

BANK GOSPODARSTWA KRAJOWEGO (DOMESTIC MANAGEMENT BANK) AS A FINANCIAL INSTITUTION IN THE STATE PUBLIC FINANCE SYSTEM

Bank Gospodarstwa Krajowego (BGK) has, in fact, existed since 1924. It was created by a President of the Republic of Poland ordinance of May 30th, 1924 on the joining (fusion) of State Crediting Institutions into Bank Gospodarstwa Krajowego. On March 14th 2003, the Sejm of the Republic of Poland passed the Act on Bank Gospodarstwa Krajowego. The draft of the act was prepared by the Government within the frameworks of realizing the economic strategy program called “Entrepreneurship – Development – Employment”. Due to the nature of the activity assigned to BGK, comprising of performing public tasks, it occupies a special position among the other banks operating on the Polish banking market. Regulation of the basic principles and the scope of BGK’s activity became necessary both due to legal and formal issues, as well as in the face of integration with the European Union. Even though the act on Banking Law contains regulations concerning the creation and organization of state banks, the Government drafted (and the Parliament approved) a separate legal act for BGK. This seems justifiable due to the scope of departures from the regulations in the Banking Law and the specific nature of BGK’s activity. Within the negotiations of the European Union, Poland strove for the placement of BGK on the list of exceptions, contained in the Directive of the European Parliament and of the Council 2000/12/EC (presently 2006/48/EC) relating to the taking up and pursuit of the business of credit institutions. The Union accepted the abovementioned position (European Union Common Position CONF-PL-66/00) and BGK received a subjective exclusion. It must be noted that institutions of a nature similar to that of BGK, excluded from the provisions of the said Directive, operate in European Union member states, examples of which may be Instituto de Credito Comercial (ICO) in Spain or Kreditanstalt für Wiederaufbau (KfW) in Germany.¹

The legal bases of BGK’s functioning are constituted by:

1 T. Olszówka, S. Skuza, Ustawa o Banku Gospodarstwa Krajowego, „Prawo Bankowe”, 2003, No. 9, p. 9.

1. The Act of 29th August 2003 on Banking Law (Journal of Laws of 2002, No. 72, item 655 with further amendments);
2. The Act of March 14th 2003 on Bank Gospodarstwa Krajowego (Journal of Laws No. 65, item 594 with further amendments);
3. The Ordinance of the Minister of Treasury of 27th August 2003 on the awarding of statute to Bank Gospodarstwa Krajowego (Journal of Laws No. 156, item 1526 with further amendments).

The operation of BGK as a bank is regulated by the provisions of the Act on Banking Law. Simultaneously, Art. 3 of the Act on BGK (as a *lex specialis* regulation in relation to the provisions of the Act on Banking Law) states that the activity of BGK is governed by the provisions of the Banking Law, unless the provisions of the Act on BGK provide otherwise.

The aims of the activity of BGK outlined by the Act clearly define its public mission and the particulars of its operations on the banking market. Thus the basic aims of BGK's operations include supporting the government social and economic programs as well as local self-governance and regional development programs carried out with the employment of public means. Currently, BGK joins its full commercial activity in the scope of national and international trade with the mission of supporting social and economic endeavours of the state. The commercial activity however, serves to increase the effectiveness of realization of commissioned tasks and the development and strengthening of BGK's infrastructure and resources employed for the fulfillment of tasks commissioned by public administration bodies.

The basic tasks of BGK include:

- operating the funds created by, entrusted or transferred to BGK based on separate acts;
- operating export transactions with the application of export supporting instruments in accordance with separate provisions of law;
- performing the activities concerning credit institutions liquidated or deemed liquidated based on the Decree of 25th October 1948 on the Principles and Mode of Liquidation of Certain Banking Enterprises, the Decree of 25th October 1948 on the Principles and Mode of Liquidation of Certain Long-term Credit Institutions and the Decree of 25th October 1948 on the Banking Reform;
- performing the activities defined by the Act of 29th August 1997 on Banking Law.

The Act on BGK allows BGK to perform all the activities defined by the Act on Banking Law. This means that BGK may run, like up until now, full banking operations, thus performing the banking activities restricted exclusively for banks as well as operations with the status of “banking activities”, under the condition that they are performed by banks. The above solution enables BGK to employ all the tools applied in banks’ operational activity for the realization of basic aims of BGK’s activity, defined in the Act.²

Tasks concerning the operating funds functioning at BGK are performed based on the provisions of separate acts, under which the funds were created.

Currently, BGK services the following funds and programs (the most important positions):

- National Housing Fund (NHF), established under the Act of 26th October 1995 on Certain Forms of Supporting House Building (Journal of Laws of 2000, No. 98, item 1070 with further amendments);
- Subsidy Fund, established under the Act of 5th December 2002 on Providing Subsidies to Interest on Mortgage Loans with Fixed Interest Rates (Journal of Laws of 2002, No. 230, item 1922 with further amendments);
- The National Road Fund, established under the Act of 27th October 1994 on Toll Motorways and the National Road Fund (Journal of Laws No. 256, item 2571 with further amendments);
- Thermo-modernization Fund, established under the Act of 18th December 1998 on Supporting Thermal Modernization Projects (Journal of Laws No. 162, item 1121 with further amendments);
- Technological Credit Fund, established under the Act of 29th July 2005 on Certain Forms of Supporting Innovative Activities (Journal of Laws No. 179, item 1484 with further amendments);
- National Credit Guarantee Fund, established under the Act of 8th May 1997 on Guarantees Extended by the State Treasury and by Certain Legal Persons (Journal of Laws of 2003, No. 174, item 1689 with further amendments);
- Students Loans and Credits Fund, established under the Act of 17th July 1998 on Student Loans and Credits (Journal of Laws No. 108, item 685 with further amendments);

2 B. Mikołajczyk (ed.), *Finansowe uwarunkowania konkurencyjności przedsiębiorstw z uwzględnieniem sektora MSP*, Difin, Warsaw 2006, p. 296

- European Union Guarantee Fund, established under the Act of 16th April 2004 on the European Union Guarantee Fund (Journal of Laws No. 121, item 1262 with further amendments);
- Export supporting Program DOKE, established under the Act of 8th June 2001 on Subsidies to Interest on Export Credits with a Fixed Interest Rate (Journal of Laws No. 73, item 762 with amendments);
- Public health units restructuring Program, established under the Act of 15th April 2005 on Public Assistance and Restructuring of Public Health Units (Journal of Laws No. 78, item 684 with amendments).

As already mentioned, BGK has been placed on a list of institutions excluded from the provisions of Directive 2006/48/EC of the European Parliament and of the Council of 14th June 2006 relating to the taking up and pursuit of the business of credit institutions.

The justification of this exclusion was the orientation of Bank Gospodarstwa Krajowego, based on the legal norms presented above, towards operating tasks commissioned by the government, while at the same time providing it with the possibility to pursue commercial operations in a scope allowing it to keep qualified staff and infrastructure necessary for the proper operation of funds entrusted to BGK, while simultaneously avoiding the creation of conditions for unfair competition towards other financial institutions.

Excluding BGK from the provisions of Directive 2006/48/EC does not mean its exclusion from the provisions of the Act on Banking Law. BGK, pursuing its banking activity (based on authorisations to perform banking operations exposing to risk any funds which have been entrusted to the bank and which are in any way repayable) is obliged to observe provisions in force for banks.

BGK, similarly to other banks, is subject to the amended (due to the introduction of the new capital requirements Basel II into the Polish legal order) provisions of the Act on Banking Law. The application of rules in force since 1st January 2008 has resulted in the increase of capital requirements towards BGK (mostly due to the increase of risk weight on mortgage loans granted from the funds of NHF and to the inclusion of operational risk - up until now, the capital requirements statement included credit and market risk), which in turn led to the decrease of the capital adequacy ratio.

The potential increase of the total capital requirement in force since 1st January 2008 results principally from the risk weight increase from 50% to 100% for mortgage-secured expositions within the activity of NHF, due to the fact that the main source of credit repayment are rents received from credited housing units and not other independent sources.

Art. 128b of the Act on Banking Law was supposed to open a certain possibility of excluding BGK from capital requirements. According to this provision, the Commission for Banking Supervision may, at the request of a state bank, exempt a part of the activity or the entire activity of that bank related to servicing funds created, entrusted or transferred to that bank pursuant to separate acts, from the obligation to comply with certain requirements and standards stipulated in the Act, provided that the activity has been isolated financially, and particularly that the bank does not participate in its financing and that the risk related to this activity is not borne by the bank in any way, and particularly that the bank is not in any way liable for losses arising from the activity.

The fund, (which is a credit fund) currently has, at its disposal, assets amounting to PLN 6.061,9 billion.³

It must however, be noted, that currently BGK has no possibility of taking advantage of the exclusion stipulated in Art. 128b of the aforementioned Act, as in the case of programs realized within the framework of NHF, BGK participates in their financing by incurring liabilities in order to support the program. Moreover, Provision 34 of BGK's Statute stipulates, that in the event of losses arising from the activity of any of the funds (serviced by BGK), the loss is covered from this fund. However, the provision does not state who is liable for losses arising from the activity of the fund should they exceed the value of the fund. The problems connected with lack of a clear definition of loss-related risk create a particularly specific situation for BGK. While calculating the capital adequacy ratio, there is no possibility to include funds located at BGK as own funds, while the assets of these funds are included in the capital requirement.

The situation of BGK in the scope of internal capital and the capital adequacy ratio due to the introduction of New Capital Requirements' (Basel II) results, in practice, from the specificity of the Bank's activity.

The activity of the aforementioned funds is similar to that of special purpose funds, although they do not constitute special purpose funds as construed by the Act on Public Finances, neither can BGK (as a bank) be included in the sector of public finances. Nevertheless, its relations with the public finances sector are close.

Firstly, the composition of the Supervisory Board reflects the ministerial bodies – members of the Council of Ministers, i.e. the Minister of Finance, Infrastructure, Treasure and Economy. Secondly, pursuant to Art. 164 of the Act on Public Finances, the Minister of Finance has the ability to locate budget surplus at BGK or at Narodowy Bank Polski. Thirdly, BGK is already an agent of the Ministry of Finance in the scope of operating foreign debt (with the exclusion of debt owed to

3 Bank Gospodarstwa Krajowego, 30th June 2008

international financial institutions). Fourthly, in accordance with the position of the Office of Public Procurement, Bank Gospodarstwa Krajowego is obliged to apply and comply with the procedures of public procurement. Fifthly, eventually, after Poland adopts the euro, BGK will be entitled to provide banking services to the state budget.⁴ Sixthly, BGK is obliged by law to operate the accounts of the National Health Fund.

These possibilities and the pursuit of tasks in the scope of funds located at BGK, considering also their size, should form part of the public finances reform. The first and foremost issue seems to be the necessity to regulate the status of funds located at BGK. Two opposing solutions seem to be possible to achieve this aim - the inclusion or the exclusion of these funds. The first proposal would mean the liquidation of the funds or a part of them (at least the credit and guarantee ones, such as NHS). The liquidation of funds would not mean the termination of the government support of individual domains of economic and social life. It would be possible to assume that BGK would continue the activities taken up until now, but exclusively as programs realized under separate acts, within own activities. The capital of the funds would be transferred to the statute fund or to a supplementary capital of BGK, which would be advantageous for two reasons:

1. it would solve the risk-related problems and cause a capital strengthening within the New Capital Requirements (Basel II);
2. it would increase BGK's operational possibilities in relation to credit concentration standards.

A recapitalization of a few billion of BGK, without any cost to the budget, seems to be a solution advantageous to both BGK as well as to the sector of public finances. It should be noted that BGK, as a state bank has very limited possibilities of recapitalization, i.e. from profit and/or from state budget recapitalization (possibly in the form of a contribution-in-kind, e.g. minority stakes held by State Treasury). After the liquidation of funds, in order to support government programs, BGK would grant credits, guarantees and sureties on its own behalf and account, using the funds from budget subsidies. Funds from the liquidation of funds (established on the basis

4 Currently, BGK pursuant to Art. 160 of the Act on Public Finances, within the framework of banking services provided to the state budget, could operate the current accounts of state special purpose funds, unless the provisions of separate acts provide otherwise, the current accounts of budgetary enterprises and of auxiliary enterprises of budgetary units and auxiliary accounts. Moreover, as a bank of first choice (without the procurement procedure), pursuant to the aforementioned article, BGK could operate the bank accounts of state legal persons established under separate acts, included in the public finances sector (government agencies).

of statement of liquidation and the opinion of an expert auditor) would increase the stature of supplementary fund of BGK. The intention, thus, should be to create legal framework in accordance with which BGK, as a commercial bank within the scope of its own activity, would pursue banking operations, supporting social and economic government programs as well as local self-governance and regional development programs, with the employment of public funds. The liquidation of certain funds in the proposed way, i.e. through the recapitalization of BGK from these funds, would solve the problem of providing BGK with appropriate own funds, enabling BGK to become more involved in large projects, of increasing the security of BGK and of fulfilling precautionary standards (capital adequacy ratio).⁵

The other of the proposed solutions would be directed at exempting the funds located at BGK from capital standards. Such a solution could be implemented in various manners. The first would be to introduce special capital standards exclusively for BGK directly in the provisions of the Act on BGK - with consideration of the specificity of the functioning of these funds. These provisions, as *lex specialis* to the Act on Banking Law would define the legal standards of exclusion for BGK - while considering the specificity of these funds' functioning. Another solution could be the amendment of Art. 128b of the Act on Banking Law, enabling to use the legal exclusion in practice. The amendment should involve creating a substantive law provision concerning the capabilities of a defined discretionary decision of the supervisory bodies without the currently isolated prerequisites, which, in practice, are impossible to fulfill. That is because it is impossible to completely relieve BGK, operating the fund, of the risk, for example in the scope of operational risk. The third alternative in this issue could be to transform the said funds into state special purpose funds. Such a solution, i.e. the creation of new special purpose funds by way of an act is provided for by the Act on Public Finances (the 1998 act did not provide for such a possibility).⁶ Another solution could be to exclude the funds from BGK and to grant them the form of a separate organizational unit, which would exclude the liability of BGK for losses arising from the activity of funds. One issue must be considered: whether or not such a unit should have legal personality; in the event of units with legal personality, they could be, e.g. special purpose funds, companies of which BGK would be the only (100%) shareholder, or legal persons managed by BGK similarly to the Social Security Fund managed by the Social Insurance Company or investment funds managed by the Investment Fund Company.

5 Currently, despite listing the funds located at BGK in the Bank Gospodarstwa Krajowego balance sheet, there are no possibilities of including them in own funds pursuant to the requirements of the Act on Banking Law.

6 The employment of solutions in the scope of funds and recapitalization of the Bank included in the public finances reform by professor Zyta Gilowska (liquidation of a part of BGK funds or their transformation into special purpose funds, or the inclusion of certain funds among Bank's own funds in exchange for transferring tasks to the Act on BGK).

Another change should be introduced in the context of banking services provided to the state budget. It does not seem like a rational solution to maintain a time limit from which BGK could start providing banking services to the state budget. The issue of preparing an adequate infrastructure for the operation of the state budget is much more important. In the author's opinion, with the amendment of the Act on Public Finances, it would be necessary to exempt BGK from the obligation to pay the obligatory reserve on public funds collected on budget accounts. Such an action would require the amendment of the Act on Narodowy Bank Polski. Also the issue of BGK's bankruptcy in terms of operating public accounts should be considered. It should be noted that NBP has no bankruptcy capacity.

The issue of public procurements does not seem to be of less importance. Without negating completely the interpretation of the Office of Public Procurement, which regards BGK as a "public utility institution", the justifiability of introducing these procedures should be considered in the context of broadly understood activity on financial markets. In the author's opinion, BGK should enjoy defined subjective exclusions in the scope of public procurements, analogically to Narodowy Bank Polski. The procedures of public procurement would not be limited to only, for example, the purchase of equipment, software, furniture, deliveries, etc. In the light of the position held by the Office of Public Procurement during the work on the Act on BGK, the EU law allows for a very small margin of exemptions from the mode of public procurement which, in the case of BGK, is limited to banking services provided to the state budget. It seems that in the light of EU regulations, the only possible solution is the subjective exclusion of a defined scope of BGK's activity from the mode of public procurement. It must, however, be noted that other banks controlled directly or indirectly by public finance sector units are not subject to the procedure of public procurement in the scope of own (commercial) activity. In the event of a subjective exclusion of BGK from the provisions on public procurement being impossible, actions should be undertaken towards the subjective exclusion of strictly banking operations (similar subjective exclusions are granted to Narodowy Bank Polski).

To sum up, BGK is currently an important institution within the system of public finances. Even though BGK remains outside of the public finance sector, it seems necessary to join the public finances reform with changes in the principles of functioning of BGK and of funds located at it. The scope of BGK's activity as an entity realizing government programs is a significant factor pointing towards the necessity to consider these issues jointly with a complex reform of public finances.

Streszczenie

Bank Gospodarstwa Krajowego (BGK) jest ważną instytucją w systemie finansów publicznych. Pomimo, że został wyłączony z sektora finansów publicznych, wydaje się jednak koniecznością połączenie reformy finansów publicznych z jego funkcjonowaniem, uwzględniając również fundusze, którymi dysponuje. Zakres działalności BGK jako jednostki realizującej programy rządowe jest znaczącym czynnikiem, który powinien być uwzględniony w procesie kompleksowej reformy finansów publicznych.