

3.1

Financial Services

Kevin R Smith, AWS Structured Finance Limited

Introduction

As with any sector in an emerging economy, the financial services sector has undergone massive change in recent years and this change is far from over. Poland has attracted a considerable amount of interest, not least because it is by far the largest country in Central Europe. With a population of around 40 million, it is four times larger than any of the other leading countries in the region. Investment has been broadly based, but a reasonable amount of inward investment has been made in the financial services sector. Privatization of the banking and insurance sectors is nearing completion and has been very successful in attracting foreign strategic investors.

There is a common misconception that the Polish currency (zloty, PLN) is in some form restricted. This is not the case as the zloty has been fully convertible for some years.

Banks

The Polish banking sector is one of the most developed in Central Europe and has undoubtedly been helped by the advanced level of privatization. There are over 50 major banks and many more smaller banks, with the majority of the larger banks being either fully or partly owned by foreign banks. Foreign capital amounts to some 75 per cent of the total assets in the Polish domestic banking sector.

As in other countries in this region, many of the banks are competing in the same sector and the majority of foreign banks initially focused on foreign companies operating in Poland and the larger local corporates. Competition has been fierce, particularly in the larger corporate sector, and this has resulted in a number of banks now looking at smaller corporates and the retail sector. However, as the market is so much bigger than in neighbouring countries, the consolidation has largely been the result of mergers and acquisitions of the Western

parent banks on a global or regional scale or by mergers of smaller local banks trying to gain market share and critical mass. As the minimum capital requirements have been increased in recent years, many of the smaller banks have actually been forced to merge in order to survive.

Overall, the banking sector is both well developed and sophisticated. It offers the majority of products and services that would be expected in any developed market economy. Telephone banking is widely available and Internet banking is being introduced by many banks. Indeed, some very good services are routinely available in Poland that are not available in the United Kingdom at present.

However, the total size of the banking sector, as a proportion of GDP, remains smaller than Poland's neighbours and, indeed, much smaller than Western Europe. For this reason alone, significant overall growth is still expected over the next few years.

One part of the banking sector that has yet to make much progress is the provision of residential mortgages. There is no doubt that this market will become very important in the future, not least because of the size of the population, and it is beginning to expand rapidly, albeit from a very small base. Development has been slow due to factors such as legislation that made it difficult for the lender to repossess the property when necessary and the lack of long-term loans, but these barriers are being removed and the mortgage sector in Poland is expected to see continued future growth.

Demand for commercial mortgages is high, being driven primarily by foreign companies investing in factory and office accommodation for their own operations. The foreign banks are the largest providers of commercial mortgages, while it is the Polish banks that lead in the provision of residential loans, although a number of other banks are now trying to increase market share.

Poles, like many people in the region, are not as conditioned as Western Europeans to borrowing in order to make purchases, although this sector of the market is now becoming more established. At present, only 10 banks issue credit cards, although this is expected to rise to 18 in due course. While some 7.4 million Visa bank cards are in circulation in Poland, less than 10 per cent of these are actually credit cards, with the remainder being debit cards. Credit cards are already widely accepted for payment and significant growth in their use is expected over the next few years.

While most aspects of the banking market are fully catered for, there has recently been rapid expansion in a number of niche areas, most notably the market for home-collected credit. This market was created in Poland by a British company in the last few years but has already grown very rapidly and is expected to continue to do so for the foreseeable future.

Financing trade and projects

Approximately 90 per cent of all trade in the European Union is conducted on an open account basis, although many companies have some form of credit insurance. Trade with Poland has not yet reached this level but already some 75 per cent of trade is conducted on this basis, this being even higher for lower-priced transactions.

Over the years there have been many successful projects financed on a non-recourse project finance basis. These have been structured both with and without assistance from the British Export Credit Guarantee Department (ECGD) and other export credit agencies. In recent times, ECGD has changed its policy on financing projects in the region in order to secure more business and this means that projects that were previously unable to obtain cover can now do so. Perhaps the most important change is that in many cases ECGD no longer needs a government guarantee but will accept municipality or large local corporate risk.

The trend towards financing major projects by way of partnerships established between central and /or local government and private companies has not been ignored in Poland. There is growing recognition of the impact that Public-Private Partnerships (PPPs) can have in developing infrastructure such as roads, rail, water treatment plants and many other large projects. This type of financing is being considered for a number of current projects. Indeed, the city of Warsaw is widely regarded as being one of the most advanced in its thinking and is actively considering a number of PPP projects.

Typically, laws need to change and attitudes and ideas need to become more flexible in order to make these projects happen. However, PPPs offer the most realistic way in which to finance the many projects required and, as this becomes more widely understood, the number of PPP projects in the country will increase dramatically. As Britain and British-based firms are world leaders in this type of finance, the development of this sector in Poland should be regarded as offering many opportunities in the future.

Investment funds

Investment funds and providers of private equity have been active in Poland for many years. In very simple terms, the preferred scenario for a fund is to invest between US\$1 million and US\$5 million in a joint venture company with a local partner and a foreign strategic investor. Clearly, this is an over-simplification and, for the right project, both smaller and much larger funds can be found; in theory, any commercially sound project can attract funds.

A number of the locally based funds are effectively subsidiaries of the more global funds or are linked to banks. As the market continues to

mature and stabilize, the growing demand for this type of funding is being met by the creation of new funds and the expansion of existing ones. The European Bank for Reconstruction and Development (EBRD) fully recognizes the important role that investment funds play in the development of an emerging economy and has co-invested in a number of investment funds in Poland.

Insurance

Taken as a whole, the insurance market is underdeveloped when compared with the European Union and the majority of interest from foreign firms has been in the life insurance sector. However, sales of all forms of insurance policies have grown rapidly in recent years and will continue to improve over time, with the life sector leading the way.

As with the banking sector, the privatization and opening up of insurance markets to foreign competition has ensured healthy competition and the provision of a wider range of products. There are some 70 insurance companies active in Poland and the majority of these are at least part owned by foreign insurance groups. Indeed, the sector continues to attract foreign competition as there is still major future potential. Despite the growing competition, PZU, which has a market share of more than 50 per cent and is majority state owned, continues to dominate the market.

The development of private pensions in Poland has made very good progress in recent years and over 80 per cent of the eligible population have invested in pension funds. While there are over 20 such funds, the market is dominated by the three largest providers. As with every country, there is an urgent need to move away from the provision of pure state systems and the Polish government has readily accepted this imperative. The speed of reform and the rapid development of private pension funds have had a very positive impact on other aspects of the financial services sector; but most specifically the Warsaw Stock Exchange has benefited greatly.

Legal

Part Two of this book is dedicated to legal issues, but given the impact of legislation on doing business in the financial services sector a brief outline is appropriate here.

The legal sector, or more correctly the law, has perhaps undergone more change than any other sector. Most of the large international law firms are present and many have been instrumental in adapting old legislation and writing new laws. As the Polish economy moves ever closer to a market-driven economy, the need for changes in legislation to allow the economy to expand and foreign companies to invest and trade

in a safe environment becomes ever greater. The scope and depth of these changes has increased significantly as EU membership beckons. It is true that many of the laws are not directly comparable with UK or EU legislation, but much progress has been made.

Accountancy

One of the requirements for any company wishing to raise debt or equity funding, trade finance, or establish any form of partnership with a foreign party has been the need to produce accounts to international accounting standards (IAS). All the large foreign accountancy firms are present and the trend towards international accounts continues to percolate down towards ever-smaller companies.

Accountancy and audit issues are addressed in Chapter 3.2.

Stock exchange

Not surprisingly, given the relative size of the country, the Polish stock exchange is the largest and most liquid exchange in the region. This is largely due to the privatization process and the flotation of the bigger previously state-owned enterprises and flow of long-term investment from the private pension funds. The situation is enhanced further as the market has been the most successful in the region at attracting foreign portfolio investors.

There is a cooperation agreement in place with the London Stock Exchange and five Polish companies are listed in London.

Corporate governance

The way in which business is conducted, the transparency of transactions and relationships, minority shareholder rights and general financial management are some of the main concerns behind corporate governance. As with many aspects of the financial services sector in Poland, much has been done but much more still needs to be done.

The overall level of corporate governance is, however, considered to be far better than in many of the other countries in the region.

Regulation

The banking sector is regulated by the National Bank of Poland, which also has a duty to set interest rates and control inflation. In contrast with a number of other countries in the region, the government has recently increased the level of independence currently enjoyed by the National Bank.

Regulation and supervision of the various parts of the financial services sector is generally regarded as being relatively good and continues to improve, although it is recognized that the lack of experienced professionals is a limiting factor.

Summary

The financial services sector has been totally transformed over the last 10 years and, while mistakes have been made and there is still much to be done, the progress made has been remarkable and past mistakes are now being recognized and rectified.

In comparison with some of the other countries in Central Europe, Poland's financial services sector can be seen as strong, developed and well regulated, in addition to being very open and of considerable interest to foreign competition.