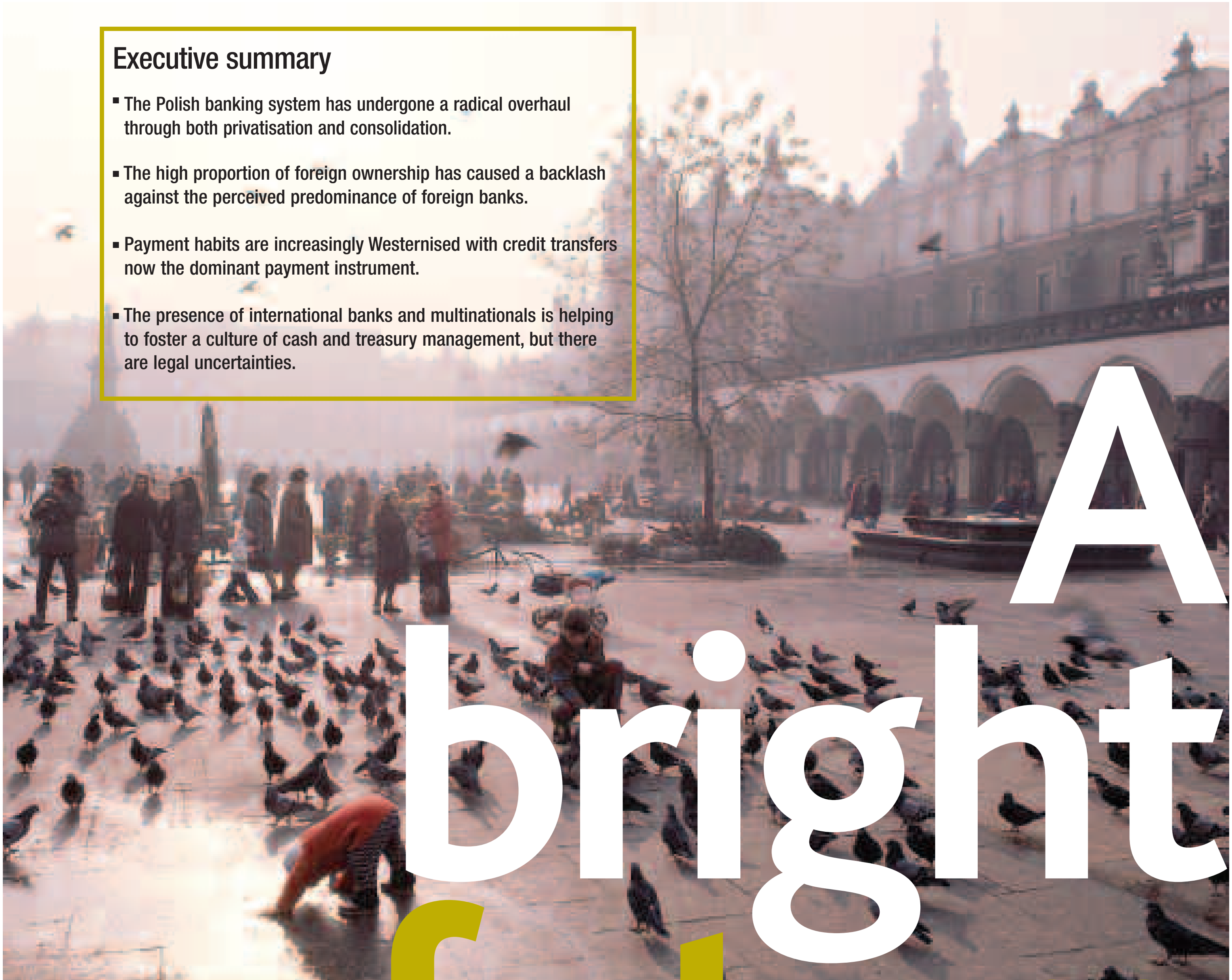

Executive summary

- The Polish banking system has undergone a radical overhaul through both privatisation and consolidation.
- The high proportion of foreign ownership has caused a backlash against the perceived predominance of foreign banks.
- Payment habits are increasingly Westernised with credit transfers now the dominant payment instrument.
- The presence of international banks and multinationals is helping to foster a culture of cash and treasury management, but there are legal uncertainties.

A bright future

From a cash and treasury manager's point of view, European Union (EU) accession has resulted in the development of a modern payment and banking system. Further progress needs to be made, particularly in the regulatory area. EU and future euro zone membership should provide the necessary impetus for Poland to align itself with European best practice.

FIT FOR THE 21ST CENTURY Over the last decade, the Polish banking system has undergone a radical transformation. Following the demise of the communist order, successive governments embarked on the wholesale privatisation of the banking sector. This process was completed in October 2004 when the Polish State partially privatised the former postal savings bank, PKO Bank Polski, the country's largest bank in terms of assets and branch network.

CONSOLIDATE OR DIE While the earlier years following the 1989 revolution saw a sharp increase in the number of banks, the Polish banking industry has since witnessed considerable consolidation. The economic recession of 1992 led to a first wave of consolidation, while the prolonged economic downturn in 2001 and 2002 triggered further rationalisation, with several foreign banks merging their local activities (Allied Irish Bank (AIB), Citibank, ING, Hypovereinsbank and so forth). As a result, the number of commercial banks fell from 96 in 2000 to 59 at present.

The increasingly competitive nature of the Polish market requires banks to seek additional economies of scale and achieve national coverage. Further consolidation seems most easily feasible in the small and relatively undercapitalised co-operative sector, where the merger of 400 local co-operative banks under the name of Bank Polskiej Spoldzielczosci has laid the foundations for future synergies. However, in the commercial banking sector the scope for merger and acquisition activity is less obvious, due to the high proportion of foreign ownership. The Polish banking market has attracted considerable foreign investment during the last decade. Consequently, over 80% of the banking sector is now controlled by foreign capital, (see *Table 2*).

This high proportion of foreign ownership has prompted a backlash from the country's political establishment. To counterbalance the perceived predominance of foreign banks, the authorities have been keen to strengthen PKO Bank Polski. While the country's premier retail bank is now a quoted company, the government ensured that most of the shares went to Polish retail investors and that it retained majority control (51%). Given the authorities' desire to maintain PKO Bank Polski in local hands, a full-scale privatisation and subsequent merger with one of the foreign-owned banks seems unlikely. Eventually, budgetary difficulties may cause a change of heart. In the meantime, however, any merger and acquisition in the commercial banking sector depends on the willingness of foreign owners to pull out of a promising market or to share control of their local bank activities with one of their international competitors. This is in effect causing something of a gridlock. In the long run though, economic realities are likely to force the hand of the foreign owners with smaller subsidiaries. Mergers between Polish subsidiaries' parent banks may be another route towards greater consolidation. Thus, the recently announced takeover of Hypovereinsbank by Unicredit, will undoubtedly lead to a merger between their local subsidiaries, Bank Pekao (Unicredit) and Bank BPH, the second and third largest Polish banks respectively. This in turn may spark further consolidation between their smaller rivals.

PAYMENT/CLEARING SYSTEM Payment habits in Poland are increasingly in line with those observed in Western Europe. Credit transfers are now the dominant payment instrument both in terms of volume and value. Credit transfers can be electronic or paper-based. At present, a high proportion of credit is still paper-based, but it is likely that increased electronic and internet banking usage will reverse that proportion in the near future. Direct debit usage is very limited, but again, usage is growing rapidly. A new direct debit system for the clearing of high-value direct debits (i.e. above the Polish Zloty (PLN) equivalent of €10,000) was introduced in October 2003. However, currently the uptake of Business-to-Business Direct Debit (GOBI) is negligible. GOBI sits alongside the retail direct debit system, which caters for transactions up to €10,000. Poland effectively bypassed cheques in its evolution towards a modern

Table 1. Major commercial banks

Bank	Total Assets (€m*) 31 Dec 2004
PKO Bank Polski	24,165
Bank Polska Kasa Opieki (BankPekao)	16,306
Bank BPH	14,801
ING Bank Slaski	9,631
Bank Handlowy w Warszawie	9,294
BRE Bank	8,256
Bank Zachodni WBK	7,279
Kredyt Bank	5,993
Bank Millennium	5,919
Bank Gospodarki Zwynosciowej	3,245**

* Exchange rate as at 21.07.05 ** Data as at 31 Dec. 2003

Source: www.bankersalmanac.com

Box 1. A key market

By far the largest of the new European Union (EU) members, Poland is a key market in central and eastern Europe. Since the fall of the communist regime in 1989, it has received significant foreign investment. Investors are attracted by the size of the market (larger than the combined markets of the other EU entrants) and the considerable long-term potential it represents.

While Poland has successfully managed its transition from command economy, prosperity levels are still below that of most of the other new EU members. Over the last decade, the country's development has been hampered by bureaucracy, lack of transparency and political instability. EU accession is likely to reduce this bureaucratic burden and contribute to a more stable and transparent political and regulatory framework.

EU membership is also having a positive influence on the ongoing restructuring of the Polish economy. Poland has started the process of reforming its large but unproductive agricultural sector. Restructuring of other loss-making sectors (steel, coal, textile …) is also progressing at a fair pace.

EU aid means that this process can now be accelerated. EU funds will also help Poland to upgrade and develop its infrastructure. At the same time, unrestricted access to the European single market is boosting the country's exports. Provided Poland achieves greater political stability, the opportunities created by increased exports and infrastructure investments will translate in a marked improvement in the country's overall prosperity.

Poland furthermore benefits from having one of the youngest populations in Europe. Its potential is further enhanced by its strategic location between western and eastern Europe; having both Europe's largest economy, Germany, and the Continent's second largest country, Ukraine, as its neighbours. Poland's close cultural and historical ties with Ukraine mean it is ideally placed to take advantage of the opportunities created by the Orange Revolution.

market economy. Consequently, usage is minimal. Payment cards on the other hand are enjoying rapid growth rates. According to the Polish Central Bank the number of cards reached 16 million at the end of 2004.

Clearing systems In the run-up to EU membership Poland has put in place a modern payment system. It consists of a TARGET-enabled RTGS system, SORBNET and an electronic net settlement system, ELIXIR. While SORBNET is run centrally by the Polish Central Bank, ELIXIR is operated on an interbank basis by the National Clearing House (KIR) via 17 regional centres. In terms of payment transactions SORBNET clears high-value PLN-denominated credit transfers above PLN1m. ELIXIR clears all other transactions including paper-based credit transfer and cheques. Paper-based items are converted into electronic file by ELIXIR or the participant banks' processing centres using an optical scanning system, IMBIR. Since March 2005, SORBNET and ELIXIR are able to clear Euro-denominated payments via their dedicated subsystems SORBNET-EURO (which is linked to TARGET via the Italian RTGS system, BI-REL) and Euro-ELIXIR. While SORBNET settles transactions individually in real time and with immediate finality, ELIXIR settles on an end-of-day basis via SORBNET. In most cases, the actual clearing and settlement cycle for low-value payments is two working days.

THE CASH MANAGEMENT LANDSCAPE

Liquidity management The presence of numerous international cash management banks and multinationals is fostering a growing cash and treasury management culture among Polish companies. EU membership is likely to accelerate this evolution. In particular, it is likely to speed up the modernisation of the regulatory framework. At present, there remains some legal uncertainty concerning the use of liquidity management schemes. The lack of clear legal guidelines means that banks differ in their understanding of what can be achieved. Therefore, it is imperative for any company seeking to set up a liquidity management arrangement in Poland to seek independent legal advice.

THE PRESENCE OF NUMEROUS INTERNATIONAL CASH MANAGEMENT BANKS AND MULTINATIONALS IS FOSTERING A GROWING CASH AND TREASURY MANAGEMENT CULTURE AMONG POLISH COMPANIES.

Notional pooling is technically feasible, but not widely offered as legal offset is not allowed. In addition, it should be remembered that notional pooling between different legal entities may be subject to a stamp duty ranging from 0.1% to 2.0%. Some banks offer interest enhancement solutions as an alternative. In practice, most companies opt for physical cash concentration. However, all resident accounts have to be nominated in PLN as the foreign exchange (FX) law does not allow resident-to-resident transactions in foreign currency. Furthermore, transfers between accounts of different legal entities attract stamp duty. In addition, resident/non-resident fund movements are subject to reporting requirements.

Table 2: Foreign bank and insurance companies' shareholdings of major Polish banks

Bank	Foreign share holders	Country of origin	Percentage	Date
Bank Pekao	UniCredit	Italy	52.93%	July 05
Bank BPH	HVB Group	Germany/Austria	71.24%	July 05
	Bank of New York	US	4.04%	
ING Bank Slaski	ING Bank	Netherlands	75%.	April 05
Bank Handlowy w Warszawie	Citibank	US	75%	July 05
BRE Bank	Commerzbank	Germany	72.16%	July 05
Bank Zachodni WBK	AIB Group	Ireland	70.5%	15 June 05
Kredyt Bank	KBC	Belgium	85.53%	July 05
Bank Millennium	Banco Comercial Português	Portugal	50%	28 Dec 04
Bank Gospodarki Zwynosciowej	Rabobank*	Netherlands	35.3%	July 05
	Bank for European Recon & Dev (BERD)	N/A	15%	

* Rabobank group is also present in Poland via the 100% owned Rabobank Polska, which was the country's 17th largest bank by assets as at 31 December 2004.

Sources: www.bankersalmanac.com and relevant bank data.

Netting techniques are also used. Again, there remains some legal uncertainty, making independent legal advice necessary.

Connectivity Usage of electronic and internet banking is increasingly widespread. With all major banks offering electronic and internet banking packages, take-up is on the increase, even among the smaller companies. Internet banking usage is particularly growing in the retail sector. Bank merger and acquisition activity and pressure from corporate customers with multiple subsidiaries has created a momentum towards standardisation. Thus, MultiCash and the SME-oriented Videotel are fast becoming the de facto standard electronic packages.

Short-term investing and funding Overdrafts and credit lines are available for short-term funding. Companies either use bank term deposits or treasury bills for short-term investments. Commercial paper and money market funds are also on offer.

The accession to the EU in May 2004 represented not only the culmination of a remarkable transition process, but also the beginning of a new phase in Poland's integration into the European mainstream with euro zone membership as the ultimate prize. From a cash and treasury manager's perspective the next decade is likely to bring a further alignment of Poland with Western Europe in terms of banking, payment instruments and systems as well as liquidity and cash management solutions.

Peter De Craene is Editor at WWCP Ltd, an independent financial publisher providing country information, research and marketing support.
peterdecraene@wwcp.net
www.wwcp.net

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Table 3. Statistical overview of payment instrument usage in Poland*

	Millions of Transactions		% change	Traffic (€bn)		% change
	2002	2003	2003/2002	2002	2003	2003/2002
Cheques	2.3	1.7	-27.7	5.6	2.9	-47.4
Credit transfers	507.1	619.8	22.2	1,157.0	448.9	-61.2
Direct debits	2.3	4.4	96.0	0.9	1.2	28.6
Debit card payments	76.4	103.2	35.0	2.3	3.1	34.6
Credit card payments	43.9	52.5	19.4	1.9	2.1	11.0
Total	632.0	781.5	23.7	1,167.6	458.2	-60.8

* Only includes instruments processed by ELIXIR and SYBIR.
Source: ECB Blue Book February 2005. Exchange rate as at 1 February 2005.