds than currently available under super-preference of covered deposits (i.e. 0.05 billion EUR). It seems that the removal of super-preference of DGS together with revision of the LCT methodology are essential for allowing DGS to proactively engage in interventions other than payout (Avgouleas et al. 2023).

Ad c. Preventive and alternative measures as well as DGS contribution within the resolution are conditional on a positive outcome of the least cost test assessment. Currently, there are no detailed rules how least cost test should be conducted, which

[19] According to Art. 44(5) BRRD, before tapping resolution funds, bank shareholders and creditors have to cover losses by making contribution amounting to at least 8% of total liabilities and own funds (TLOF) of the bank subject to resolution.

elements should be included and how it should be calculated. Therefore, it is proposed to harmonize the LCT methodology. The harmonized least cost test would provide the elements which should be taken into account when estimating costs related to DGS intervention as well as costs of deposit payout. A specific methodology is to be provided by the European Banking Authority (EBA). Nevertheless, according to the amendments to DGSD, LCT should capture both direct and indirect costs[20]. Generally speaking, broader inclusion of costs in calculation of LCT should increase the scope of DGS funding for interventions other than payout (Costa et al. 2022).

Ad d. Finally, the possibility to engage DGS in actions outside resolution, such as preventive and alternative measures are to be maintained. However, both types of measures are slightly amended. Preventive interventions of DGS would be better framed and dependent on new conditions. The main aim of this kind of interventions should be to provide necessary support for a viable bank, i.e. which has not met any conditions qualifying it as FOLTF. It is proposed that a requesting bank would submit a note with measures to strengthen its financial position or, when necessary, to restore the compliance with supervisory requirements. Depending on the type of preventive measure requested (capital support or liquidity support), this note should also specify either ways to raise capital or repayment schedule of a loan. In case a bank would fail to deliver on its commitment made in the note, or to repay the preventive support granted by DGS, the supervisory authority would have a power to request the bank to submit a remediation plan outlining how the bank plans to restore compliance with supervisory requirements, ensure long-term viability and repay the preventive liquidity support. In case DGS would grant capital support it ought to sale its stake to a private sector purchaser as soon as possible. For banks which have been subject to national winding-up procedures leading to a market exit, deposit insurer would still have the possibility to provide support within alternative measures aimed at preserving the access of depositors to their deposits. The new provisions specify the transparency conditions for a marketing process of assets and liabilities of the bank concerned.

Preventive and alternative measures under the EC proposal remain, however, national options. It might be argued that it would be more beneficial to make them a standard tool of the crisis management framework. Brescia Morra et al. (2023) and recently the ECB in its Opinion (CON/2023/19) propose that both preventive and alternative measures should be made available across the EU, while J. Eule et al. (2022) focus only on alternative measures and argue that wider application of these measures can limit DGS upfront outlays, ensure uninterrupted access to deposits and banking services and contain the risk of destabilizing bank runs, thus benefiting DGS, depositors and financial stability. It should be noted that making alternative measures a mandatory feature of the crisis management framework would mean that banks for which resolution is not an option (due to negative PIA) would also be

[20] As pointed out by De Aldisio et al. (2019) although calculating indirect costs would be more difficult than direct costs, these cost could be material, thus having a great impact on the outcome of the LCT assessment.

liquidated in an orderly and cost-efficient manner. The portfolio transfer supported by deposit insurer would be far more beneficial than a piecemeal liquidation because transfer strategies allow to maintain value of the banking business, minimize risks for financial stability and protect depositors (not only covered but all) as deposits are transferred to an acquirer (Ramos-Muñoz et al. 2023).

4. A broadened DGS mandate – potential difficulties and challenges ahead

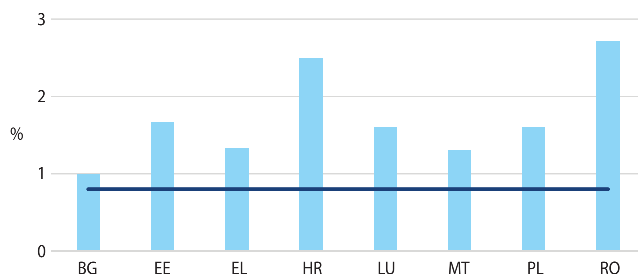
The proposed CMDI reform aims at widening the scope of resolution to include also small and medium-sized banks. This is to be achieved by facilitating access to industry-funded safety nets, i.e. deposit guarantee schemes and resolution funds. Although the above mentioned changes should facilitate DGS involvement in interventions other than payout, there still could be some difficulties and challenges related with their introduction.

First, while the DGS bridge financing mechanism to reach 8% TLOF threshold to access resolution fund would have positive impact on managing resolution of smaller deposit-funded banks, it would basically mean that DGS covers to (some extent) losses that, in the absence of this mechanism, would have been borne by uncovered depositors. Although providing financing to support transfer strategies will certainly be least costly than payout of covered deposits, it still will be costly for DGS, in particular in case of "larger" medium-sized banks. It has to be noticed that the population of small and medium sized banks is very heterogenous with regard to both their size measured by assets as well as to their business models, which determines their funding sources. The assets of this group of banks in the banking union vary from 100 million EUR to almost 30 billion EUR (SRB 2023). As the threshold to reach resolution fund is defined in percentage of total liabilities and own funds of a given bank, it means that the absolute amount contributed by DGS would depend on (1) the remaining internal loss absorbing capacity of a bank (i.e. amount of own funds and eligible liabilities which could already be used to cover losses in the run-up to resolution) and (2) the size of the bank, i.e. the larger bank, the larger absolute amount of TLOF and 8% of it.

Providing gap financing risks also more frequent usage of DGS funds, and thus their faster depletion. In such a situation DGS will be required to replenish its funds by collecting ex post contributions which might be procyclical, in particular in times of system-wide tensions. These additional contributions would constitute burden on banks which in turn might impact their profitability. Nevertheless, it seems that the broadening DGS mandate necessitates more DGS funds. This could be done either via collecting ad hoc ex post contributions each time a shortfall in DGS funds occurs or via strengthening DGS financial capacity gradually by setting a new higher target level and providing transition period to reach it. Currently the minimum target level to be reached by 3 July 2024 is 0.8% of covered deposits of banks belonging to

the given DGS. DGSD allows to set both a higher and a lower level (but not lower that 0.5%), if deemed necessary by the national authorities. Eight Member States introduced a higher target level ranging from 1% to 2.71% (see Chart 3), while only one Member State decided for a lower (0.5%) target level (Spitzer 2022).

Chart 3. EU Member States which set a higher DGS target level



The navy blue line marks the minimum target level at 0.8%.

Source: Own work based on (EBA 2022).

Interestingly, five[21] of those Member States who introduced a higher DGS target level have also implemented preventive or/and alternative measures into their national legal frameworks. This shows that widening the spectrum of DGS tasks requires at the same time securing appropriate financial capacity of the deposit guarantee fund. Chart 3 shows that the most common higher level adopted by these Members States is around 1.6%. However, in case such an amendment is introduced within DGSD the calibration of a new target level would require an in-depth analysis. Ensuring appropriate financial capacity of DGS is of crucial importance as any shortfalls of DGS funds could not only constrain the ability of a deposit insurer to effectively perform its functions but also undermine depositors confidence. To that end, it seems that in order to safeguard sufficient, credible and effective firepower of DGS with its new broadened mandate, it might be appropriate to set a higher target level of deposit guarantee fund.

Second, although introduction of a general depositor preference is a welcome change as it would unlock funds for DGS intervention other than payout, this change, however, would not be beneficial for DGS in cases of bank liquidation and subsequent deposit payout. The CMDI reform aims at broadening the scope of banks subject to resolution but it does not mean that all banks would be resolved in that way. In particular, it cannot be excluded that some banks might have a negative public interest assessment and would be liquidated under standard insolvency proceedings, which would entail deposit payout. In such cases a general depositor

[21] As noted earlier Greece and Luxembourg implemented alternative measures, while Croatia, Malta and Poland implemented both preventive and alternative measures.

preference would worsen the DGS position. This is because under the current regulations DGS has super-preference status in the hierarchy of claims which means that it is satisfied from the proceeds of an insolvent bank before other creditors and in particular before uncovered depositors. Under the general depositor preference approach DGS would rank pari passu with other depositors regardless of their eligibility and coverage, which basically means that it would have to bear losses to the same degree as all deposits (Dobler et al. 2020). To that end, there might be some concerns about introducing a single-tier depositor preference.

A possible alternative way forward, which would be more beneficial for the DGS in case of insolvency proceedings and at the same time allow to unlock more DGS funds for interventions other than payout, could be the introduction of a two-tier depositor preference. In this approach all deposits would rank above ordinary unsecured claims, however, there would be two tiers (layers) of deposits: (1) covered and preferred deposits and (2) non-preferred and non-covered deposits. Deposits in the first tier would rank pari passu and above deposits in the second tier, while deposits in the second tier would rank pari passu and above ordinary unsecured claims (see Figure 1). According to the EC (2023) estimates introducing a two-tier depositor preference would enable to unlock 0.21 billion EUR of DGS funds, which is five time less than under a general depositor preference, but four times more than currently. However, in comparison to a general depositor preference, a two-tier depositor preference would ensure a better protection to DGS, i.e. higher recoveries, in case of bank liquidation.

Figure 1. DGS position in hierarchy of claims under single and two-tier depositor preference

Creditor hierarchy	General depositor preference (single tier)	Two-tier depositor preference
senior	Secured liabilities	
↑	All deposits (covered deposits/DGS, non-covered preferred deposits, other)	Covered deposits/DGS and non-covered preferred deposits
		Other non-covered and non-preferred deposits
junior	Ordinary unsecured liabilities	

Source: (EC 2023).

Another challenge might relate to the methodology of the least cost test. According to the EC proposal both direct and indirect costs should be included in the LCT. However, it might be challenging to calculate indirect costs such as e.g. potential systemic impact of a bank's failure or contagion effect. There might be also some political issues related with the CMDI reform. Although the proposed changes to the

CMDI framework have been widely supported by the European institutions, like the ECB or the SRB[22], it is still possible that at the national level some objections might arise. In particular, in the absence of the pan-European deposit insurance (EDIS), the cost of this reform will be mostly borne by the national deposit guarantee schemes. Thus, it is possible that there might be some resistance towards e.g. removal of super-preference status of covered deposits/DGS.

Conclusions

Deposit guarantee schemes should be allowed to intervene in a broad and flexible manner. This is particularly important for smooth crisis management of smaller banks which either could have problems with meeting 8% TLOF requirement within the resolution procedure or could not qualify for resolution at all. In such situations initiating national insolvency proceedings and conducting piecemeal liquidation with a payout of covered deposits could be less efficient than allowing DGS to support resolution or to take alternative measures.

To that end, extending the role played by DGS in crisis management is a step in the right direction. This could be done by making current national options included in Art. 11(3) and 11(6) DGSD more uniformly available in the whole EU. However, this would not be enough. Further reforms are necessary to make those DGS functions operationally available. First, ranking of covered deposits and subsequently DGS (which subrogates into rights of covered depositors) has to be changed, i.e. the current super-preference of covered deposits should be replaced by single or two-tier depositor preference. Second, least cost test has to be modified and harmonized so that both indirect and direct costs are taken into account. All these changes implemented together would have a potential to unlock DGS funds and make deposit insurers proactive participants in crisis management. Nevertheless, broadening DGS mandate risks also more frequent usage of DGS funds. Therefore, in order to avoid shortfalls in DGS funds, it might be necessary to strengthen its financial capacity by gradually raising DGS target level from the current 0.8% of covered deposits.

Having said that, the 2023 proposal of CMDI reform published by the European Commission should be assessed positively as it tries to address all identified obstacles in a greater involvement of DGS funds in crisis management. Nevertheless, some challenges or costs of the proposed measures could also be identified. What is important now, is to ensure that all these amendments are appropriately balanced to deliver the optimal result. So far, works on the CMDI proposal are on-going in the European Council and in the European Parliament.

[22] Both institutions expressed their support from the CMDI proposal in a joint press release published on 18 April 2023, available at: ECB and SRB welcome European Commission's legislative proposals for bank crisis management and deposit insurance framework (europa.eu)

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Financial technologies and traditional banking: new conditions of financial market with respect to competition and risk

Abstract

The digital revolution brought new factors that influenced the traditional banking market. Banks were forced to compete not only with other players from the banking sector but also with FinTech companies. Therefore, the aim of this paper is to investigate the impact of digital financial technology on traditional banking in the context of the new conditions of competition on the financial market in EU. This paper investigates the impact of digitalization and FinTech on performance of traditional banks.

This paper consists of a qualitative and quantitative assessments. In the theoretical part this paper confirms the crucial role of FinTech companies in shaping new financial market and that digitalization has changed the conditions of competition and risk. Finally, the quantitative investigation confirms that innovative technology had an impact on traditional bank performance.

Keywords: FinTech, competition, risk, traditional banking performance, COVID

JEL Codes: G21, F36; G2; G21; G34.

Technologie cyfrowe i bankowość tradydyjna: nowe uwarunkowania rynku finansowego w zakresie konkurencji i ryzyka

Streszczenie

Cyfrowa rewolucja wpłynęła na model tradycyjnej bankowości. Banki zostały zmuszone do konkurowania nie tylko z innymi graczami z sektora bankowego, ale także z przedsiębiorstwami FinTech. Dlatego celem niniejszego artykułu jest zbadanie wpływu przedsiębiorstw (FinTech) na tradycyjną bankowość i wreszcie na wyniki banków w UE, w nowych warun-

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kach rynkowych. Niniejsza praca składa się z analizy jakościowej i ilościowej. W części teoretycznej niniejszy artykuł potwierdza dużą rolę przedsiębiorstw FinTech w kształtowaniu poziomu konkurencji w sektorze finansowym. Badanie ilościowe potwierdza, że nowe technologie miały wpływ na wyniki tradycyjnych banków. Ponadto nowi gracze zmienili warunki konkurencji na rynku finansowym.

Słowa kluczowe: FinTech, konkurencja, ryzyko, bankowość tradycyjna, COVID

Kody JEL: G21, F36, G2, G21, G34

Introduction

In recent years, the FinTech sector has been growing extremely fast and therefore will have a massive impact on the financial market. The development of digital technologies and mobile devices have brought innovative changes in the financial system as w whole and the accessibility of numerous services rendered through electronic distribution channels has improved (Scardovi 2017; Boobier 2020; Beaumont 2020; Boot et al. 2021). The new players include both small firms (startups) and big technological firms BigTech, the importance of which is growing in the transformation of the market of services that used to be restricted only for banks. While the most noticeable change, due to the use of innovative technologies, took place in the payments segment, also FinTech companies gradually started basic banking services, including lending activities. Like banks, FinTech operators provide consumer, corporate and mortgage loans (Claessens et al. 2018). Due to the increased competition in the financial market, new players take part of the profits from traditional banks. Currently, to maintain their market position, traditional banks will change their business models, which has significant consequence for the future of the entire financial sector. Advances in information technologies have transformed banking practices and products. The technical solutions have also become one of the important internal factors enabling banks to streamline their management systems, improve work quality and create new distribution channels. Appropriate use of the innovative technologies enabled banks to keep their market positions, that in consequence enhanced the level of competition in the banking industry (Philippon 2016; Claessens et al. 2018). Competitors from the FinTech sector, firstly, have access to a wider group of customers than traditional banks, and secondly, they provide their customers with additional benefits consisting in greater convenience of using financial services at lower costs. In addition, players from the BigTech sector offer financial services as part of a much wider set of activities, have a high growth potential and can be great competitors for traditional commercial banks.

Furthermore, the COVID pandemic had a tremendous impact on the growth of the FinTech sector. On the one hand, the spread of the COVID pandemic affected the economic slowdown, on the other hand it spurred on the development of sales channels based on FinTech. Finally, the political situation has caused inflation to rise globally, which has caused interest rates to rise and problems in the traditional banking sector, confirmed by the events related to the collapse of i.e., Signature

Bank and Silicon Valley Bank (SVB) bank in 2023. These events may have weakened the position and trust in traditional banking system.

The aim of this paper is to investigate the impact of digital financial technology (FinTech) on traditional banking and finally on banking performance in EU at the new conditions of competition on the financial market. This paper consists of qualitative and quantitative analysis. In the theoretical part this paper confirms the big role of FinTech companies in shaping new financial market. Finally, the quantitative investigation based on panel data confirms that new technology had an impact on the traditional bank's performance.

1. The impact of FinTech enterprises on the structure of the financial sector

1.1. Basic definitions

FinTech is part of the process of evolving financial innovation. FinTech has theoretically been shown "to be risky but of value" (e.g., Thakor 2020), with supporting recent evidence that it yields substantial value to investors. The Financial Stability Board (FSB 2017) defines FinTech as "technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions, and the provision of financial services. There is no uniform market definition of the FinTech. Among the entities using digital technologies on the loan and lending market, one should distinguish large enterprises, the so-called BigTech. Their activity in finance presents a special case of FinTech innovation. The term FinTech refers to enterprises using technological innovations in financial services, while large technology companies (BigTech) offer financial services as part of their activities, which have a much wider scope (BIS 2019). BigTech companies have the other lines of business. Their core business is usually non-financial, while lending is only a part of it, often a small one. Notably, technological giants such as Amazon, Apple, and Google, which already operate in the lending market, have immense potential for the development of financial services because they have access to a huge amount of customer data (BIS 2020, p. 7). Greater involvement of leading BigTech companies in the financial services market may bring significant changes. Traditional banks collect information on customer credit histories over a prolonged period, while BigTech companies can use their advantage on the lending market thanks to non-financial data about their customers and can use this data on a much larger scale in their financial activities (BIS 2020). In the era of digital technologies, traditional commercial banks face competition in the lending market not only from BigTech companies, but also from new players - the so-called neobanks. New banks use advanced technologies to provide banking services in the retail banking segment, via smartphone applications and online platforms. They can obtain

banking licenses under the existing regulatory regimes, and it is they who can grant loans, create relationships with customers or have traditional banks as business partners.

To sum up, FinTech is a broad concept, there are banks which use FinTech technology as an additional distribution channel, as well as new banks (neobanks) which do not have traditional branches, non-banking FinTech companies (e.g., start-ups) and large technological companies BigTech. Barclays Bank installed the first ATM in UK, in 1967. The ATM was the first innovation that clearly showed the deep potential interlinkage between finance and technology (Nicoletti 2017, pp. 14–15). Therefore, ATMs are among the product innovations that fostered the development of the FinTech sector. Currently, "FinTech", have started to play an important role in the provision of many financial services. However, Buchak et al. 2018 found that on the US mortgage market traditional banks provide products of higher quality than those of FinTech (they stressed, however, that the traditional banks lose their market share because of a greater regulatory burden).

1.2. Market structure in the financial sector; theoretical approach

An important factor shaping the financial system is the market structure, which affects the level of competition and banks' market power (cf. Pawłowska 2021; Degryse et al. 2009). The theory suggests that any departure from the perfect competition results in restricting the borrowers' access to credit, at higher prices. The impact of market structure on banks' lending and deposit operations was first studied by Pagano 1993. In recent years there have been ongoing debates concerning the economic role of market structure and size of bank within the banking industry. Changes in competition within the banking sector are taking place through two channels: mergers and acquisitions (M&A) and regulations stimulating barriers to enter and to exit. Digital technologies increase the possibility to enter and to exit the financial market. Fundamental advances on the internet, mobile communications, distributed computing, and information collection and processing have underpinned a range of recent innovations in finance (see FSB 2017; 2019). Consumers in both advanced and emerging market economies have increasingly adopted digital financial services that are more convenient.

Studies concerning competition in the banking sector draw theoretical and empirical models from the The Industrial Organization Approach to Banking (IOAB) theory, concerned with the issue of measuring competition in the banking sector and defines the following measures of competition: the Lerner index, the H-statistic, and the Boone-indicator (cf., Hicks 1935; Demsetz 1973; Besanko & Thakor 1992; Degryse et al. 2009; Van Hoose 2010; Bikker & Leuvensteijn 2014; Pawłowska 2014). On the one hand, following the traditional stance in the theory of economics, market power of banks results in a lower supply, albeit at higher costs. On the other hand, considering information asymmetry and agency costs, it is conducive to a phenomenon that shows a positive or non-linear connection between market power and access to credit. Also, the Structure-Conduct-Performance paradigm

(SCP) figures still prominently among theories that relate market power to bank profitability (cf., Van Hoose 2010). Bain (1951) developed the SCP model. This theory states that in a market with higher concentration, banks are more likely to show collusive behavior and their oligopoly rents will increase their performance (profitability) (the SCP paradigm dominated until the late 1970s). A new trend concerning structural effects on bank profitability started with the application of the Market-Power (MP) and the efficient-structure (ES) hypotheses. The MP hypothesis, which has been also referred to as the Structure-Conduct-Performance (SCP) hypothesis, asserts that increased market power yields monopoly profits. A special case of the MP hypothesis is the relative-market-power (RMP) hypothesis which was created by Smirlock (1985). Smirlock (1985) stressed that there is no relationship between concentration and profitability, but rather between bank market share and bank profitability and suggested that only banks with large market shares and well-differentiated products can exercise market power and earn noncompetitive profits. However, subsequent results of analyses based on the SCP paradigm have shown that the relationship between the structure of the market and conduct is even more complex (Pawłowska 2014).

Following the 2008 financial crisis, which validated the banks' rising role in the economy, particular attention was drawn to the growing concentration of the banking sector and a rising size of TBTF (To Big to Fall) banks and brought renewed interest to the issue of the optimum size of the financial sector (Haldane 2012). A classic model based on the SCP paradigm suggested that a more concentrated system is marked by lower competition, which enhances the likelihood of collusion, which in turn drives bank profits and a positive relationship between concentration and profitability. The market structure defined under the SCP model is of major importance for the character of such market conduct as pricing, collusion, agreements, marketing operations and scientific and research activity. In the traditional SCP model, market structure unidirectionally determines businesses' market conduct, which consequently determines market performance. Performance is measured through profitability, effectiveness, and productivity (Martin, 1989). The increase in the volume of assets of individual banks, the increase in concentration within the banking sectors, and cross-border links between large banks mean that we can now talk about the policy of international organizations in relation to TBTF institutions. Possible solutions to the problem of TBTF banks were discussed in many reports (i.e., reports by de Larosière, Vickers, Volcker, and Liikanen) and concepts were presented for reforming the banking system. In the United States, Volcker attempted to solve the problem of TBTF banks by defining the necessary reforms, which were introduced in the Dodd-Frank Act in 2010. The Vickers report (Vickers 2012), concerning the reforms of the banking sector in the UK. Pawłowska (2016) describes an important role of the banks' size and the market structure for EU banks in the context of TBTF. The empirical findings based on panel data from the period 2004–2012 show that the EU's banking sectors are not homogeneous, and that there is asymmetry between the effect of banks' competition on the stability of banking sectors in the countries of Central and Eastern Europe versus

Western Europe. There is also research showing that the excessive size of banks has an adverse effect on systemic risk (Laeven et al. 2016). However, currently in the digital age, bank's competitors are also non-banking financial institutions, including FinTech companies providing financial services and BigTech.

2. The effect of FinTech on the financial sector

In entering the area of traditional operations restricted for banks only, FinTech companies exert a tremendous impact on the competition in financial services. The so-called traditional banking or traditional banks include banks that have a universal banking business model, but also banks that conduct investment activities; for the sake of simplicity, the word traditional will be used to describe the combined model of universal banks (Blakstad, Allen 2018, pp. 148–149). Traditional banks align their business models with digital techniques, which entails serious consequences for the future of the entire financial sector (cf. Petralia et al. 2019).

2.1. The impact of FinTech on the market structure of the financial sector

In the era of digitalisation and internet use growing ever more common, it is important to analyse the effect of FinTech financial innovation on the market structure, including on the emergence of channels through which new technologies affect the competition level in respective market segments. The analysis of the interactive version of the classic SCP paradigm may lead to a conclusion that the new digital techniques are currently the prevailing element of technological progress affecting respective elements of the paradigm, i.e., structure, conduct and performance. FinTech firms affect a change in the structure of the financial services market owing to the following factors: the number and size of market participants, entry and exit barriers and the access to information and technology for all the market participants. According to (FSB 2019, pp. 3–4), financial technologies may affect the structure of the financial services market via the following channels: influence on banks' profitability, providing valid services by third persons.

The new providers of financial services i.e., loans or payments, such as FinTech, may take over a portion of the revenues of banks and other existing financial institutions, which on the one hand may potentially send their profits higher than the banks', but also make them more vulnerable to losses. Accordingly, the financial sector's resilience and its risk raking capacity may be affected. The pace at which new providers enter the sector may be a key factor in finding how bank align their models with the existing market situation. It seems that neobanks and BigTech companies may have a competitive advantage over traditional banks, especially in the retail banking segment. Thanks to the use of digital technologies, they can provide banking services at lower costs than traditional banks. On the one hand, their profit model is based on fees and commissions, but also (to a lesser extent) on interest income, with lower

operating costs related to the use of cloud technology and Big Data. In turn, traditional banks may face additional costs in adapting old, complex systems to the current data technology and architecture. Therefore, new banks may take away profits from traditional banks, which may become less profitable (BIS 2019).

Providing valid services by third persons i.e., segment of payments within the third-party providers (TPPs) has impact on market structure. Financial institutions rely on third party service providers as regards data, physical communication, and cloud services. It seems that over time, the dependence of traditional financial institutions and FinTech firms on external providers may grow. Furthermore, the entry of a big, well established technological firm to the financial services market ("Big Tech"), with their well-established networks and intensive customer data collection, have got a foothold in the financial services, particularly in payments, but also in lending, insurance, and property management. Entering a business area restricted for banks may be a source of tougher competition with renowned financial institutions. Moving forward, the new BigTech players could offer cheaper services as they could use the data acquired in other areas of their activity. BigTech have scope to compete with financial sector incumbents because of their vast size, global customer networks, brand recognition and ability to leverage their proprietary data to offer personalised services. Many also have strong financial positions. Although the use of BigTech provided financial services is currently more prevalent in jurisdictions such as China for reasons of economic and regulatory development, demographics, and culture, BigTech have the potential to gain significant market share in developed regions, also including the EU soon (BIS 2019). Big techs can leverage unique market power in providing contextual finance the bundling of financial services with core activities, due to the Data-Network-Activity (DNA)[1] feedback loop. Contextualized finance may result in improved operational efficiency and portfolio performance relative to traditional financial institutions (Feyen et al. 2021, pp. 23–25).

According to Vives (2017), competitors from the FinTech sector are putting pressure on the traditional business model of banks. Compared to FinTech companies, banks have two competitive advantages in the financial market (1): they can borrow cheaply, have access to cheap deposits and have access to explicit or implicit insurance by the government, and (2) they enjoy privileged access to a stable customer base (Vives 2017).

It should be noted that the activities of traditional banks are influenced differently by threats and opportunities from BigTech than by FinTech companies (BIS 2020). BigTech companies usually enter the financial services market thanks to brand recognition. Their entry into the financial services sector is possible thanks to the complementarity of databases of financial and non-financial services customers and the associated economies of scale and product scope (BIS 2019, p. 63). BigTech

[1] Data analytics, Network externalities and interwoven Activities ("DNA") constitute the key features of big techs' business models. These three elements reinforce each other, (e.g., the "network externalities" beget more users and more value for users (see. BIS 2019, p. 62). The source and type of data and the related DNA synergies vary across platforms.

companies seem to play a significant role in shaping financial services in the future. It seems, however, that the differentiator for banks, which provides them with loyal customers, is the element of trust and the fact that traditional banks, unlike the new players, are institutions of public trust (Thakor 2020). Endogenously, banks have stronger foundations to maintain trust. And trust is asymmetrical - it is harder to gain it than lose it. When a borrower defaults on their obligations, the borrower's trust is undermined, banks can withhold a crisis of trust, whereas for FinTech lenders it may be difficult on account of the nature of their operations. While considering the effect of COVID on the above issue a conclusion may be drawn that, on the one hand, the spread of the pandemic affected economic slowdown and the banks' worse performance, on the other hand it spurred the development of sales channels based on FinTech new technologies. Much as researchers agree on the profound and widespread consequences of new technology affecting the financial sector, there is no consensus on the probable future model of financial services provision. Some are of the opinion that what counts the most is the cooperation between the traditional banks and the new FinTech entities, including through mergers and acquisitions. Notwithstanding, according to a report by Carletti et al. 2020, banks will behave differently with respect to FinTech than to Big Tech. Future cooperation based on so-called coopetition is viewed as more likely in the case of FinTech, whereas in the case of Big Tech, it is dominance in certain segments that seems to be more likely.

It should be noted that financial market imperfections are also of significance to the new players. Historically speaking, the operations of traditional banks aiming to foster relations with their customers used to be considered a factor lessening information asymmetry between the fund's provider and the credit market customer (inter alia Akerlof 1970; Stiglitz & Weiss 1981), both ex ante risk (negative selection), as well as moral hazard may be mitigated by banks on account of their experience in finding and monitoring borrowers (Diamond 1991). However, the spread of internet use and its platforms has enabled the immediate of matching lenders and borrowers thanks to so-called peer-to-peer loans (P2P). In their case, the intermediation of financial institutions is not necessary, which is emphasised, among others, by Morse 2015. Bank's traditional functions include borrower information processing. Therefore, adaptation and special attention being drawn to products' usefulness, convenience of use and accessibility have become a basic requirement for banks. This can help build and maintain customer loyalty, although, first and foremost, it is a way to stand out on the market.

2.2. Risks attributable to FinTech and BigTech companies operating in the financial market

The technological progress and digitalisation provide numerous advantages, but they may also bring new risks and give rise to new threats. Risks associated with the operations of FinTech and Big Tech may be classified on a micro- and macroeconomic level.

Microeconomic risks involve, directly or indirectly, possible losses brought by loss of funds by financial institutions due to operational risk, e.g., because of a cyberattack, due to risk inherent in sharing infrastructure, such as cloud services, or due to infractions or failures of new solutions that have not been tested yet.

There is also operational risk related to usage of service providers being third persons. External service providers have growing visible and critical impact on financial institutions, especially in so-called cloud computing and data services. Because many third-party service providers can cross regulatory limits, greater attention is shifted to the management of combined operational risks, which may ultimately weaken financial stability. Also, the role of cyber risk systemically increased. Cross-border cooperation and coordination among authorities is important for a well-operating financial system. Innovations in cross-border credit, trade, and payment transactions, including smart contracts, raise doubts as to their compliance with domestic laws regarding jurisdiction have impact on legal risk. The application of a large amount of data as the basis for financial services comprehensively covering economic functions, including credit, investment, and insurance, is growing. The analysis of large data amounts fuels transformations in various industries as it enables extensive analyses and improves risk identification and assessment.

Macroeconomic risks chiefly pertain to systemic risk. Systemic risks are of high significance for the macroprudential policy (FSB 2017). Systemic risks address the effects of contagion, pro-cyclicality and increasing volatility. Another risk source may arrive along with so-called systemically important institutions. As mentioned, an important aspect is enhancing cyber security (Bobbier 2020). Although cyber risk does not only threaten FinTech, the higher the reliance on digital solutions, but the more access points for hackers also looking for a weak link in the network. BigTech provide their financial services either competing with the traditional financial institutions or in cooperation, as an overlay on their products and infrastructure. Next to providing financial services alone, BigTech also invest in financial institutions from outside of their groups. It follows that the fundamental problem associated with new technology is posed by security systems arising from the use of an electronic distribution channel.

A systematic rise in the value of online transactions justifies their need for continuous perfection. Transaction security is central to building trust between the customer and the company providing financial services. Also, the pro-cyclicity may arise from a few sources, including greater concentration in certain market segments, as well as from financial flows becoming large and unstable on FinTech credit platforms. Any assessment of FinTech influence on financial stability, however, is undermined by restricted access of both official, as well as privately disclosed FinTech data. The gravity and universality of complex networks and the related effects of contagion may rise as FinTech's importance grows. It must be noted that the threats and opportunities from BigTech affect banking operations differently than those from FinTech (cf. Tanda & Schena 2019, p. 47). It must be noted that BigTech are predominantly active in financial sectors targeting markets, the largest of which being China, USA, Japan, Korea, and the UK in Europe (BIS 2020).

To mitigate these risks, many regulators are already undertaking proactive monitoring of developments and cooperating across economic sectors at national, and international – European levels. The financial crisis brought about several regulatory measures related to the introduction of uniform regulations for the banking sector in the whole EU, (CRD IV package). Currently, the European Parliament is working on The Digital Services Act package consist of the Digital Services Act and Digital Markets Act, and the DORA Act (Digital Operational Resilience Act). The aim of this Acts is to create a safer digital space and to establish a level playing field for business.

3. The impact of digital technology on profitability of traditional banks: empirical results

3.1. Models' description

In the empirical part was examined the impact of new technologies on the bank performance in EU with using simple regression model based on panel data. BigTech companies were not considered in the study due to the lack of data in this area. Only FinTech companies were examined. However, when examining the influence of the FinTech on bank performance, it should be distinguished whether we are examining the FinTech as an element within the banking sector (new technologies used by traditional banks) or as an external element outside the banking sector, because new digital technologies are being adopted also by traditional banks. Product innovations in traditional banks include ATMs and modern PayTech payment systems using applications for mobile devices (smartphones).

The panel data set was constructed based on the annual panel data at the level of EU countries. The set of used data contained microeconomic and macroeconomic data in the form of a (cross-sectional and time-series) panel for 28 countries of the European Union excluding Croatia and Romania but including data for UK. The following variables are considered to be variables describing new technology: share of the number of individuals using the internet for online banking in the population, with internet banking understood as electronic transactions, such as bank transfers or direct debits, as well as checking the account balance or history; ATMs allowing authorized users to withdraw cash and number of ATMs per 1,000 km; number of mobile phone subscriptions per 100 people; internet access from a mobile device, laptop, or notebook (percent of people); and number of secure web servers per 1 million people. Profitability was measured by ROA and ROE indices published by the European Central Bank. Data concerning loans are form European Credit Research Institute (ECRI) at the Centre for European Policy Studies (CEPS). Macroeconomic data for individual EU countries were obtained from publicly available online databases of international organizations, such as International Monetary Fund, European Central Bank (Statistical Data Warehouse), Eurostat. Additionally, we consider FinTech variables from the study:

Cornelli, Doerr, Franco, & Frost (2021). It should be noted that FinTech solutions have emerged in the last 5–6 years, so analysing them in earlier periods is difficult. Another limitation, in addition to missing data and some variables have been available since 2014. Finally, panel data covered the years from 2010 to 2021 and included data from 26 EU economies. Due to missing data, this was an unbalanced panel. Descriptive statistics of the collected and correlation matrix are presented in Table 1 of the Appendix.

3.2. Model and Results of Panel Data Regressions

In this chapter we present the definition of the models and variables and present the results of models based on baseline equation. The model was estimated using panel data analysis techniques. Also, the model concerns the impact of the COVID pandemic on the performance of banks.

In the model, the dependent variable is banks' profitability, while the independent variables are GDP, size of the banking sector measured by the size of lending market, concentration of the banking market, digitalization and FinTech. The model uses two types of variables to describe the new technology (inside $DigTech1_{c,t}$ and outside the banking sector $DigTech2_{c,t}$).

Baseline equation (1) represents the output specification of the constructed econometric model:

$$Y_{c,t} = \mu_t + \gamma_c + \alpha_1 MS_{c,t} + \alpha_2 GDP_{c,t} + \alpha_3 Size_{c,t} + \alpha_4 DigTech1_{c,t} + \\ + \alpha_5 DigTech2_{c,t} + \alpha_6 FinTech_{c,t} + \beta_1 \mathrm{COV}_{c,t} + \beta_2 FinTech_{c,t} * COV_{c,t} + \varepsilon_{c,t} \quad (1)$$

where the explained variable $Y_{c,t}$ is expresses return on assets (ROA) or return on equity (ROE) in country *c* in year *t*.

As explanatory variables the following variables were used in country *c* in year *t*:

- as variable describing $GDP_{c,t}$ was adopted *GDP* grow *y/y*;
- as variable $Size_{c,t}$, describes the size of the banking sector as: total loans to *GDP*(*L_GDP*)[2] and total loans per capita (*L_PC*);
- the concentration ratios $MS_{c,t}$ as indicators of market structure: the share of the five largest credit institutions in total assets (*CR5*) and the HHI for assets (the sum of the squares of the market share of individual banks)[3].

The model uses two types of variables to describe digitalisation:

- as variables describing the new technology inside the banking sector $DigTech1_{c,t}$: *INTER* as the number of individuals using the internet for online banking in the population, *ATM* as number of ATMs per 1,000 km^2; *CARD* as logarithm of number of payment cards.

[2] The HHI index was used for the robustness check in the regressions based on equation (1).
[3] This variable was used for the robustness check in the regressions based on equation (1).

- as variables describing the new technology outside the banking sector $DigTech2_{c,t}$, we considered: *MOBILE* as the number of mobile phone subscriptions per 100 people[4], server as the number of secure web servers per 1 million people (*Server*).

The above variables concerning digitization in financial system were selected after examining the correlation between them. Also, we consider the following new FinTech variables from the study Cornelli, Doerr, Franco, Frost, (2021), for country *c* in year *t*:

- as variables describing a FinTech we considered, FinTech equity financing in relation to GDP (*FinTech*1); logarithm of number of transactions in the FinTech sector in relation to GDP (*FinTech*2)[5].

In the model we consider the impact of the COVID pandemic on the credit market and the performance of banks. In case to test the impact of a pandemic on the banking sector was defined a binary variable defining the COVID pandemic (COV): COV = 1 for 2020–2021 years, COV = 0 otherwise. The model also considers the interactions between variables to estimate the influence of the development of the FinTech companies and the COVID pandemic: $FinTech_{c,t} * COV_{c,t}$.

Based on the equation (1) ten estimates were made. Table 2 in the Statistical Appendix presents the results of the five panel regressions[6]. Table 3 in the Statistical Appendix presents the results of the five linear regressions with multiple fixed effects. The coefficients of the model were estimated using the STATA package.

In Table 2, the negative and significant coefficient α_1 was found for *CR5* (Column 4). Also, in Table 3 the negative and significant coefficient α_1 was found for *CR5* (Columns 4–5). It may mean that concertation in the banking sector had a negative impact on profitability in the EU in the analysed period. Also, the impact of *Size* is negative in the analysed period. This may mean that concentration has negative impact of profitability of traditional banks. However, the impact of GDP is ambiguous in the analysed period.

It should be noted that, the coefficient of the variable *INTER* turned out to be positive, which means that Internet use for Internet banking affected banks' profitability (Columns 2, 4 and 5 in Table 2). In Table 3, also, a positive and significant coefficient α_4 was found for the variable *INTER* (Columns 2, 4 and 5) as well as the coefficient of the variable ATM (Column 4 in Table 3). However, the impact of variable *Card* is insignificant in the analyses period.

Furthermore, variable *Server* also affected the level of profitability in the banking sector. In Tables 2 and 3, a positive and significant coefficient α_5 was found for the variables indicating server as the number of secure web servers per 1 million people (Columns 1, 2 and 4 in Table 2 and in Table 3). However, the impact of variable *MOBILE*, indicating the share of people using mobile devices to access banks via Internet, is insignificant in the analysed period.

[4] Of course, mobile phone users also use the services of traditional banks.
[5] This variable was used for the robustness check in the regressions based on equation (1).
[6] The model was estimated with using panel regressions (FE) and simple regression based on cross-sectional data.

To sum up, those above results confirm that digitalisation, in the banking sector and outside banking sector, had a positive and significant impact on the profitability of banks in the EU.

Finally, in Table 2, a negative and significant coefficient α_6 was found for the variables FinTech (Column 2). Furthermore, in Table 3, also a negative and significant coefficient α_6 was found for the variables FinTech (Columns 2 and 5) This implies that new FinTech had a negative and significant impact on profitability of banking sector in the EU.

On the one hand, digitalisation had a positive impact on bank performance. On the other hand, Fintech companies had a negative impact on bank performance. The impact of COVID pandemic is ambiguous. The results of the quantitative study presented in Tables 2 and 3 showed that variable defining the COVID pandemic has insignificant affect on the performance of traditional banks. Also, in Tables 2 and 3, an insignificant coefficient β_2 was found for the variables to estimate the influence of the development of the FinTech companies and the COVID pandemic. However, the COVID pandemic can be said to have caused accelerated development of digital technologies and of the FinTech companies.

To sum up, the results of the models allowed to confirm that digital technologies and FinTech have the impact on bank profitability.

Summary

In recent years, financial innovation called FinTech has become the main factor in the transformation of the financial sector on a global scale and has impacted the level of competition due to the possibility of increasing the bank's market power, creating new business models, and introducing processes and products. Undoubtedly, technical changes have a significant impact on the shape of traditional banks. By entering the area of activity previously reserved for banks, FinTech companies exert a huge influence on the financial services sector. Traditional banks adapt their business models to digital technologies, which has significant consequences for the future of the entire financial sector. The COVID pandemic has only accelerated this process.

This paper finds, based on the panel data model, that new technologies and FinTech companies have the impact on bank profitability in EU. On the one hand, digitalization had a positive impact on bank performance. On the other hand, FinTech companies may deprive traditional banks from the profit. Furthermore, new players have changed the conditions of competition and create new risks in the financial market.

The move to platform-based business models is changing market structure in financial services. While platforms can harness powerful economic forces to achieve efficiency gains and greater financial inclusion, at the same time, BigTech firms have the potential to become dominant through the advantages afforded by the so-called data-network-activities (DNA). Also, BigTech, which already operate in the

lending market, have immense potential for the development of financial services. Improving data statistics in this area of BigTech remains an important issue that will improve monitoring of this phenomenon and analysis of the competitive advantage of FinTech providers compared to traditional banking services.

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Annex

Table 1. Construction of variables and summary statistics of EU of banking sectors data and real economy data (mean and standard deviation (SD). Panel data are observed yearly from 2010–2021.

Variable names	Definitions	Nu. of Obser	Mean	Std. Dev.	MIN	MAX
GDPpc	The gross domestic product per capita	336	35023.6	22098.2	6812.41	118823.6
GDP	The gross domestic product growth rate yoy	336	2.975	2.7812	-1.4	25.1
L_GDP	Loans to GDP %	336	12.907	12.201	0.522	50.905
L_PC	Loans per capita	336	0.065	0.0359	0.0117	0.1802
CR5	Share of the 5 largest credit institutions in total assets[a)]	336	62.96	18.1816	26.18	97.28
HHI	Herfindahl-Hirschman index is the sum of the squares of the market share of individual banks for assets[b)]	336	0.14	0.156	0.0245	1.3
ROA	Return on assets	336	0.61	0.7828	-2.55	3.04
ROE	Return on equity	336	7.1482	8.3403	-29.28	24.07
*FinTech*1	FinTech equity financing in relation to GDP; data from the study: Cornelli, Doerr, Franco, & Frost (2021), pp. 31–43.	266	0.1068	0.468	0	6.69
*FinTech*2	Log of number of transactions in the FinTech sector in relation to GDP; data from the study: Cornelli, Doerr, Franco, & Frost (2021), pp. 31–43.	286	0.00023	0.0004	0	0.0027
Card	Log of number of credit cards	233	1.280	1.379	0.3225	19.665
ATM	Number of Automated Teller Machines per 1000 km^2 (ATM)	283	118.7	130.891	4.79	687.5
INTER	Internet banking (% of individuals)	278	48.44	16.84	2	90
Server	Number of secure servers	295	24628.98	11298.2	39.02	277133.7
MOBILE	number of mobile phone subscriptions per 100 people	281	124.375	15.625	91.9	172.12

[a)] CRk denotes the market share of the *k* largest banks in net assets.

[b)] The Herfindahl-Hirschman Index (HHI) is calculated as the sum of the squares of each commercial bank's market share (e.g., in net assets). Index values range from 0 to 1, with higher index values indicating higher market concentration.

Source: own calculations based on ECB, Eurostat data, European Credit Research Institute (ECRI). Data concerning FinTech are observed yearly, data are missing for Romania and Croatia, also some data for 2021 is not available (see: Cornelli, Doerr, Franco, Frost 2021).

Table 2. Empirical Results for the model (FE)

	(1)	(2)	(3)	(4)	(5)
	ROA	ROA	ROA	ROA	ROA
CR5	0.000	0.001	0.001	-0.011**	-0.004
	(0.005)	(0.005)	(0.006)	(0.005)	(0.006)
GDP	0.001	0.001	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Size (L_PC)	-0.299***			-0.387***	
	(0.093)			(0.095)	
Card	0.034	-0.032			-0.047
	(0.031)	(0.056)			(0.145)
Server	0.163***	0.154***		0.152***	
	(0.029)	(0.032)		(0.038)	
FinTech	-0.008	-0.039*	0.014	-0.015	-0.012
	(0.021)	(0.021)	(0.024)	(0.023)	(0.025)
COV	-0.035	0.094	0.977	0.243	0.663
	(0.985)	(1.145)	(0.970)	(1.079)	(1.304)
FINCOV	0.022	0.010	-0.052	0.002	-0.044
	(0.053)	(0.063)	(0.053)	(0.060)	(0.071)
INTER		0.013***		0.019***	0.020***
		(0.004)		(0.004)	(0.005)
ATM			0.000	0.001	
			(0.001)	(0.001)	
MOBILE			0.128		0.212
			(0.589)		(0.595)
Constant	-0.426	-1.112**	-0.674	-0.406	-1.271
	(0.516)	(0.477)	(2.816)	(0.532)	(2.862)
Observations	200	196	164	160	152
Number of krajid	25	25	26	26	25

*** p < 0.01, ** p < 0.05, * p < 0.1.

Source: own calculations.

Table 3. Empirical Results for the model of linear regressions with multiple fixed effects

	(1)	(2)	(3)	(4)	(5)
	ROA	ROA	ROA	ROA	ROA
CR5	-0.003	-0.004	-0.001	-0.010***	-0.006*
	(0.003)	(0.003)	(0.003)	(0.003)	(0.004)
GDP	0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Size (L_PC)	-0.209***			-0.341***	
	(0.051)			(0.063)	
Card	0.044	-0.046			-0.061
	(0.034)	(0.063)			(0.141)
Server	0.188***	0.169***		0.157***	
	(0.031)	(0.033)		(0.037)	
FinTech	-0.022	-0.072***	-0.019	-0.013	-0.046*
	(0.020)	(0.019)	(0.022)	(0.021)	(0.023)
COV	0.187	1.138	1.455	0.632	1.912
	(1.121)	(1.295)	(1.143)	(1.172)	(1.454)
FINCOV	0.016	-0.038	-0.072	-0.018	-0.104
	(0.060)	(0.072)	(0.063)	(0.066)	(0.080)
INTER		0.010***		0.017***	0.015***
		(0.003)		(0.003)	(0.003)
ATM			0.000	0.001*	
			(0.000)	(0.000)	
MOBILE			0.371		0.433
			(0.492)		(0.488)
Constant	-0.406	-0.212	-1.172	-0.533	-1.406
	(0.407)	(0.420)	(2.411)	(0.455)	(2.407)
Observations	200	196	164	160	152

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Source: own calculations.

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Common aspects of COVID-19 measures and sustainable banking principles. Case study of Turkey

Abstract

COVID-19, which has spread rapidly around the world after this date, was officially detected in Turkey in March 2020. As in the rest of the world, many sectors in Turkey were negatively affected by the pandemic. One of the sectors most affected by the COVID-19 pandemic was the banking sector. Therefore, the Central Bank of the Republic of Turkey, the Banking Regulation and Supervision Agency, the Banks Association of Turkey and banks quickly published measures. The banking system was redesigned with masks, social distance and hygiene principles. New working order and financial products were created for the pandemic. "Sustainability Guidelines for the Banking Sector" announced by the Banks Association of Turkey is a guide for banks in Turkey. These principles, consisting of ten articles, create a framework for sustainable banking in Turkey. The purpose of this study is to determine how related the measures taken during the Covid-19 pandemic are to sustainable banking principles. To that end in this study, measures taken in compliance with COVID-19 regulations and sustainable banking principles were identified. Adaptive principles are grouped under common headings. The measures taken, the issues of "resilience and adaptability" and "economic recovery and resilience" came to the fore the most. Since there is no similar study in the literature, it is thought that it will guide regulatory authorities and academic studies.

Keywords: banking, COVID-19 measures, sustainable banking, resilience

JEL Codes: E50, I18, Q56

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Wspólne aspekty działań związanych z COVID-19 oraz zasad zrównoważonej bankowości. Przykład Turcji

Streszczenie

W marcu 2020 roku COVID-19, który szybko rozprzestrzeniał się na całym świecie, został wykryty w Turcji. Podobnie jak w innych krajach na świecie, pandemia dotknęła wiele sektorów tureckiej gospodarki. Jednym z sektorów najbardziej dotkniętych pandemią COVID-19 był sektor bankowy. Bank centralny (Türkiye Cumhuriyet Merkez Bankasi), nadzór bankowy (Banking Regulation and Supervision Agency), związek banków (Türkiye Bankalar Birliği), a także banki szybko podjęły działania. System bankowy został przeorganizowany z uwzględnieniem maseczek, dystansu społecznego oraz zasad higieny. Wprowadzono nową organizację pracy oraz nowe produkty finansowe. W 2021 roku związek banków ogłosił zmodyfikowane wytyczne dotyczące zrównoważonego rozwoju dla sektora bankowego: *Sustainability Guidelines for the Banking Sector*. Wytyczne zawierają 10 zasad, które tworzą ramy dla budowy zrównoważonej bankowości w Turcji. Celem artykułu jest ocena zgodności działań podejmowanych w czasie pandemii COVID-19 z zasadami zrównoważonej bankowości. W artykule zidentyfikowano działania antycovidowe, które były zbieżne z zasadami zrównoważonej bankowości, następnie przypisano je do wyodrębnionych 6 obszarów zgodności. Największą zgodność zidentyfikowano w obszarze „odporności i zdolności adaptacyjnych" oraz „odbudowy gospodarczej i odporności".

Słowa kluczowe: bankowość, działania związane z COVID-19, zasady zrównoważonej bankowości, odporność

Kody JEL: E50, I18, Q56

Introduction

The COVID-19 pandemic has affected many sectors not only on the basis of countries but also all over the world. Governments, public and private sectors have suddenly entered into a major crisis. A similar situation was also valid for Turkey.

Many measures have been taken, especially regarding public expenditures. The first COVID-19 case in Turkey was detected on March 10, 2020. Afterwards, public finance measures were published by the ministry. According to this regulation, the submission and payment periods of annual income tax returns have been postponed. Additionally, a tax deferral was made for 6 months for many business lines. A regulation called the Economic Stability Package with an estimated amount of 100 billion Turkish lira was announced. Incentives were given to healthcare workers (SESAM 2023).

In addition to all these regulations, another sector affected by the pandemic was the banking sector. In this regard, the Central Bank of the Republic of Turkey (Türkiye Cumhuriyet Merkez Bankasi: TCMB), the Banks Association of Turkey (Türkiye Bankalar Birliği: TBB), the Banking Regulation and Supervision Agency (BRSA) and all banks announced measures.

Many of the instruments used in the fight against COVID-19 are also compatible with sustainable banking activities. The purpose of this study is to determine how related the measures taken during the Covid-19 pandemic are to sustainable banking principles. It is aimed to compare the relationship between the activities carried out in Turkey in the fight against COVID-19 and sustainable banking principles. In the following sections, firstly, the studies in the literature in this field are examined. Next, the development of the pandemic in Turkey is briefly discussed, and then the measures of all institutions are grouped and explained according to sustainable banking principles.

1. Literature Review

There are many studies in the literature on the impact of COVID-19 pandemic on banking activities in Turkey. However, the issue of COVID-19 and sustainable banking has not been analyzed much. These papers collectively suggest that the COVID-19 pandemic has had various impacts on banking activities in Turkey. The main studies are briefly summarized in this section.

Bayar & Varisli (2020), in this study; highlighted the impact of COVID-19 pandemic on the volume of consumer loans in Turkey. It is found that COVID-19 pandemic has a statistically significant and positive impact on the volume of consumer loans in Turkey.

Beybur & Cetinkaya (2020), in their studies; highlighted the increased usage of Turkish digital banking products and services during the COVID-19 pandemic in Turkey. As a result of analysis, the impact of the pandemic on the use of digital banking products/services was tried to be explained.

Ekim Kocaman (2021), in this study; analyzed the Turkish Banking Sector and Market Concentration During COVID-19. It has been determined that the concentration in asset shares and loan volume in the Turkish Banking Sector has increased, and the dominance of state-owned deposit banks in the market has increased.

Yurttadur (2021), in this study; focused on the effects of COVID-19 pandemic on profitability of participation banks in Turkey. It was found that the economic crisis caused by the COVID-19 pandemic did not negatively affect the profitability of participation banks, and even the profitability of participation banks increased after the onset of the pandemic.

Kendir et al. (2022), in their studies; determined the effects of COVID-19 pandemic on bank loans and protested promissory notes of banks. According to this study, it was observed that some sectors' credits increased considerably, but the credit demands of sectors such as education and health decreased. In addition, consumer loans and protested bills of banks have increased significantly compared to previous years.

Ergin Unal et al. (2022), in their studies; analyzed the effects of the COVID-19 pandemic on the banking, tourism and industrial sectors in the Turkish economy. It is determined that there is a unilateral causality relationship with the number of COVID-19 cases.

Demirel (2022), in this study; evaluated the impact of the COVID-19 pandemic on individual Turkish mobile and internet banking and corporate mobile and internet banking usage. According to the study, it was determined that after COVID-19, individual mobile banking usage, corporate mobile banking usage, corporate internet banking usage increased, but individual internet banking usage decreased.

Erden & Aslan (2022), in their studies; analyzed the impact of the COVID-19 pandemic on the sustainable development of the Turkish banking sector. For this purpose, many variables were analysed and high correlations were found.

Cetiner & Gurel (2022), in their studies; investigated the impact of the COVID-19 pandemic on sustainable finance practices. In the study, sustainable finance and its effects were defined and the negative effects of the COVID-19 pandemic in the field of sustainable finance were evaluated.

The most recent studies on the subject in other countries are listed below.

Sumadi (2020), in this study measured the impact of the COVID-19 pandemic phenomenon on Islamic banking. According to this study, fluctuations in financing and fund collection were determined.

Xie et al. (2022), in their studies; examined the impact of the COVID-19 pandemic on the sustainability of banks in developing Asian countries. As a result of the analysis made with various variables, it was determined that COVID-19 had a significant impact on these countries.

Karim et al. (2022), in their studies; focused on sustainable banking regulations pre and during coronavirus outbreak.

OECD (2022), in this study; identified the current situation and proposed solutions for sustainable financing after the COVID-19 outbreak. It was determined that restrictions during COVID-19 sustained health of banking sector through its well-regulated monitoring mechanism.

2. Timeline of the COVID-19 pandemic in Turkey

The first case of COVID-19 emerged in China in December 2019 and turned into a global pandemic. After that the first COVID-19 case in Turkey was on March 11, 2020. In the following period, various safety measures were taken not only in the world but also in Turkey. Some of these measures recommended by the Ministry of Health included curfew, switching to distance education, temporary closure of places such as cafes and restaurants, and cancellation of public events.

January 14, 2021, vaccinations started as part of the fight against COVID-19. The "Controlled Normalization" process started on March 2, 2021. In this context, curfew restrictions, the conditions under which food and beverage establishments can provide service, and the conditions under which students at which levels would begin face-to-face education were determined according to the risk situations in the provinces.

In the ongoing process, there was an increase in the number of cases and in April 2021, a "Full Lockdown" period was implemented, which included uninterrupted curfew restrictions. Activities of all workplaces were suspended except for exempted establishments in areas such as production, manufacturing, food, cleaning and health, all intercity travel was subject to permission, face-to-face education was suspended in all institutions including kindergartens, nurseries and all exams were postponed (Gocumlu & Usul 2022).

The period that marked a return to normal life has begun in Turkey as of July 1, 2021. According to Turkish Statistical Institute (2021), it was announced that a total of 87,334 people died due to COVID-19 in 2020 and 2021.

3. Sustainable Banking Framework in Turkey

Sustainable banking activities in Turkey were determined by the "Green Agreement Action Plan" published in July 2021. In the action plan, the Turkish Banking Regulation and Supervision Agency was given the task of preparing the "Sustainable Banking Strategy Document". The main purpose of this document is to determine the general strategies and policies required for the Turkish banking sector to establish a sustainable banking infrastructure in the coming periods.

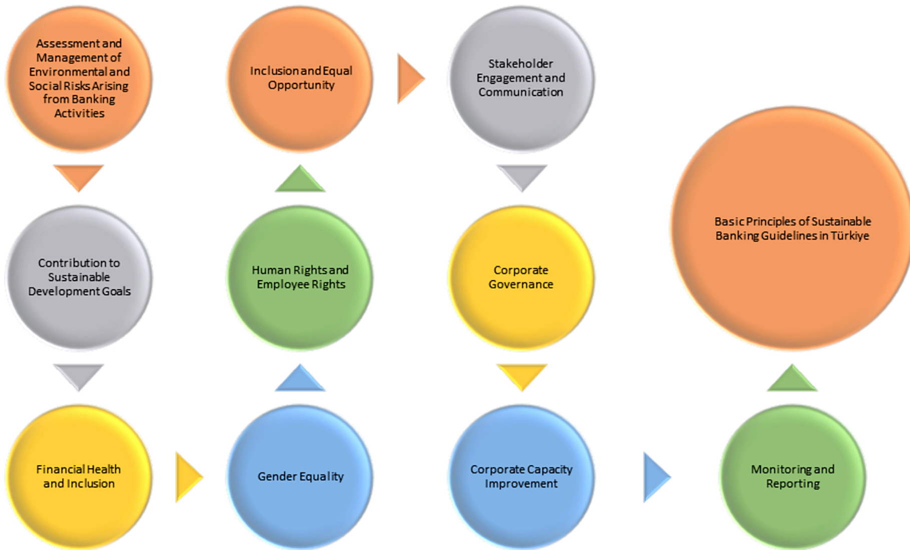
In this context, cooperation was made with relevant parties, especially banks that are members of the TBB and the Participation Banks Association of Turkey, in the preparation of the strategy document.

For this purpose, the TBB published the "Sustainability Guidelines for the Banking Sector" in 2014. The Guideline was updated in March 2021 (Banking Regulation and Supervision Agency 2021).

The basic sustainable banking framework has been determined as shown in Figure 1.

In the study, while determining common issues with COVID-19 measures, the basic principles of the sustainable guideline are grouped under several headings. Main headings are focusing on risk management, resilience and adaptability, prioritizing social and environmental well-being, collaboration and stakeholder engagement, technology and innovation, economic recovery and resilience. In these groups, COVID-19 measures and sustainability guidelines for the banking sector principles were mutually discussed.

Figure 1. Principles of Sustainable Banking in Turkey



Source: The Banks Association of Turkey (2021), Sustainability in Turkish Banking Sector, https://www.tbb.org.tr/en/Content/Upload/Dokuman/190/Sustainability_in_Turkish_Banking_Sector17052021.pdf (accessed: 10.10.2023).

4. General Framework of Measures Taken Within the Scope of COVID-19

With the increase in the number of COVID-19 cases, the Central Bank of the Republic of Turkey, the Banks Association of Turkey, the Banking Regulation and Supervision Agency and all banks have taken various measures. Since the regulations made with regards to COVID-19 are very detailed, they are examined briefly in this section.

According to the Central Bank of the Republic of Turkey (2020), the measures taken for COVID-19 consisted of 4 parts.

Primarily the policy interest rate was reduced by 100 basis points to 9.75% on March 17, 2020. A set of precautions containing 4 main issues was created in March and April.

Flexible liquidity management was provided for transactions made with local and foreign currencies. Additionally, repo auctions with maturities up to 91 days were added to the financial market. Open Market Operations (OMO) liquidity facility limits have been increased. SWAP transactions were expanded. Asset backed and mortgage-backed securities were included in the collateral pool.

The second part was aimed to ensure the continuity of loans and to support export businesses. For this purpose foreign currency reserve requirement ratios were reduced. Banks' liquidity enhancement, forward repo and swap options were increased.

Third, rediscount loan arrangements were made. The cash flow of exporting companies was supported. The maturity of rediscount credit repayments was extended. Additional commitment closing period was given. Maximum rediscount loan maturities have been extended. New credit opportunities provided.

Fourth, the liquidity of the government's domestic debt securities market was boosted. For this purpose, the conditions for direct purchase transactions in the open market operations portfolio have been improved. Banks were offered the opportunity to sell the government domestic debt securities purchased from the Unemployment Insurance Fund to the TCMB. It was decided that the limits on the possibility of selling government domestic debt securities directly to the TCMB would be applied independently of the repo transaction limits. In addition, Primary dealer banks were given a limit for selling government domestic debt securities equal to their repo transaction limits.

The TBB has taken measures under three main headings. These were general measures, measures implemented by banks and measures taken by the TBB.

The Banking Regulation and Supervision Agency (2020b) has also announced COVID-19 measures. In brief, calculations for foreign currency transactions in capital adequacy measurement have been changed. For many financial institutions, the delay period for non-performing receivables classification has been extended. Payment of credit card debts has been delayed. Changes were made in the payment of debts in many credit branches. An adjustment was made regarding the Liquidity Coverage Ratio.

5. Common Aspects of COVID-19 Measures and Sustainable Banking

According to the Banks Association of Turkey (2020), COVID-19 measures that comply with the sustainable banking framework principles in Turkey are grouped under the headings below.

5.1. Focusing on risk management

The issue of focusing on risk management has become very important not only in sustainable banking but also in pandemic crises such as COVID-19. In this process, banks are focusing more and more on risk management activities in all operations. COVID-19 measures aim to control and reduce the risk of infection and limiting the negative effects of the pandemic, while sustainable banking focuses on identifying

and managing risks related to environmental, social and governance issues. Both require a proactive and adaptive approach to risk management to effectively address and mitigate emerging risks. The issue of identifying and reducing risks is important both when taking COVID-19 measures and in terms of sustainable banking principles. Risk management comes to the forefront especially in environmental and social sustainability. For this purpose, it is important to identify and mitigate risks. Among the measures regarding COVID-19 in Turkey, those related to risk management are listed below.

The Asset Ratio application was started on May 1, 2020. It was aimed to minimize the negative impact of the pandemic process on the Turkish economy, market, production and employment. In addition, it was planned to ensure the effective utilization of the resources held by the banks. Asset Ratio application has been abolished as of December 31, 2020, with the start of the normalization process (Banking Regulation and Supervision Agency 2020a).

It has been decided that 0% risk weight could be applied to banks receivables from the Central Government of the Republic of Turkey and those held in foreign currency in the calculation of the amount subject to credit risk.

Flexibility has been provided to banks regarding the maximum rate regarding the interest rate risk standard ratio arising from banking accounts.

Members of the Risk Center were requested to write a “force majeure” note in the credit registry for natural and legal persons who fell into default within the scope of the curfew practices.

Additional funding was provided to be used in rediscount loans in Turkish Lira, with the guarantee of the Credit Guarantee Fund (Kredi Garanti Fonu: KGF) originating from the TCMB.

Due to possible short-term decreases in collateral values, flexibility has been provided in the fair value calculation of financial collateral, which must be made at least every 6 months.

Bank customers who had temporary payment problems were given the opportunity to restructure their loans with appropriate terms and a grace period.

Customers who were found to be negatively affected by the epidemic were reported to the Risk Center as being affected by the COVID-19 epidemic, not their economic activities, so that a more accurate evaluation of these customers was made.

Detailed risk information was shared by the KGF in order to support the evaluation of loan applications effectively and accurately.

5.2. Resilience and Adaptability

In sustainable banking activities, it is necessary to be resistant to shocks and adapt to changing conditions. Similar measures taken in Turkey for COVID-19 are listed below.

The minimum payment rate for individual credit cards has been reduced to 20%. In addition, citizens whose credit card debts were postponed were given the opportunity to define a grace period, including the minimum amount, until the end of 2020.

It was possible to postpone the principal and interest payments of consumer and vehicle loans extended by banks/companies during the pandemic period, upon the request of the customers.

It was decided that the 90-day delay period, which caused loans to be classified as non-performing loans by banks, would be applied as 180 days for loans monitored in the first and second groups. Despite the 90-day delay, the provisions to be allocated for loans that continue to be classified in the second group were allowed to continue to be allocated according to the banks' own risk models used in calculating the expected credit loss within the scope of Turkish Financial Reporting Standards (TFRS) 9.

The 90-day delay period was applied as 180 days for financing and factoring companies, and 240 days for financial leasing companies.

Due to the COVID-19 pandemic, flexibility was provided in the minimum ratios regarding the liquidity levels of banks.

The limitation for transactions of banks with non-residents to purchase Turkish lira on maturity has been reduced from 10% of shareholders' equity to 1%.

It has been decided to delay the debts of customers whose cash flow has deteriorated due to COVID-19 measures. Additional financing opportunities were provided to companies upon request.

Stock financing support was provided to exporters in order to maintain capacity utilization rates during the temporary slowdown in exports.

By increasing the KGF limit, additional collateral opportunity was provided to companies that needed liquidity and had a collateral gap.

Open rediscount loan principal and interest payments were postponed and the maximum maturity was extended.

For houses worth less than 500000 Turkish Lira, the creditable amount has been increased and the minimum down payment has been reduced.

In daily gold purchase transactions of 100 grams or more, it has been decided that the gold would be transferred to the relevant person's account and/or made available for use with a value date of one business day.

It has been decided that the total of Turkish Lira placements, repos and loans to be made by banks to financial institutions located abroad would be limited to 0.5% of the banks' last calculated legal equity.

The withholding tax rate for natural persons on financial bills has been increased from 10% to 15%.

The notice period for open export account notification to the Tax Office Directorates has been extended.

5.3. Prioritizing social and environmental well-being

Social and environmental responsibility is also important both in terms of sustainability and public health. The regulations within this scope are listed below.

The use and amounts of conditional loans specific to COVID-19 were increased.

In order to facilitate firms' public payment obligations such as tax and social security institution (SSK), cash management limits were increased and instalment facilities were improved.

Due to the curfew, bank branches were reminded to carry out all kinds of banking transactions and actions using non-branch channels. Recommendations were given to banks regarding the postponement of customers' actions.

In order to protect employment, companies were provided with long-term loans and additional limits equal to monthly personnel salary expenses.

5.4. Collaboration and Stakeholder Engagement

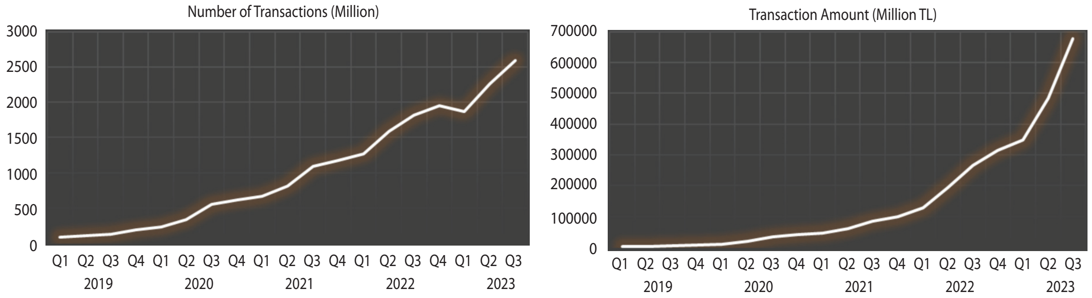
Many institutions cooperated during the COVID-19 process. In terms of sustainable banking, the TCMB, the TBB and many of the banks have made decisions and acted together.

5.5. Technology and Innovation

The COVID-19 pandemic has further increased the importance of technology in banking activities. Especially the use of mobile branches and contactless payment systems have become more common. Innovation in healthcare and public health was encouraged in banking products. Technology-driven solutions were made.

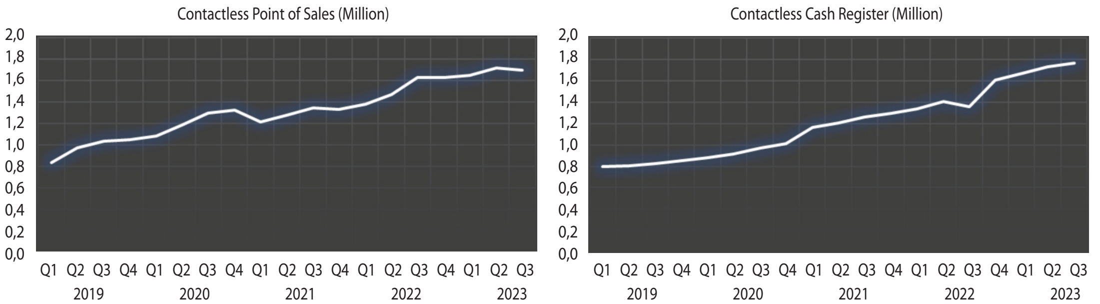
As shown in the figure 2 to 4 all variables increased over the 5 years in Turkey. These variables are number of transaction with credit cards, transaction amount of credit cards, contactless point of sales, contactless cash register, number of contactless cards, mobile contactless & QR payment.

Figure 2. Number of transactions and transaction amount with credit cards in Turkey



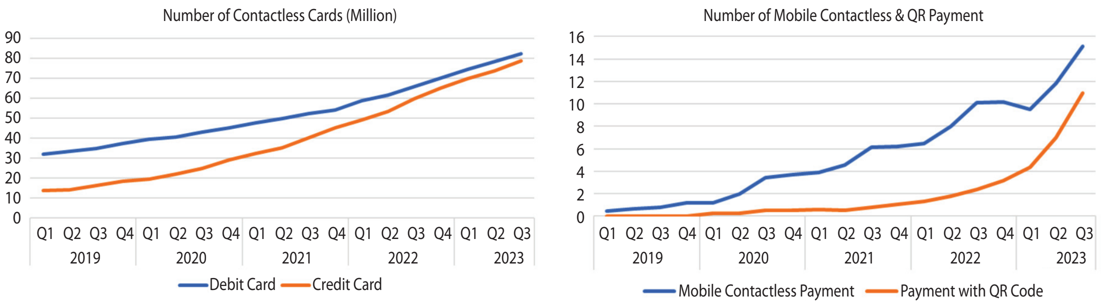
Source: The Interbank Card Center (BKM), 2019–2023, https://bkm.com.tr/yerli-ve-yabanci-banka-kartlarinin-yurt-ici-kullanimi/ (accessed: 08.10.2023).

Figure 3. Contactless point of sales, contactless cash register in Turkey



Source: The Interbank Card Center (BKM), 2019–2023, https://bkm.com.tr/temassiz-pos-okc-yazilim-sayilari/ (accessed: 09.10.2023).

Figure 4. Number of contactless cards, mobile contactless & QR payment in Turkey



Source: The Interbank Card Center (BKM), 2019–2023, https://bkm.com.tr/mobil-temassiz-karekodla-yapilan-odeme-islemleri/ (accessed: 09.10.2023).

The following measures have also been made. Transactions can be made free of charge via ATM mobile and internet branch. Daily withdrawal limits from ATMs have been increased. Many banks have redesigned their branches according to social distance and hygiene rules. Bank employees have been given the opportunity to work remotely. Customers have been directed to the mobile-internet branch.

Additionally, customers have continued to use similar products after the COVID-19 period. Many banks have shaped the design of their branches according to the new normal.

5.6. Economic Recovery and Resilience

Economic recovery and resilience are also important in terms of sustainable banking and pandemic management. Many of the regulations are included in this subject.

Customers were given the opportunity to postpone their principal, interest and installment payments, depending on demand, under current conditions.

The areas of use of the Treasury-backed KGF guarantee in the loans provided to companies have been expanded.

Special loan packages have been created for various sectors such as textile, housing and domestic auto production.

Depending on demand, overdraft account and credit card limits were increased in order to meet compulsory payments and use them for urgent expenses.

To meet working capital needs; corporate card limits of companies with corporate credit card and direct debit system limits have been increased.

By increasing the general credit limits, it was possible for credit customers to allocate additional cash credit limits to be used to pay their checks drawn on the relevant bank.

The commitment closing period, which was 2 years for short-term loans, was extended and the time given to exporters was increased.

The terms given to the buyer within the insurance limits have been extended free of charge.

Special loan packages were issued to finance new or second-hand housing purchases, to meet the financing needs of furniture, electronics, white goods, home textiles, dowry and bicycles, and for vehicles from contracted companies engaged in domestic production.

Members of the union of chambers and commodity exchanges of Turkey were provided with favorable loan opportunities to continue their commercial lives and maintain their current employment.

Conclusion

During the COVID-19 pandemic, various measures were taken around the world to control the spread of the virus. These measures, such as masks, isolation and hygiene requirements, have had a significant economic impact on the banking sector. On the other hand, sustainable banking practices have come to the fore in recent years as banks have become aware of the need to align their operations with environmental and social objectives.

Both COVID-19 measures and sustainable banking practices have many things in common. The main goal prioritizes the welfare of individuals and societies by emphasizing the importance of collective action and responsibility. Although their approaches are different, they both aim to address systemic vulnerabilities and increase resilience.

As mentioned in the study, there are 10 principles in the framework of sustainable banking in Turkey. Even though each of these principle does not fully comply with COVID-19 regulations, many of them show similar features. For this reason, similar concepts were grouped and the COVID-19 regulations were matched.

Sustainable banking practices can contribute significantly to a more resilient and sustainable economic recovery. The COVID-19 pandemic has forced banks to change their strategies and operations, as in many sectors. Remote working, the design of branches, the increase in digitalization and the sale of financial products for the pandemic have also come into question. In addition, with the pandemic, the importance of sustainability and durability in the banking sector has become even more evident. Environmental, social and governance principles, which are the basis of sustainable banking, have become even more important. The COVID-19 pandemic has shown once again that the environment is vital to the long-term well-being of society and the economy.

According to the study, the most similar topics regarding COVID-19 measures and sustainable banking are "resilience and adaptability" and "economic recovery and resilience". From this point of view, it is understood that other titles should also be emphasized in the regulations to be made in the future.

COVID-19 measures and sustainable banking share common features. Both prioritize the well-being of individuals and societies, emphasizing the importance of collective action and responsibility. Both aim to address systemic vulnerabilities and build resilience, but approaches may differ. It is therefore crucial that governments, financial regulators and all financial institutions take a holistic approach and find synergies between COVID-19 measures and sustainable banking to build a more resilient and equitable future.

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Sustainable Investing in the United States

Abstract

The aim of the paper is to assess the performance of active sustainable investing in the U.S. particularly in the context of the rising anti-ESG movement. The paper presents the author's concept: The Seven Tribes of Sustainable Investing, which include: 1) negative screening, 2) positive/best in class, 3) impact, 4) thematic, 5) ESG integration, 6) shareholder engagement and 7) minimum standards, which have differing financial outcomes and impacts. The development and the roots of the anti-ESG movement are also synthesized. An analysis of the returns of 10 sustainable funds shows that none of these funds significantly underperformed their benchmarks over a 10-year period. These results provide a counter-argument to the proponents of the anti-ESG movement and, in particular, contradict the claims that sustainable investments do not fulfill their fiduciary duty. Therefore, the conclusion emphasizes the validity of promoting and pursuing the ESG concept against its opponents, in the U.S. and beyond.

Keywords: Sustainable Investing, sustainable funds, anti-ESG legislation, return on investment

JEL Codes: G10, G23, K22, O16

Zrównoważone inwestowanie w Stanach Zjednoczonych

Streszczenie

Celem opracowania jest ocena wyników aktywnego zrównoważonego inwestowania w USA w kontekście rozwoju ruchów anty-ESG. W artykule przedstawiono autorską koncepcję: "The Seven Tribes of Sustainable Investing" zawierająca siedem odrębnych i różniących się strategii inwestycyjnych: 1) negatywna selekcja, 2) pozytywna selekcja, 3) wpływ społeczny, 4) inwestowanie tematyczne, 5) integracja celów ESG, 6) zaangażowanie akcjonariuszy i 7) minimalne

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standardy, które prowadzą do różnych wyników finansowymi i wpływu na społeczeństwo i środowisko. Syntetycznie scharakteryzowano także rozwój ruchów anty-ESG i ich przyczyny. Z analizy zwrotów z 10 zrównoważonych funduszy wynika, że w ciągu dekady żaden z tych funduszy nie osiągał znacząco gorszych wyników od benchmarku. Wyniki te stanowią kontrargumenty dla zwolenników ruchu anty-ESG, a zwłaszcza przeczą tezom, że zrównoważone inwestycje nie spełniają obowiązku powierniczego. Dlatego w konkluzji podkreślono zasadność promowania i realizowania koncepcji ESG, wbrew jej przeciwnikom, i to nie tylko w USA.

Słowa kluczowe: zrównoważone inwestowanie, zrównoważone fundusze, regulacje anty-ESG, zwrot z inwestycji

Kody JEL: G10, G23, K22, O16

Interest in sustainable investing in all of its various forms has been on the rise in the United States for some time now[1]. With the growing interest in investment considering environmental, social and governance criteria (ESG investment), the interest of regulators and lawmakers and the number of regulations in this area have increased. It is expected that the value of ESG investment will increase significantly over the next few years. On a global basis, Bloomberg has forecasted US$53 Trillion of sustainable finance will be invested by 2025 accounting for more than a third of all global investment decisions (World Economic Forum 2022). Regardless of volatility in market conditions and geopolitical realities[2], sustainable investing in the US has seen long-term financial outperformance.

1. The Seven Tribes of Sustainable Investing

Sustainable Investing or Impact Investing are the two most frequently used overarching terms to describe what are actually seven very distinct and separate investment strategies which differ in specific practice and in financial performance.

[1] In 2019, for example, Morgan Stanley found that 95% of millennials had interest in sustainable investing (Morgan Stanley 2019). In 2020, three out of four sustainable funds identified by Morningstar (investment research firm that compiles and analyzes fund, stock, and general market data) financially outperformed their category (Hale 2021). In 2021, a majority of investors in ExxonMobil (U.S.-based oil and gas company) voted to change board members and elected at least two board candidates nominated by activist investors who pledged to steer the company toward cleaner energy and away from oil and gas. The key to making this happen was Blackrock joining a majority of financial institutions in the so-called Climate Action 100+ which features investors managing over US$68 Trillion to pass the related shareholder resolution (Climate Action 100+ 2021).

[2] As COVID's first major waves led many to work from home in 2020 into 2021, the price of a barrel of oil was briefly negative. In early 2021, as these trends continued, oil companies in Houston wondered what to do with their many thousands of engineers as long term investment projects no longer seemed financially viable let alone expected impacts with climate reality gave further pause to future activity and positioning, yet this all changed with the early 2022 invasion of the Ukraine by Russia, partnered with the rise of supply chain shortages leading to higher prices (especially oil and gas) and inflation.

The seven tribes include: 1) negative screening, 2) positive/best in class, 3) impact, 4) thematic, 5) ESG integration, 6) shareholder engagement and 7) minimum standards (Krosinsky 2023).

1) Negative Screening (excluding specific companies or sectors from a fund or portfolio), which very much represents the origins of the field of what used to be called Socially Responsible Investing. While some pension funds feel the need to be universal owners, or "own the market," some investors, whether individuals, or families, or in some cases large asset owners such as city or state pension funds, university endowments, or foundations choose not to invest in every single company or investment opportunity that might come their way for various reasons, hence the phrase negative screening. All city and state pension funds need to maximize financial returns within the asset allocation and annual return expectations that are set for their beneficiaries. Calls for divestment from a region or sector or single company are part of negative screening, but are not a primary strategy, and as such, divestment pushes often do not create meaningful change. One person or organization sells a stock, another buys those shares, and there has been no clear case of a company not having adequate investors interested if the price is right[3].

Negative screening started with calls for divestment from Apartheid in South Africa, which in some ways was an easier ask as South African business was a very small component of the global economy and corporate supply chains, versus say divestment from fossil fuel production which use is fully embedded in the supply chains of pretty much all large publicly traded companies. Again, the recent "anti-ESG" focus in the United States has come from a logical concern that if enough investors didn't want to own specific assets, it could increase the cost of capital or otherwise create a stigma on owning such assets, but sustainable investing is more than just divestment.

2) Positive Screening instead is in effect the polar opposite of negative screening or the first wave of socially responsible investing. Rather than investing in an index or market and subtracting out a few perceived bad actors (which tends not to perform all that well financially by the way, Norges Bank for example, one of the world's largest asset owners, lost money divesting away from tobacco and weapons they reported a few years ago (Katz 2018)), positive approaches look for specific opportunities, especially perhaps for solving climate change.

Such opportunities include companies providing solutions which can help make industries more efficient, or as became increasingly understood in recent years, healthcare has become a key focus for investors interested aiming to help solve

[3] There is therefore no tangible evidence that divestment causes any shift in the financial value of targeted companies, though the rise of interest in climate risk is likely to be behind the "anti-ESG" movement itself, as without adequate investor interest, stock prices can and do fall, as was seen when for example coal company Peabody Energy fell from roughly $70 a share some ten years ago to falling out of the S&P 500 for financial reasons. It can be said that calls to "ban ESG" are in effect just one more negative screen, and are similarly not the best way to optimize financial performance for investors as a result.

social challenges related to health. Venture Capital is also increasingly aimed at finding newer companies seeking to solve sustainability challenges, with over $100B invested in recent years and no slow down seen in climate focused fund activity (CTVC 2022).

3) Impact investing (investing with intention to improve the wellbeing of a target region and group of individuals) is again different, now having over $1 Trillion in investment, largely in solutions for those less well-off such as providing access to healthcare, financial services, housing, education and similar mostly private market investment opportunities (Hand, Ringel, Danel 2022).

4) Thematic investing (typically private equity or venture capital in nature and are often focused on areas such as *cleantech*/renewable energy or water among other related innovations and categories of sustainable finance) is again a unique category, and essential, with Bloomberg New Energy Finance among others calling for 3–5 times more trillions per year to solve climate change (BNEF 2022), much of this funding will come in the form of renewable energy project finance, including derisking strategies as has been largely deployed to date[4].

5) Integration (ESG integration attempts to position companies with perceived high material ESG ratings as investment opportunities that can increase a portfolio's return or lower portfolio risk) is where greenwashing concerns have largely come in to recent focus. Concerns about the quality of ESG Data are well documented (Berg, Kölbel, Rigobon 2022). ESG focused ETFs may in fact not qualify for the SEC's climate disclosure rule (now expected in Spring 2024) proposed categorizations of focus or impact, potentially making them less attractive over time for investors seeking positive impact and better financial returns (SEC 2022), further clarifying that there are many different strategies and outcomes from sustainable investing that makes categorizing ESG Investing as one thing inappropriate.

6) Shareholder engagement (when investors use their power to encourage the companies they invest in to pursue material ESG opportunities) is a longstanding practice which has established an essential otherwise missing check and balance on the financial system. Some pension funds invest in indexes and then engage with the companies they own to seek better outcomes. CalPERS, for example previously reported financial outperformance that was attributed to shareholder engagement efforts targeted at improving poorer performers on governance (Junkin 2015). The NY State Common Retirement Fund manages over $250 Billion for over 1 million beneficiaries, and has a very active corporate engagement team, and also invests over $20 Billion on sustainable finance directly (DiNapoli 2021), showing that leading investors can and often use multiple of these seven tribes in their work.

7) Minimum Standards (strategies which involve applying principles, rules, processes and norms as minimum standards for investment) represents one more methodology to "lift the tide of all boats." For example, if one visits a restaurant in

[4] Case studies for solving the SDGs using finance can be found in the InvestNYC white paper published by New York University, for example, back in 2021 (Krosinsky et al. 2021).

Manhattan, there is a letter in the window telling you whether the food is safe to eat, yet investment has not had this “seal of approval” in place historically. Increasingly, asset owners such as the Yale Endowment (YaleNews 2021), NYS Common (Krosinsky 2019) and Norges Bank (Norges Bank Investment Management) have been putting such minimum standards in place, which in Asia for example, could be quite useful for investors and society more generally if put in place comprehensively on issues such as the quality of food and drinking water.

The seven categories above represent different and unique approaches which, as one might suspect, have differing financial and impact outcomes. Investors can use none of these, one of these, some of these or all. Combinations of the above seven strands of activity are often deployed by investors when seeking to address specific issues (Krosinsky 2017). As a result of these disparate strategies, there can be certain common misunderstandings when it comes to ESG, which could be useful for readers to further reference and clarify unnecessary confusion (Krosinsky 2022). One of the dangers involves calling the entire field one thing, be it “ESG Investing” or otherwise, as is it gives space to those who want to ban altogether or slow as much as possible the potential effects of these practices.

2. Anti-ESG legislation

Momentum behind sustainable finance in the US has indeed been slowed by the rise of an “anti-ESG” movement, especially from the middle of 2022 up through the end of 2023. Some states are using their legislative power to limit ESG investing, citing concerns that ESG investing is putting policy and social objectives ahead of financial objectives, or even concerns relating to the impact that ESG investing could have on their local economies[5]. Several states have proposed or adopted new legislation that would prohibit or significantly limit their state governments from investing in ESG strategies or from doing business with financial institutions that adopt specific ESG policies (Anti-ESG Bills) (Dial, Goldberg, Mann 2022). States such as Oklahoma (Carter 2023) recently joined others such as Florida[6] and Texas (Hagan, Querolo 2023) in passing or seeking to pass legislation attempting to prevent their state pension systems from considering environmental, social, and corporate governance (ESG) issues[7].

[5] These Anti-ESG Bills vary considerably from state to state. Almost all the state Anti-ESG Bills require state entities to take certain anti-ESG actions, be it divesting from companies that engage in ESG investing or refusing to contract with companies that engage in ESG discrimination (the definition of which varies somewhat state-to-state).

[6] In 2023 Florida’s Governor signed into law a bill designed to block the consideration of ESG factors in investment decisions. The law requires that investment decisions (and proxy voting decisions) for state pension assets be made on the basis of “pecuniary factors” only.

[7] The source of this “anti-ESG” movement is known and well documented, coming from funders such as Barre Seid via more visible advocates such as Leonard Leo and the Heritage Foundation (Peters 2022). Potential future Presidential candidate Ron DeSantis is among politicians which have been somewhat vocal on the “anti-ESG/anti-woke” front, arguably seeking such funding. Roughly half of US states are considered Republican, and election cycles tend to sway from left to right in the US,

A lack of uniformity among state laws in this area means businesses operating in more than one state may have to make difficult choices. The broader economic consequences of anti-ESG laws are still undetermined, but compliance with these new laws presents immediate challenges (Donefer 2023).

This sort of dilemma caused Blackrock (the world's largest asset management company, with $9.42 trillion AuM as of June 30, 2023) to not support environmental resolutions filed against companies. In 2023, the firm voted against such proposals 91% of the time (Ligon 2023), and so tangible effects of the "anti-ESG" movement are being experienced. More recent trends include antitrust legislation (Latham & Watkins 2023), and depending on election cycles, the US government may swing from allocating billions to trillions towards climate progress through the Bipartisan Infrastructure Law and Inflation Reduction Act, to implementing anti-ESG legislation at the federal and state level, making elections and the opinions of the American people most relevant as to whether progress on climate in the US will stall or proceed and at what pace.

Meanwhile, regardless of this "anti-ESG" legislation movement, active sustainable investors have been financially outperforming over the long term, earning higher returns while managing tens of billions more dollars on the back of achieving such financial success for their clients (Krosinsky, Mulji 2023).

3. Financial performance of sustainability-focused funds

Given the recent rise of "anti-ESG" legislation in some US states, the Sustainable Finance Institute (SFI) (Krosinsky, Collins Ocumarez 2023) recently endeavored to look at how sustainability-focused funds have actually been performing financially on behalf of their clients. This SFI study focused on active sustainable investors in public equity, who specifically intend and aim for maximized financial returns for their clients while prioritizing sustainability considerations at the same time. The analysis considered active fund managers with over $10 billion in assets under management, who were in operation for more than 10 years, and had accessibility to US investors where this "anti-ESG" movement has been concentrating. As below, 10 such funds were analyzed for their returns against their chosen benchmarks up through Dec 31st, 2022 (Table 1).

while socially and environmentally concerned millennials will inherit many trillions of dollars over the years to come, putting US financial institutions in a bit of a bind, trying to make everyone happy at the same time.

Table 1. The 3-, 5- and 10-year performance of active sustainable investing in the US (%)

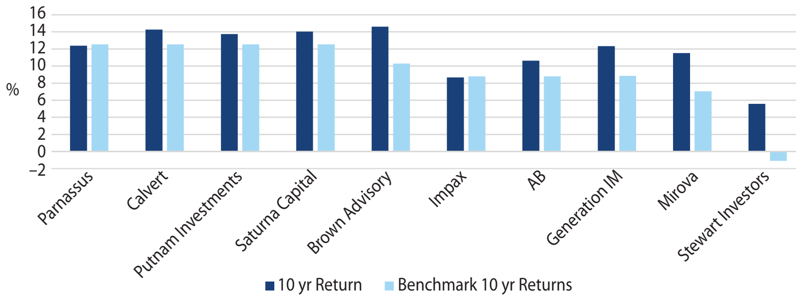
Selected Funds		Annualized Returns		
Fund Manager	**Fund Name**	**3 yr Return**	**5 yr Return**	**10 yr Return**
Generation Investment Management	Generation Core Equity	2.48	6.91	12.38
Parnassus	Parnassus Core Equity Fund	7.95	10.41	12.39
Calvert Research and Management	Calvert Equity Fund I	9.99	13.92	14.26
Putnam Investments	Putnam Sustainable Leaders Fund	7.31	10.87	13.75
Saturna Capital	Amana Growth Fund	12.09	13.92	14.02
Brown Advisory	Brown Advisory Large-Cap Sustainable Growth	7.92	12.28	14.61
Mirova	Mirova Global Sustainable Equity Fund	7.34	11.89	11.53*
Impax	Impax Global Environmental Markets Fund	5.85	5.35	8.67
Stewart Investors	Global Emerging Markets Sustainability Fund	2.12	3.19	5.57
AB	AB Sustainable Global Thematic	7.74	7.97	10.64

* Mirova Global Sustainable Equity Fund has been operating for 9.5 years. 10-year returns therefore show annualized returns since inception

Source: Sustainable Finance Institute.

Looking at 10-year annualized returns, eight of the ten funds outperformed their benchmark by a margin of 100 BPS or more (Figure 1). Four of the eight funds, the largest sustainable funds managed by Generation Investment Management, Stewart Investors, Brown Advisory, and Mirova, beat their benchmark by more than 3 p.p. On average, such sustainability-focused funds earned 2.48 p.p. more than then their benchmark. Only two funds barely underperformed, yielding returns within 30 BPS of the benchmark. Over 10 years, none of the funds significantly underperformed demonstrating some of the benefits and resilience of ESG-focused investing when placing a dual emphasis on both sustainability and financial criteria and considerations.

Figure 1. The 10-year returns of active sustainable funds in the US vs. benchmark

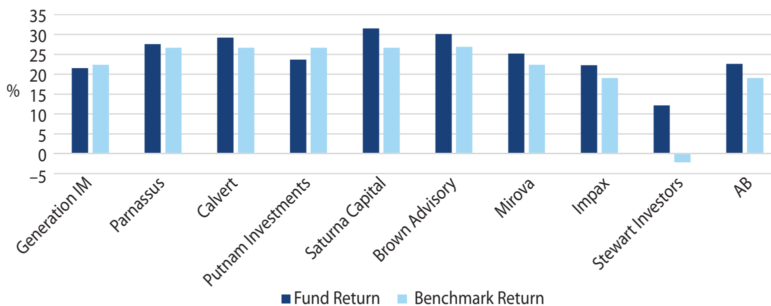


Source: Sustainable Finance Institute.

Following the worst of the COVID pandemic and related supply chain constraints, and amid heightened geopolitical tensions, 2022 was a year of turmoil for most investors, whether focused on sustainability or not. The S&P 500 fell 18% making it the worst year for markets since 2008. This shock hit fund managers across global markets including sustainability-focused investors. 8 out of the 10 funds studied underperformed relative to their benchmark during this period.

While 2022 may have been a bad year, in both 2020 and 2021 however, the investors in the study consistently beat benchmarks. For example, eight of these ten funds in 2021 beat their benchmarks with an average of 3.17 p.p. higher return across all funds analyzed (Figure 2).

Figure 2. 2021 Returns of the analyzed funds vs. benchmark



Source: Sustainable Finance Institute.

Looking at fund performance through different time periods helps frame how such funds can benefit pension fund beneficiaries and other long term focused investors.

Active sustainable investors seek to protect their clients from risks incurred by badly run companies (e.g.; recent governance scandals tend to wipe out 50 percent of shareholder value) while seizing the many opportunities emerging from ongoing innovation as well as potential shifts in consumer preference as well as across the global economy. It has also been seen that such funds often financially outperform their benchmark after fees over the longer term as well.

Outperformance for active sustainable investing has a long, positive history. In 2008, an analysis on all of the 850 funds then publicly available globally and which use sustainability as a primary consideration, found outperformance over 1-, 3- and 5-years for funds taking a positive approach (Sustainable Investing 2008).

In late 2013, exactly ten years ago, the Value Driver Model[8] study for the Global Compact and PRI (UN Global Compact) found significant outperformance for the previous 3 years for companies transforming towards sustainability in terms of increased market share from their evolving towards offering more sustainable products and services, accomplishing better risk management and achieving increased productivity from energy efficiency savings and human capital optimization strategies.

In 2018, a Brown University study found comprehensive outperformance for active sustainable investing in the US as opposed to passive approaches which did not outperform. The studies have thereby demonstrated over 3-, 5-, 10- and 20-years that active sustainable investing outperforms financially more often than not, at a time when most active managers underperform their benchmarks after fees.

This fully then refutes arguments that "ESG" necessarily leads to lower financial returns, and makes active sustainable investing the strategy of choice for investors, making this a key opportunity for all fund managers to consider to drive maximized financial performance while helping achieve societal improvement.

Concluding remarks

Considering the results of the above studies, there is little evidence to suggest that any use of ESG considerations whatsoever in a fund's primary, active investment strategy is a breach of fiduciary duty, and laws being passed to prevent such strategies from being invested in not only potentially harm financial outcomes for beneficiaries, but these "anti-ESG" laws themselves should be seen as a breach of the key fiduciary duty pillar of prudence.

Opponents of these practices argue that including ESG factors in investment decision making is a violation of fiduciary duty, arguing that investment decisions should be made solely on a company's potential returns rather than including

[8] The Value Driver Model utilizes key business metrics to determine and illustrate how corporate sustainability activities contribute to overall performance.

extraneous factors. This argument hangs on the fact that considering ESG factors will result in lower returns. In reality, ESG considerations can lead to improved financial performance as can be seen from the evidence above.

Other evidence of improved financial outcomes can be seen from the work of NYU Stern's Center for Sustainable Business (CSB) which hosts a freely accessible body of academic case studies (CSB Research) of corporate strategies which specifically lead to better financial returns while also improving environmental and social impacts.

Related to all the evidence above, let's consider the Brown Advisory Sustainable Growth Fund, which aims to invest in a concentrated portfolio of companies with internal sustainability strategies that generate tangible business benefits, such as revenue growth, cost improvement, or enhanced franchise value. This fund looks for companies whose products have a competitive advantage due to sustainability drivers, such as resource-efficient design or manufacturing, and that offer solutions to long-term sustainability challenges (Brown Advisory). Over the last ten years, the Brown Advisory Large Cap Sustainable Growth Strategy has generated an average annual return of 15%. At the same time, they seek to generate positive outcomes ranging from emission reductions to improved health outcomes.

Further, fund managers who perform shareholder engagement with public companies, such Norfolk Southern, are looking to help avoid the sort of disasters that affected so many lives in small towns such as East Palestine, Ohio in recent times.[9] Such examples of shareholder engagement are an important check and balance on the financial system which ensures corporations hear from leading investors to ensure their practices meet a minimum acceptable standard of safety for communities and employees alike, especially when governments at times remove safety protocols which can lead to less safe conditions for workers and families.

This ties to how companies are specifically governed, which when left on their own volition, can result in situations seen recently at companies such as Boeing or Southwest Airlines, who saw dramatic share price declines due to safety concerns or a lack of minimum operational competence, while trying to be too efficient on behalf of maximizing returns for shareholders. Investors focused on governance can help establish minimum standards as to how companies perform, which preserves shareholder value for investors as NY State Comptroller Thomas DiNapoli, the sole trustee of the $250 Billion NY State Common Retirement Fund recently pointed out at a Bloomberg event (Bloomberg 2023).

Governance is also essential for US investors when considering non-US investment. Asia is already half of the global economy by many measures. Without consideration of corporate governance, such investments in developing economy public companies based pretty much anywhere in Asia would be a clear breach of fiduciary duty.

[9] Norfolk Southern is rail public company operate one of the most expansive rail networks in the country. In February 2023, a Norfolk Southern train derailed in the small town of East Palestine, Ohio, marking one of the U.S.'s biggest environmental disasters in recent memory. In the following days, huge fires sent a dark cloud of chemicals and smoke into the air and over nearby towns.

Fiduciary duty would seem to require consideration of global market opportunities and whether you can trust that your money is being invested in well run companies or not, making it hard to understand how "anti-ESG" legislation can be allowed to stand up under any reasonable scrutiny.

However, there are legitimate concerns that need to be addressed when it comes to greenwashing, as well as the true impact of sustainable investing, which some find useful in so far as "field building," and which we agree on its import accordingly (Marti et al. 2023), especially when it comes to what should be the overarching goals of sustainable finance. One overarching goal realistically needs to see established that a majority of investors come to fully consider sustainability issues across all asset classes, so that these considerations become embedded into primary financial decision making. Progress has been made in this regard, but more is necessary, and the "anti-ESG" movement is just one more obstacle now to overcome.

The outperformance of active sustainable investing is an encouraging sign that "anti-ESG" efforts will not succeed for fiduciary duty reasons alone. Investors can use a dual filter of both sustainability and financial considerations going forward, as long as they employ such ESG considerations with expertise in search of better financial returns. If a majority of investors used such approaches, across all asset class, the success of these investors, as well the success of the regions and companies they invest in can be measured, arguably giving the best chance of maximizing both financial and societal outcomes going forward.

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Shaping the European Secured Notes (ESN) market

Abstract

The article characterizes the process of shaping the European Secured Notes (ESN) market, as a new pan-European capital market instrument for funding banking activities, based on the experience of the covered bonds market. ESN is particularly dedicated to lending to small and medium-sized enterprises. The characterization was structured into four thematic areas, consisting of: the importance of double-recourse instruments, the concept of the new capital market instrument, investors' preferences and the feasibility study of the new instrument. Analyses of literature and empirical sources indicate that the ESN market has significant potential for development due to the business benefits and political support of the EU and its agencies, despite the skepticism of financial market players to date.

Keywords: European Secured Notes, SME, ESG, sustainable economy, Capital Markets Union, covered bonds

JEL Codes: G18, G28

Kształtowanie rynku europejskich obligacji zabezpieczonych (ESN)

Streszczenie

Artykuł charakteryzuje proces kształtowania rynku europejskich obligacji zabezpieczonych (*European Secured Notes*, ESN), na bazie doświadczeń rynku listów zastawnych, jako nowego pan-europejskiego instrumentu rynku kapitałowego służącego finansowaniu działalności bankowej, w szczególności w zakresie kredytowania małych i średnich przedsiębiorstw. Charakterystykę ustrukturyzowano w ramach czterech obszarów tematycznych, na które składają się: znaczenie instrumentów o podwójnym regresie, koncepcja nowego instrumentu kapitałowego, preferencje inwestorów oraz studium wykonalności nowego instrumentu. Analizy literatury i źródeł empirycznych wskazują, że rynek ESN ma znaczący potencjał rozwoju ze względu na uzasadnienie biznesowe oraz poparcie polityczne UE i jej agend, mimo dotychczasowego sceptycyzmu podmiotów rynku finansowego.

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Słowa kluczowe: europejskie obligacje zabezpieczone, MŚP, ESG, zrównoważona gospodarka, Unia Rynków Kapitałowych, listy zastawne

Kody JEL: G18, G28

Introduction

As part of the debate on the Capital Markets Union[1], an initiative of European Secured Notes (ESN) emerged based on the concept of covered bonds as instruments of stable, long-term funding of banking activities. ESNs would enable banks to fund a new class of assets for small and medium-sized enterprises (SME)[2], taking into account ESG (environmental, social, governance) standards[3]. ESN uses techniques[4] and best market practices[5] of covered bonds in a new capital market instrument, which would also be available in situations of market stress or financial crisis, thus acting anti-cyclically.

The ESN project gained importance following the announcement of the European Commission's (EC) Capital Markets Union action plan[6] and due to the possibil-

1 The Capital Markets Union project aims to facilitate the inflow of investments from other countries to the European Union and the flow and transfer of capital mainly to small and medium-sized enterprises, among others: by increasing financing through capital markets compared to classic bank financing. Rezolucja Parlamentu Europejskiego z dnia 9 lipca 2015 roku *w sprawie tworzenia unii rynków kapitałowych*, 2015/2634 (RSP). Dz.U.UE C 265/09 z 11.8.2017; *Unia Rynków Kapitałowych. Stanowisko Giełdy Papierów Wartościowych w Warszawie S.A. w sprawie koncepcji Unii Rynków Kapitałowych*, Giełda Papierów Wartościowych w Warszawie S.A., 27.04.2015, https://www.gpw.pl/pub/GPW/files/PDF/ Stanowisko_GPW_unia_rynkow_kapitalowych2.pdf (accessed: 28.08.2023).

2 Unlike mortgage loans, which are the underlying assets of mortgage covered bonds.

3 Environmental, social and corporate governance criteria are a set of corporate standards used by socially conscious investors to select potential investments. Environmental criteria take into account how a company protects the environment, including, for example, its corporate policy on climate change. Social criteria define how a company manages relationships with employees, suppliers, customers and the communities in which it operates. Corporate governance concerns a company's leadership, executive compensation, audits, internal controls, and shareholder rights. *Environmental, Social, and Governance (ESG) Criteria*, Investopedia, https://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp (accessed: 27.08.2023).

4 In particular, the double recourse mechanism (to the issuer and separated pool of assets), overcollateralization (loans securing the issued covered bonds constitute more than 100% of the issue value), segregation and the requirement of high quality assets (only loans meeting specific quality conditions may constitute collateral and they are separated from the issuer's assets), public supervision (independent supervision over separated pool of assets) and high requirements for information transparency (covered bonds and the loans securing them are subject to high, standardized information requirements) (Dżuryk 2020).

5 Defined in the Covered Bond Label, which is a kind of quality mark of a covered bond. This certificate was developed by the European Covered Bond Council (ECBC), an organization bringing together the community of European issuers of covered bonds, in close cooperation with investors, regulators and all key stakeholders. *Harmonized Transparency Template*, Covered Bond Label site, https://www.coveredbondlabel.com/htt (accessed: 27.08.2023).

6 *Capital markets union 2020 action plan: A capital markets union for people and businesses*, European Commission, 24 September 2020, https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan_en (accessed: 27.08.2023).

ity of using this instrument as a tool for rebuilding the European economy after the Covid-19 pandemic, primarily in relation to small and medium-sized enterprises, which constitute the backbone of European economy.

The aim of the article is to characterize the experience of building the ESN market[7]. The study is structured into four thematic areas, which include: the importance of double-recourse instruments, the concept of a new capital instrument, investors' preferences, a feasibility study of the new instrument and the position of the European Banking Authority (EBA) towards the ESN.

The characteristics of the process of shaping the ESN market was developed on the basis of available literature, projects and normative acts of the EU and its agencies, in particular the EBA and the European Covered Bond Council (ECBC), which includes entities that are actively involved in the development of the new instrument.

1. Double recourse financial instruments

As part of the debate on capital flows in the EU, Jean-Claude Juncker, defining the goals for the EC, outlined the concept of creating a Capital Markets Union (Juncker 2016). The main goals of the integration of capital markets are: greater diversification of financing of the European economy and lowering the cost of obtaining capital. In particular, the Capital Markets Union is intended to[8]:

- improving the flow of capital from investors to key areas of the European economy, i.e. start-ups, small and medium-sized enterprises and investment projects;
- increasing market efficiency and financial intermediation in the transfer of funds internationally to companies financing their development, at an acceptable cost and on the same conditions as on the domestic market;
- reducing the risk of transfer and allocation of capital within the European Union to entities that are better able to use it;
- diversifying financing sources and reducing the dependence of the European market on banks, thus increasing its resistance to financial crisis.

The EC has committed to creating the foundations of a Capital Markets Union covering all EU member states, with the primary task of expanding access to long-term financing. It was crucial that the financial sector responded to this initiative by developing appropriate instruments enabling the promotion of stable and safe long-term financing of the economy in the EU.

Initially, it was intended to develop a double-recourse instrument based on the experience of covered bonds, but maintaining their distinct differences. This was based on the high resistance of covered bonds, which was verified macroprudentially in the stressful conditions of the global financial crisis of 2007–2009 (Grossmann

[7] The article is a preview of the monograph on European Secured Notes being prepared by the author.

[8] *The role of Dual Recourse Instruments for Long-Term Finance in Europe*, A. Jobst (ed.), European Covered Bond Council, February 2015, p. 2.

& Stöcker 2015, p. 110–111). While maintaining the integrity of traditional covered bonds as a long-term funding instrument for the banking sector, their selected features were used to develop a new double-recourse instrument. The aim was to expand the sources of funding for the banking sector by new high-credit quality instrument. It was assumed that such an instrument would bring the following direct benefits[9]:

- obtaining significant additional funds for a new asset class, with potentially lower financing costs for SMEs;
- increasing the volume of SME financing by increasing the net interest margin of banks due to lower costs of funding banking activities;
- expanding the set of liquidity management tools for banks (LCR[10] and NSFR[11]);
- introducing a more effective vehicle for transmitting monetary policy;
- making it easier for regulators and investors to monitor bank balance sheets by implementing uniform and transparent standards of reporting and transparency of SME financing.

Success in implementing a new double-recourse instrument for funding bank lending to SMEs could serve as an example for the development of financing instruments for other sectors of the economy, especially taking into account the needs of energy transformation or implementation of the ESG concept.

2. The concept of a new capital market instrument

In February 2015, the EC submitted for consultation a project to organize a Capital Markets Union, supported, among others, by the ECBC. ECBC, supported the development of long-term investment financing and a single capital market in the EU. Supporting the idea of the Capital Markets Union, ECBC emphasized the key role of the EC in coordinating market and institutional initiatives at the national, European and international levels[12]. The ECBC's position, reflecting a bottom-up

[9] *The role of Dual Recourse Instruments…, op.cit.*, p. 8.

[10] Under the rules of the Bank for International Settlements (BIS), banks in the European Union must maintain liquid assets to meet future cash outflows. The EC has defined in detail the assets eligible for this requirement (*Liquidity Coverage Ratio*, LCR). Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council *with regard to liquidity coverage requirement for Credit Institutions*. Text with EEA relevance. OJEU 11/1 dated 17.1.2015.

[11] Due to the failure of many banks to adequately measure, manage and control liquidity risk in 2007 and beyond, the Basel Committee on Banking Supervision (BCBS) introduced two liquidity standards as part of the post-crisis Basel III reforms. The first was the liquidity coverage ratio (LCR). It increases the short-term resilience of banks. The second standard, the Net Stable Funding Ratio (NSFR), aims to promote longer-term resilience by creating incentives for banks to fund their operations from more stable sources. *Net Stable Funding Ratio (NSFR) – Executive Summary*, website of Bank for International Settlement, https://www.bis.org/fsi/fsisummaries/nsfr.htm (accessed: 27.08.2023).

[12] *Analysing the Potential of Dual Recourse Funding Instrument, European Secured Note (ESN), as a Source of Long-Term Financing for the Real Economy in the EU*, European Covered Bond Council, 12.05.2015.

market approach[13], also expressed the market consensus on the development and implementation of a new pan-European instrument for funding bank lending activities through[14]:

- expanding the investor base for SMEs and
- high-quality securitization consistent with the characteristics of sustainable financing.

The ECBC proposal concerned in particular an instrument based on the double recourse mechanism called the European Secured Note (ESN)[15], an instrument that would enable the funding of other classes of assets, compared to traditional mortgage bonds secured by mortgage loans (mortgage covered bonds) or public sector assets (public covered bonds), especially for SMEs and infrastructure projects financed through[16]:

- a double-recourse balance sheet instrument using financing techniques typical of covered bonds;
- an off-balance sheet structure using techniques known from high-quality securitization, with a risk-sharing option for the investor and capital relief for the issuer.

An additional advantage of this new instrument is its countercyclical nature and availability in conditions of market stress. The concept of a new set of ESN-type instruments assumed universal acceptance and similarity of technological solutions in all EU countries, in particular[17]:

- eligibility criteria,
- definitions,
- risk parameters,
- access to data and
- IT solutions.

Moreover, an initiative based on bottom-up market consensus and best market practices could be relatively quickly implemented into national regulations. In turn, clear regulatory and supervisory rules for a high-quality financing instrument would create opportunities for feasibility study on risk and price analysis to be conducted by issuers and investors at the European level.

ECBC proposed the road map for the reconstruction of the European economy, which supports the EC initiative by identifying regulatory constraints. The solu-

[13] *ECBC Response to the Green Paper on Building a Capital Markets Union,* European Mortgage Federation – European Covered Bond Council, Brussels, 12 May 2015, https://hypo.org/app/uploads/sites/2/2021/04/ECBC-Response-to-the-Green-Paper-on-Building-a-Capital-Markets-Union-CMU-2.pdf

[14] *Ibidem*.

[15] *ECBC Response to the Green Paper on Building a Capital Markets Union…*, *op. cit.*, p. 1.

[16] *Ibidem*, p. 2.

[17] *Ibidem.*

tions proposed by the ECBC did not require significant regulatory changes. ECBC concluded that[18]:

- traditional covered bonds ensure the stability of the financial system and access to capital markets in crisis conditions thanks to their clear macroprudential characteristics, and any dilution of these characteristics, by increasing the risk, could violate the systemic importance of this asset class;
- in light of the ongoing discussion on both financing SME and infrastructure projects in the context of high-quality securitization techniques and standards, it is important to establish demarcation criteria separating traditional covered bonds and ESNs due to other types of underlying collateral assets.

In the ECBC's opinion, private sector stakeholders could play a greater role in financing the growth of the real economy if they were given the opportunity to assume risk and price it on a pan-European market platform allowing them to properly analyse the market on a cross-border basis.

An ESN based on the assets of small and medium-sized enterprises, firmly embedded in the national legal, regulatory and supervisory framework, compliant with UCITS[19], could contribute to the implementation of the Capital Markets Union project. The provision of regulatory support for this instrument could be significant and include: eligibility for LCR and repo transactions of the European Central Bank and the Bank of England, lower risk weights in CRR[20] and Solvency II[21], CRA III[22] eligibility and exclusion from bank resolution procedures (bail-in) [23].

This initiative should be supported by the EC and other European institutions performing appropriate functions or tasks in institutional coordination. This may concern the development of uniform guidelines for member countries, the promotion

[18] *Ibidem.*

[19] Dyrektywa Parlamentu Europejskiego i Rady 2014/91/EU z 23 lipca 2014 r. *w sprawie koordynacji przepisów ustawowych, wykonawczych i administracyjnych odnoszących się do przedsiębiorstw zbiorowego inwestowania w zbywalne papiery wartościowe w zakresie funkcji depozytariusza, polityki wynagrodzeń oraz sankcji*, która zmieniła Dyrektywę 2009/65/EC (*Undertakings for the collective investment in transferable securities, UCITS*). Dz.U.UE L 257/186 z 28.8.2014.

[20] Rozporządzenie Parlamentu Europejskiego i Rady (UE) nr 575/2013 z dnia 26 czerwca 2013 r. *w sprawie wymogów ostrożnościowych dla instytucji kredytowych i firm inwestycyjnych, zmieniające rozporządzenie (UE) nr 648/2012* (*Capital Requirements Regulation,* CRR). Dz.U.UE L 176/1 z 27.6.2013.

[21] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council *on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)*. Text with EEA relevance. OJEU L 12/1 dated 17.1.2015.

[22] Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 *on credit rating agencies*. Text with EEA relevance. OJEU L 146/1 dated 31.5.2013.

[23] J. Young, Bail-In: *Definition and Role in a Financial Crisis*, Investopedia, https://www.investopedia.com/terms/b/bailin.asp (accessed: 27.08.2023); *Operational guidance on bail-in implementation*, Single Resolution Board, https://www.srb.europa.eu/en/content/operational-guidance-bail-implementation (accessed: 27.08.2023).

of the roles of national and supranational institutions in investing in ESN or guaranteeing the new instrument, and the promotion of preferential regulatory treatment in the appropriate perspective (for repo transactions or capital requirements), and finally, unification of the definition and categorization of SMEs.

3. Characteristics of ESN demand research

Societe Generale conducted a survey among 16 institutional investors (real money investors), including 75% respondents were asset managers, to examine their attitude towards the ECBC proposals regarding ESN (Costa 2015). Respondents had approximately EUR 5 trillion assets under management. The questionnaire contained 11 questions and aimed to determine what ESN structure they would prefer and what common criteria and features would be necessary to trigger investor demand. The study omitted bank investors because this segment is regulated (at least in terms of LCR eligibility or preferential risk weight), which affects the perception of ESN. It was assumed that large asset managers are more open to new double-recourse instrument. The study also included entities investing in traditional covered bonds.

ESNs, whose purpose is to fund banking activities, position between traditional covered bonds and high-quality securitizations. ECBC proposed two possible ESN structures. The first was a balance sheet instrument (similar to a covered bond), with a dynamic collateral pool and double recourse to the issuer's bank. The second one off-balance sheet and double recourse, also with a dynamic pool of collateral, which can provide capital relief for the issuer and risk participation for the investor.

The market needs a standardized definition of an SME loan or other eligible asset serving as security for the issue to develop ESN. Common quality characteristics and eligibility criteria should be applied equally to all EU countries and it is desirable that ESNs benefit from preferential regulatory treatment. According to Societe Generale analysts, public supervision together with UCITS eligibility will have the key impact on popularizing ESN on the market, especially considering the scope of preferential regulatory treatment in the field of LCR, Solvency II, CRA III and for repo transactions with the ECB and the Bank of England. Moreover, the transparency of ESN data will be important.

Rating agencies also commented on the proposal for the new instrument (Costa 2015, p. 1). Fitch concluded that the credit risk of the balance sheet ESN could be assessed in line with the covered bond rating criteria and the credit risk of the capital relief could be assessed in line with the global structured finance rating criteria. Depending on the type of structural enhancement (increasing collateral) of the new instrument, Fitch could raise ESN's rating by 1-2 notches above the issuer's bank rating, provided that the rating was within the investment grade range. DBRS also stated that it is possible to issue a rating for both types of ESN structures, but the methodology will depend on detailed solutions, including the legal framework, security information, data transparency and whether or not a guarantee is provided.

ESN may be attractive to investors, especially in a situation where the profitability of covered bonds would be relatively low.

Respondents preferred the on-balance sheet structure of ESN over the off-balance sheet structure. They pointed out that cover pools should be homogeneous and easily comparable. For investors preferring off-balance sheet ESNs, an external guarantee would not be necessary, but preferential regulatory treatment would be essential to stimulating demand. In the opinion of respondents, EU legal regulations were preferred to contractual solutions. Other important factors stimulating demand were: liquidity, index inclusion and, to a lesser extent, credit rating. In the context of price, the positioning of the new instrument between covered bonds and other asset classes was indicated as a key demand factor.

4. ESN feasibility study

At the request of the EC, Richard Kemmish Consulting Limited developed a feasibility study for ESN[24], taking into account the supervisory treatment and prudential status of covered bonds as a reference base, and assessed the development potential of this new asset class.

For the purposes of the feasibility study, ESNs were defined as securities using structures developed on the traditional covered bond market to fund assets, in this case loans for SMEs and for infrastructure projects.

The importance of the ESN for the European economy should be seen in the context of the fact that SMEs constitute approximately 99 percent of enterprises in the EU, employ approximately 93 million employees and generate almost EUR 4 trillion of added value[25]. Up to 80 percent their financing comes from the banking system, and only the rest from the capital market (Wehinger 2012). It is also important that SMEs systematically report difficulties in access to financing as one of the most important problems, and their scale varies over time and is not the same for individual countries[26].

The EC Recommendation from 2003[27] defines SMEs as entities employing a maximum of 250 employees with an annual turnover not exceeding EUR 50 million or an annual balance sheet value not exceeding EUR 43 million. Unfortunately, in practice, other definitions are also used (e.g. ECB, national regulations or bank procedures), which constitutes difficulties in the development of ESN.

[24] *Feasibility Study on European Secured Notes*, Richard Kemmish Consulting Limited, European Commission, July 2018.

[25] Eurostat data according to definition of a small and medium-sized enterprise based on annual turnover.

[26] *Survey on the access to finance of enterprises*, website of European Central Bank | Eurosystem, https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html (accessed: 27.08.2023).

[27] Zalecenie Komisji z dnia 6 maja 2003 r. *w sprawie definicji mikroprzedsiębiorstw oraz małych i średnich przedsiębiorstw*. Dz.U.UE L 124 z 20.5.2003.

While definitional issues make it difficult to accurately estimate the total exposure of the banking system to SMEs[28], banks covered by the European Banking Authority's transparency survey (representing 85 percent of banking assets in the EU) reported a total exposure of EUR 3 trillion to this asset class[29]. For comparison, this figure for housing mortgage loans, which constitute security for traditional covered bonds, amounted to EUR 7 trillion[30].

Infrastructure bank loans are defined in Solvency II[31] and the Capital Requirements Regulation (CRR)[32]. The exposure of European banks to this asset class is difficult to estimate using the top-down method, among others: due to the cross-border nature of this market, and in particular due to the fact that a significant part of these loans were granted by non-European banks. Bottom-up bank statistics presented in the EBA transparency report showed that these assets amounted to approximately EUR 0.9 trillion[33].

Although there were no bonds based on the ESN concept in the European Union, there were issues of similar financial instruments[34]:

- In 2013, Commerzbank issued a double-recourse instrument secured by loans to SMEs. This issue was structured contractually and as such did not benefit from regulatory supervision, legal protection or preferential prudential treatment that traditional covered bonds receive. However, it was well received by investors and is an interesting casus for ESN.
- Both in Italy and France, national central banks have introduced solutions enabling the use of SME loans as collateral for open market operations. However, these were not highly structured instruments and central banks used relatively high valuation haircuts.
- In Italy, a law (Obbligazioni Bancarie Collateralizzate) was adopted that allows the use of SME loans as security for the issuance of double-recourse bonds, similar to covered bonds, although no implementing regulation has been issued.
- Turkish covered bond regulations allow SME loans to serve as collateral. However, investors' perception of the country's sovereign credit quality suggests that the structure of these bonds is not a good model for ESN.
- SME loans are sometimes used as collateral in securitization transactions. Since the 2007–2009 crisis, a large number of these transactions have been held back by issuers in order to use the assets as collateral for repo transactions, although

[28] Exposures to small and medium-sized enterprises in the banking system are defined in Art. 501 of the Capital Requirements Regulation (CRR), which contains a limit of EUR 1.5 million for a given entity.

[29] *2017 EU-wide transparency exercise*, European Banking Authority, https://www.eba.europa.eu/risk-analysis-and-data/eu-wide-transparency-exercise/2017 (accessed: 27.08.2023).

[30] *ECBC European Covered Bond Fact Book 2017 Edition*, European Mortgage Federation | European Covered Bond Council, Brussels, 25 August 2017.

[31] Commission Delegated Regulation (EU) 2015/35..., *op. cit.*

[32] Rozporządzenie Parlamentu Europejskiego i Rady (UE) 575/2013..., *op. cit.*

[33] *2017 EU-wide transparency exercise*..., *op. cit.*

[34] *Feasibility Study on European Secured Notes*..., *op. cit.*, pp. 32–36.

due to the lower level of disclosure in this market it was not possible to accurately estimate their value. Securitizations, while not dual-recourse instruments per se, are effectively dual-recourse if they are retained by the issuer and used as security.

Traditional overed bonds are subject to special prudential treatment under various EU legal acts and it would be advisable to extend some of them to ESN[35]:

- Derivatives, such as interest rate swaps used to hedge covered bonds, are exempt from clearing under the European Market Infrastructure Regulation (EMIR)[36]. It would be appropriate to ensure the same treatment for derivatives linked to the new instrument, as this would not be contrary to the objectives of this Regulation and would be important for achieving an efficient ESN structure.
- Traditional covered bonds are included in the list of instruments exempt from bail-in under the Bank Recovery and Resolution Directive (BRRD)[37]. Although secured debt is exempt from write-off, it would be necessary to clearly indicate ESN in the list of exempt securities because the related derivative transactions could not benefit from the collateral of the cover pool of underlying assets as in some jurisdictions the bonds themselves are not technically secured but guaranteed by security holder.
- The UCITS Directive allows higher concentration limits for single bonds issuer in the case of eligible covered bonds. This is unlikely to be a problem for ESN in the foreseeable future. However, there is some ambiguity regarding the treatment of other instruments by issuers that also issue covered bonds within this limit. Clarifying this confusion would be helpful for the development of the ESN market.
- Banks investing in covered bonds may assign them a lower risk weight as part of capital requirements. The granting of the same treatment to ESNs is not justified by any empirical data on the risk characteristics of the underlying assets. Moreover, treating ESNs on an equal footing with covered bonds, in accordance with the Capital Requirements Regulation (CRR), would risk undermining the preferential treatment of covered bonds (in recognition of their low risk) and creating a discrepancy between the actual risk and the prudential treatment. The riskier nature of the underlying assets suggests that ESNs should have a higher risk weight than covered bonds, but the benefits of the supervisory process and instrument structure suggest that they should have a lower risk weight than the corresponding unsecured bonds.

[35] *Feasibility Study on European Secured Notes…*, *op. cit.*, pp. 9–10.

[36] Rozporządzenie Parlamentu Europejskiego i Rady (UE) nr 648/2012 z dnia 4 lipca 2012 r. *w sprawie instrumentów pochodnych będących przedmiotem obrotu poza rynkiem regulowanym, kontrahentów centralnych i repozytoriów transakcji*. Tekst mający znaczenie dla EOG. Dz.U.UE L 201/1 z 27.7.2012.

[37] Dyrektywa Parlamentu Europejskiego i Rady 2014/59/UE z dnia 15 maja 2014 r. *ustanawiająca ramy na potrzeby prowadzenia działań naprawczych oraz restrukturyzacji i uporządkowanej likwidacji w odniesieniu do instytucji kredytowych i firm inwestycyjnych* oraz zmieniająca dyrektywę Rady 82/891/EWG i dyrektywy Parlamentu Europejskiego i Rady 2001/24/WE, 2002/47/WE, 2004/25/WE, 2005/56/WE, 2007/36/WE, 2011/35/UE, 2012/30/UE i 2013/36/EU oraz rozporządzenia Parlamentu Europejskiego i Rady (UE) nr 1093/2010 i (UE) nr 648/2012. Tekst mający znaczenie dla EOG. Dz.U.UE L 173/190 z 12.6.2014.

- The liquidity of mortgage bonds was appreciated by treating them as assets included in banks' liquidity coverage ratio (LCR). ESNs are expected to meet the main criteria for inclusion in this indicator, but there will be no empirical data to support this until the market is more established. This is important to support the development of ESNs, which may initially be classified as Tier 2 until the results confirm their eligibility for Tier 1.
- The treatment of covered bonds by investors of the insurance sector depends primarily on the capital allocation rules set out in Solvency II. Based on the premises of the European Insurance and Occupational Pensions Authority (EIOPA) regarding preferential treatment of covered bonds[38], it would be desirable to ensure the same treatment of ESNs secured by loans to small and medium-sized enterprises[39].
- Central banks in Europe accept covered bonds as security with varying degrees of seniority compared to other asset classes. The EC concluded that it is likely that the ECB will grant preferential treatment to ESN. Other central banks were less willing to do so.

The EC expressed the view that the development of ESN will be limited by the procedure for determining the net stable funding ratio (NSFR), although this problem also applies to covered bonds. A more favourable calculation method would be beneficial for the development of the ESN market.

The EBA has published best practices in the regulation, structuring and supervision of the covered bond market[40]. Many of these were subsequently included in the Covered Bonds Directive[41]. Some of the recommendations regarding best practices can be directly applied to ESN, in particular regarding[42]:

- double recourse;
- segregation of the cover pool;
- bankruptcy;
- administration after declaring insolvency;
- derivatives;
- appointing an entity to monitor the cover pool;
- regulatory supervision;
- responsibilities of the competent authority in the event of bankruptcy.

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[38] Covered bonds are characterized by lower spread variability due to the granular pool of assets.

[39] Does not apply to ESNs secured by infrastructure loans.

[40] *Opinion of the European Banking Authority on the preferential capital treatment of covered bonds*, European Banking Authority, London, 1 July 2014; *Recommendations of the Harmonisation of the Covered Bond Frameworks in the EU*, European Banking Authority, London, 18 November 2016.

[41] Proposal for a Directive of the European Parliament and of the Council *on the issue of covered bonds and covered bond public supervision* and amending Directive 2009/65/EC and Directive 2014/59/EU. Text with EEA relevance, Brussels, 12.3.2018; Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 *on the issue of covered bonds and covered bond public supervision* and amending Directives 2009/65/EC and 2014/59/EU. Text with EEA relevance. OJEU L 328/29 dated 18.12.2019.

[42] *Feasibility Study on European Secured Notes…*, *op. cit.*, p. 58.

Other best practice recommendations require the following modifications[43]:

- Rules on the composition of the cover pool, which are more difficult to define for ESNs, should remain the responsibility of national supervisory authorities.
- It would not be appropriate or practical to allow non-EEA assets to be included in the cover pool.
- The loan-to-value (LTV) ratio as a measure of credit quality is not appropriate in the case of ESN. There are many alternative measures, of which the EC considered the most appropriate to be the probability of default, which was set at 0.76 percent because it is a similar measure of risk to the 80 percent LTV limit in the current legislation.
- Taking into account the risk associated with the underlying assets in relation to the risk of mortgage residential loans, the EC concluded that the minimum overcollateralization ratio of 12.2 percent for loans to small and medium-sized enterprises and 7.4 percent for infrastructure loans would be appropriate amounts for these asset classes.
- The requirement that the collateral pool maintain liquid assets equal to at least the net outflows under the covered bond program for a further 180 days was considered appropriate, but the differences in ESN issuances from case to case support the calibration of the liquidity measure remain under the responsibility of national supervisory authorities.
- Although supervisory stress tests would be more appropriate for ESNs than for traditional covered bonds, the specific nature of this asset class across jurisdictions (and possibly between different programs within the same jurisdiction) made it appropriate to adapt stress tests, within certain broad parameters, should remain the responsibility of national supervisory authorities.
- The definition of underlying assets would be less harmonized for ESNs than for assets backing traditional covered bonds, so greater emphasis should be placed on disclosure of detailed information about the cover pool. Disclosure of individual assets in the collateral pool would be necessary for ESNs backed by infrastructure loans, but is not necessary for instruments backed by loans to small and medium-sized enterprises. The covered bond market has achieved a very high, harmonized standard of information disclosure through market consensus. The EC assumed that a similar solution would also be achieved on the ESN market. Otherwise, the EBA should consider establishing disclosure standards for ESNs.

Based on face-to-face meetings, an investor survey and a review of publications, the EC concluded that there is significant investor demand for ESNs secured by loans for small and medium-sized enterprises, although there was some skepticism as to whether this asset class will actually develop. There was, however, much greater reticence towards ESNs secured by infrastructure loans, mainly due to their varying credit risk and the complexity of the underlying assets.

43 *Ibidem*, pp. 58–69.

All investors perceived the adequate fair value of this asset class to be between traditional covered bonds and unsecured debt from the same issuer, and ESNs secured by loans of small and medium-sized enterprises may be more similar in price to covered bonds than to unsecured bonds. The prudential treatment of the ESN, in particular for bank liquidity purposes, and the eligibility of the collateral within the ECB were considered to be the two most important factors in setting the price of the ESN in relation to covered bonds. The supervisory framework was also considered important. As it is more difficult to define a new asset class or standardize the structure across Europe, compared to traditional covered bonds, investors have found greater transparency and reliance on local supervisory processes and a clear, harmonized definition of the new instrument to be equally important elements of ESN valuation.

Investors were divided as to whether investments in ESNs in the initial phase of market development would replace their investments in traditional covered bonds or whether they would replace investments in other asset classes. However, they recognized that as the ESN market develops, they may become an independent asset class.

The EC looked at the national specificity of the ESN concept in 11 member states[44]. In Italy, strong interest in the new asset class has been identified, primarily as a source of collateral for liquidity management purposes and as a replacement for less efficient existing asset-backed financing. In France, there was relatively little appetite for this asset class among major banks, and all preferred traditional covered bond funding. This attitude was confirmed by the relatively low interest in the ESNI (Euro Secured Notes Issuer) instrument of the French central bank (Banque de France). Only one of the banks, without a significant position on the mortgage loan market, expressed great interest in the new asset class. None of the consulted Swedish stakeholders were interested in ESN. They all expressed the belief that traditional covered bonds would be a more advantageous and sufficient source of funding banking activities. In Germany, the dominance of the covered bond market (Pfandbrief) and the traditionally high level of liquidity, especially in savings banks, indicated little potential for the development of ESNs secured by loans of small and medium-sized enterprises. In turn, ESNs secured by infrastructure loans were found to have potential that is not widely recognized in other member states. Although the new asset class would pose some structuring challenges, a model of preferential prudential treatment was not considered necessary to enhance the financing structure. Spanish market participants emphasized the significant and growing surplus of financing opportunities in the traditional covered bond market and the lower credit quality of loans to small and medium-sized enterprises, which made traditional covered bonds their preferred funding instrument for the foreseeable future. In Denmark, little need for a new financing instrument was identified and some stakeholders expressed concern that ESNs could undermine the traditional covered bond market. It was considered unlikely that the Central Bank of Denmark

[44] *Ibidem*, pp. 81–88.

would accept ESN denominated in Danish krone as collateral. Irish banks limited the use of secured financing due to large deposit balances and the need to issue senior debt for bank resolution purposes (bail-in). At the same time, it was recognized that during the financial crisis, ESNs could serve as a useful tool for generating liquidity from bank balance sheet items, although interest in this instrument was relatively low. In Poland, there were divergent opinions on the potential of ESN. Some issuers argued that due to the structural surplus of deposits over loans, there would be little or no need for secured financing, while others stated that ESNs could be a way for smaller banks to overcome the market entry barriers resulting from the Polish model of specialist mortgage banking. Romanian banks did not use the possibility of funding using covered bonds due to the excess liquidity in the banking system. They expressed some skepticism about the credit quality of the underlying assets. Furthermore, the European Investment Bank (EIB) loan available at that time was deemed to have more than met the financing needs of the SME sector at that time. In Slovakia, banks were previously obliged to issue specific amounts of covered bonds. When this restriction is lifted, banks expected a significant reduction in secured funding. Loans to small and medium-sized enterprises there constituted a relatively small part of total banking assets. Estonia did not have legal framework regarding covered bonds. None of the stakeholders saw any significant disadvantages of the ESN concept, but in the foreseeable future it was expected that the main effort would be devoted to developing regulations on financing using traditional covered bonds.

It should be assumed that there will be significant differences in the upfront and ongoing costs of ESNs in different countries and for different issuers, in particular due to differences in the scale of necessary changes to banks' IT systems that will be needed to handle transactions based on loans for small and medium-sized enterprises. This would not necessarily be the case for infrastructure ESNs, given the nature of the underlying assets. Other upfront costs were expected to be similar to those of traditional covered bond transactions, although slightly higher.

The rate of return expected by investors depends largely on the overall rate of return in the market for various instruments at a given time. Taking into account long-term averages for covered bonds and senior unsecured bonds issued by banks of 37 basis points and 93 basis points above mid-swaps, respectively, it was estimated that the ESN would require a yield of 45 to 50 basis points above mid-swaps. This would represent an additional cost compared to traditional covered bonds of 8 to 13 basis points, while saving compared to unsecured financing of 43 to 48 basis points[45]. The credit enhancement required by rating agencies was estimated to be 23 percent[46], although it may vary significantly from case to case. The obtained estimated values depend on many decisions that have not yet been made and on arbitrary decisions of the EC. Therefore, they should be treated as maximum yields that are possible to achieve for the base scenario of the adopted assumptions.

[45] *Ibidem*, pp. 92 and 94.
[46] *Ibidem*, p. 96.

Assuming that the ESN market ultimately finances the same proportion of eligible underlying assets as the traditional covered bond market in each country, the potential market size would be EUR 1139 billion for SME ESNs and EUR 195 billion for infrastructure ESNs[47]. However, given the lower effectiveness of collateral and the higher cost of financing for ESNs compared to covered bonds, it is unlikely that these levels will be achieved.

As a result of the research, the following scenarios were identified in which ESN emissions may occur[48]:

- Funding of banks in the event of a significant deterioration in the economic situation on the mortgage loan market, which reduces the possibility of issuing traditional covered bonds. In an extreme downturn scenario (a two standard deviation decline in the value of mortgage loans over five years), 11 banks were identified that could use the ESN to cover a business funding shortfall of EUR 104 billion. Taking into account the decline in available mortgage assets by another 10 percent, the number of banks would increase to 16 and the volume of ESN issuance to EUR 121 billion.
- Under normal market conditions, obtaining financing by banks that do not have assets that could secure a traditional covered bond program, but have assets that could constitute security for the ESN program. There were 7 banks meeting this criterion in the transparency survey, which would represent a potential issuance size of EUR 86 billion.
- Circumstances in which the assumption that ESNs are more expensive or less effective in terms of security than traditional covered bonds does not prevail, for example where there are particular problems with national covered bond regulations or the mortgage loan market, for example in Poland or elsewhere in the future.

In the last two cases, it is difficult to estimate the potential volumes of ESN programmes.

The potential benefits of ESN legislation include[49]:

- Increasing the availability of funding and/or reducing the cost of funding the underlying assets. This would be the case for a small number of specialist lenders, as institutions with assets eligible for the issuance of covered bonds would primarily use traditional programs.
- Increasing the availability of funding and/or reducing funding costs in growth scenarios where traditional sources of funding may prove insufficient. Assuming 1 percent mismatch between loan growth and deposit growth over a five-year period, 10 banks in the EBA transparency survey would lack the issuance capacity under traditional covered bond programs, which could lead to the issuance of ESNs worth up to EUR 18 billion. Increasing the financing gap to 10 percent

[47] *Ibidem*, p. 100.

[48] *Ibidem*, pp. 103 and 105.

[49] *Ibidem*, pp. 14–15.

would result in an increase in the number of banks to 19 and the volume of ESN issuance to EUR 34 billion.

- Increased financial stability. The extent to which ESNs could remedy 5 percent annual funding shortfall over a 5-year period indicates the extent to which ESNs can be used in emergency liquidity situations.
- Increase in investments. Based on the average level of investment, it was estimated that 15 percent of ESN investors would come from outside the EU as these assets would be relatively more attractive to them.
- Benefits for investors in the EU. ESNs would enable risk diversification in traditional covered bond portfolios resulting from excessive prices of residential properties in some member states.

Legislative actions towards ESN were considered justified because, assuming that the market would develop anyway in the absence of dedicated regulations, a more desirable scenario would be the introduction of legislative solutions that would ensure that this would happen in a harmonized manner.

The costs of ESN's legislative activities include[50]:

- Potentially negative impact on the existing traditional covered bond market. This phenomenon can be divided into damage that would occur as a result of contagion if the ESN program became insolvent, and more theoretically, which is difficult to estimate, damage if no insolvency occurred but there was competition for investors. The range of potential insolvency costs was estimated at EUR 100 to 400 million.
- An increase in the encumbrance of the bank's assets, although this was not considered a significant risk as the impact on the LGD (loss given default) of unsecured lenders is minimal in the case of the likely volumes of ESN issuance.

5. SWOT analysis of ESN

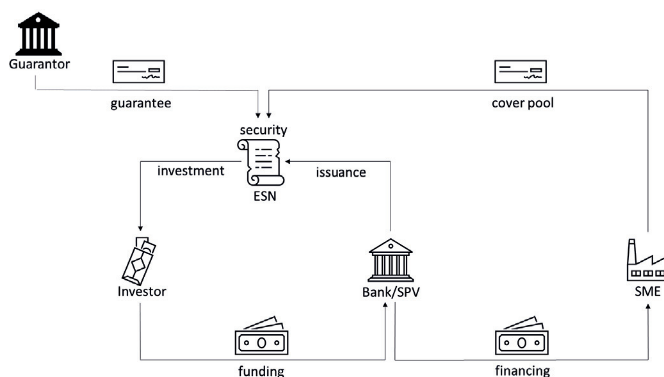
The financial mechanism of ESN is similar to the financial mechanism of covered bonds. The issuer of ESN is therefore either directly a bank providing financing to small and medium-sized enterprises or its special purpose vehicle, depending on the mortgage banking model of a given domestic market. The basic security for the issue of instruments purchased by investors are receivables from loans granted – as in the case of covered bonds, and additionally possible guarantees from public entities – which distinguishes ESN from covered bonds. Funding banking activities using ESN is of a targeted nature, which means that the funds from the programme are used to finance lending to small and medium-sized enterprises.

ESN is a new instrument for funding banking activities, ensuring stable, long-term financing, even in situations of market stress. At the same time, it increases the bank's liquidity management capabilities. The advantage of ESN is that its structure is based on the best market practices of covered bonds, while its weakness is its

[50] *Ibidem*, p. 15.

structurally lower credit quality, resulting from the higher risk profile of loans for small and medium-sized enterprises compared to mortgage loans, which are the underlying assets for the issue of covered bonds. The higher risk of loans for small and medium-sized enterprises also results from the fact that they are usually unsecured, while residential loans are secured by a mortgage. Obtaining adequate investor interest in a new instrument may therefore require either obtaining additional security, in the form of a guarantee from a public entity, or ensuring an appropriately higher profitability. Mortgage loans and covered bonds are long-term instruments, while loans for small and medium-sized enterprises have shorter maturities, which means that the assets securing the issue of the new instrument will be subject to greater rotation. ESN has no credit history yet, while the covered bond has been present on the capital market for over 250 years and enjoys an impeccable credit history (no case of default has been recorded so far). The disadvantage of the new instrument, as in the case of covered bonds, is the increase of assets encumbrance, which reduces the available pool of assets subject to redemption in the event of restructuring or liquidation of the bank.

Figure 1. ESN financing model



Source: Own study

An opportunity for the development of the ESN market is the significant demand and, at the same time, a persistent shortage of financing for small and medium-sized enterprises, especially since ESNs should contribute to reducing the cost of financing for small and medium-sized enterprises. From an investor's point of view, ESN is an opportunity to achieve higher profitability and expand diversification. The new instrument should help to increase the level of investment by stimulating the inflow of capital from outside the EU. An element building the supply of new instruments would be providing ESN with regulatory preferences known from the covered bond market (e.g. capital relief for bank issuers or eligibility for repo transactions with the ECB). ESN expands the range of monetary policy instruments of

central banks by analogy to the covered bond purchase program. Increasing the possibilities of stable, long-term funding of banking activities, also in crisis situations, contributes to increasing stability not only at the level of individual banks but also at the level of the entire financial system. The EC's high priority for supporting small and medium-sized enterprises and the development of investments and the capital market is also a stimulus for the development of the ESN market. Due to the different risk profile, it is important that the new instrument is properly separated from covered bonds so that its introduction does not negatively impact the covered bonds market. A threat to the success of the new instrument was the need to issue redemption instruments (MREL type), which displaced potential ESN issues. The freeze of global markets as a result of the Covid-19 pandemic, was not conducive to the development of new instruments. The widespread lockdown and disruption of supply chains, which led to the global crisis, forced the implementation of stimulus programs that floated the market with cheap funding, as a result of which the markets are now facing unprecedented high inflation, which was compounded by the outbreak of the war in Ukraine, and recently additionally in the Middle East, leading to an increase in overall investment risk.

ESN is an interesting proposal of a new, countercyclical, capital market instrument that can replace the expiring anti-crisis, pro-inflation government aid programs.

Table 1. ESN SWOT

Strengths	**Weaknesses**
• Expanding the range of funding and liquidity management instruments for banks. • Based on best market practices. • A countercyclical market tool that can replace government anti-crisis aid programs.	• Structuraly lower credit quality. • Typically no collateral and short maturity of the underlying assets. • No credit history of the new instrument. • Increased encumbrance of bank assets.
Opportunities	**Threats**
• The need for financing and the possibility of reducing the costs of financing for SMEs. • Investor demand for instruments with higher profitability, increased diversification and investment level. • Possible regulatory preferences. • Expanding the range of monetary policy instruments. • Positive impact on the stability of the financial system. • EC support resulting from the goals of the Capital Markets Union.	• Potentially negative impact on the covered bond market. • Necessity to issue redemption instruments. • Increased market risk.

Source: Own study.

Summary

The search for new solutions supporting the financial sector on the one hand and facilitating financing the real economy on the other led to the formulation of the concept of the Capital Markets Union and within it a new capital market instrument. The article characterizes selected aspects of the construction of the ESN market, which is used in particular to finance small and medium-sized enterprises by banks.

The concept of a new double-recourse capital market instrument for stable, long-term funding of bank lending to SMEs is high on the EU's priorities. Modeled on solutions that contributed to the popularity of covered bonds, ESNs address the financial needs of a key segment of the European economy, particularly affected by the COVID-19 pandemic. At the same time, they meet the needs of investors looking for profitable, low-risk instruments. By ensuring the transparency and standardization of ESG data for SMEs, ESNs can support the development of a post-pandemic and sustainable European economy, especially after the end of government support programs and quantitative easing by central banks. The development of ESN would be supported by the preferential regulatory treatment known from covered bonds, as well as the capital relief for banks based on the securitization mechanism by lowering prudential requirements. The analysis carried out across the main stakeholders: issuers, investors, the real economy sector as well as market supervision and political decision-makers, leads to the conclusion that the ESN market, despite the lack of enthusiasm among some market players, has significant potential and its construction has a well-founded business justification, supported politically and normatively by EU agencies.

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Implications of the CCD2 for the consumer credit market in Poland

Abstract

A properly functioning consumer credit market is important for households, economies and financial market integration. The dynamic nature of changes in the financial market, such as the digital revolution, changing consumer attitudes or the emergence of new products, necessitates the adaptation of regulations to new market conditions. Directive (EU) 2023/2225 of the European Parliament and of the Council on credit agreements for consumers and repealing Directive 2008/48/EC (hereinafter: CCD2), dated 18 October 2023, aims precisely to take into account new aspects and rules of the consumer credit market, ensuring a high degree of consumer protection. The purpose of this article is to characterise the main changes and new rules related to the offering and granting of consumer credit in the European Union, together with the recommendations related to the implementation of the CCD2 into the national legal order.

Keywords: consumer credit, consumer protection, creditworthiness, information requirements

JEL Codes: G18, G28, G51

Implikacje wynikające z CCD2 dla rynku kredytów konsumenckich w Polsce

Streszczenie

Prawidłowo funkcjonujący rynek kredytów konsumenckich jest istotny z punktu widzenia gospodarstw domowych, gospodarek i integracji rynku finansowego. Dynamiczny charakter zmian na runku finansowym, takich jak rewolucja cyfrowa, zmiana postaw konsumenckich czy pojawianie się nowych produktów, wymusza dostosowania regulacji do nowych warunków panujących na rynku. Dyrektywa Parlamentu Europejskiego i Rady (UE) 2023/2225

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w sprawie umów o kredyt konsumencki oraz uchylająca dyrektywę 2008/48/EC (dalej: CCD2), z dnia 18 października 2023 roku, ma właśnie na celu uwzględnienie nowych aspektów i zasad funkcjonowania rynku kredytów konsumenckich, zapewniających wysoki stopień ochrony konsumentów. Celem artykułu jest charakterystyka podstawowych zmian i nowych zasad związanych z oferowaniem i udzielaniem kredytów konsumenckich w Unii Europejskiej wraz z rekomendacjami związanymi z implementacją CCD2 do krajowego porządku prawnego.

Słowa kluczowe: kredyty konsumenckie, ochrona konsumenta, zdolność kredytowa, wymogi informacyjne

Kody JEL: G18, G28, G51

Introduction

Consumer credit allows for the acceleration of consumer needs in relation to the financial capacity of households at the time of borrowing (Grochowska 2015, pp. 93–122). It can also be an important instrument for long-term financing of consumer needs (Pawłowska-Szawara 2020, p. 8). In both cases, it contributes to economic growth through relatively easy access to liquid funds and thus increases demand and consumption of certain products (EBA 2023). A well-functioning consumer credit market therefore benefits consumers, producers and sellers of goods and services and stimulates economic growth (BEUC 2019).

The consumer credit market is also one of the elements of a single financial market in the EU representing one of the main priorities for action by the European Commission (EC). The concept of integrating the consumer credit market in the EU has two main objectives. Firstly, integration aims to establish uniform legal standards to foster the smooth functioning of the common EU credit market and equal access to it for all service providers. Secondly, integration measures aim to ensure a high level of consumer protection, which should increase consumer confidence in financial services, especially those offered cross-border. This protection is to come primarily from the regulation of the activities of financial institutions and the empowerment of consumers (Waliszewski 2016, pp. 121–136). This is due to the fact that the individual consumer in his/her relations with banks or other intermediaries in the financial market is usually the weaker party, mainly in terms of specialist qualifications as well as the risk accompanying the concluded transactions (Ofiarski 2019). Therefore, the new legal infrastructure in the integrated consumer credit market assumes that access to these services, both on the part of intermediaries and consumers, should be free and, in addition, information about the conditions for obtaining consumer credit by the borrower should be comparable, regardless of the place of residence of the consumer or the place where the transaction is concluded, and the prices of the compared credit services should be similar.

In the process of integrating the consumer credit market in the EU, a landmark moment was reached when the 27 Member States reached consensus on the final

provisions of the Consumer Credit Directive (Directive 2008/48/EC[1]), which was adopted on 23 April 2008.

The reports on the implementation of Directive 2008/48/EC presented by the EC in 2014[2] and 2020[3] pointed to the incomplete achievement of its objectives in ensuring high standards of consumer protection and supporting the construction of the single credit market. It prompted EU legislators to review the existing consumer credit rules in the EU and this was due to, among other things:

- the incorrect wording of certain articles of the Directive;
- changes in the credit market resulting from digital transformation and the use of computer applications (including AI) in processes in credit processes;
- variations in application and enforcement practices across Member States;
- the lack of coverage of certain consumer credits (e.g. BNPL products – buy now pay letter);
- changes in consumer behaviour and preferences.

In order to improve the functioning of the single market in consumer credit, the EC has initiated a process to update the rules for granting these credits, which is reflected in a new directive (CCD2) that was finally adopted on 18 October 2023.[4]

1. The consumer credit market in the European Union

At the end of October 2023, consumer credit debt in the euro area reached a record high of nearly EUR 734 billion[5]. Between 2016 and 2022, the average rate of growth of consumer credit debt across the EU oscillated around 3% per annum, with 4.9% between 2016 and 2019 and as low as 0.0% between 2020 and 2022. This was mainly due to the consequences of the COVID-19 pandemic, the war in Ukraine and the weaker economy, as well as a significant increase in inflation and interest rates, which translated into a decline in consumer sentiment and a reduction in their willingness to finance their needs with consumer credit.

In terms of volume, the four largest consumer credit markets, Germany (23.4% of EU volume), France (22.9%), Italy (13.6%) and Spain (11.2%), together hold over 71% of the EU market. This in fact implies a high concentration of this market.

[1] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133, 22.5.2008, pp. 66–92.

[2] Report from the Commission to the European Parliament and the Council on the implementation of Directive 2008/48/EC on credit agreements for consumers, COM(2014) 259 final, Brussels, 14.5.2014.

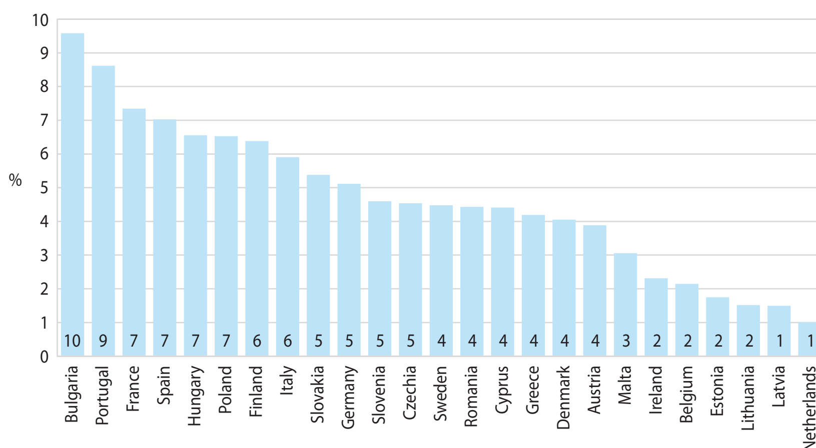
[3] Report from the Commission to the European Parliament and the Council on the implementation of Directive 2008/48/EC on credit agreements for consumers, COM(2020) 963 final, Brussels, 5.11.2020.

[4] Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC, OJ L, 2023/2225, 30.10.2023, http://data.europa.eu/eli/dir/2023/2225/oj.

[5] https://data.ecb.europa.eu/data.

In comparison, Poland, with a 5.0% share, is in fifth place. However, the ratio of consumer credit volume to GDP significantly alters the ranking, with Bulgaria and Portugal having the largest ratios (10 and 9%) and six countries (Netherlands, Latvia, Lithuania, Estonia, Belgium and Ireland) having the smallest ratios of up to 2%[6]. Poland, together with Hungary, Spain and France, is at the top of this ranking at ca. 7%, slightly less with Finland at 6.4% (Figure 1).

Figure 1. Ratio of consumer credit to GDP in selected EU countries in 2022



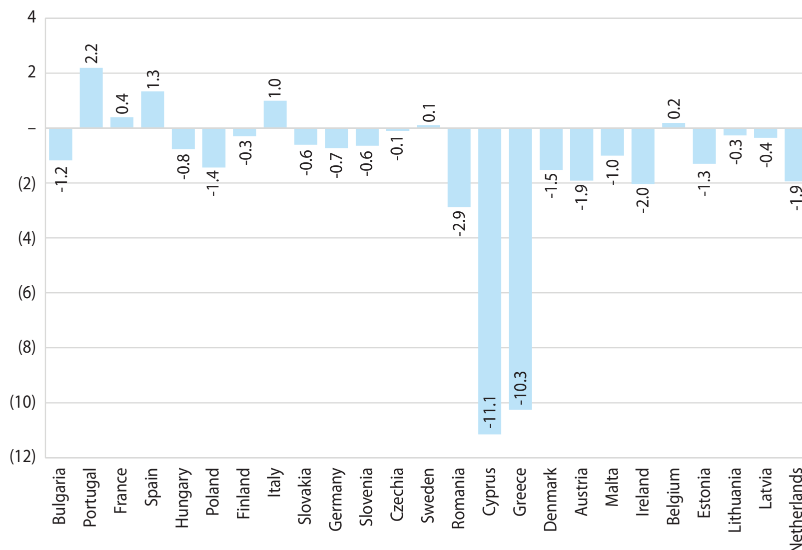
Source: ECB, https://data.ecb.europa.eu/data; https://data.ecb.europa.eu/data/datasets/BSI/BSI.M.BG.N.A.A21.A.1.U6.2250.Z01.E and similar data for other countries.

A dynamic analysis of the consumer credit volume relationship across EU countries shows uneven trends. Between 2015 and 2022, only seven of the 26 countries analysed recorded an increase in the ratio under study, most notably the Luxembourg (+4.4 p.p.), Portuguese (+2.3 p.p.) and Spanish (+1.3 p.p.) markets. In contrast, there was a relatively high decline in Cyprus (-11.1 p.p.), Greece (-10.3 p.p.) and Romania (-2.9 p.p.). The group of countries with a declining trend in the share of consumer credit in GDP also includes Poland, which still had 9% in 2019 and only 6.5% in 2022.

Variation in the level of debt in the consumer credit market is also apparent when population (per capita) is taken into account. According to data from the ECB and Eurostat, at the end of 2022 the relationship ranged from €3089 in Finland to €309 in Latvia, with an average level for the EU-25 of €1487. According to Lannoo and Andersson (2023), Northern and Western European countries are generally characterised by higher levels of consumer credit per capita compared to Central and Eastern Europe, where lower values are recorded.

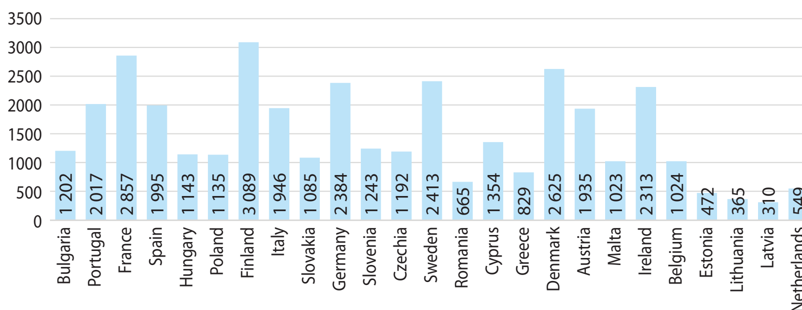
[6] Calculations based on ECB Data Portal, https://data.ecb.europa.eu/data, data for 2022.

Figure 2. Change in the ratio of consumer credit to GDP in selected EU countries from 2015 to 2022 (in percentage points)



Source: own compilation, based on: ECB, https://data.ecb.europa.eu/data; https://data.ecb.europa.eu/data/datasets/BSI/BSI.M.BG.N.A.A21.A.1.U6.2250.Z01.E and analogous data for other countries.

Figure 3. Level of consumer credit per capita in selected EU countries in 2022



Source: ECB, https://data.ecb.europa.eu/data; https://data.ecb.europa.eu/data/datasets/BSI/BSI.M.BG.N.A.A21.A.1.U6.2250.Z01.E and corresponding data for other countries; https://ec.europa.eu/eurostat/databrowser/view/demo_pjan/default/table?lang=en.

The different levels of consumer credit debt in the European Union represent a certain constraint on financial market integration and the growth of cross-border retail transactions. This diagnosis was one of the prerequisites for harmonising the rules for the functioning of consumer credit markets in the EU in order to bridge the differences that exist while creating conditions for free access to this type of credit also across borders and with a high level of consumer protection.

2. New rules for the functioning of the consumer credit market in the European Union proposed by Directive 2023/2225

One of the objectives of the CCD2 is to develop and implement a more transparent and efficient legal framework for consumer credit. This should lead to increased consumer confidence and protection and facilitate the development of cross-border credit activities (Recital 9 of the CCD2).

EU Member States were obliged to adopt and publish by 20 November 2025 the provisions necessary to implement Directive (EU) 2023/2225 of the European Parliament and of the Council on credit agreements for consumers and repealing Directive 2008/48/EC (Article 48 CCD2). In this aspect, it is worth pointing out the main differences in the conditions for consumer credit between the 2008 Directive (CCD1) and the 2023 Directive (CCD2):

- extending the scope of the Directive to credits below EUR 200 and raising the upper limit to EUR 100,000;
- inclusion of new products within the scope of the Directive;
- changing the rules on advertising credit products;
- the way information is presented at the pre-contractual stage;
- Revision of the creditworthiness examination rules, including the obligation to carry out a creditworthiness assessment taking into account all credits covered by the Directive;
- identifying measures to limit high interest rates;
- change to the rules on tying and bundling;
- specifying debt advisory services.

In the new Directive, it has been decided to widen the quota range of consumer credits, in order to avoid that harmful products for consumers are not covered by the Directive, including low-quota ones.

One of the objectives of the Directive was to take into account the changes that occurred in the market after 2008. Hence, it was included in its scope:

- BNPL transactions – buy now pay letter;
- interest-free credit agreement and free of other charges;
- all overdrafts, with repayment due within one month;
- crowdfunding loans and credits;
- leasing contracts that include an option to buy back the leased asset.

The Directive clarifies the rules on advertising for credit products. Firstly, standard information in advertising should be visible and presented in an attractive format, taking into account the technical limitations of the information media (e.g. smart phones, telephones) and be clearly legible or audible. Standard information in advertising should be separated from other content. Where the advertisement refers to a product promotion, the lender should make this clear; both what the promotion relates to and when it is valid.

Secondly, the Directive prohibits for the first time advertising of selected credit products. In Article 8, paragraph 7, it contains a ban on advertising content that:

- suggest that credit will improve the consumer's financial situation;
- report that the consumer's other repayment obligations have little or no impact on the assessment of the credit application;
- erroneously suggest that credit increases financial resources, is a substitute for savings or can raise the consumer's standard of living.

Thirdly, Article 8(8) contains a list of credit advertisements, the prohibition of which is at the discretion of the Member States. This concerns the possibility of prohibiting advertising in which:

- it emphasises the ease or speed of borrowing,
- provides for a discount when taking out a loan,
- the proposed grace period is longer than 3 months.

Fourthly, the Directive changes the way information is provided at the pre-contractual stage by modifying the Standard European Consumer Credit Information Sheet, which is to have two parts:

- Part I: Key information[7]:
  - Identification of the lender or credit intermediary;
  - Total loan amount;
  - Duration of the loan agreement;
  - The borrowing rate or, where applicable, the different borrowing rates applicable to the credit agreement;
  - The annual percentage rate of charge (APR);
  - Total amount to be repaid;
  - Costs in the event of late payments.
- Part II: additional information on the credit agreement:
  - Instalments and, where applicable, the order in which they will be credited;
  - Warning of the consequences of non-payment or late payment;
  - Right of withdrawal;
  - Early repayment;
  - Address details of the lender or credit intermediary.

Fifthly, Article 15 mandates that the consumer must unambiguously and voluntarily consent to the conclusion of any credit agreement or purchase of ancillary services. This is intended to eliminate the practice of including already filled-in default options or – by default – ticked boxes in the contract.

[7] The key information, which has been added for the first time, consists of two parts that must appear on the first and second page of the standard information sheet. As recital 37 of the CCD2 states: "*To help consumers understand and compare different offers, the key elements of the credit should be provided in a prominent way on the first page of that form, through which consumers should see all essential information at a glance, even on the screen of a mobile telephone. In case all of the key elements cannot be displayed in a prominent way on one page, they should be displayed in the first part of the Standard European Consumer Credit Information form on two pages at most.*" Recital 37 of the CCD2.

Sixthly, Article 12(1) introduces an obligation to provide the consumer with a fair and free pre-contractual explanation (See more extensively Galązka 2021, pp. 68–69). In particular, creditors are obliged to explain to the consumer the information contained in the standard information sheet, the main provisions of the proposed credit agreement or the proposed ancillary services, as well as the consequences of concluding the agreement, including the consequences of not servicing the credit on time[8].

Seventh, Article 3 of the CCD2 defines advisory services as 'personal recommendations made to the consumer in respect of one or more transactions relating to credit agreements and constituting an act separate from the granting of credit and from the act of credit intermediation'. In addition, where a creditor or credit intermediary provides advice, they are obliged to disclose to the consumer whether the recommendation will be based solely on their own product range or whether it also includes other market products, and to inform the consumer of any fee for advice. In addition, when advising the consumer, the creditor must obtain the necessary information and assess the consumer's financial situation in order to recommend the most suitable product, in line with the principle of acting in the consumer's best interest. It is incumbent on Member States to provide independent, easily accessible advice to consumers who are in default on their consumer credit obligations or who may be at risk of such default.

Eighth, according to Article 16(4), the use of the term "independent advisor" will only be possible where a creditor or financial intermediary recommends a sufficiently large number of offers available on the market, or where they do not receive remuneration for advice from one creditors.

Ninthly, the CCD2 regulates tying[9] and bundling practice[10]. According to Article 14(1), combined sales are allowed while tying is prohibited. Specifically, this means that the creditor will be able to require the consumer to open a bank account or take out credit insurance) from which capital instalments or other charges will be collected, but the costs of servicing such an account will have to be included in the total cost of the credit in the contract.

[8] Pursuant to Article 11 of the Consumer Credit Act of 12 May 2011 (Journal of Laws 2011 No. 126, item 715), 'The creditor or credit intermediary shall, prior to the conclusion of a consumer credit agreement, provide the consumer with explanations regarding the content of the information provided prior to the conclusion of the agreement and the provisions contained in the agreement to be concluded, in such a way as to enable the consumer to take a decision regarding the consumer credit agreement'. What remains to be interpreted is the possible difference in scope between Article 12(1) of the Directive and Article 11 of the Consumer Credit Act

[9] Bundling practice means offering or selling a credit agreement as a package with other separate financial products or services where that credit agreement is not available to the consumer on a standalone basis.

[10] Tying practice means offering or sale of a credit agreement as a package with other separate financial products or services where that credit agreement is also available to the consumer separately but not necessarily on the same terms and conditions as offered in combination with those other products or services.

Tenth, according to Article 18(3) of the CCD2, "the *assessment of creditworthiness shall be carried out on the basis of relevant and accurate information on the consumer's income and expenses and other financial and economic circumstances which is necessary and proportionate to the nature, duration, value and risks of the credit for the consumer*". Where the creditworthiness assessment is carried out using automated data processing, the consumer has the right to obtain the intervention of a human being representing the creditor. This means that the consumer has the right to a fair and understandable explanation of the assessment carried out and of the functioning of the automated data processing, taking into account the variables that have been used in the creditworthiness assessment. The consumer, in turn, in such a case has the right to present his or her position and may request a reassessment.

Eleventhly, Article 34 of the CCD2 obliges member countries to promote measures to support consumer financial education, including on responsible borrowing and debt management. Programmes and projects in this area should be dedicated primarily to consumers who have no credit experience and are taking out a commitment for the first time in the consumer credit segment and to borrowers accessing credit offers through digital tools. The Directive sees financial education as a key condition for the integration of credit markets in the EU. It is accepted that financially aware consumers can benefit from the opportunities of the single market. Indeed, education enables a better understanding of credit products and rational decision-making in the financial sphere, taking into account the risks arising from the purchase of a particular financial service[11]. Furthermore, financial education of the public improves the status of consumers in terms of knowing, exercising and enforcing their rights. According to the diagnosis, financial education should take place throughout life (Penczar 2014, p. 13). This is further justified by the fact that the dynamic development of financial markets, under conditions of globalisation, has contributed to the emergence of many innovative credit products or transfer to third markets used in other conditions. Hence, the intentions and actions of the European Commission aim to integrate markets for consumer services by, inter alia, increasing legal protection, which in turn requires appropriate qualifications of the users of these services.

Twelfth, pursuant to Article 36(2) of the CCD2, lenders are obliged to have appropriate relevant procedures and policies in place for the early identification of borrowers experiencing financial difficulties. This includes requirements to restructure the loan, at a stage prior to the commencement of enforcement proceedings. As emphasised by D. Adrianowski (2019, pp. 94–112), the right to restructure the liability and other forms of settlement of the client with the bank is one of the most important factors for its protection. According to the CCD2, restructuring measures may include partial or full refinancing of the loan or modification of the existing contractual terms, such as extending the term of the agreement, temporary suspension of loan instalment payments, partial debt forgiveness and debt consolidation, among others.

[11] Many bank customers have problems understanding even the simplest financial products (Marcinkowska 2011, pp. 5–19).

The Directive does not change the consumer's right of withdrawal – without giving any reason – up to 14 days from the conclusion of the agreement, nor the right of early repayment. However, it is clarified that in the event of early repayment, the consumer is entitled to a reduction in the total cost of the credit outstanding, taking into account all the costs (interest and non-interest) calculated by the creditor.

It is left to the jurisdiction of EU Member States to set interest rate caps or restrictions on excessive charges for other costs (fees and other non-interest costs).

3. Impact assessment of the implementation of Directive 2023/2225 and recommendations for the Polish consumer credit market

The assessment of the effects of implementation helps to properly direct the actions introducing the regulations into practice and also to determine their impact on obliged entities. Among the various diagnostic methods used for this purpose, the expert method[12], classified as a heuristic method[13], is relatively popular.

For the purpose of assessing the impact of the new rules of the consumer credit market in the European Union and in Poland, a survey conducted and by the author, among experts of the Polish credit market, was used. The survey was conducted in October/November 2023 as part of the agenda of the European Financial Congress (EKF Research) in cooperation with Deloitte (Penczar 2014). Nineteen experts participated in the study. In addition to assessing the impact of the CCD2 regulation, the broader research objective was to assess the opportunities and threats to the development of the Polish consumer credit market in the 2026 perspective and such issues for consumer finance market players.

Among the positives of CCD2, creating potential for market growth, the experts highlighted above all the following:

- adapting regulations to the rapidly changing economic and business environment;
- extending the Directive to all players, which will reduce arbitrage in the consumer finance market and lead to equal rights and obligations for all credit market participants and a more level playing field;

[12] It most often involves conducting surveys among a purposively selected group of experts in a particular field. This method is applicable for projecting unknown or uncertain and long-term impacts requiring highly specialised knowledge. In addition to expert techniques, focus group interviews, panel studies, semi-structured interviews, brainstorming (single or mixed), morphological methods, Gordon's analogies are also applicable; see (Antoszkiewicz 1990, p. 103 et seq.).

[13] Heuristic methods are classified as creative problem-solving sciences. In the case of heuristic methods, intuition, foresight and gut feelings play an important role, which should be characterised by the persons selected for the study – professionals in the field under study, experts, in more detail: (Orzeł 2005; Antoszkiewicz 1990).

- reducing regulatory arbitrage by bringing a wider range of financial products and services, hitherto excluded from the Directive (e.g. BNPL), within its scope;
- increasing consumer protection, which will have a positive impact on the transparency and credibility of the financial sector, resulting in market growth;
- product and contractual transparency, e.g. through the implementation of additional forms with more information on credit parameters, e.g. through the obligation to provide a completely new document – the so-called SECCO (Standard European Consumer Credit Overview) – and greater (although insufficient) adaptation of information obligations to digital media;
- the further development of innovative fintech and e-commerce solutions that banks will be able to offer their customers in collaboration with the digital players sector;
- a commitment by member states to support financial education and provide consumers with access to debt counselling;
- regulating the consumer finance sector, which will increase consumer confidence in the non-bank lending market;
- curbing unfair practices such as automatic renewal of the credit agreement or the automatic ticking of relevant default options (so-called boxes) on lenders' forms.

Among the risks to the development of the consumer credit market associated with the implementation of CCD2, the experts participating in the survey pointed to:

- the need to revise procedures, offers and update systems to comply with the directive, which will generate additional costs, while a large part of the provisions contained in the CCD2 have already been regulated in Polish law and implemented in banking systems;
- potentially increased operational cost of providing finance and increased time in the customer service process;
- the increased risk involved in assessing a consumer's creditworthiness, which should be done in the interests of the consumer and not to reduce credit risk on the part of the creditor;
- the need to provide, at the consumer's request, an explanation of the credibility assessment principles, including the rules used in the automated processing of personal data and their impact on the final decision;
- the possibility for the customer to challenge the credit decision for automated processes;
- the introduction of a large amount of mandatory information in consumer credit advertising, which may make it difficult for the consumer to understand;
- shifting the burden of responsibility for the consumer's decisions to the creditor;
- still extensive information obligations that do not lead to the consumer knowing and understanding more.

The CCD2 furthermore limits the range of parameters used to assess creditworthiness, for reasons of consumer privacy. The assessment is to be made solely on the basis of

information concerning the consumer's financial and economic situation, primarily based on his or her income and expenditure. The assessment of creditworthiness, or rather creditworthiness, has so far been based more on a richer set of information, including non-financial information such as age or occupation, although these have not been crucial in verifying creditworthiness. Reducing the scope of analysis of information about the borrower carries the risk of reducing the effectiveness of scoring models.

Experts also pointed to the lack of consumer databases and information for assessing creditworthiness in Poland as a threat to the credit market. The CCD2 imposes an obligation on creditors to obtain from the applying consumer information about his/her income and expenses. When, in the creditor's assessment, the extent of the information needed is sufficient, supporting evidence must be obtained from the consumer and the data obtained must be verified through a system of traditional paper documents. This has at least two disadvantages. The first is a return to the paper income certificates used in the past. The second is the risk of fraud or unreliability of the certificates submitted.

Summary

The adoption of new rules for the functioning of the consumer credit market in the European Union was necessary in order to improve competition and ensure a high level of consumer protection. Dynamic changes in the credit market, linked inter alia to the development of digital services and the use of artificial intelligence, have resulted in the emergence of new credit products and changes in consumer attitudes. The purpose of the CCD2 is precisely to adapt its provisions to the new market conditions. There is no doubt that the implementation of the CCD2 Directive into the Polish legal order will be a challenge for entities offering and granting consumer credit, resulting, inter alia, from the necessity to incur adjustment costs and introduce rules and solutions not previously in force. It also represents an opportunity to increase market potential by increasing consumer confidence in the market and providers.

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Corporate banking In Poland. Economic role, market trends and development prospects[1]

The leading role of banks in the financing of the economy and domestic enterprises in Poland

The key elements of any financial system are, in addition to the central bank, first and foremost: the other monetary financial institutions (represented mainly by banks, and to a much lesser extent other credit institutions and money market funds), investment and pension funds and insurance companies. While a well-functioning financial sector is a lever for growth and progress, irregularities within it can place a significant burden on it.

In almost all continental European countries, monetary financial institutions (MFIs) play a key role in the financial system, with the capital market being less important. In some EU countries, however, the market part is well developed, accounting for

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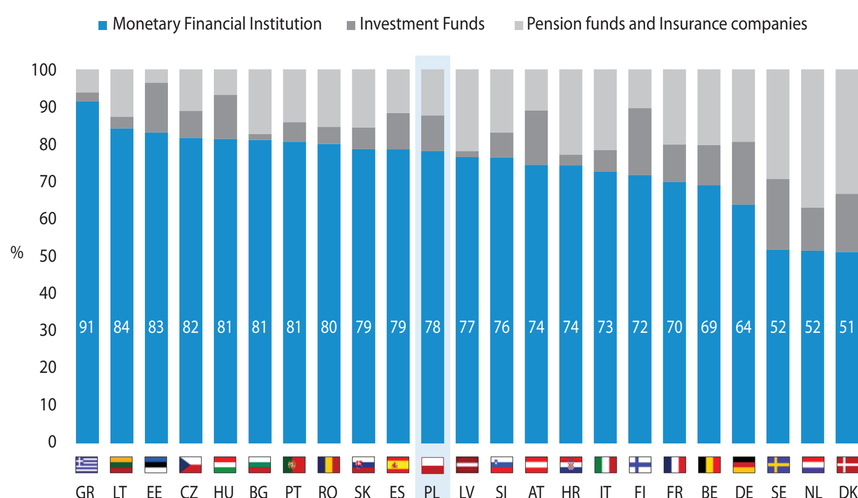
[1] The study is based on the Report prepared by the authors as part of the analyzes of Bank Pekao and presented at the Corporate and Investment Banking Congress in Warsaw on November 7, 2023.

at least 30% of the total assets of the narrowly defined financial sector. Apart from the specific cases of Luxembourg, Malta, Ireland or even the Netherlands (which, for tax reasons, is a popular location for many foreign investment funds), this group includes some of the most developed economies of Western Europe (Denmark, Sweden, Germany or Belgium). In Poland, the position of monetary financial institutions (banks) is stronger than the EU average. In 2022, they held 78% of total financial sector assets, i.e. 9 p.p. more than the EU average. The particularly strong reliance of the financial system on the banking sector is a common feature of most Central European countries and some countries in the south of the continent (Greece, Portugal, Spain).

Investment funds play a relatively important role in the Polish financial system compared to other countries in the region (10% share in total assets). In contrast, the 12% share of other institutions (pension funds and insurance companies) is lower than in most Member States.

Between 2010 and 2022, the share of banks and other MFIs in the assets of the Polish financial system increased by 9 p.p. This trend contrasted with the declining role of these institutions in the European Union (down by 10 p.p.). This strong increase in the share of MFIs was driven on the one hand by the numerous development barriers faced by the capital market and on the other by their growing role in financing the state's borrowing needs. This was manifested by an increase in the share of debt instruments – mainly treasuries – in the total assets of monetary financial institutions from around 20% in 2010 to nearly 30% in 2022.

Chart 1. The share of monetary financial institutions (MIF) in the total assets of the financial sector in selected EU countries [2022]*



* Bulgaria, Estonia and Finland data for 2021.

Source: Eurostat and own calculations.

The significant financing of treasury instruments in Poland contributed to the decline in the importance of traditional lending in the period 2010–2022 by 3 p.p., mainly due to much weaker demand growth after 2019 as a result of the pandemic, as well as significant increases in interest rates. However, this decline was still significantly weaker than that observed in the EU (-7 p.p. in the corresponding period). On the other hand, the share of bank loans in the assets of the Polish financial sector amounted to 46% at the end of 2022 (according to ECB data) and was definitely higher than the EU average (31%), with only small countries in the region (Slovakia, Lithuania and Estonia) having higher ratios. The cited data document that banks in Poland are the financial foundation of the economy. It can be added that in the case of a certain group of enterprises, especially the largest ones, there is a greater diversification of financing sources (apart from banks, also the capital market and loans from foreign parent companies).

Typology of banking sector development in the EU

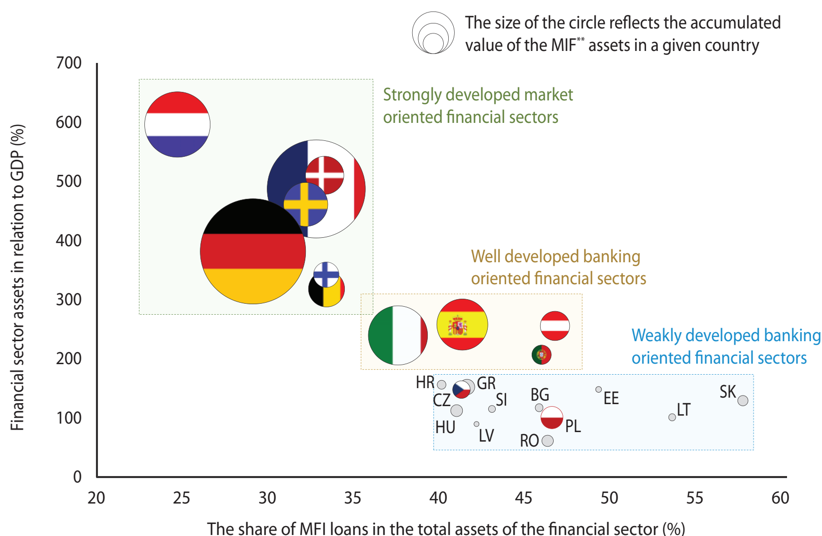
The typology of EU countries according to the criterion of the level of financial sector assets to GDP and the share of MFI loans in financial sector assets makes it possible to distinguish three types. The first is the so-called 'affluent north' or old EU countries with strongly developed market-oriented financial sectors, comprising the Netherlands, France, Denmark, Sweden, Germany and Finland and Belgium (financial sector assets exceeding ca 300% of GDP). The second type includes Italy, Spain, Austria and Portugal (above 200% of GDP) with a strongly developed bank-oriented financial sector. The third type includes the remaining EU countries, not exceeding 200% of GDP characterised by underdeveloped bank-oriented financial sectors (cf. Chart 2). In the so-called comparative perspective, the Polish financial sector is the largest in the third distinguished segment, with a strong position of banks in the financial market and a relatively high potential for development.

Dynamics and trends of bank financing of enterprises in Poland after 2010

The active role of domestic banks in financing entrepreneurship and thus stimulating economic growth in Poland is reflected in changes in the volume of loans to enterprises after 2010. After a very intensive first decade of the 21st century in this respect (total growth more than doubled), the last several years have been a period of continued expansion of banks in this area. According to ECB data, since 2010, the volume of loans granted to businesses by banks in Poland has increased (calculated in euro) by more than 60%. This is the fifth best result in the entire European Union, after Luxembourg Finland, the Czech Republic and France. In terms of nominal growth of these banking assets (+ EUR 35 billion), Poland ranks eighth in the Community, behind only the banking systems of Western European

countries. This was achieved despite the unfavourable trend in the exchange rate, as there was a significant weakening of the złoty against the euro. The period of dynamic development of business banking in Poland was particularly marked in the years 2011–2019, when banks increased their corporate financing by 59%. Stronger expansion in the area of business loans was manifested at the time only by financial institutions from

Chart 2. Model and level of MIF sector development in selected EU countries [2022]*



* Bulgaria, Estonia and Finland data for 2021.
** Banks and other credit institutions.

Source: Eurostat and own calculations.

Luxembourg. Unfortunately, the outbreak of the COVID-19 pandemic brought a strong slowdown in business activity, and the uncertainty of developments resulted in a deep decline in investment. Despite massive 'injections' of funds – as part of the anti-crisis shields – there was a sharp reduction in demand for bank loans in 2010. As a consequence, Poland suffered the third strongest decline in their volume in the EU (after Lithuania and Ireland) in 2020 (-11% y/y). The next year and a half was a period of fairly rapid 'catching up', halted by Russia's aggression against Ukraine, and the accompanying economic slowdown, energy crisis and sharp rise in interest rates as a reaction to high inflation. For these reasons, in a period marked by strong uncertainty and volatility, corporate loans in Poland grew by only 2% between 2020 and 2023.

In general, after 2010, despite the occurrence of certain developmental barriers, corporate banking in Poland enjoyed favourable growth conditions due to, inter

alia, the macroeconomic environment, the persistent competitive advantages and foreign expansion of Polish companies, reporting demand for financing, as well as many specialised services provided by banks (e.g. trade finance, business consultancy). For the years 2010–2022, this assessment is justified by the following circumstances, among others:

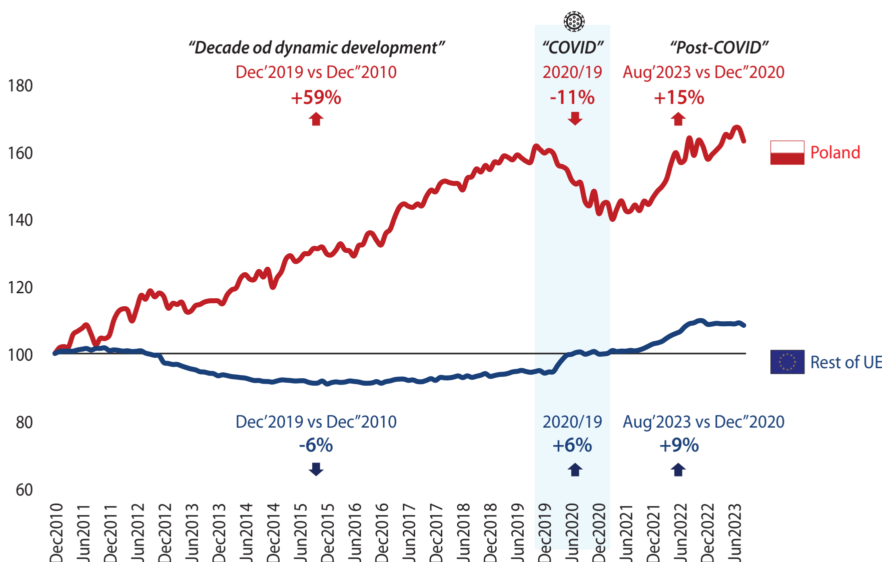
- Poland's GDP increased by more than 50%, which was the third best result in the EU (after Ireland and Malta);
- the scale of activity of Polish companies, measured by the value of their revenues, showed a 2.5-fold increase and total investment outlays were ca 2.5 times higher;
- the level of short- and long-term liabilities of Polish companies increased by 2.8 and 2.5 times respectively ;
- a factor conducive to growth was the continuing availability of cheap bank financing in a historically low interest rate environment for most of the period under review;
- the progressive internationalisation of firms is evidenced, inter alia, by the rapidly increasing ratio of exports of goods and services to GDP (up by as much as 23 p.p. to 63%; there was also a marked increase in both the percentage of firms exporting and the share of foreign sales in the total turnover of Polish firms;
- despite the disruption of the trend after the outbreak of the pandemic and the war in Ukraine, loans to businesses grew clearly faster than those to households (according to the NBP, the total value of loans to businesses increased by 83% in PLN, while the value of loans to households was nearly 20 p.p. lower).

Corporate credit demand is characterised by a strong sensitivity to changes in the economic cycle. The demand for external financing clearly weakens in periods of increased investment uncertainty and/or a real deterioration in the financial situation of companies, while it shows a vigorous growth in years of better economic conditions. This regularity has been very pronounced over the past decade or so, which has not been neutralised even by shielding measures in the form of liquidity injections for companies within the framework of anti-crisis shields.

Loans to businesses and households in Poland grew solidly until 2019, after which their trajectory diverged. Loans to businesses temporarily showed a relatively strong decline while loans to households maintained a trend of strong growth, especially in a near-zero interest rate environment and in the face of a persistently good housing market. In contrast, there was a very clear rebound in corporate demand in 2021, with a much weaker one in the retail segment. High and rising inflation in late 2021 and early 2022 contributed to a sharp tightening of monetary policy, amid the extensive consequences of the war being fought across Poland's eastern border in Ukraine (including population migration, rising energy commodity prices, the spectre of an energy crisis, economic sanctions against Russia and Belarus, changing exchange rates, new and greater risks). Initially, the increase in interest rates had a stronger impact on household credit demand (stabilisation in the first eight months of 2022 and a y/y decrease from September 2022). In contrast, the dynamics of corporate

lending accelerated, which bore the hallmark of stockpiling in an environment of more expensive raw materials). At its peak, in August 2022, the dynamics was close to 20%, before quickly turning negative and reaching -6% in August 2023.

Chart 3. Changes in the volume of business loans in Euro. Poland versus rest of EU in 2010–2023 [Dec'2010=100]

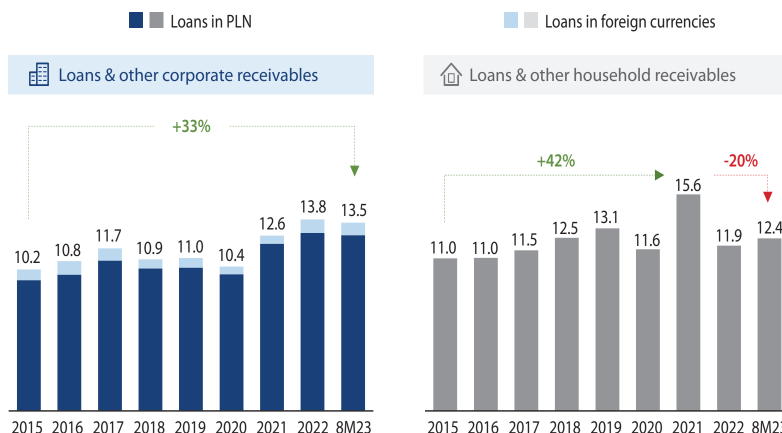


Source: EBC, own calculations

After 2010, differences in the dynamics of loan portfolios of the corporate and household segments led to a change in the entity composition of assets, from ca 31% to ca 34% for the former in August 2023. Although in the turbulent environment of the 2020–2023 period both credit segments for the non-financial sector showed very similar, weak (only a few percent) growth, corporates showed greater sensitivity in these conditions.

Loan turnover in the corporate segment is faster, due to the high share of financing of current financing needs. Thus, the ratio of new loans to total loans to corporates, at the end of a given period, is quite high. Therefore, in the trend, the volume of new corporate loans was higher than in the retail segment but only slightly. Although the situation in this respect changed visibly in 2022 and the first half of 2023, as banks extended more loans to companies than to households (cf. Chart 4). It is worth noting that in May 2023, an absolute record was set for monthly sales of loans to businesses (over PLN 18 billion). The reason for this can be seen in the strong increase in companies' demand for working capital loans in an environment of rapidly rising costs and business revenues.

Chart 4. Monthly average value of newly granted corporate versus households loans* (PLN billion)



* No renegotiated contracts.

Source: National Bank of Poland and own calculations.

The distribution of corporate lending to small and medium-sized enterprises (SME) and large companies was similar over the period under review. By mid-2023. SME held ca 55% of total bank claims on businesses. At the same time, from 2010 to the end of 2017, SME loans grew e slightly faster (73%) than larger corporations (63%). From January 2018 to August 2023, these proportions changed in favour of entities with 250 or more employees (29% vs. 12%).

The higher dynamics of lending to large entities is basically related to the greater resilience of this group of companies to economic fluctuations and the lower sensitivity of investment sentiment... In the SME sector, the collapse in loan demand as a consequence of the pandemic was not only more intense but also longer (the difference was ca 10 months). The recovery in loan demand for large companies lasted until the turn of Q3 2022. after which the SME sector was more active. In contrast, corporates entered a y/y decline towards the end of 2Q23, which deepened in 3Q2023.

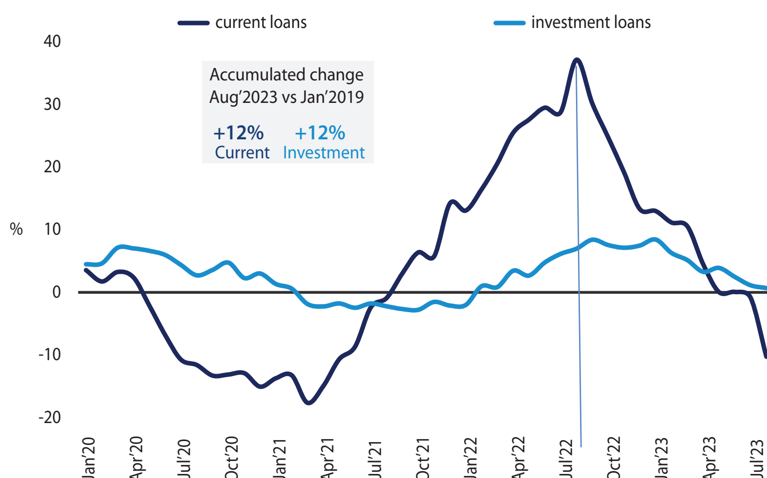
Since the end of 2010, the share of long-term receivables in the Polish banking sector has been growing and the share of investment loans almost doubled (3Q23). However, between Dec'10 and Aug'23, their share in total bank exposure to Polish companies increased by around 4 p.p., from 50% to 54%. During this period, the share of current (working capital) loans remained stable at 41% (total volume growth over the period in question of over 80%), while the importance of the small category of other loans and receivables from companies (which recorded a mere 15% growth over the period in question) declined markedly.

In the case of current loans, a break in the long-term growth trend was evident in 2H20 1H21 more strongly than in investment loans. This was, on the one hand, the result of strong economic perturbations caused by successive waves of pandemics and related and sanitary restrictions, and on the other hand, a reaction to the sizable liquidity injection that companies received under the government's anti-crisis shields. The decline in y/y growth in this area reversed sharply in mid-2021 under the influence of an increasingly pronounced post-pandemic recovery and rising inflationary pressures, reaching its peak in Aug'22 (37% y/y growth). Between 4Q22 and 1H23, the resolution of some corporate problems, including pandemic logistical bottlenecks, the calming of the situation on commodity markets (and the consequent slowdown in inventory accumulation) and, over time, the economic slowdown combined with gradual disinflation, led to another strong weakening in the growth rate of this category of corporate loans, and in 3Q23 even a y/y decline.

It is worth noting that investment loan volumes have been much more stable over the last four years, as the business cycle was flatter and longer. It is important to note that there was no decline in their y/y dynamics throughout the crisis year 2020, which is due to the natural inertia of financing long-term projects and also less sensitivity to shock events.

Generally speaking, looking at the evolution of corporate loans after 2010, it can be concluded that the growth factor of the corporate banking sector was investment loans, while current loans were characterised by high volatility of dynamics.

Chart 5. Dynamics of current and investment loans (y/y) in Jan'2020–Aug'2023



Source: National Bank of Poland, own calculations

PLN versus foreign currency corporate loans

Loans granted in PLN represent the dominant part of corporate sector liabilities towards domestic banks, accounting in Aug'23 for approximately 70% of their total volume. After 2010, however, foreign currency loans (predominantly denominated in euro) showed a nearly doubled growth rate, with the total volume increasing by 126% by Aug'23 (PLN loans by 69%). Over the entire period, the share of foreign currency loans in total bank receivables from corporates increased by 7 p.p. The higher y/y dynamics of foreign currency corporate loans was inherent in recent years. Since the beginning of 2019, their value in billion PLN has increased by more than 20% in total, with only 4% growth in PLN exposures. The period of higher dynamics of foreign currency loans has continued uninterrupted since Jul'22, although it is weakening), while the PLN loan category has recorded a y/y decline since Apr'23.

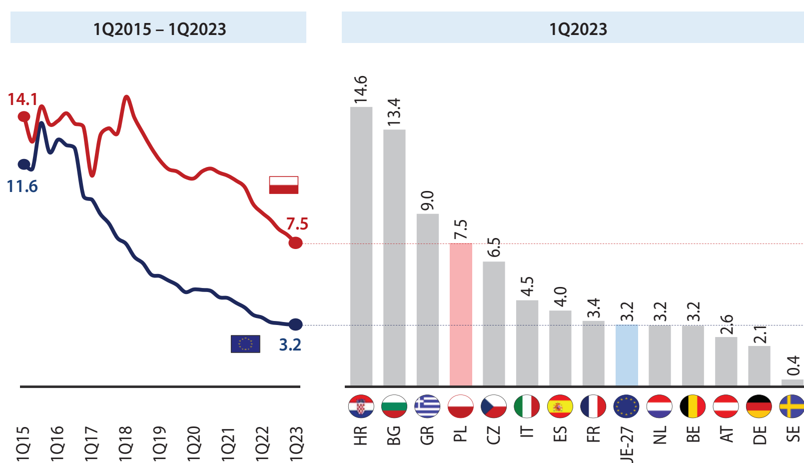
The most important factor behind the higher dynamics of foreign currency lending is the persistent interest rate disparity between Poland and the euro area and other developed economies. The differences in interest rates between PLN and foreign currency loans are conducive to the search for cheaper alternatives to PLN financing – all the more so as an increasing part of companies' revenues is generated precisely in euro. This is due to both the ongoing foreign expansion and the continued strong orientation of Polish exports towards EU countries, mainly Germany and other Euroland countries. The stronger increase in the volume of foreign currency loans in the period under review is also a consequence of changes in the exchange rate (between December '10 and August '23, the złoty weakened against the euro by approximately 15% and in October '22 by as much as 23%). The depreciation of the Polish currency automatically increases the zloty value of euro-denominated loans granted to businesses. And this is regardless of changes in their demand for bank financing. The cumulative impact of these two factors occurred in 2H22n. The steeper path of interest rate rises by the MPC in Poland compared to the ECB significantly increased interest in much cheaper euro financing, which was further supported by record trade volumes with foreign countries. Moreover, this was compounded by the strong weakening of the zloty throughout 2022. Overall, there was a significant acceleration in the dynamics of foreign currency lending to businesses, which culminated in Jan'22 at 27% y/y.

Quality of loans to businesses

Since the beginning of 2018, the share of non-performing receivables (NPLs) in the banking sector's corporate loan portfolio in Poland has been improving and even the relatively strong economic turbulence caused by the Covid-19 pandemic or the outbreak of war in Ukraine did not negatively affect the quality of corporate loans. In the large corporate segment, it even decreased by 4 and 3 p.p. of PLN and foreign currency loans respectively. Positive trends (a total decrease of 3.5 p.p. in

the NPL ratio) were also observed in the analysed period in terms of PLN SME receivables. The only category in which the NPL ratio in Aug'23 was still higher (by less than 1 p.p.) than in Jan'18 was foreign currency SME loans, although here too the situation was improving in 2023.

Chart 6. NPL indicator for companies in Poland versus EU and selected EU countries (%)



* According to the ECB methodology.

Source: EBC and own calculations.

The increasing quality of the corporate loan portfolio in recent years is primarily the result of increasingly effective credit risk management in Polish banks and the good financial situation of the corporate sector. In 2022, the aggregate net result of companies with 10 or more employees reached a record high of PLN 301 billion, and was almost twice as high as the average in 2017–2020.Moreover, 2021–2022 was a period for Polish companies not only of significant revenue growth, but also of a marked improvement in profitability

(in 2021 it was at a record high) and maintaining stable liquidity. In 1H2023, there was a 0.6 p.p. decline in margins and net profitability, but their level (as well as nominal net profit) was still historically high. In these conditions, with relatively weak demand, there is no risk of a sharp deterioration in the NPL ratio, and the share of non-performing receivables in the total corporate loan portfolio should remain at levels below long-term averages.

Attention is drawn to the large differences in portfolio loss between large company and SME loans. In the case of both PLN and foreign currency receivables, they amount to 5–6 p.p. to the detriment of SME sector exposures. In the case of large corporate loans, the NPL ratio has reached a relatively low level in recent years

(3.8% for PLN receivables and only 2.7% for foreign currency receivables). These values do not deviate significantly from EU averages. However, the clearly inferior quality of the SME loan portfolio means that the NPL ratio of the entire corporate portfolio of Polish banks is still much higher than the EU average, especially in comparison with the large EU countries (Germany, France and, until recently, Italy or Spain, which were struggling with serious economic problems). Worse indicators than Poland are found almost exclusively in the less developed Member States from Central and Eastern Europe. Despite the favourable trend of corporate NPL ratios in Poland, their level still represents one of the most significant challenges of the Polish corporate banking sector and requires further improvement of risk management methods, including in particular the identification of credit quality risks at an early stage.

Changes in margins on new PLN and foreign currency loans and deposits for businesses

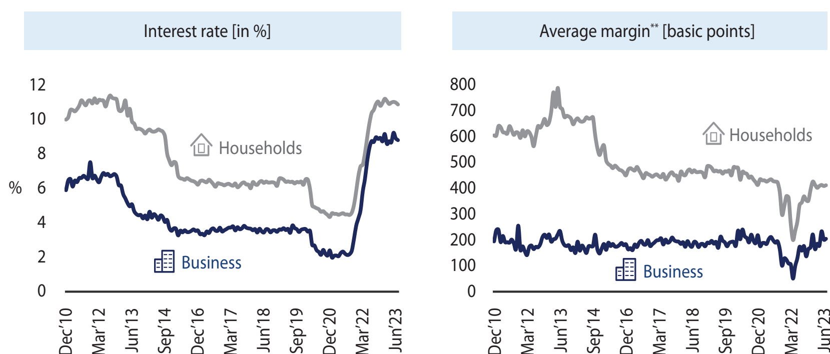
Interest rate rises have significantly improved the margins on corporate financing by Polish banks. The average interest rate on new loans to companies in just a few months of the end of 2021 and 1Q22 increased and was higher than in the whole of the past decade (around 9%) and remained at this level until 3Q22. In addition, the tightening of monetary policy became, in a fairly short period of time, the impetus for an improvement in average bank margins on corporate loans, which still reached very low levels in the first phase of the NBP rate hike cycle ('at the bottom' of Apr'22 they were only around 50 BPS and were probably the lowest after 1990. From that point onwards, the margins began to increase for several months to the average levels observed in previous years (around 200 bp.). In addition, the gap between interest rates and thus average margins obtained on new corporate and household loans has recently narrowed further. In the 20 months of 2022 and 2023, it averaged less than 200 bp. (in favour of retail loans), while it was around 230 bp in 2021, 240 bp in 2020 and 280 bp in 2019. This implies an increase in the attractiveness of corporate financing from the point of view of the banks lending to them, which was influenced, among other things, by weaker demand for high-margin consumer loans (and thus a decrease in their share in the structure of new retail lending).

Less favourably for the banks, the margins on new loans to businesses granted in euro have developed recently. In 2022, the initial interest rate increases on these loans were out of line with changes in the 3M EURIBOR rates, resulting in a reduction of more than 100 BPS in the average margins on newly granted financing of this type. In October'22, there was a change and margins on new euro corporate loans but did not reach the average level of 2019–2021, i.e. around 230 bp.

The impact of interest rate rises was more favourable for banks on PLN deposits for businesses (representing just over ¾ of banks' total liabilities to business customers)

than on loans. The typical delay in adjusting interest rates on term deposits resulted in a surge in margins earned on these products mainly in 4Q22–1Q23. Consequently, the average level of margins exceeded 5% (i.e. was higher than for the entire previous decade). This allowed margins on term deposits to stabilise in the 100–150 BPS range, which was still much better than the average of the previous decade +/- 50 BPS). However, the source of the greatest improvement in banks' margins on corporate servicing was gold current deposits. In 2H22, the volume of these h deposits grew rapidly in the wake of rising corporate turnover, and their interest rates remained almost zero despite strong increases in NBP rates. Hence, the margins earned on them by banks reached long unseen levels of over 600 bp. The interest rate adjustments on PLN deposits in 2023 were small enough to reduce their margins by up to 100 bp, making them one of the most profitable classic banking products.

Chart 7. Average interest rates and margins for new business and houshold loans in PLN* in Dec'10–Jun'23



* Along with renegotiated contracts.
** The difference between the loan interest rate and 3-month WIBOR.

Source: National Bank of Poland and own calculations.

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After 2010, Poland was among the fastest growing corporate banking markets in the EU. Our country stood out at the time not only because of its above-average economic growth rate, but also because of the dynamic development of Polish companies, increasingly operating internationally. However, recent years have brought for banks, on the one hand, an accumulation of demand barriers affecting both the retail and business banking areas, and on the other hand, an accumulation of challenges of an institutional nature (credit holidays, franking credits). The resulting inconveniences for banks were already partially compensated in 2022 by the positive effects for them of interest rate rises, which in 2023 translated into a record high result for the entire banking sector. At the same time, in the period

under review, we could observe considerable structural changes in the market for corporate loans and deposits (including, inter alia, strong fluctuations in demand for working capital loans, the growing popularity of foreign currency loans, or successive waves of growth in the area of current and term deposits).

It seems, however, that it was business banking that encountered somewhat more fertile ground during this economically turbulent period. This was reflected, inter alia, in higher loan growth than in the retail segment, especially in deposits, a more pronounced improvement in the quality of the corporate loan portfolio (with the exception of foreign currency receivables from SMEs), as well as a generally better response of margins to interest rate rises in the case of corporate products. This was not hampered by the generally greater sensitivity of the corporate segment to changes in the macroeconomic environment, as the 'losses' incurred in more difficult times were more than compensated for by solid increases in good economic times.

Business models and strategies of the largest banks in Poland in the corporate banking segment

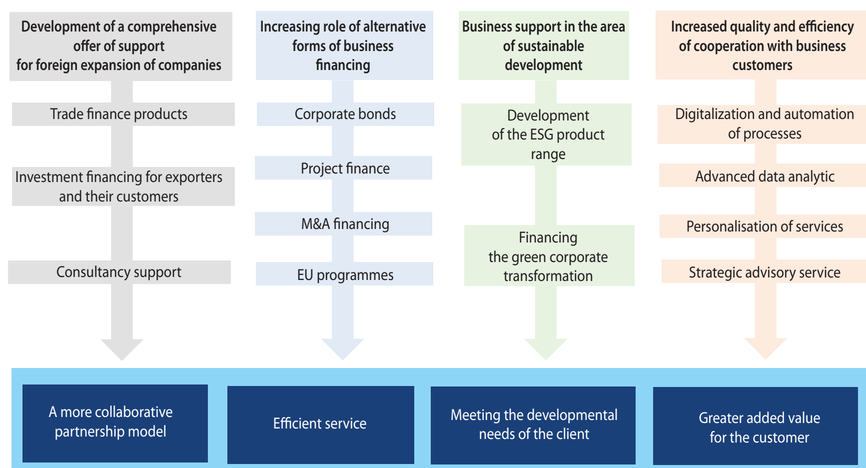
Since the beginning of the system transformation in the 1990s, after a short period of explosion in the issuing of operating licences to new commercial banks, the number of which exceeded 100, a process of concentration triggered by both the processes of sanitation of problem banks and rationalisation aimed at improving profitability (e.g. through economies of scale) began. The direction of changes in the business model of banks in Poland in the area of corporate banking was aimed at better adapting their activities to the needs of enterprises and helping to create added value. Banks responded to the increased volatility of the economy, cost rationalisation, digitalisation and computerisation, as well as the internationalisation of corporate activities. Legal norms and general regulations and, in particular, the implementation of ESG concepts were very important. In response to the environment, banks' strategies were stimulated internally and focused on the search for efficient ways to allocate capital, provide new services and service business areas, as well as on the modernisation of technology and banking operations and process optimisation. As a trend, corporate banking in Poland organically combined external conditions, whether global, regional or national, with internal changes in the organisation and operation of banks.

Significant activities of a strategic nature undertaken by banks in the area of corporate banking include, above all:

- development of the offer of comprehensive support for foreign expansion of corporate clients;
- development of alternative (including specialised) forms of financing corporate activities;
- support for companies in the area of sustainable development and ESG;

- improving the quality and efficiency of business customer service, e.g. through the use of the latest technological developments (digitalisation and automation), development of advisory services, personalisation of services or creation of additional value for customers based on advanced data analytics.

Chart 8. Key elements of the customer-centric evolution of corporate banking



Source: Bank Pekao.

At the end of 2Q23, the share of the eight largest banks in the sector's assets was over 60% and amounted to PLN 1.8 trillion. The leader in this respect was PKO BP with a share of ca 16%, followed by Bank Pekao (ca 10%) and Santander Bank Polska (ca 9%). It is characteristic that the eight largest banks in Poland are universal in nature, with a diversified asset structure reflecting priorities in servicing specific market segments (e.g. BNP Paribas Polska has a specialisation in developing relationships with agri-food market participants, supporting the sustainable transformation of this sector). In the loan portfolios of ING Bank Slaski, Bank Pekao, Santander Bank Polska and BNP Paribas Polska, the share of the business segment fluctuates around or exceeds 50%, while the portfolios of Millennium Bank or Alior Bank indicate a focus on retail banking.

In shaping their market positions, banks in Poland try to use their competitive advantages in individual sub-segments, although the strategies of the largest banks in the area of corporate banking used for this purpose have many common features, such as:

- concentration and striving to improve the efficiency of capital management through, among other things, cross-selling and sector specialisation;
- the use of advanced data analytics to strengthen relationships with corporate customers and improve their satisfaction with the bank;

- development of electronic and mobile banking by expanding the scope and possibilities of self-service in remote channels (primarily for SME);
- automation and optimisation of credit processes with a view to increasing customer satisfaction (convenience, speed and, predictability of decisions);
- actively participating in the energy transformation of the Polish economy, as well as supporting corporate customers in implementing ESG concepts.

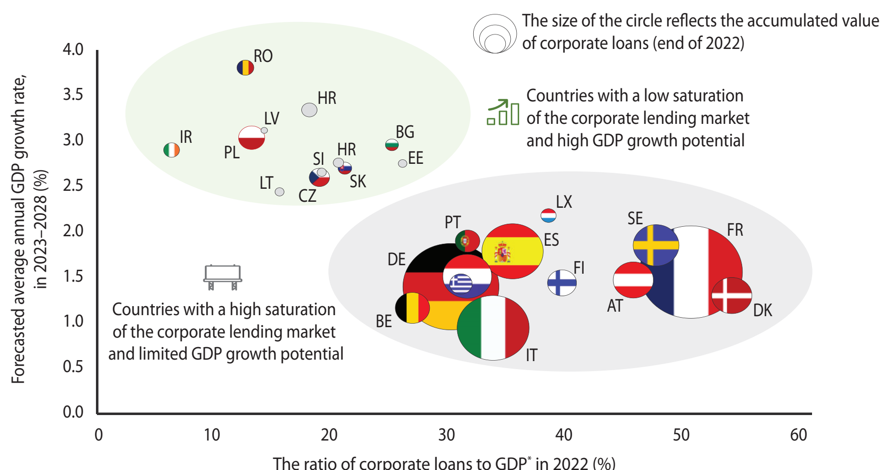
With the development of banking technology and computerisation, banks have gained access to rich databases that have enabled the development of relationships in corporate banking and the support of the competence of banking staff in dealing with customers as a factor of bank success. The use of staff competencies and information from databases make it possible to create competitive advantages based on specific activities in selected market segments. The choice of these segments is often rooted in the history of mergers and acquisitions in the banking sector or specific missions to operate in the Polish market, which to a certain extent determined the current asset structure. For example, the current customer base and portfolio of corporate assets at BNP Paribas Polska were shaped by the M&A processes the bank went through over the last decade. By contrast, in the case of Alior Bank, which was founded in 2008 as a bank primarily based on the online channel and targeting retail banking customers, today has a corporate portfolio that is relatively overweighted towards smaller companies, and the bank's strategy itself naturally addresses mainly solutions for micro, small and medium-sized companies. The origin of capital is often also significant. Being part of an international, financial capital group naturally supports opportunities to strengthen its position in international banking and servicing foreign capital groups (i.e. global corporations with their origin in the country of the main shareholder). In turn, the direct or indirect presence of State Treasury capital in the bank's shareholding structure and the bank's long history of presence on the Polish market often correlates with the possession of a significant portfolio of clients from a group of Polish enterprises and so-called national champions.

Corporate financing structure, investment needs and development potential of corporate banking in Poland

The marked slowdown in the development of the corporate loan market in recent years may raise doubts about the long-term prospects of this part of the Polish banking sector. However, comparative analyses to other European countries indicate that the Polish market is much less saturated with loans, which may be an indication of a relatively high development potential. According to the ECB, the weak growth in the volume of domestic corporate loans, over the last four years, with a solid average annual rate of nominal economic growth, has resulted in a decline in the loan-to-GDP ratio by around 3 p.p., to a level not seen in the whole of the previous decade of around 13%. In turn, for the EU (excluding Poland) at the end of 2022, with a successive decline, the ratio was 11 pp lower than in 2010. In terms of the ratio of business loans

to GDP, Poland ranks third from the bottom in the EU (ahead of Romania and Ireland). The gap in the saturation of the business loan market between Poland and the EU average at the end of 2022 was as high as 21 p.p., comparable to the gap in the housing loan market. This may be an indicative measure of the development potential of the domestic banking sector. This assessment is further legitimised by the results of the analysis conducted in terms of GDP growth rate forecasts and the ratio of business loans to GDP (cf. Chart 9).

Chart 9. Share of loans to enterprises in GDP and projected growth rate in 2023–2028



* Loans to domestic non-financial enterprises.

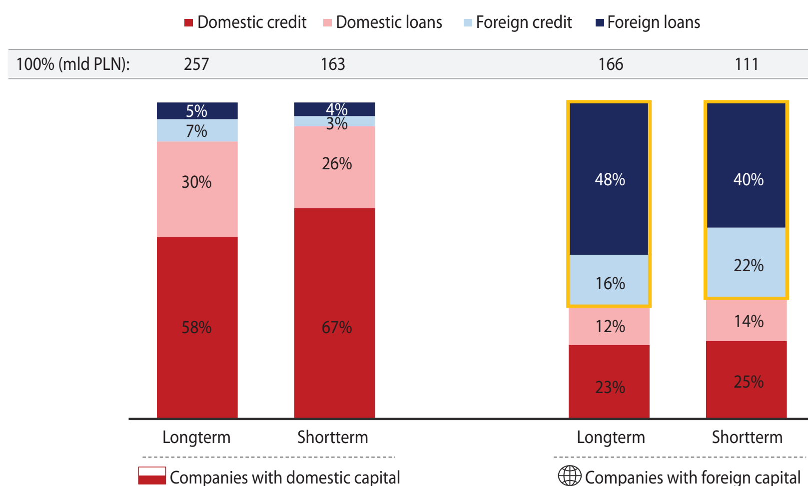
Source: EBC, Eurostat, own calculations.

This two-criteria analysis leads to the grouping of EU countries into two clusters. The first is formed by the so-called new EU member states plus Ireland , as countries with high development potential for corporate banking (fast GDP growth rate and low saturation of corporate loans). The second cluster is made up of the so-called old EU member states with the highest saturation of the corporate loan market and relatively worse GDP growth prospects. to which they belong (low saturation of the corporate loan market), yet with above-average good (compared to the entire EU) medium-term economic prospects.

In the first cluster, by far the largest volume of corporate loans is held by banks in Poland and the relatively low saturation of the market with loans creates high growth potential. This is all the more so because enterprises in Poland are faced with gigantic investment challenges, with an estimated value of ca PLN 250 billion a year on average. These include, on the one hand, large-scale infrastructure investments (e.g. in energy, roads and rail transport, modernisation of the army), as well as investments resulting from the Fit for 55 commitments and the possibility

of using funds from the National Reconstruction Plan and, in particular, funds from the new perspective of the EU Structural Funds. In addition, it will be important to invest in research and development in view of the planned increase in their share of GDP to catch up with other EU countries. A challenge in this area will be financial engineering resulting from, among other things, the role of investors of public entities and the need to develop public-private partnerships in lending for investment projects.

Chart 10. Structure of corporate* credits and loans by term and grantor in Poland or abroad



* Data for companies with 10 or more employees.

Source: Pont Info, own calculations.

When considering the saturation of credits for enterprises and the development potential of this market segment in Poland, one cannot overlook the role of foreign parent companies in financing their subsidiaries (in terms of capital or organisation). In particular, it is about alternative sources of financing to domestic banks, as the offer of banks in Poland is not attractive enough to finance their needs more favourably, especially investment ones. This is another limiting factor in catching up with the EU-leading corporate credit saturation ratios.

In 2015–2022, enterprises with 10 or more employees with foreign capital brought on average ca 40% of the revenue of the enterprise sector in Poland , while their share in total investment outlays was 38%. In turn, an analysis of data on the structure of SME loans and credits (GUS reports with the symbol F-02) reveals significant differences in the financing structure of Polish entities and those with foreign capital. At the end of 2021, the former took 60% of all short-term and around two-thirds of long-term loans and credits from Polish banks, while a further 30%

and 26%, respectively, came from non-financial domestic entities with capital ties to them. The debt structure of companies with foreign capital was asymmetric, as domestic banks accounted for only 23% of all long-term loans and credits and 25% of short-term loans and credits. On the other hand, 64% of long-term and 62% of short-term financing came from abroad, in particular loans from parent companies (nearly half of all long-term loans and advances and 40% of short-term loans. In 2021, the use of foreign financing by companies resulted in a severe reduction in the assets of Polish banks. In the case of enterprises with Polish capital, this amounted to approximately PLN 44 billion, while in the case of enterprises with foreign capital it was more than PLN 170 billion. What is more, SME liabilities on foreign loans and credits show an increasing trend. Between 2015 and 2021, the amount of liabilities increased by PLN 42 billion, i.e. by nearly ¼, i.e. by more than a quarter. However, this increase was smaller than that of domestic financing. As a result, the share of foreign sources in total SME loans and advances decreased by around 5 p.p. over the period.

The development potential of the corporate banking sector may be further enhanced by the foreign expansion of Polish companies within the EU as well as with third countries, which will naturally create demand for specialised financing and advanced advisory services.

Between 2015 and 2022, Poland's share of intra-EU trade increased from 5.1 to 6.1%, and with third countries it is lower (3.3%) but with an increasing trend. However, it must be taken into account that this expansion will face demand barriers in EU countries and the UK in conjunction with the phases of the business cycle and the technology race requiring high capital expenditure. All the more so as one has to reckon with a reduction in the competitive advantages of Polish enterprises resulting from lower costs, labour standards and, finally, entrepreneurial flexibility, especially of SMEs. Assuming no fundamental changes in business conditions, Poland will remain an important production base for the wealthier Western Europe, and Polish companies, operating on an increasingly international scale, will be quicker than their EU competitors to increase their presence also on third markets.

Opportunities to finance investment needs in the transition of the economy to sustainable development

In the context of the major investment challenges facing Poland later this decade, the question arises to what extent the banks' capacity to finance such needs has not been undermined by several years of weaker financial performance of domestic institutions, which, especially in 2021

and 2022 were burdened by large regulatory costs (credit holidays, franking credits). All the more so as the problem of CHF loans has not yet been fully resolved. As at the end of 1H23, the estimated total value of created provisions of banks with portfolios of such loans in their balance sheets amounted to around PLN 46 billion, which accounted for 62% of the volume of such loans. Covering the entire portfolio

requires incurring additional costs on account of created provisions of about PLN 27 billion, and it should be remembered that the target level of provisions will be even higher. Another thing is that the current environment of high interest rates is conducive to a quicker final resolution of the franking problem by the banks, which as of today seems to be closer than further.

Importantly, the high interest rates and record profits of banks this year are also conducive to improving their capital adequacy ratios. After both the total capital ratio and Tier 1 ratio fell by more than 2 p.p. between 2H21 and 3Q22, recent quarters have already seen them improve strongly, in both cases to record levels (21.6% and 19.9% respectively at the end of 1H23). Despite these achievements, the question remains as to whether these are sufficient parameters for banks to be the leading provider of capital for all transformational investments, representing a de facto additional outlay over and above that incurred by companies and other domestic entities (including the government sector and households) to date. Analyses and simulations indicate that the potential for domestic financial institutions to finance such investments is significant under certain conditions. On the one hand, this is due to the possibility of releasing part of their capital surplus and, on the other hand, feeding the capital base from annual profits. The estimated maximum potential for generating additional loan volume resulting from the release of capital surplus across the sector would be ca PLN 400bn. By 2030, this would mean a maximum of PLN 55–60 bn of additional lending per year. On the other hand, assuming annual replenishment of the capital base with part of the profits generated in the amount of PLN 10 billion, it would be possible to further increase lending by a maximum of another PLN 100 billion annually. In view of the inclination of some banks to maintain a dividend policy favourable to shareholders, this would be possible in the presence of relatively good market conditions (especially interest rates), as well as a limited number of crisis events weighing on banks' results (e.g. additional regulatory burdens, participation in financing bankruptcies). Under these assumptions, the maximum total potential for banks in Poland to increase their financing of the economy can be estimated at around PLN 150–160 billion per year.

Between 2010 and 2022, the average annual increase in loans and other receivables of banks amounted to less than PLN 60 billion. Assuming that this trend would continue in the following years as well, the remaining amount of up to PLN 100 billion per year could be used to finance new investments in the Polish economy. In combination with other available instruments (e.g. EU funds, foreign credits and loans, debt instruments) and investors' own funds, the financing of investment projects transforming the Polish economy to a new higher quality seems realistic.

The above estimates indicate that the Polish banking sector could be a key vehicle for financing new and desirable investments in Poland. This would benefit both the economy and the banking sector itself, especially the corporate banking segment, whose development could significantly accelerate under such conditions. A separate problem is the supply-side aspects of making such investments, including the ability of individual sectors to effectively undertake the relevant projects.

While the simulation of the development of the banks' capital base provides a rationale for increased lending, its feasibility and business efficiency will depend on the regulatory environment of the financial sector as a whole and processes in the real economy. Both these aspects will determine the sector's ability to generate profits that banks could use to increase their capital.

A separate problem is the implementation of large and mega investments in particular, involving multi-phase transformation projects. This involves both technological and financial barriers. Such barriers include:

- The size and complexity of projects. For example, the estimated value of the investment associated with the construction of the first nuclear power plant is PLN 86 billion and the offshore wind farm 'Baltica' is PLN 30–40 billion. The banking sector is preparing to finance such costly and technologically complex investments, but funds from individual financial institutions are not sufficient to cover the required outlays. This implies the need to arrange bank consortia with the participation of domestic and foreign banks, as well as advanced financial engineering using the funds of national or EU support programmes) and capital market instruments.
- Banks' requirements for sustainable development. The requirements on borrowers in relation to climate and environmental policy result in banks limiting their financial exposure to companies and transactions involving 'non-green' assets, while increasing financing to support the development of zero- or low-carbon energy sources. This means that other factors such as environmental, social and corporate governance (ESG) impacts must be analysed alongside return on investment. In practice, investment projects will be subject to higher requirements by banks than before. The decision to grant financing will be preceded by an examination of the expected impact of the investment on the environment – if this is negative, commercial criteria will not be a sufficient argument for granting financing.
- Law and regulation. Effective participation in financing sustainable development and especially climate transformation requires the elimination of legal risks, especially those originating from EU directives or regulations. Furthermore, the implementation of sustainability and ESG concepts requires additional investment or costs on the part of the banks themselves. This will require the involvement of the entire organisation and, in particular, the revision of lending policies and procedures, the adaptation of IT infrastructure, the revision of the competences of staff and business partners, and customer education. Open coordination of business models and alignment of the strategies of banks and financiers will be necessary. The development of databases and the application of modern technologies in the shaping of customer relations will extend the credit assessment horizon and affect funding volumes accordingly, within adjusted concentration limits and prudential standards.
- Convergence of the status of financial market players. Under conditions of high demand for mobilising capital for systemic transformation in line with the con-

cept of sustainable development and intensifying competition in the financial services market, the inequality of the status of financial market players generates additional development barriers, risks and affects customer confidence.

"Bankability" of projects. The dynamics and complexity of regulatory changes will imply the need for support in the loan process by specialised consultants. On the one hand, support to the borrower in the preparation of the loan documentation, especially from the side of formal and financial requirements, and on the other hand, support to the lender – from the substantive and technological side, allowing an objective assessment of the feasibility and economic efficiency or due diligence of the project. Overcoming or mitigating the above barriers will depend to a large extent on the content of the rules, regulations and the attitudes of the regulator towards emerging challenges. Of cardinal importance will be those solutions that will generate operating costs and allow for the generation of profits in the increasingly competitive environment in which banks operate. In light of the analyses conducted and projections formulated, it can be argued that in the foreseeable future, banks in Poland will constitute a key link in the civilisational leap to the era of sustainable development.

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The future of corporate banking in the opinions of bankers and entrepreneurs

Introduction

The Corporate and Investment Banking Congress (CIBC) is an initiative of the European Financial Congress (EFC), including speeches and discussions on financing and support for businesses by financial institutions. The 9th Edition of the CIBS was organized at the Warsaw Stock Exchange on 7 and 8 November 2023. Plenary speeches and debates in sessions were attended by dozens of practitioners and academics and there were 416 registered participants. One could hear in the content of the speeches an echo of the sentence, which was uttered almost a century ago by Maria Curie-Sklodowska “not to be defeated by either people or events”, quoted by the Chairman of the Program Council of the Congress Mr. Jerzy Kwiecinski.

Today, this can be neither *ex post* crisis management nor the use of widely recognized methods of strategic management or techniques for designing the future based on historical data and experience. In a turbulent and especially rapidly changing environment, management of the future is needed. Among other things, it involves flexible and dynamic thinking and, above all, innovation in decisions about the future with creative use of new technologies and consideration of the diversity of both individuals and business environments. This requires that we wisely use the maxim of George Box, who proclaimed that “all models are wrong, but some are useful”.

In the first plenary speech, Paweł Borys – President of the Polish Development Fund, outlined the main trends observed in the world of finance, pointing out that despite several turbulent years starting with the global financial crisis of the first decade of the 21st century, the year 2024 promises to be a relatively good one for the Polish banking sector. The rationale for this is, among other things, the very good

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performance of banks and also the opportunities that can be discounted through appropriate adjustments of business models, both in the short and long term, to several processes in the local, regional and global environment. These processes can even be referred to as trends. Firstly, the regionalization trend associated with supply chain shortening and decoupling, nearshoring or inshoring favoring direct investment (FDI) in Poland. Secondly, the technological revolution related to artificial intelligence (AI), which is forecast to contribute up to 40% of productivity growth while the industrial revolution is estimated to have contributed 10% and the Internet 30%. Thirdly, experts expect the end of the era of cheap money, which was emblematic of the first decades of this century (due, among other things, to a decline in liquidity in the global market). Fourthly, the challenge and sign of the coming years will be an extensive energy transition, and this will be true for both energy producers and end consumers. Inshoring processes will also be of no small importance here. Fifthly, unfavorable demographic trends (however, there may be approximately 3.5 million fewer people in Poland) must be compensated by modern technologies. Sixthly, and finally, there is a clear trend of increasing geopolitical and international tensions (e.g., in the Middle and Far East, Eastern Europe), which will force the shortening of the horizon of business assessments.

In the assumptions of the Congress Program Council, the issues of the future of corporate banking were to be considered from at least two points of view. First of all, on the basis of a thorough diagnosis and forecasting assumptions developed by banking specialists and a debate among executives of the largest banks in Poland. On the other hand, they wanted to confront the position of banks with the opinions of business managers from the real sphere. Business managers debated on "The future of corporate banking through the eyes of entrepreneurs."

Opinions of bankers

The speech of Ernest Pytlarczyk, Director of the Bureau of Macroeconomic Analysis of Bank Pekao S.A., who characterized selected aspects of the Report "Corporate Banking in Poland – trends and prospects", with elements of Polish specificity, connoted the outlined synthetic vision of development in global terms.

The panel session on "The Future of Corporate Banking through the Eyes of Bankers" was featured by: Lech Gałkowski – Member of the Management Board, Head of the Business and Corporate Banking Division, Santander Bank Polska S.A., Andrzej Kopyrski – Vice President of the Management Board, supervising the Corporate and Enterprise Banking Area, PKO Bank Polski S.A., Jerzy Kwieciński – Vice President, supervising Corporate Banking, Markets and Investment Banking Division, Bank Pekao S.A., Michal Mrożek – Vice President, ING Bank Śląski S.A., Adam Pers – Vice President, Corporate and Investment Banking, mBank S.A., and Agnieszka Wolska, Vice President, BNP Paribas Bank Polska S.A.

The participants in the debate were asked to make statements with reference to both plenary speeches by P. Borys and E. Pytlarczyk, keeping in mind the thesis of Nobel laureate I. Pavlov that "in theory, fact is always king and before fact one should bow."

Agnieszka Wolska, in her speech, pointed out that corporate banking in Poland has interesting solutions even for foreign banks, stressing, however, that the canon of the BNP Paribas corporate banking model is the mix of customer needs and business efficiency. She added that since exports generate 63% of GDP and foreign-owned companies generate as much as 40% of GDP, banks meeting the demand for financial services must be active in at least the European area.

For the BNP Group, the ESG trend creates the potential for competitive advantage and is a major driver of growth in the European Union and companies in Poland. In the modern business environment, it is necessary for a bank to contribute to the value protection, and although regulations are not particularly comfortable for credit institutions in this aspect they are beneficial for customers. This is why, hedging techniques are being developed, either to protect acquired assets from sudden or unexpected losses, or to provide greater flexibility so that positions can be held even when they would otherwise have to be closed at a significant loss (e.g. bond hedge, commodity hedge, interest rate hedging). In this case, the bank becomes the client's partner in protecting value. In the Polish capital market, bank support for succession in family businesses will become increasingly important. This will require integrating both local competencies and the SME, Corporate and Private Banking business lines, accompanying clients in strategic decision-making. On top of these substantive requirements, it will be necessary to impose a cost efficiency filter using modern technology. At the same time, it is impossible to do everything on one's own in a bank supporting oneself with external entities for effective standardization, customization, learning from the best and adapting best practices, especially leading technology companies. On the other hand, the skillful use of these determinants to offer the customer effective satisfaction of needs will constitute a peculiar act of art.

Adam Pers, noting the race of banks to serve needs of customers better and better, stressed that the trends mentioned earlier (e.g., nearshoring, AI) or the great need for infrastructure investments are opportunities for the banking sector, without which neither the energy transition nor the construction of road networks or rail routes will be possible. In this context, the real shrinkage of banks' capitals in recent years, both as a result of inflation and the acquisition of Treasury bonds, should be considered negative. This process may also have undesirable consequences in the case of pre-financing investments that are to benefit from EU funds. The demand for bank credit financing is also inshoring processes, especially intense after the experience of breaking the supply chain with China. Hence, in general, there is a need for a climate and regulations that allow banks to expand their capitals, especially when considering the assets of the Polish banking sector in relation to GDP and comparisons to developed countries.

Michal Mróżek agreed with the tenor of the previous statements, comparing the banks' activities to sailing on a rough sea, especially in terms of risk management and customer development support. He also appealed to take an occasional glance in the rear view mirror. This will make it easier to understand that not everything has the same evaluation over time:

- due to geopolitical processes or geoeconomics (e.g., the popularity of globalization vs. the need to shorten the supply chain);
- the issue of banks entering the role of advisors (e.g., using the experience of international capital groups);
- the emergence of new functionalities or divisions in banks (e.g., working capital solutions).

Changing social needs and attitudes, both globally or internationally but also domestically, also need to be adequately addressed. The following can be considered essential here:

- regulatory interference and prudential requirements, benchmarks (e.g., WIBOR, WIRON);
- symmetry of the interests of the individual customer and the bank;
- the concept of sustainability and environmental transformation;
- finally, simply the expectation and preference for stability.

Of capital importance is already and will be increasingly important technological revolution in a number of aspects.

So as to meet these challenges it is not only necessary to seek capital, but also to modify business models. Just one instructive example. The financing of one offshore wind farm costs an amount of about 4 billion euros and there are supposed to be 8–9 such farms in Poland. For the realization of such projects there is a need to revise operational models and discourse with the regulator, both national and EU.

Jerzy Kwiecinski agreed with the trends outlined in the Paweł Borys› speech, emphasizing that in the past 30 years we have come out of problems better than forecast. Paradoxically, high inflation, harmful to the socio-economic system, allowed banks to improve their results. At Bank Pekao, the result for 2023 will probably be a record, but with the reduction of interest rates, there will be risks and it will be necessary to actively look for ways to generate income. One must also bear in mind that the Polish banking sector is relatively small (relative to GDP) and weak from the financing large investment projects point of view. And what constitutes its weakness may symmetrically be advantageous in a situation of rapid changes in the parameters of bank operations. The Polish financial market is mainly a bank debt market and not an equity market. Anyway, it can be argued that in some aspect the Polish banking sector has regressed and its balance sheet total has fallen below 90% of GDP, when in many EU countries it is much higher. It can be assumed that this calls for greater involvement of the banking sector in the capital market despite the resistance of the Polish Banking Authority (KNF) due to the risks involved. The distant position of Poland in the share of corporate R&D expenditures and at

the same time a higher growth rate than in countries,where the rate of resource allocation to R&D is much higher, also needs to be explained and properly addressed.

In the broad spectrum of issues of the future of corporate banking, the importance of ESG issues must be properly emphasized. This is especially evident when dealing with foreign partners or competitors. Therefore, if we do not adequately address this matter in the Polish banking sector someone else will take care of it business-wise. Similarly, as other banks perceive it, an urgent and important challenge is to follow the financial service needs of customers conducting expansions to foreign markets. The more than 60% share of exports in GDP is a strong and credible indication of this. If such needs are not adequately serviced by the Polish banks then revenues will "flee" abroad. As for the technological and especially IT revolution, one must take into account the circumstance that we have a kind of surplus of importance when it comes to IT personnel in the CEE region (much better than in the US). This is an opportunity factor to be exploited. But for this to happen, it is necessary to go beyond our own banking "bubble" in the discussion.

Andrzej Kopyrski began with an optimistic attitude to the future of corporate banking, as he assumes that this one appeals to a much greater extent than retail banking to the human-to-human relationship, regardless of the excellent support of the transaction process with solutions based on modern technologies. PKO BP, taking advantage of its good financial situation, related, among other things, to relatively high interest rates, is investing heavily in state-of-the-art technologies to the tune of about PLN 1 billion. This is also due to the fact that 'tech-is-friend', because it enables the collection and analysis of large databases, helpful in forecasting the future, with AI being able to play a significant role in estimating needs and risks with cognition and addressing customer preferences.

In the second thread, more from the perspective of investors, there was a thesis about the growing role of corporate banking in the valorization of banks. Data from the Pekao Report shows that the retail banking sector grew very well, but treating the customer as a consumer contributed to the materialization of non-liquid risks. Therefore, it is important to maintain a certain balance between the retail and corporate components. Especially, since the vast majority of commercial banks in Poland are universal banks with a strong corporate component. This, in turn, hits fertile ground with equity investors. This indicates that two legs, both retail and corporate, are and will be needed in banking, not only now for balance. The third thread highlights the issue of catching up with lagging foreign expansion. It's both about "following the customers" and not getting locked in a "beautiful little local aquarium," this allows one to get an idea of the novelties in the foreign environment and adapt them to the bank's services. Such projects are currently being undertaken by PKO BP and this is important not only for serving customers abroad, but especially for domestic banks playing a key role in stimulating product development and dissemination in the local market. Due to their market position and financing potential, PKO BP and Pekao have an approximately 50% share in corporate banking, hence expansion must be seen in the development of M&A

transactions that appear on the domestic market. PKO BP will implement them, in a certain time perspective, only in the regional market, and as for the global market we will see. Fourthly, as far as the level of bank financing of the economy is concerned, Poland is located more or less in the middle of the average level for the EU, which has its negative sides, but there are also advantages, since customers do not have such exposure to interest rate changes or turbulence in the banking market, which allows companies to maintain greater financial autonomy from these processes. Fifthly, we are facing great challenges in developing the capital market, as evidenced by the annual debates at the CIBC. However, it has been difficult to develop this segment of the financial market, especially the debt market, under conditions of structural over-liquidity, where all issues of securities or bonds first went to the balance sheets of banks, and only in the second place did they go to the market – and in those banks that were able to effectively manage their exposure. Given the estimates of investment needs, an opportunity and a need open up for the development of this market to be properly stimulated. Symptoms of this can also be seen on the Warsaw Stock Exchange, as mentioned by President Izabela Olszewska in her welcome speech. The example of POLSAT's recent issue, which was well structured and placed on the market, can also be cited here. PKO BP has the team, the potential and the customers, whom we are educating on how to use the capital market and how to combine financing needs through equity and credit instruments. The bank must take the initiative.

Lech Gałkowski began his speech with a rhetorical question: "What is corporate banking for?". In response, he said that to help customers grow and this is a guarantee that banks will need for many years to come. Especially in Poland, where most companies are relatively small hence banks need to grow with their customers in the development processes. In the paradigm that customers come first, one must be able to respond to their expectations of convenient banking, i.e. easy, cheap and pleasant, as well as self-service. This requires symmetry between the customer and the bank, and in relation to Santander Bank Poland such a philosophy is implemented better than in other locations in Europe. In order to provide the best services, you need to have appropriately competent staff, and in the market we compete for talents. A comparison of the strategies of the banks included in the previously presented Pekao Report shows that they are almost twinned. And if at present the easily observable differentiating factor for banks in Poland is the level of technological sophistication, then in a relatively short time horizon these differences can be expected to disappear. In contrast, an internal factor of competitive advantage will be the treatment of human resources.

Among other things, SLIDO responses to the Internet audience indicated that there is no contradiction or conflict between intensive development of technology and preservation of relationality, with relationality (version 2.0) being and will be more important – even in the long horizon – in corporate banking than in retail banking.

When asked about the peculiar counterpoint of the ca 20% solvency ratio and the constraints on financing investment needs in Poland, the panelists pointed to

the uneven distribution of this ratio across banks and also to the Polish Banking Authority approach to the value of this ratio, where an excess over the minimum required level does not easily imply the possibility of credit growth. There are also issues of capital buffers and also the question of the scale of financing of large or major projects. In the latter aspect, there has been some divergence of positions, particularly on the issue of loan syndications or syndication of large-value loans. In the case of PKO BP, no significant limitations were seen in lending to relatively large investment projects, which in the past have been organized in the form of loan syndicates, provided they are good business projects. (For example, financing the construction of nuclear power plants or, to some extent, large offshore wind farms has been identified as an exception). With regard to such large-scale projects, an appropriate role falls to those domestic banks that belong to foreign banking groups, which can arrange financing, structure and then syndicate it accordingly. An example is Citi Bank's activity in arranging financing for energy transition projects or offshore wind farms in Poland. New forms of cooperation between domestic and foreign banks will be needed here, with an appropriate division of tasks arising from, on the one hand, knowledge of the client and the market and, on the other hand, the ability to arrange and structure financing. In this context, the problem of capitalization of banks and its attractiveness to investors rather than relying mainly on retained earnings was raised. There were also calls to move away from the club deal model to diversified methods and advanced financial engineering, but the condition for this is to reduce the fetish of balance sheet value by putting transactions on the bank book. There is a need for activity in the sphere of dedicated (to the situation of the enterprise and normative and real conditions) composition of financing needs of enterprises. This includes developing the concept of cooperation with customers, with an educational component, which the Americans called "originate-to-distribute".

Opinions of entrepreneurs

The positions of bankers regarding the corporate future were confronted with statements from representatives of the real economy in a Congress panel titled "The Future of Corporate Banking through the Eyes of Entrepreneurs," which included Filip Kuropatwa – Vice President for Finance of UNIMOT S.A. – fuel and energy group; Robert Ostrowski – Deputy President of the Management Board for Economic Affairs of Jastrzębska Spółka Węglowa, the largest producer of hard coking coal in the EU; Małgorzata Winiarek-Gajewska – President of the Management Board of NDI Group – a capital group operating in the construction sector; Piotr Woźny – President of the Management Board of Zespół Elektrowni Patnów-Adamów-Konin (ZE PAK) three lignite- and biomass-fired district heating plants in the Konin Basin; Beata Żaczek – Vice President of the Management Board of the PEKABEX Group – specializing in system construction in Poland and Scandinavia, with five factories in Poland and one factory in Germany; and Adam Żołnowski – CFO, Member of

the Management Board of BALTIC HUB – a container terminal in Gdańsk with huge handling capacity. Statements by representatives of entrepreneurs focused primarily on issues of meeting their needs for bank financing and elements of the development forecast for the industry they represented.

The panelists had access to the Bank Pekao Report and were briefed on the main themes of the bankers› statements on the future of corporate banking.

Malgorzata Winiarek-Gajewska said that experience shows that "the construction industry is not liked in the Polish banking sector" despite the fact that it generates more than 10% of GDP, and forecasts – not only the Bank Pekao Report – show that investments worth hundreds of billions of zlotys relate mainly to activities involving companies in the construction sector. Colloquially, the expectations of entities in this sector from banks expresses a wish: "they would like to be comfortable". And this means, among other things, parallel development of the activities of enterprises in this industry and a banking offer adapted to this development, taking into account cost and financial considerations. Optimistic that the banks' declarations emphasized the development of corporate banking, i.e. no longer the question "if?" but "how?". The key is to remove the asymmetry of looking at projects. Assuming that the implementation of ESG concepts and regulations is unquestionable, it cannot be overlooked that for the company it involves additional costs, in a highly competitive market. This aspect is not respected by banks. On the other hand, the possible foreign expansion of construction companies, due to ESG standards, among other things, requires an adequate capital base, both: own and leveraged from external sources. However, both now and in the foreseeable future, "construction has robots up to its ears" in the country. In contrast, a lack of financial support from banks, using a variety of financial instruments, could mean the loss of contracts to foreign competitors. Sometimes this includes making settlements between the credited company and the bank more flexible. An illustration can be the "Polish Deal" program dedicated mainly to local governments, financed with the participation of Bank Gospodarstwa Krajowego – state bank (BGK). The value of projects in this program is relatively high. However, according to the Program, payments are divided into two and at most three tranches, over the life of the project. In turn, typical settlements with banks take place at monthly intervals. Credit for such projects has been sought from banks, including BGK, but without success. The inadequacy of the typical repayment schedules and tranches provided for by the Program was a key factor in the banks' lack of interest in financing these investments.

An important constraint on Polish construction companies undertaking large contracts is also the lack of long-term contracts (e.g., 15-year public guarantees). Such a product for the construction industry does not exist.

All of this points to the need for greater systemic integration of the practice's needs for investments, including transformational or infrastructure investments, legal regulations, the capabilities and interests of banks and the capabilities and interests of construction companies. In other words, the key problem is "how to organize this

in the daily business life”, in line with making the client comfortable and being able to count on the banks’ support in solving the problems encountered. Symptoms of optimism are emerging from the ideas being referred to at this Congress by bankers.

Beata Żaczek stressed that about one quarter of PEKABEX›s revenue comes from foreign contracts, and the Company uses the services of a number of banks on the Polish market. Unfortunately, the problem so far is the reduction of financing when the symptoms of crisis appear, which can be described somewhat sarcastically with the comparison that banks provide an umbrella when the sun shines. This could be assessed as a pro-cyclical activity of banks.

An unusual situation for Polish banks is the circumstance that PEKABEX has a factory in Germany, for which it is the so-called parent company. This situation requires financing that is atypical for companies in Poland and more diversified, taking into account the original ideas with which PEKABEX comes out on the German market. Unfortunately, it is neither easy nor pleasant to obtain adequate financing. Also related to the issue of foreign expansion of Polish companies is the potential participation in the reconstruction of Ukraine and doing business there. Leaving aside the large scale of uncertainty, companies are humanly afraid of possible involvement, as they are unfamiliar with the specifics of the market and would like to be able to count on the support of banks both: in terms of payments and liquidity. It seems that such and similar challenges will not be solved in the foreseeable future by AI, which will not be able to replace the “human-to-human” relationship thatwe will need for a long time to come.

Filip Kuropatwa – the complexity of the portfolio of products and services and the breadth of M&A projects makes us an atypical customer (standard from operational service to M&A) and here we have service, but we are also a trader when we require spec products with high leverage and risk. Even more so with relatively low margins. We are also looking for trade finance related to energy where you also need a legal infrastructure since it bothers us from the of collateral for banks point of view and Swiss or London banks are included. We are looking with hope and desire to develop new business in energy transition and transportation of energy sources. This will require a customized approach by the banks and without a briefing. Legislation will not be able to move forward. It will take ideas, expertise and highly leveraged trade finance.

Robert Ostrowski – Jastrzębska Spółka Weglowa (JSW) belongs to the mining industry (disliked by banks) and coal industry (passee according to banks), but with high specificity. JSW produces coking coal necessary for steel production, not thermal coal. The Polish financial market has understood this, while foreign banks still do not understand this specificity and the value chain in which we operate. We have been applying to Polish and foreign banks to obtain credit based on ESG goals, guaranteeing JSW’s continued growth while meeting the ambitious climate transformation goals enshrined in our strategy. Foreign banks have refused to provide us with credit already at the initial stage of analyzing the applications, without giving any reasons, despite the fact that it contradicts their strategies. Discusssions with Polish banks lasted several months and ended with the signing of

an agreement. We obtained syndicated financing – banks and financial institutions – under the sustainability linked-loan formula as the first entity in the mining sector in Central and Eastern Europe (PLN 1.65 billion). In addition, we managed to incorporate into the financing of the so-called green part a new hedging instrument with a guarantee from the Export Credit Insurance Corporation for the environmental part. This appeared for the first time on the market, and thanks to this we are forerunners, which proves the development of banking products.

Customization of the banking sector for customers is important, but banks must first of all understand the company's profile in terms of ESG, as financial criteria are not enough. This requires industry and customer-specific knowledge as a condition for broader lending of their investments, and especially to move to the next stage of application processing in foreign banks, after basic quantitative analysis by bank analysts. Cyber-security is another important issue, it is necessary to ensure the security of trading at a high level in cooperation with customers.

In Piotr Woźny's opinion, the issues of financing the energy transition should be considered taking into account the legacy of the centrally planned economy in the energy sector in the People's Republic of Poland. The six regions formed at that time, in which systemically important power plants were built in close proximity to coal deposits in the two decades between 1960 and 1980, are now a serious constraint on the energy transition both technologicaland financial.First of all, the specifics of these power plants mean that they were designed for constant energy production capacity 24 hours a day and their technical characteristics do not, in principle, allow for the flexibility of energy supply required today, due to the increasing shares of energy from wind turbines and photovoltaic cells. Already, at certain times there are cases when professional energy producers are ready to pay consumers for the surplus they have in the system (negative energy price). If the scenario of Poland's exit from the EU is not to be realized, and the chances of renegotiating the EU ETS (European Emissions Trading Scheme) are almost nil, we face dramatic technical and financial challenges of building an alternative energy system that meets European standards. Secondly, the transformation and building of an alternative system requires complex decarbonization projects, innovative system coordination and huge financial investments. Among other things, it involves managing the time-temperature imbalance (fluctuations during the day and in the seasons due to weather peculiarities or the solar cycle) and the structural imbalance of energy capacity, taking into account the gradual phasing out of classic coal-fired power plants, stabilizing the system's energy capacity (power plants, wind turbine energy and photovoltaic energy) and taking into account the fluctuations in the demand of the entire spectrum of consumers. Current RES projects, without innovative solutions for storing surplus energy, the imbalance indicated above will further exacerbate. This, in itself, may pose a risk to entities financing of these installations. And at the same time, the needs for organizing an alternative energy system are gigantic, and there are many indications that without cooperation within the triad of state institutions-producers/prosumers and financial institutions with appropriate legislation, the threatened crisis will not be solved.

Under these conditions, Zespół Elektrowni Pątnów-Adamów-Konin (Group of Power Stations Pątnów-Adamów-Konin – ZE PAK) is working to end the burning of coal in its power plants by the end of 2024 and replace it with other energy sources, especially gas and biomass. Unfortunately, the necessities arising from both environmental needs and EU climate regulations do not meet with an adequate supply structure for the expenditures financing of such a transformation.

ZE PAK, taking into account the imbalance in the capacity of wind turbines and photovoltaics, is developing a network of the former, taking into account, moreover, that in the Polish climate the efficiency of the capacity installed in "windmills" is greater (winds throughout the year and also during periods when the sun does not shine) and more capital-intensive (the cost of the turbine and the land).

ZE PAK is also developing hydrogen plants, but only with its own funds, but seeking financing from domestic or EU public funds. Banks will not be ready to finance these projects for a long time to come.

As for nuclear power, first of all, the Polish state needs to answer the question of what the nuclear financing model will be (e.g., contracts for difference as in the UK). Wind farms and PSBs fit perfectly into the system. Previously, there were hopes for external funds from the EU (not a single Euro or public zloty was paid for the energy transition in Eastern Greater Poland). Currently, a project is being prepared to build a gas power plant with a capacity of 600 Mega Watt, which is needed to stabilize the system. Older systems will soon cease to function because they were not designed for current conditions. Classic financing is OK and there is much to be done on innovative issues. In response to the formulated problems of bank financing of the energy transition, a representative of Pekao Bank declared that the Bank is ready to negotiate financing for projects that appear unbanked.

Adam Żołnowski – stressed that on the success of the BALTIC HUB project, the State Treasury earned about PLN 8.5 billion from customs, VAT and excise duties in 2022 alone. An interesting fact, however, is that there was practically no interest from Polish banks in financing the Terminal 1 project, as it was implemented under the project finance formula. The initiators went for funds to foreign banks, which financed the investment charging high margins appropriate to the risk. Investment in Terminal 2 was already easier, because it was possible to reduce the risk of this project with the revenues generated by the already operating Terminal 1. There was no problem with financing Terminal 3, despite the fact that the process of raising capital took place during the pandemic. This was because investors fully understood that in order to obtain financing, including the selection of the most favorable offer, it was necessary to interest financial institutions not only in the domestic market, but also in the global market in the project, and in various formulas, including the private placement option.

Nevertheless, in the context of the expected capital deficit in the Polish financial market, there is a risk that in the future banks in Poland will choose only lucrative projects, i.e. those with low risk and high margins. This may perpetuate the tendency to seek capital abroad.

Regarding the challenges of in- or near-shoring, the situation is ambiguous. On the one hand, in the short term and in the absence of administrative interference of the sanction type, the chances for the development of transshipment services are very good. In the context of the conflict in Ukraine and the change in the direction of cargo streams until the Ukrainian Black Sea ports are rebuilt, the prospects for transshipment in Polish ports, including in particular Gdańsk, are bright. On the other hand, the risk of regional autarky tendencies must be treated as a threat. However, there are many indications that such a risk must be considered in the medium or even long term.

Concluding remarks

A comparison of the scenarios outlined by representatives of the managements of Poland's largest banks on the future of corporate banking with the opinions of the managements of large companies in various industries from the perspective of meeting their needs for financing investment projects allows several conclusions to be drawn:

1) The various industries of the real economy are not treated equally by banks, especially in terms of financing investment projects.
2) The universal nature of commercial banks in Poland (including in terms of financing different industries or types of businesses) and the increasing specificity of the activities of business entities contribute to problems in assessing the nature and effectiveness of business projects and limit their financing.
3) Businesses face problems in the long-term financing of projects, especially those with high expenditures and a long investment cycle, and those for which guarantees cannot be obtained from specialized public institutions.
4) It is necessary to make the banks' approach to the economic situation more flexible for borrowers and support them in periods of turbulence and not just offer an "umbrella when the weather is sunny".
5) The problem of more favorable conditions for financing enterprise projects by foreign financial institutions compared to the offers of domestic banks needs to be solved.
6) Modern financial engineering solutions are not sufficiently popularized or known to entrepreneurs.
7) Banks and banking-related institutions do not satisfactorily use the information needed to evaluate non-standard projects or financial advice.
8) System-preferred solutions to ESG concepts and sustainability more broadly are not adequately instrumented by bank regulations or procedures.
9) Large energy transition programs require effective cooperation between state institutions, producers and distributors of raw materials or energy, and financial institutions.
10) The development of production or service technologies, banking technologies, including advanced financial engineering require the security of economic transactions, the cultivation and development of direct relations between bank and customer representatives, to a degree higher than in retail banking.

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The most important threats to economic policy, financial system stability and PLN credibility – results of the 12th edition of the forecast consensus of the European Financial Congress

Introduction

The forecasting consensus of the European Financial Congress is based on the opinions of 27 experts and prominent macroeconomists received by December 8, 2023.

In this report, we focus on measures aimed at sustainable economic development and financial stability. Therefore, we traditionally begin our report with consensus macroeconomic forecasts made by who we believe are the best macroeconomists, then we present the most significant threats to the Polish economy, the stability of the financial system and the credibility of PLN, along with the probability of their occurrence. Finally, we present recommended actions.

In the first stage, each Expert presented the three most important threats in each area in his opinion. On the basis of these indications, we selected a list of those most frequently recurring, and in the second stage, each survey participant was to assess, on the one hand, the likelihood of the occurrence of a given phenomenon and, on the other hand, the importance (significance) of each threat.

Based on the threats identified earlier, each expert rated the probability of a given phenomenon on the one hand, and the importance (significance) of each threat on

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the other. Each expert had a total of 100 points to distribute among the hazards. In addition, he assigned a probability of occurrence rating to each.

A graphical representation of the experts' opinions is presented in the Risk Maps, where the diameter of the circles representing each type or risk is the sum of the products of the weight and the probability of occurrence of a given risk.

1. Forecasts of economic growth and its components

The year 2024 will be marked by a marked acceleration in GDP growth, to around 2.8% y/y, from 0.5% y/y in 2023. The primary driver of growth will be an acceleration in personal consumption, with a relatively modest acceleration in investment.

The dynamics of private consumption will accelerate from minus 0.7% y/y in 2023 to 3.8% in 2024. A similar rate of growth in private consumption will continue in the next two years. The primary reason for the acceleration of private consumption will be the marked deceleration of inflation, translating into an increase in the real income stream of private sector workers, as well as the significant scale of pension valorization, the significant scale of wage increases in the public sector, and the increase in the minimum wage. In addition to these factors, there is a marked improvement in consumer sentiment indicators, which means that the money stream going to households will be spent more willingly than in previous quarters, dynamizing consumption and GDP as a whole.

Gross fixed capital formation will see a decline to 2.4% y/y in 2024, following a 7.2% y/y increase this year. This will be compounded by the still high level of uncertainty among entrepreneurs (especially medium-sized and smaller ones), the still high cost of financing investments due to high inflation and interest rates, and the „breakthrough" of the EU financial perspective resulting in a very small scale of investment in the local government sector in 2024. Experts expect a more pronounced acceleration of investment in 2025, to 5.4% y/y – when the level of interest rates will already be lower and when European funds from the new perspective should begin to flow in. It is worth noting that investment dynamics in the future could be even higher if the new government managed to convince investors and the business sector that they will not be surprised by sudden changes in legal and tax regulations, that new regulations will be subject to a thorough consultation process, and that a sufficiently long *vacatio legis* will be provided to allow good preparation for the introduction of new regulations.

Table 1. Forecasts of economic growth and its components for 2023–2026

DATA			SURVEY RESULTS				NUMBER OF EXPERTS
Indicator	Measure	2022	2023P	2024P	2025P	2026P	
GDP (y/y; %)	average	5.3	0.5	2.8	3.4	3.6	[10]
	deflection		0.2	0.5	0.1	0.3	
Domestic demand (y/y; %)	average	5.2	-2.1	3.3	3.7	3.6	[10]
	deflection		1.1	1.5	0.2	0.3	
Individual consumption (y/y; %)	average	5.2	-0.7	3.8	3.9	3.5	[10]
	deflection		0.2	0.9	0.3	0.7	
Gross outlays on fixed assets (y/y; %)	average	4.9	7.2	2.4	5.4	6.6	[10]
	deflection		0.9	2.4	1.4	1.2	

Source: Statistics Poland, https://bdm.stat.gov.pl/, European Financial Congress, 2023.

2. Labor market situation

Experts expect a slight slowdown in the rate of wage growth in the economy to 10.4% y/y in 2024 from 12.6% y/y in 2023. It is worth noting that the slight slowdown in nominal wage growth will be accompanied by a marked decline in inflation, which will translate into an increase in real wages, which in turn will have positive consequences for private consumption. Survey respondents expect the number of people employed in the national economy to grow by 0.5%, following a 0.4% increase in 2023. It is worth noting, however, that growth in the number of employed will become increasingly difficult, due to the shrinking labor pool and the record-low unemployment rate – the lowest (*ex aequo* with the Czech Republic) in the entire EU.

Experts expect a very slight decline in the unemployment rate, to 2.8% in 2024 and 2.6% in 2026 (after 2.9% in 2023). The relatively small expected drop in the unemployment rate is due to the fact that it is already the lowest in the European Union, and it is difficult to count on a significant drop from these levels. It is worth noting that in large cities the unemployment rate is already below 2% and therefore clearly below the natural unemployment rate. This is good news from the point of view of workers, but at the same time such a low labor pool will be a significant constraint on further economic growth in the coming years, especially since investment has not been high for many years now. The demographic challenges are behind the increasingly frequent call in expert recommendations for the development of a comprehensive immigration and assimilation policy.

Table 2. Forecasts of the situation on the labor market until 2026

DATA			SURVEY RESULTS				NUMBER OF EXPERTS
Indicator	Measure	2022	2023P	2024P	2025P	2026P	
Unemployment rate (LFS; end of year; %)	average	2.9	2.9	2.8	2.7	2.6	[8]
	deflection		0.1	0.2	0.3	0.4	
Salaries in the national economy (y/y; %, nominal)	average	12.3	12.6	10.4	7.6	6.7	[10]
	deflection		0.4	1.6	1.4	1.8	
Employed in the national economy (as of the end of the period; y/y; %)	average	1.4	0.4	0.5	0.7	1.0	[8]
	deflection		0.4	0.6	0.4	0.5	

Source: Statistics Poland, https://bdm.stat.gov.pl/, European Financial Congress, 2023.

3. Inflation rate, public finance sector

According to EKF experts' forecasts, 2024 will be marked by a clear deceleration of average annual inflation, from 11.6% y/y in 2023 to 5.8% y/y in 2024. At the same time, forecasts show that even at the end of next year (6.1% y/y), inflation will remain clearly above the upper limit of the MPC's inflation target (3.5%). The average of analysts' expectations is that inflation will approach the upper limit of the target only at the end of 2025 (3.6%) and will go below it at the end of 2026 (3.2%) – but will still fall short of the inflation target (2.5%) during the forecast period.

Respondents expect the National Bank of Poland's reference rate to fall from 5.75% at the end of 2023 to an average of 5.3% at the end of 2024.

Experts forecast the deficit of the public finance sector – calculated according to the EU methodology – at 4.9% of GDP in 2024 after a deficit of 5.4% of GDP in 2023. Such a high deficit in 2024, despite the projected GDP growth of 2.8%, implies a significant scale of imbalance in public finances, all the more so since for 2025 the surveyors forecast a deficit of 4% of GDP with GDP itself growing by 3.4% y/y. Significant public finance sector deficits will mean a buildup of debt: respondents forecast the level of public finance sector debt calculated in accordance with the EU methodology at 53.3% in 2024 and 54.6% of GDP in 2025.

Experts expect a continuation of the trend of strengthening of the zloty against the two most important currencies for our economy, that is, the euro and the dollar. With regard to the EURPLN exchange rate, the average annual rate is expected to fall to 4.36 in 2024 from 4.53 in 2023.

Likewise for USDPLN, the average annual rate is expected to fall to 3.97 versus 4.19 in 2023.

Table 3. Forecasts of inflation, currencies and the public finance sector to GDP

DATA			SURVEY RESULTS				NUMBER OF EXPERTS
Indicator	Measure	2022	2023P	2024P	2025P	2026P	
Inflation (CPI; annual average; %)	average	14.4	11.6	5.8	4.3	3.3	[10]
	deflection		0.1	0.9	0.5	0.4	
Inflation (CPI, XII; %)	average	16.6	6.8	6.1	3.6	3.2	[9]
	deflection		0.3	1.3	0.4	0.5	
EUR/PLN (annual average)	average	4.7	4.5	4.4	4.3	4.3	[7]
	deflection		0.0	0.1	0.1	0.1	
EUR/PLN (year-end)	average	4.7	4.4	4.3	4.3	4.4	[5]
	deflection		0.0	0.1	0.1	0.1	
USD/PLN (annual average)	average	4.5	4.2	4.0	3.9	3.9	[7]
	deflection		0.0	0.1	0.1	0.2	
USD/PLN (year-end)	average	4.4	4.0	3.9	3.8	3.8	[5]
	deflection		0.1	0.1	0.2	0.2	
Reference rate (year-end; %)	average	6.8	5.7	5.3	4.4	4.1	[10]
	deflection		0.1	0.4	0.5	0.6	
Public finance sector result according to EU methodology (% of GDP)	average	-3.7	-5.4	-4.9	-4.0	-3.4	[9]
	deflection		0.4	0.5	0.4	0.3	
Public finance sector debt according to EU methodology (% of GDP)	average	49.3	50.7	53.3	54.6	54.1	[7]
	deflection		2.6	2.5	2.9	3.8	
Balance on the current account of the balance of payments (% of GDP)	average	-2.4	0.6	-0.5	-0.4	-0.7	[9]
	deflection		0.4	1.3	1.1	1.2	

Source: Statistics Poland, https://bdm.stat.gov.pl/, European Financial Congress, 2023.

4. The most important threats to economic prosperity in the 2026 outlook

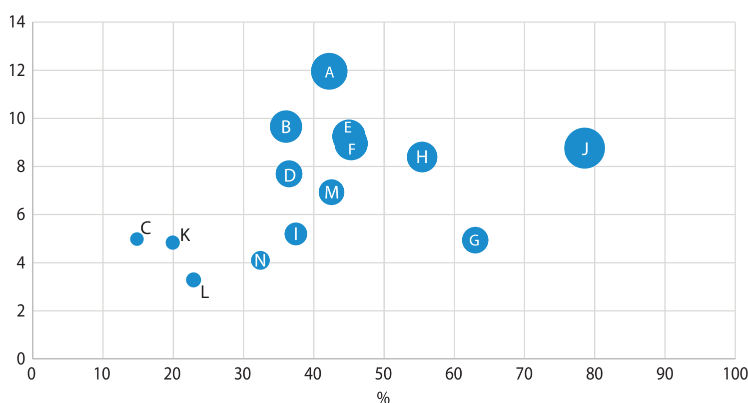
The threat for which the total weight is greatest in the opinion of the specialists surveyed is the perpetuation of high inflation and high interest rates, severely hampering growth (stagflation scenario) – and this threat is indicated as the most important for the fourth consecutive time. It was indicated by 93% of respondents. It synthesizes the conglomerate of problems and threats to the economy generated by very high, and possibly perpetuating inflation above acceptable levels.

The next places, similar in weight, were occupied by the following threats:

- Insufficient investment, limiting growth potential,
- An inconsistent policy mix, including relatively expansionary fiscal policy and a lack of clear monetary policy direction,
- unfavorable demographic structure,
- The low rate of energy transition combined with the high energy intensity of the economy and the risk of rising energy prices,
- The risk of an escalation of the war in Ukraine and
- Weakening global economy, risk of recession in major economies.

In summary, the most important risk in the opinion of specialists is the risk of perpetuating the stagflationary scenario, while the risks slightly further down the list have relatively similar weights.

Chart 1. The most important threats to Poland's economic prosperity in the 2026 outlook



A	Persistence of high inflation and high interest rates, strongly inhibiting growth (stagflation scenario).
B	Risk of escalation of war in Ukraine.
C	Conflict with the EU – risk of delayed and/or limited inflow of funds.
D	Weakening global economy, risk of recession in major economies.

E	Inconsistent policy mix, including relatively expansionary fiscal policy and lack of clear monetary policy direction.
F	Insufficient investment, limiting growth potential.
G	The cost of an election year for the economy – additional burden on public finances.
H	Low pace of energy transition combined with high energy intensity of the economy and risk of rising energy prices.
I	Deteriorating state of public finances and their transparency.
J	Unfavorable demographic structure.
K	Destabilization of the domestic banking sector.
L	Increase in state interventionism undermining the dynamism of the market economy.
M	Global risk of conflicts outside Europe, mainly in the Far East.
N	The exodus of workers, particularly from the technology and financial sectors, to more developed economies.

Source: European Financial Congress, 2023.

5. The most important threats to the stability of the financial system in the 2026 outlook

The November/December assessment of risks to the stability of the financial system shows a marked reduction in the strength of key risks and the likelihood of their materialization compared to expert assessments in June this year.

Nevertheless, the biggest threat to the financial system remained the legal risks of mortgages. All the specialists interviewed highlighted risks related to the invalidity of contracts, lack of remuneration for the use of capital, the CJEU ruling on CHF-denominated loans, and risks related to WIBOR-based loans.

According to nearly 90% of experts, a significant threat to the stability of the financial system is the deterioration of public finances combined with expansionary economic policies. This is the second most important factor in terms of both importance and likelihood of occurrence. It should be noted, in particular, that the importance of this factor has increased compared to the survey conducted in June this year.

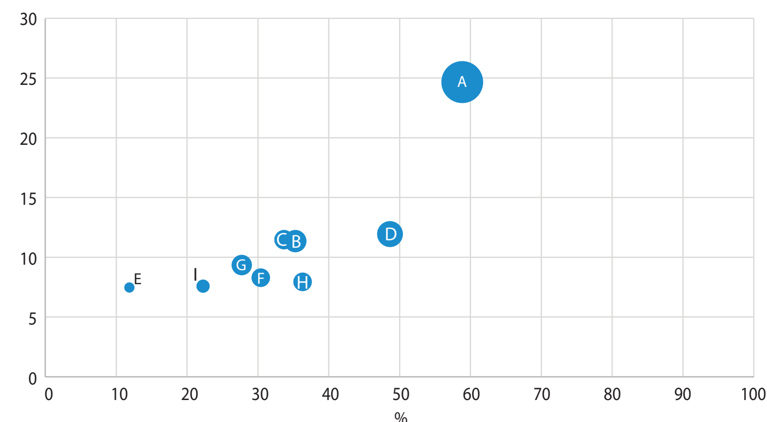
In third place was singled out the risk of deepening state interference in the banking system. In the opinion of 93% of experts, interference manifested in the overdependence of selected banks on the state and excessive financing of the state budget by banks raises the costs and risks of the banking sector. It should be noted, however, that the threat is now priced much lower than it was as recently as June this year.

In terms of financial stability risks, the threat of deterioration in the quality of the loan portfolio – the first factor directly influenced by the banking sector itself – is also falling. The risk is considered in terms of the negative consequences of rising interest rates, weakening currency, unstable economic situation and worsening growth prospects.

In this context, it is still important to note the risks associated with the lack of a well-considered and consistent macroprudential policy, with the probability of this risk now nearly 10 p.p. lower than six months ago.

It is also important that experts do not see a significant threat in the form of the risk of bankruptcy of a large bank in Poland and the risk of contagion caused by the problems of large financial institutions in the US and Western Europe.

Chart 2. The most important threats to the stability of the Polish financial system in the 2026 perspective



A	Legal risks of mortgages (invalidity of contracts, lack of remuneration for use of capital, CJEU ruling on CHF, risks related to WIBOR-based loans).
B	Deepening state interference in the banking system raising the costs and risks of the banking sector (excessive dependence of selected banks on the state, excessive financing of the state budget by banks).
C	Deterioration in the quality of the loan portfolio due to rising interest rates, weakening currency, unstable economic situation and worsening growth prospects.
D	Deterioration of public finances combined with expansionary economic policies.
E	Risks associated with the failure of a major bank.
F	Growing inconsistency in economic and regulatory policies, increasing banks' risk aversion.
G	Lack of thoughtful and consistent macroprudential policies.
H	Inconsistency and unpredictability of regulation.
I	*Contagion* risk caused by problems of large financial institutions in the US and Western Europe.

Source: European Financial Congress, 2023.

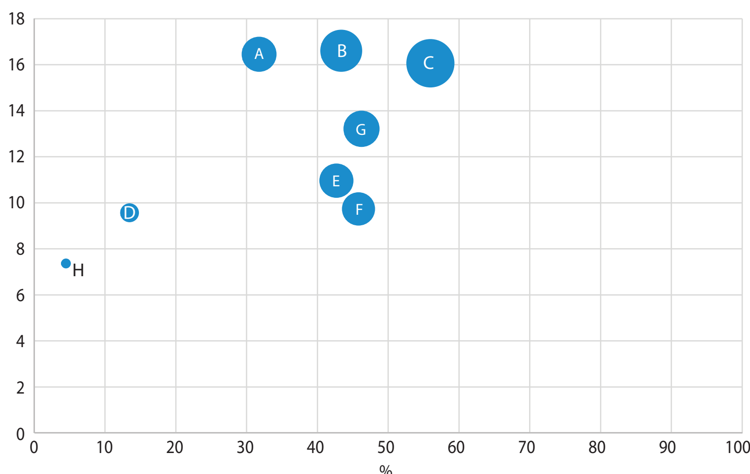
6. The most important threats to the credibility of the zloty in the 2026 perspective

Survey respondents point to three top threats with very similar weights:

- Persistence of inflation clearly above the EU average, accompanied by the persistence of negative real interest rates.
- Risk of capital outflows due to an increase in geopolitical (including a prolonged conflict in Ukraine) and macroeconomic risks.
- Low effectiveness of monetary policy and its inconsistency with fiscal policy, low credibility of the central bank and its growing politicization.

At the same time, it is worth noting on the significant decrease in the weight of risks related to tensions on the Polish-EU line and the risk of "Polexit."

Chart 3. The most important threats to the credibility of the zloty in the 2026 outlook



A	Risk of capital outflows due to increased geopolitical risks (including the protracted conflict in Ukraine) and macroeconomic.
B	Persistence of inflation clearly above the EU average, accompanied by the persistence of sharply negative real interest rates.
C	Low effectiveness of monetary policy and its inconsistency with fiscal policy, Low credibility of the central bank and its growing politicization.
D	Conflict with the EU – risk of delayed and/or limited inflow of funds.
E	Risk of election promises destabilizing public finances.
F	Expansionary fiscal policy, translating into high deficits, Increase in borrowing needs and increase in public debt.
G	Deteriorating state of public finances.
H	The government's persistent anti-EU narrative and the risk of Polexit.

Source: European Financial Congress, 2023.

7. The most important recommended areas of action in Poland's economic policy

Consolidation of public finances and increasing their transparency[1]

Poland's public finances have become increasingly opaque in recent years, while at the same time public sector debt has increased significantly, and the scale of the planned debt increase planned in the 2024 budget is nominally the highest in history, despite the expected solid GDP growth. Experts recommend improving the transparency of public finances, defining a credible medium-term path for deficit reduction and its consistent implementation, and changing the structure of public finance spending by reducing social spending, while increasing spending on improving the quality of public services and on pro-development goals.

Within this area, experts recommend:

- Improving the transparency of public finances, the return of fiscal rules, bringing all public spending under parliamentary control;
- Reducing the deficit of public finances;
- Defining a credible medium-term path for the consolidation of public finances and its implementation;
- Changing the structure of public spending by reducing social spending, increasing spending on pro-development goals, including improving the quality of public services both through increased spending in these areas and measures aimed at improving efficiency;
- Ensuring a consistent *policy mix*.

Implement an effective anti-inflation policy

Experts note the ineffectiveness of the anti-inflation policy pursued in recent years, while their forecasts indicate that by the end of 2026 inflation will be in the upper band of the inflation target, failing to reach the target itself. Such high inflation causes significant erosion of savings, disrupts the market process of asset allocation and hinders investment, through the high cost of financing it. In order to lower inflation permanently, experts call for restoring the credibility of the NBP institutions and confidence in monetary policy, maintaining positive real interest rates until inflation descends to the target, and ensuring a consistent policy mix between monetary and fiscal policy.

Under this policy, experts propose:

- Maintaining positive real interest rates until inflation goes down to target;
- Reduce the scale of financial market over-liquidity;
- Restoring the NBP's credibility and confidence in monetary policy;
- Protecting household savings.

[1] More widely: Center for Strategic Thought, https://www.efcongress.com/aktualnosci/raport-stabilny-i-przejrzysty-budzet-pod-kontrola-obywateli-plan-naprawczy/.

Stimulating investment and innovation

The systematic decline in the rate of investment relative to GDP for many years is a worrying phenomenon in the context of, among other things, demographic challenges or technological advances taking place on a global scale. In this context, experts call for measures to stabilize legislation (including tax legislation in particular), to make regulations more consistent, and to ensure that any newly introduced regulations are fairly consulted and provide sufficient time to prepare their implementation. Experts also point to the need to deregulate the economy, take measures to stimulate business innovation and stimulate the development of the new technology sector. Experts point out that many of the tools for stimulating investment are already implemented, but need to be „refreshed", to check whether their parameters provide a guarantee of their effective operation.

Under this policy, experts propose:

- Consistent and stable legislation including tax legislation;
- Deregulation of the real economy;
- To undertake effective policies to stimulate business innovation;
- To stimulate the development of the new technology sector and create favorable conditions for the inflow of foreign capital into the sector;
- Reforms to improve the labor market including increased labor force participation and migration policies;
- Intensification of activities in the use of EU funds, including the end of the dispute over the rule of law and the rapid release of funds from the NIP.

Accelerating the energy transition

The challenge of energy transition is one of the most important for the economy: on the one hand, much of the current generation apparatus is obsolete and will have to be shut down in the coming years for technological reasons, and on the other hand, the national energy mix is not in line with, for example, European plans to reduce CO2 emissions, and such a structure of energy sources will not only translate into high energy costs, but will also limit the competitiveness of domestic companies.

In this context, experts call for the urgent development and subsequent implementation of a comprehensive energy transition plan, financed as widely as possible by European funds and private capital (regulatory facilitation, investment incentives), with safeguards for the poorest citizens.

Under this policy, experts propose:

- Preparation of a comprehensive plan for the energy transition in Poland;
- Actions to quickly achieve the energy transition through, among other things, rapid unlocking of NIP funds, regulatory facilitation and measures to encourage private sector involvement in and financing of the transition;

- Restructuring of the energy sector based mainly on EU and private Polish and foreign capital;
- Carry out the energy transition in a way that respects and protects the poorest citizens;
- Energy diversification – nuclear power.

Recommended measures to restore balance and self-reliance to local governments (based on the Local Government Finance Congress and the European Local Government Forum)

The experience of political transformation proves that local self-government has proven to be an effective, efficient and proven institution that provides basic public services. Therefore, we recommend launching the process of restoring the subjectivity and financial independence of local governments and reversing the centralization of competencies. The process of centralization of the state and growing political clientelism among local government officials caused primarily by declining own revenues should be reversed to better meet the needs of Poles. This process does not have to be tied exclusively to regulatory changes, including statutory ones, although such will certainly also be needed. The new state administration should take steps in this direction in many places and scopes.

In recent years, local self-government has been significantly weakened in the undisguised process of centralizing the state and reducing its capacity and competencies. This applies to the finances, regulation and independent decision-making of local government at the municipal, district and provincial levels.

We have seen a progressive process of reducing own revenues and general subsidies in favor of grants and non-transparent state investment programs, in which the chances of subsidies depended directly and to a great extent on the political colors of the local governor. Regulatory and competence changes led to a reduction in the independence of local governments. Local governments lost the ability to decide in their own affairs, as their competencies and authority were taken over by agencies and central administration entities, such as the Polish Water Authority, the curators' offices and ministries.

Meanwhile, local government proved to be more effective and efficient after 1990 in providing the public services it was mandated to provide to residents.

The following list of measures is not exhaustive of all the areas that need to be changed to restore local governments' agility and ability to act effectively and efficiently. It is limited to financial matters in particular.

In the short term, we advocate taking the following actions:

- Provide local governments with financial compensation in 2024 for lost own revenues caused by the changes in income taxes based on fair and transparent distribution of subsidies;
- Giving real authority over the WFOSiGW to the regions through the decisions of the Minister of Climate and Environment (pending statutory changes restoring

the state of 2015), so that they are real tools for regional authorities in carrying out regional development policy;
- Restoration of authority over pricing of public goods provided by municipalities, e.g., water and sewage services, district heating;
- in the case of central programs being launched (e.g., by the BGK), the introduction of clear, transparent and unambiguous criteria for granting support to local governments.

In the long term:

- Preparation and implementation of a new law on local government revenues taking into account, among other things, equalization of revenues based on the different unit costs of public services in different local governments, environmental subsidy. Overarching goal: stability, predictability and adequacy of local government finances to the services provided;
- Changes in local taxes, among other things, allowing differentiation of property tax rates depending on the provisions of local law, i.e. zoning plans.

Support for sustainable housing development

As part of the sustainable housing development program, we specifically call for:

I. Reduction of legal risks associated with housing loans.
II. Launch of the domestic mortgage bond market.
III. Making the "premises-for-land" program more realistic.

Ad I. Reduction of legal risks associated with housing loans[2]

1. Develop a template for a standard housing loan agreement and agree on it with all stakeholders.
2. Obtain opinions from regulators and the Supreme Court confirming the pattern's compliance with applicable laws.
3. Subsequently, giving the model statutory status.

Housing loans are taken out for several decades. Experience teaches that a loan agreement that was not questionable at the time of conclusion can be challenged years later by the consumer and declared invalid by the court. The consequence of the court's decision is the way the parties to the contract are settled, which generates huge losses for the banks and, above all, their decapitalization. This situation leads to a drastic reduction in the lending activities of banks, especially the financing of large infrastructure projects of the state, from which all citizens suffer, and in a broader perspective – the financial stability of the state.

[2] More widely: Center for Strategic Thought, https://fundacjacms.pl/nowy-ksztalt-rynku-kredytow-mieszkaniowych/.

It should not be forgotten that the risk of challenging a contract can also prove costly for the consumer. Contrary to popular belief, it is not the customer who acts against the bank, but a law firm does on his behalf. The cost of this service is borne by the consumer. In the best case scenario, that is, a win against the bank, the cost of the service diminishes the client's profit. In the event of a loss, the customer not only gains nothing, but still has to bear all the costs. These losses can be large.

The actual reason for undermining contracts is the unfavorable materialization of market risks for the consumer, not legal defects in contractual provisions. Initially, the dispute between customers and banks and the undermining of credit contracts concerned only foreign currency loans. Now, there are more and more lawsuits from consumers challenging contracts for gold loans, in addition to those taken out in recent years. The courts cite, among other things, so-called significant views on the matter issued by the President of the OCCP, in which he deems the contractual provisions that are the subject of the lawsuit against the bank to be impermissible.

Despite the courts declaring thousands of home loan contracts invalid, the Office limits itself to challenging contractual provisions as inconsistent with consumer law or good morals. Unfortunately, these negative decisions have not once been accompanied by proposals for contractual clauses that comply with consumer law. As a result, the OCCP's Register of Prohibited Clauses counts thousands of items, while a complementary register of permitted terms has never been created. By the same token, a bank granting a home loan in which it does not use any of the prohibited clauses still faces the risk of invalidating the contract for that loan in the future.

In the absence of any list of permissible provisions, it is necessary to use a model home loan contract that minimizes legal risks, as is done in many developed countries. Such a template should give both parties a guarantee that the contract they have entered into will not be challenged in the future.

The benchmark must be acceptable to all, so its development will in practice be a long negotiation process, in which three parties must participate: the consumer, the bank and the court.

The first proposal has already been prepared and is currently being reviewed by regulators: UOKiK and UKNF. The draft thus agreed upon should also be reviewed by the Supreme Court's Civil Chamber.

It is important to be aware that the failure of this process will signal that in the Polish reality, providing housing loans to consumers, is very risky, which will increase the cost of credit and reduce housing financing.

Ad II. Launching a domestic mortgage bond market[3]

Mortgage bonds can provide an instrument to stimulate long-term savings, as they are the safest long-term bonds-secured by the healthiest mortgages. The financial crises have confirmed the reliability of mortgage bonds. A report by the UKNF even formulated the thesis that "the mortgage bond has basically turned out to be the winner of the crisis, as its advantages could not be so well presented until now" (Report on the work of the Group on the issuance of mortgage bonds by banks, UKNF 2013). It would be difficult to find a better alternative for the safe placement of savings than mortgage bonds.

A mortgage bond is a special secured bond that is exceptionally safe for the purchaser. In the more than 250-year history of mortgage bond issuance, there has been no case of default, despite many crises. Also, the recent global financial crisis proved that it is the only instrument, providing continuity of long-term and low-cost financing when the markets for other similar debt instruments (MBSs, ABSs) are in trouble.

The concern of politicians is now only for borrowers (credit vacations) while the several times larger population of depositors feels cheated. The rich are putting their savings in real estate, increasingly outside Poland. Poorer people (the average retail savings balance in banks is estimated at PLN 36,000) have no such alternative. There are also no REITs on the Polish stock market due to the lack of an appropriate law. Investors can purchase shares in American REITs. An alternative to REITs could be domestic mortgage bonds, which finance the domestic real estate market.

The launch of the mortgage bond market in Poland achieves at least three important goals:

1. provides security for long-term savings which automatically means supporting sustainable development, especially of the real estate market,
2. Increases the stability of the financial system,
3. Increases the credibility of the capital market.

How to launch a mortgage bond market in Poland?

1. Demand should be mainly domestic in the current environment, as the sale of mortgage bonds to foreign investors could increase the excess liquidity of the domestic banking sector and act pro-inflationary.
2. To trigger retail demand you need to:
   – diversify the offer in terms of maturities (5, 6, ... ,10-year);
   – Offer pledge letters of low denomination, such as PLN 1,000;
   – Offer anti-inflation guarantees to buyers.

   Banks could, for example, offer retail customers mortgage bonds bearing interest at a fixed or variable rate at the level of interest rates on current term deposits. Savings placed in mortgage bonds, however, would have additional anti-inflationary guarantees.

[3] More widely: Center for Strategic Thought https://www.efcongress.com/aktualnosci/rekomendacje-ekf2023-rekomendacja-dotyczaca-uruchomienia-rynku-detalicznych-listow-zastawnych/.

3. Demand from institutional buyers, especially banks, can be further created by exempting mortgage bond investments from bank tax, purchases by the NBP, and/or the BGK.

It would be very important for regulators to support investment in mortgage bonds through a cap policy for PPKs, OFEs and FIO/FIZs, as well as Social Security.

In order to guarantee the supply of mortgage bonds, it is necessary for the FSC to impose an obligation on universal banks to close the term gap with debt instruments, particularly mortgage bonds.

Work on launching a mortgage bond market was started this year under the aegis of the UKNF. It would be important to support these activities from the Ministry of Finance and the Warsaw Stock Exchange.

Ad III. Realization of the "premises-for-land" program

We recommend urgent action to increase the supply of housing, in order to:

1. curb the rapid and excessive increase in housing prices caused by additional demand associated with the implementation of the "2% Safe Credit" program;
2. provide social assistance for the uncreditworthy, including immigrants (increasing the pool of public housing).

The fastest way to trigger the supply of housing is currently to offer developers land for development in exchange for housing ("premises for land"). This is because it does not require any legal changes but only a realistic implementation of the Law of December 16, 2020 on the disposal of real estate with "premises-for-land" settlement (Journal of Laws 2021, item 223). It has been "dead" since its enactment, i.e. for three years, and its provisions have so far been used by only one municipality in Poland (Warta Municipality). Not only does the implementation of this concept not require a change in the law, but, more importantly, it costs virtually nothing to taxpayers.

The realization of the right to housing for people beginning their working lives is an important pillar of the policy of sustainable socio-economic development. An important element of this policy is housing preferential loans, which should be continued and developed, also so as not to lose public support. However, preferential lending increases the demand for housing and the limited supply of housing leads to an increase in housing prices.

How, then, to avoid the paradox that public (taxpayer) subsidies for loans cause young borrowers to buy more expensive housing.

The most important thing is the rapid stimulation of housing supply, which would offset the additional demand created by soft loans and the associated price increase. The phase lag of supply in relation to the surge in demand in the real estate market is 2–3 years. This means a rapid increase in housing prices in the next 2 years stimulated by public funds allocated for subsidies to borrowers. It is possible to

shorten this period and lower the expected price increase by reducing bureaucracy and excessive paperwork for developers, while developing non-working assets owned by local governments and the State. In addition, important arguments for stimulating the „housing for land" program are:

- Increase the pool of rental housing;
- Support for migration policy;
- Social assistance for those who are not creditworthy.

Ultimately, the "apartment-for-land" program could also include the segregated land of the National Property Stock, the State Forests, the Military Property Agency.

Of course, making the housing-for-land program more realistic should not be the only recommendation for sustainable housing development, but it is a way to quickly address social challenges without involving public money.

Tenders should be stimulated offering undeveloped land planned for residential development in exchange for apartments and/or other properties (e.g., kindergartens, nurseries) built by the developer.

If we assume that the cost of the land is 10–25 percent of the total cost of building an apartment, then upon completion of construction, for example, one in five apartments would be handed over by the developer to the municipality, which transferred ownership of the land.

For developers, this would be an offer similar to the "buy now, pay later" idea, which has been met with enthusiasm in the consumer finance market.

The implementation of the "unit for land" concept makes it possible to build much more and faster and with much lower risk for the developer, and above all without significant start-up expenditures and capital freezes. The municipality, on the other hand, should be interested in the developer getting a building permit quickly, as it will receive more housing units faster and in settlement.

So you can expect a lot of bidding interest from developers.

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