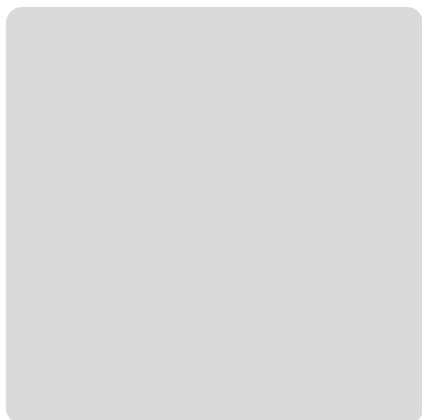

ING Bank Śląski S.A.

Annual Financial Statements for the year 2018

ING

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Income statement

for the year ended 31 December

	Note	2018	2017
		[IFRS 9]	[IAS 39-non-transformed data]
Interest income, including:	2	4 526.8	4 089.9
Interest income calculated using effective interest rate method		4 521.5	n/a
Other interest income		5.3	n/a
Interest expenses	2	907.7	835.6
Net interest income	2	**3 619.1**	**3 254.3**
Commission income	3	1 393.5	1 290.2
Commission expenses	3	156.9	144.3
Net commission income	3	**1 236.6**	**1 145.9**
Net income on financial instruments at fair value through profit or loss and FX result	4	90.6	119.0
Net income on the sale of securities measured at amortised cost		1.0	n/a
Net income on the sale of securities measured at fair value through other comprehensive income and dividend income		54.3	n/a
Net income on investments	5	n/a	54.0
Net income on hedge accounting	6	7.9	15.3
Net income on other basic activities	7	4.1	-5.8
Net income on basic activities		**5 013.6**	**4 582.7**
General and administrative expenses	8	2 212.9	2 048.6
Impairment for expected losses	9	476.6	n/a
including profit on sale of receivables		26.7	n/a
Impairment losses and provisions for off-balance sheet liabilities	9	n/a	399.6
Tax on certain financial institutions	10	371.7	330.1
Share of profit (loss) of subsidiaries and associates accounted for using the equity method		59.3	54.6
Gross profit (loss)		**2 011.7**	**1 859.0**
Income tax	11	485.8	455.9
Net profit (loss)		**1 525.9**	**1 403.1**
Weighted average number of ordinary shares		130 100 000	130 100 000
Earnings per ordinary share (PLN)	12	11.73	10.78

The diluted earnings per share are the same as the profit per one ordinary share.

The Income Statement should be read in conjunction with the notes to the financial statements being the integral part thereof.

Statement of comprehensive income

for the year ended 31 December

	Note	2018	2017
		[IFRS 9]	[IAS 39 non-transformed data]
Net profit for the period		**1 525.9**	**1 403.1**
Total other comprehensive income, including:	34	**679.4**	**-84.0**
Items which can be reclassified to income statement		**674.0**	**-77.2**
debt instruments measured at fair value through other comprehensive income – gains/losses on revaluation carried through equity		12.1	n/a
debt instruments measured at fair value through other comprehensive income – reclassification to the financial result due to sale		-31.8	n/a
gains/losses on revaluation of available-for-sale financial assets carried through equity		n/a	192.8
reclassification to the financial result due to sale of available-for-sale financial assets		n/a	-31.7
cash flow hedging – gains/losses on revaluation carried through equity		1 033.1	n/a
cash flow hedging – reclassification to profit or loss		-339.4	n/a
effective part of cash flow hedging relationship		n/a	-206.0
settlement of the valuation of securities reclassified from the portfolio available for sale to the portfolio of loans and receivables		n/a	-0.2
settlement of the valuation of securities reclassified from the portfolio available for sale to the portfolio of financial assets held to maturity		n/a	-32.1
Items which will not be reclassified to income statement		**5.4**	**-6.8**
equity instruments measured at fair value through other comprehensive income – gains/losses on revaluation carried through equity		6.3	0.0
actuarial gains/losses		-0.9	-6.8
Net comprehensive income for the reporting period		**2 205.3**	**1 319.1**

The Statement of Comprehensive Income should be read in conjunction with the notes to the financial statements being the integral part thereof.

Statement of financial position

as at 31 December

	Note	2018	2017	2016
Assets		[IFRS 9]	[IAS 39 non-transformed data]	
Cash in hand and balances with the Central Bank	13	1 237.4	2 815.1	1 825.0
Loans and other receivables to other banks	14	776.5	2 234.5	1 113.4
Financial assets held for trading	15,16	1 711.6	1 314.8	3 943.9
Derivative hedge instruments	17	909.6	967.2	1 338.6
Investment securities	18	31 937.3	n/a	n/a
Investments	18	nd	25 907.4	25 721.3
Loans and other receivables to customers	20	99 125.8	87 358.7	78 038.0
Investments in controlled entities	21	634.6	474.3	419.2
Property, plant and equipment	22	550.4	542.8	571.6
Intangible assets	23	425.0	418.5	419.6
Assets held for sale	24	10.9	11.1	31.8
Deferred tax assets	25	209.0	130.9	154.2
Other assets	26	183.4	163.7	132.8
Total assets		**137 711.5**	**122 339.0**	**113 709.4**
Liabilities				
Liabilities to other banks	27	1 807.7	1 044.6	2 019.9
Financial liabilities at fair value through profit or loss	28,16	1 464.3	1 714.3	1 590.8
Derivative hedge instruments	17	611.8	699.2	1 468.1
Liabilities to customers	29	117 293.8	104 075.8	95 168.4
Liabilities under issue of debt securities	30	300.3	300.3	866.4
Subordinated liabilities	31	1 076.9	626.9	664.9
Provisions	32	149.5	89.9	59.0
Current income tax liabilities		264.5	220.2	119.6
Other liabilities	33	1 406.4	1 773.0	1 277.4
Total liabilities		**124 375.2**	**110 544.2**	**103 234.5**
Equity				
Share capital	34	130.1	130.1	130.1
Supplementary capital - issuance of shares over nominal value	34	956.3	956.3	956.3
Accumulated other comprehensive income	34	1 169.7	493.2	577.4
Retained earnings	34	11 080.2	10 215.2	8 811.1
Total equity		**13 336.3**	**11 794.8**	**10 474.9**
Total equity and liabilities		**137 711.5**	**122 339.0**	**113 709.4**
Carrying amount		13 336.3	11 794.8	10 474.9
Number of shares		130 100 000	130 100 000	130 100 000
Carrying amount per share (PLN)		102.51	90.66	80.51

The Statement of Financial Position shall be read in conjunction with the notes to financial statements being the integral part thereof.

Statement of changes in equity

2018 [IFRS 9]

Note: 34	Share capital	Supplementary capital - issuance of shares over nominal value	Cumulative other comprehensive income	Retained earnings	**Total equity**
Opening balance of equity	**130.1**	**956.3**	**493.2**	**10 215.2**	**11 794.8**
The impact of changes to the accounting principles in connection with the implementation of IFRS 9*	0.0	0.0	1.1	-249.0	**-247.9**
Opening balance of equity adjusted for changes to the accounting principles	**130.1**	**956.3**	**494.3**	**9 966.2**	**11 546.9**
Net result for the current period	-	-	-	1 525.9	**1 525.9**
Other net comprehensive income, including:	**0.0**	**0.0**	**675.4**	**4.0**	**679.4**
financial assets measured at fair value through other comprehensive income – gains/losses on revaluation carried through equity	-	-	18.4	-	18.4
debt securities measured at fair value through other comprehensive income – reclassification to profit or loss due to sale	-	-	-31.8	-	-31.8
cash flow hedging – gains/losses on revaluation carried through equity	-	-	1 033.1	-	1 033.1
cash flow hedging – reclassification to profit or loss	-	-	-339.4	-	-339.4
disposal of non-current assets	-	-	-4.0	4.0	0.0
actuarial gains/losses	-	-	-0.9	-	-0.9
Other changes in equity, including:	**0.0**	**0.0**	**0.0**	**-415.9**	**-415.9**
valuation of share-based payments	-	-	-	0.3	0.3
dividends paid	-	-	-	-416.2	-416.2
Closing balance of equity	**130.1**	**956.3**	**1 169.7**	**11 080.2**	**13 336.3**

*) The impact of changes to the accounting principles in connection with the implementation of IFRS 9 is described in chapter Accounting policy and additional notes in the item II.1.2. *Impact of IFRS 9 Financial instruments implementation for Bank's financial statements.*

2017 [IAS 39 – non-transformed data]

Note: 34	Share capital	Supplementary capital - issuance of shares over nominal value	Cumulative other comprehensive income	Retained earnings	**Total equity**
Opening balance of equity	**130.1**	**956.3**	**576.8**	**8 631.7**	**10 294.9**
effect of changes in accounting policy from the implementation the equity method for valuation controlled entities	-	-	0.6	179.4	**180.0**
Opening balance of equity adjusted for changes to the accounting principles	**130.1**	**956.3**	**577.4**	**8 811.1**	**10 474.9**
Net result for the current period	-	-	-	1 403.1	**1 403.1**
Other net comprehensive income, including:	**0.0**	**0.0**	**-84.2**	**0.2**	**-84.0**
gains/losses on revaluation of available-for-sale financial assets carried through equity	-	-	192.9	-	192.9
reclassification to the financial result due to sale of available for-sale financial assets	-	-	-31.7	-	-31.7
settlement of the valuation of securities reclassified from the portfolio available for sale to the portfolio of loans and receivables	-	-	-0.2	-	-0.2
settlement of the valuation of securities reclassified from the portfolio available for sale to the portfolio of financial assets held to maturity	-	-	-32.1	-	-32.1
effective part of cash flow hedging relationship	-	-	-206.0	-	-206.0
disposal of non-current assets	-	-	-0.3	0.2	-0.1
actuarial gains/losses	-	-	-6.8	-	-6.8
Transactions with shareholders, including:	**0.0**	**0.0**	**0.0**	**0.8**	**0.8**
valuation of share-based payments	-	-	-	1.0	1.0
settlement of the purchase of shares in subsidiary	-	-	-	-0.2	-0.2
Closing balance of equity	**130.1**	**956.3**	**493.2**	**10 215.2**	**11 794.8**

The Statement of Changes in Equity should be read in conjunction with the notes to the financial statements being the integral part thereof.

Cash flow statement

for the year ended 31 December

	Note	2018	2017
		[IFRS 9]	[IAS 39 non-transformed data]
Net profit (loss)		**1 525.9**	**1 403.1**
Adjustments		**-4 337.3**	**4 194.9**
Share of profit (loss) of subsidiaries and associates		-59.3	-54.6
Depreciation and amortisation	8,22,23	190.0	181.3
Interest accrued (from the income statement)	2	-3 619.1	-3 254.3
Interest paid		-884.5	-806.8
Interest received		4 370.6	3 878.2
Dividends received	5	-6.3	-14.1
Gains (losses) on investing activities		-0.8	-0.9
Income tax (from the income statement)	11	485.8	455.9
Income tax paid from the income statement		-467.8	-332.0
Change in provisions	32, 41	42.7	30.9
Change in loans and other receivables to other banks	14, 41	387.4	-269.3
Change in financial assets held for trading	15,16,41	-396.1	2 629.2
Change in available-for-sale financial assets	18, 41	n/a	3 070.4
Change in debt securities measured at fair value through other comprehensive income	18, 41	-6 363.1	n/a
Change in hedge derivatives	17, 41	663.9	-603.5
Change in loans and other receivables to customers	20, 41	-12 039.0	-9 260.2
Change in other assets	26, 41	-19.9	31.2
Change in liabilities to other banks	27, 41	761.0	-975.3
Change in liabilities at fair value through profit or loss	16,28,41	-249.2	122.2
Change in liabilities to customers	29, 41	13 216.9	8 914.0
Change in other liabilities	33, 41	-350.5	452.6
Net cash flow from operating activities		**-2 811.4**	**5 598.0**
Purchase of property plant and equipment	22	-131.5	-82.0
Disposal of property plant and equipment		0.7	0.7
Purchase of intangible assets	23	-80.7	-73.1
Purchase of shares in subsidiaries and associates	21	-120.0	-1.3
Disposal of assets held for sale		11.5	8.1
Purchase of equity instruments measured at fair value through other comprehensive income		-1.2	n/a
Purchase of debt securities measured at amortized cost		-567.6	n/a
Disposal of debt securities measured at amortized cost		1 055.8	n/a
Purchase of held-to-maturity financial assets		n/a	-3 211.3
Interest received from held-to-maturity financial assets		n/a	186.7
Dividends received	5	6.3	14.1
Net cash flow from investing activities		**173.3**	**-3 158.1**
Long-term loans received		432.6	0.0
Interest on long-term loans repaid		-12.5	-12.4
Interests from issued debt securities		-7.6	-23.0
Redemption of debt securities		0.0	-565.0
Dividends paid		-416.2	0.0
Net cash flow from financing activities		**-3.7**	**-600.4**
Effect of exchange rate changes on cash and cash equivalents		73.6	-359.1
Net increase/decrease in cash and cash equivalents		**-2 641.8**	**1839.5**
Opening balance of cash and cash equivalents		**4 598.2**	**2 758.7**
Closing balance of cash and cash equivalents	41	**1 956.4**	**4 598.2**

The Cash Flow Statement should be read in conjunction with the notes to the financial statements being the integral part thereof.

Accounting policy and additional notes

I. Bank details

1. Key Bank data

ING Bank Śląski S.A. ("Bank") with the registered office in Katowice, Sokolska Str. 34, was entered into the Entrepreneurs Register with the National Court Register maintained by the Commercial Division of the District Court in Katowice under the number KRS 5459. The Bank statistical number is REGON 271514909, and the tax identification number is NIP 634-013-54-75.

2. Scope and duration of operations

ING Bank Śląski S.A. offers a broad range of banking services rendered to individual and institutional clients in line with the scope of services outlined in the Bank's charter. The Bank runs operations both in the home currency and in foreign currencies. The Bank is also active in the domestic and foreign financial markets. As set out in Bank's Statutes, the duration of business of the Company is indefinite.

3. Share capital

The share capital of ING Bank Śląski S.A. is PLN 130,100,000 and is divided in 130,100,000 ordinary bearer shares of a par value of PLN 1.00 each. Bank's shares are quoted on the Warsaw Stock Exchange (sector: banks).

4. Shareholding structure of ING Bank Śląski S.A.

ING Bank Śląski S.A. is a subsidiary of ING Bank NV, which as at 31 December 2018 held 75% share in the share capital of ING Bank Śląski S.A. and 75% shares in the total number of votes at the General Meeting. ING Bank NV belongs to the Group, herein referred to as ING Group.

As at 31 December 2018, the shareholders owning 5% and more votes at the General Meeting of ING Bank S.A. were:

No.	Entity	Number of shares and votes	% of total number of shares and votes at General Meeting
1.	ING Bank NV	97 575 000	75,00
2.	AVIVA Otwarty Fundusz Emerytalny AVIVA Santander	10 732 305	8,25

5. ING Bank Śląski S.A. Management Board and Supervisory Board composition

On 20 September 2018, the Chairman of the ING Bank Śląski S.A. Supervisory Board received letters of resignation tendered by Ms. Justyna Kesler on her resignation from the capacity of Vice-President of the Management Board of ING Bank Śląski S.A., effective 31 December 2018. At the same time, on 23 November 2018, the Supervisory Board appointed Mr. Lorenzo Tassan-Bassut as the Vice-President of the Bank's Management Board, effective 1 January 2019.

As at the end of 2018, the composition of ING Bank Śląski S.A. Management Board was as follows:

- Mr. Brunon Bartkiewicz - Bank Management Board President,
- Ms. Bożena Graczyk - Bank Management Board Vice-President,
- Mr. Michał Bolesławski - Bank Management Board Vice-President,
- Ms. Joanna Erdman - Bank Management Board Vice-President,
- Mr. Marcin Giżycki - Bank Management Board Vice-President,
- Ms. Justyna Kesler - Bank Management Board Vice-President,
- Mr. Patrick Roesink- Bank Management Board Vice-President.

Also, on 9 March 2018, the Chairman of ING Bank Śląski S.A. Supervisory Board received letter of resignation submitted by Mr. Christopher J. Steane - resignation from the position of a member of the Supervisory Board of ING Bank Śląski S.A, effective 5 April 2018. The reason for resignation was Mr. Christopher J. Steane assumption of another position in the ING Group. At the same time, on 5 April 2018, the General Meeting appointed Mr Michał Szczurek to the Supervisory Board of ING Bank Śląski S.A.

As at the end of 2018, the Supervisory Board of ING Bank Śląski S.A. worked in the following composition:

- Mr. Antoni Reczek - Chair,
- Ms. Małgorzata Kołakowska - Deputy Chair,
- Mr. Aleksander Galos - Secretary,
- Mr. Adrianus Johannes Antonius Kas (Ad Kas) - Member,
- Mr Norman Tambach – Member,
- Mr. Aleksander Kutela – Member,
- Mr. Michał Szczurek – Member.

6. Entity authorised to audit the financial statements

KPMG Audyt Spółka z ograniczoną odpowiedzialnością Sp.k. with registered office in Warsaw is the entity authorised to audit the financial statements.

7. Approval of financial statements

These annual financial statements of the ING Bank Śląski S.A. for the period from 1 January 2018 to 31 December 2018 have been approved by the Bank Management Board on 26 February 2019.

The consolidated annual financial statements of the ING Bank Śląski S.A. Group for the period from 1 January 2018 to 31 December 2018 will be published and approved on the same day as the standalone financial statements.

The annual financial statements of the ING Bank Śląski S.A. for the period from 1 January 2017 to 31 December 2017 were approved by the General Meeting on 5 April 2018.

II. Statement of compliance with International Financial Reporting Standards

These annual financial statements of the ING Bank Śląski S.A. for the period from 1 January 2018 to 31 December 2018 were prepared in compliance with the International Financial Reporting Standards ("IFRS") approved by the European Union. The financial statements take into account the requirements of the standards and interpretations approved by the EU except for the standards and interpretations mentioned in item 1 below, which either await approval by the EU or have been already approved by the EU but shall take effect after the balance sheet date.

1. Changes to accounting standards

In these annual financial statements the Bank took account of the following binding standards and interpretations approved by the European Union for annual periods starting on or after 1 January 2018:

Change (EU effective date provided for in the parentheses)	**Influence on the Bank's statements**
IFRS 9 Financial Instruments	The new standard has an impact on the Bank financial statements due to the need of its retrospective application. More detailed information about the impact on the initial application was presented in item 1.2.
IFRS 15 Revenue from Contracts with Customers taking account of the application date change (the accounting year starting on 01 January 2018 or later)	Implementation of the IFRS 15 has no material impact on the financial statements of the Bank. The Bank carried out a detailed analysis of the contracts for the delivery of goods or services to the client, taking into account the following requirements of the new standard: ➢ goods and services are subject to ordinary activities ➢ goods and services are provided in exchange for remuneration. The Bank stated that the items of the income statement, which will be recognized in accordance with IFRS 15, are: ➢ commission income ➢ other revenues / costs, in the range not covered by other standards, i.e. except for items that have been excluded from the scope of IFRS 15. A detailed analysis of the revenue recognition, taking into account the principle of five steps in accordance with the requirements of IFRS 15, did not show differences between the current recognition of revenues and the recognition according to IFRS 15. The Bank did not identify positions for which a change in accounting should be required.
Clarifications to IFRS 15 Revenue from Contracts with Customers	The application of this clarifications to the standard has no material impact on the Bank's financial statements.

IFRS 4 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*	The Bank does not pursue insurance activity, and due to this, the change has no impact on the financial statements of the Bank.
Changes resulting from the review of IFRS implemented as part of the 2014-2016 cycle (published in December 2016). Related to IFRS 1 and IAS 28	The application of changes to the standards have no material impact on the Bank's financial statements.
IFRS 2 *Classification and measurement of share-based payment transactions.*	The amendment to the standard has no material impact on the Bank's financial statements.
IAS 40 *Transfers of investment property*	At the balance date, the Bank has no investment property and did not change the use of the property and due to this, the application of this amendment has no impact on the financial statements of the Bank.
IFRIC 22 *Foreign currency transactions and advance consideration*	The application of this interpretation has no impact on the financial statements of the Bank.

The published standards and interpretations which were already issued and approved by the European Union as at 31 December 2018 but were not previously applied by the Bank:

Change **(EU effective date provided for in the parentheses)**	**Influence on the Bank's statements**
IFRS 16 Leasing (the accounting year starting on 1 January 2019 or later)	The application of the new standard will have impact on recognition, presentation, measurement and disclosures of the assets that are subject of the operational lease in the Bank financial statement, acting as lessee. The implementation of the new standard will have impact on the balance sheet total assets of the Bank, nevertheless will has no material impact on the financial results of the Bank. Lease payments by maturity are presented in note 40.
IFRS 9 Prepayment Features with Negative Compensation (the accounting year starting on 1 January 2019 or later)	The application of this interpretation will have no impact on the financial statements of the Bank.
IFRIC 23 Uncertainty over Income Tax Treatments (the accounting year starting on 1 January 2019 or later)	The Bank's analysis shows that the implementation of this interpretation will have no impact on the financial statements of the Bank.

The published standards and interpretations which were already issued but were not approved by the European Union as at 31 December 2018 and were not previously applied by the Bank:

Change **(expected IASB effective date provided for in the parentheses)**	**Influence on the Bank statements**
IFRS 10 and IAS 28 "Sale or Contribution of Assets between an Investor and its Associate or Joint Venture" (the accounting year starting on 1 January 2016 or later) EU approval was postponed for an indefinite period.	Status of approval of the changes has not changed since 12 February 2016. Nevertheless, the potential implementation of changes in the published form will not affect the Bank's financial statements.
IFRS 17 *Insurance Contracts* *(the accounting year starting on 1 January 2021)*	Not applicable
Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* *(the accounting year starting on 1 January 2019)*	Based on current stage of assessment, the implementation of these amendments to the standard will have no impact on the financial statements of the Bank.
Changes resulting from the review of IFRS implemented as part of *the 2015-2017 cycle (published in December 2017).* *Related to IFRS 3, IFRS 11, IAS 12 and IAS 23* *(the accounting year starting on 1 January 2019)*	The Bank's analysis shows that the implementation of the amendments to the standards will have no impact on the financial statements of the Bank.

Amendments to IAS 19 *Plan amendment, curtailment or settlement* *(the accounting year starting on 1 January 2019)*	Based on the current stage of the assessment, no impact is expected by the Bank to the Bank's financial statements from implementation of the changes.
Amendments to References to the Conceptual Framework in IFRS Standards *(the accounting year starting on 1 January 2020)*	The Bank's analysis shows that the implementation of these amendments will have no impact on the financial statements of the Bank.
Amendment to IFRS 3 *Business Combinations* *(the accounting year starting on 1 January 2020)*	The application of these amendments will have no impact on the financial statements of the Bank.
Amendments to IAS 1 and IAS 8 *Definition of Material* *(the accounting year starting on 1 January 2020)*	The application of these amendments will have no impact on the financial statements of the Bank.

The European Union has decided not to launch the endorsement process of the interim standard IFRS 14 Regulatory Deferral Accounts (the accounting year starting on 01 January 2016 or later) and to wait for the final IFRS Standard.

1.1. IFRS 16 Leasing

IFRS 16 Leases was published by the International Accounting Standards Board in January 2016 and approved for application by the European Union in October 2017. IFRS 16 supersedes IAS 17 "Leases" and concerns the recognition, measurement, presentation and disclosure of leases. The key changes apply to the lessee.

The Bank chose not to go for the early application of the standard, and therefore it applies the International Financial Reporting Standard 16 Leases for the first time for reporting periods starting on 1 January 2019. The Bank decided to apply the modified retrospective approach to its lease contracts. Consequently, the Bank does not restate comparative information.

At the date of initial application of the standard, the Bank made a full analysis of the contracts to assess whether a contract is a lease contract or whether it contains a lease, and decided to separate lease elements from non-lease elements. The Bank does not apply the provisions of the standard to the lease of intangible assets. The Bank acts as a lessee in the real estate lease contracts (including contracts on the perpetual usufruct right to land), car leases, IT infrastructure leases and office equipment leases.

The new regulation implements uniform rules for the lessee to record lease contracts, while accounting for the exemptions included in the standard. As a consequence, it is necessary to recognise the right-of-use asset and the lease liability. The Bank recognises the right-of-use asset at the initial application date at the amount equal to the lease liability, adjusted to account for any prepayments or lease payments accrued in relation to that lease contract, as recognised in the statement of financial position immediately before the date of initial application. Upon the first application of the new regulation, the Bank measures the lease liability at an amount equal to the present value of the other lease payments, discounted by the application of the lessee's incremental borrowing rate on the date of initial application.

The Bank applies the lessee's incremental borrowing rate to set the present value of lease payments for all lease contracts. The Bank defines the interest rate implicit in lease as the total of the interest rate of swaps and the internal transfer price, upon accounting for the currencies in which the lease contracts are denominated and the contracts maturity dates.

The lease term is determined upon accounting for the extension and shortening options available in the lease contracts, if the use of the option is probable. In the case of open-end lease contracts with a

termination option available for both parties to the contract, the Bank evaluates whether or not there are any material costs relating to the termination of the agreement. If there are no material costs, the notice period available to both parties to the contract is set as the lease term. When the costs of terminating the contract are material, the Bank assumes that the lease term is 4 years. The open-end contracts held by the Bank are primarily the real estate lease contracts. The term adopted results from the strategy relating to the physical presence in a given location, ensuring flexibility and business effectiveness while accounting for the customer expectations and preferences.

The Bank applied the simplified approach envisaged for short-term leases (including lease contracts with a lease term ending 12 months after the date of initial application of the standard) and the leases of low-value assets. In that case, the Bank recognises the systematic lease payments in profit or loss. A contract may be classified as a short-term contract if the contract term is 12 months or less. Assets may be classified as low-value assets if the acquisition price of a new asset is under EUR 5,000.

The impact of IFRS 16 on the financial statements as at 1 January 2019 is presented in the specification below.

Recognising a right-of-use asset:	**467.0**
real estate lease	452.4
car lease	13.9
others assets	0.7
Recognising a lease liability:	**469.3**
real estate lease	454.7
car lease	13.9
others assets	0.7

The table below contains a reconciliation of differences between operating lease commitments disclosed applying IAS 17 at the date 31 Dec 2018 and lease liabilities as at 1 Jan 2019 i.e. at the date of initial application of IFRS 16.

	31 Dec 2018	opening balance adjustments	01 Jan 2019
Future rental commitments under MSR 17	**483.5**		
opening balance adjustments in connection with the implementation of IFRS 16, including:		**-14.2**	
(-) discounting effect using leasee's incremental borrowing rate as at 1 Jan 2019		-54.1	
(-) recognition exemption for short-term leases		-8.6	
(-) non-lease components of a contract		-51.6	
(+)/(-) extension and termination options reasonably certain to be exercised		100.1	
Lease liability under IFRS 16			**469.3**

1.2. Impact of IFRS 9 Financial instruments implementation for Bank's financial statements

The IFRS 9 "Financial Instruments" was published by the IASB in July 2014 and was adopted by the European Union in November 2016. The IFRS 9 replaces the IAS 39 "Financial Instruments: Recognition and Measurement" and includes classification and measurement requirements for financial assets and liabilities, impairment of financial assets and hedge accounting. The new requirements are effective from 1 January 2018. The Bank took a decision to apply retrospectively the principles of classification, measurement and impairment through the adjustment of the opening balance sheet as at 1 January 2018, without adjusting comparative periods.

In 2019, the Polish Financial Supervision Authority intends to implement a new Recommendation R, wherein the authority plans to include material interpretation issues relating to IFRS 9 and propose best practices and mechanisms that allow for effective credit risk management at banks.

1.2.1. Classification and measurement

IFRS 9 is based on the uniform approach to the classification and valuation of financial assets based on the business model for management of financial assets and characteristics of contractual cash flows for the financial assets item.

According to IFRS 9, the financial assets are categorised as follows:

- financial assets measured at amortised cost;
- financial assets measured at fair value through other comprehensive income;
- financial assets measured at fair value through profit or loss.

IFRS 9 introduces two criteria that determine the classification and measurement of financial assets:

- business model assessment – made to determine how the financial assets item is managed in the context of its categorisation as:
  - held to collect within a business model whose objective is to hold financial assets in order to collect contractual cash flows;
  - held to collect and sell within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; or
  - held for other business purposes and
- assessment whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated. Analysis conclusions form the confirmation whether the assets item is measured in line with the business model or at fair value through profit or loss.

Business models

Business model structure reflects the current organisational framework of the Bank. It was analysed thoroughly and assessed using business decision triggers as to financial assets management.

Following the assessment, the Bank assigned all debt instruments and credit receivables to one of the business models:

- "Hold to collect" which assumes holding financial assets to collect contractual cash flows – the financial assets which were classified under IAS 39 as "Loans and receivables" and "Investments held to maturity" were assigned to this model;
- "Hold to collect and sell", i.e. the financial assets held to collect contractual cash flows and sell; the financial assets which were classified under IAS 39 as "Available-for-sale financial assets" were assigned to this model;
- "Other" – held for other business purposes which under IAS 39 were classified as financial assets held for trading.

Cash flow analysis

The financial assets held under individual business models were divided into smaller portfolios based on the analysis of contractual terms of the product offer. Their cash flows were examined using a selected sample of agreements from those portfolio through analysis of contractual terms and based on the analysis of system data which define the timing and amount of realised cash flows. The analyses sought to identify the elements which are not payments of principal and interest on the principal amount outstanding. The following aspects of agreements were analysed:

- terms and conditions on credit facility prepayment,

- financial leverages which increase the variability of cash flows, whereby they do not have the economic characteristics of interest,
- the terms which could potentially limit the legal claims to certain assets of the borrower,
- the terms which modify the time value of money.

The financial assets wherefor the contractual cash flows are not payments of principal and interest on the principal amount outstanding are mandatorily measured at fair value through profit or loss regardless of the business model applied.

Financial liabilities

IFRS 9 does not change considerably the requirements for financial liabilities vis-à-vis the IAS 39 ones. The only change pertains to the presentation of the measurement component reflecting the credit risk for the liabilities designated for measurement at fair value through profit or loss at initial recognition. The component is presented in the relevant item of other comprehensive income. The change of the relevant requirements did not impact the financial statements of the Bank, because the Bank did not designate the liabilities for measurement at fair value through profit or loss.

Impact of changes in classification and measurement

Application of IFRS 9 guidelines in the classification and measurement area brought the following major changes:

- For the financial assets of the Bank, the credit exposures which have a financial leverage element in their interest structure were identified. In line with IFRS 9 requirements, the cash flows under those assets are not solely payments of principal and interest on the principal amount outstanding, and thus they are obligatorily measured at fair value though profit or loss. As at 1 Jan 2018, the carrying amount of those credit exposures was PLN 278 million. Since the difference in the fair value of those assets versus their measurement at amortized cost (as per IAS 39) is immaterial, the issue does not impact the level of Bank's capital but only disclosures for loans and receivables. Credit exposures classified for measurement at fair value are presented in the statement of financial position in the item 'Loans and other receivables to customers' and their value is shown in the explanatory notes.
- The minority strategic capital investments of the Bank were measured at acquisition price as per IAS 39. The Bank took an irrevocable decision to classify the said capital investments for measurement through other comprehensive income as per IFRS 9. The relevant IFRS 9 guidelines limit the possibility of application of the measurement of those assets as at acquisition price. Recognition of estimated fair value of those cfinancial assets as at the date of initial application of IFRS 9 led to increasing the revaluation reserve at PLN 62.2 million (without tax effect). Adjustment no. 2 in table with the summary of the impact below in section 1.2.4).
- Before application of IFRS 9 principles, some portfolios of assets were reclassified between the financial categories as per IAS 39 guidelines. The Bank made two reclassifications of securities: in 2008 the Bank reclassified a portion of debt securities from available-for-sale financial assets to loans and other receivables category and later, in 2015 the Bank reclassified a portion of debt securities from available-for-sale financial assets to financial assets held to maturity. Fair value of debt securities as of reclassification date constituted their new amortised cost. This meant that the difference between the new amortized cost and the amortization charges was subject to depreciation to the income statement until the date of redemption of securities in the same way as the discount or premium. In addition, gains and losses that were recognized in other comprehensive income prior to reclassification were also subject to depreciation to the income statement. Reclassified assets included the items covered with the fair value hedge accounting wherefor hedge links were invalidated in consequence of reclassification. This

resulted in the necessity to start reverse depreciation valuation adjustment due to hedged risk. As at December 31, 2017, these assets were measured at amortized cost, the implementation of the IFRS 9 standard did not change the method of their valuation. By applying IFRS 9 principles retrospectively, unamortised accounting adjustments made under IAS 39 were removed from the balance sheet. As at 1 Jan 2018, the adjustment had a negative impact on the equity of PLN 77.6 million (without tax effect, Adjustment no. 3 in table with the summary of the impact below in section 1.2.4).

The table below presents the categories of measurement adopted for financial assets and liabilities in accordance with IAS 39 (as at 31 December 2017) and new categories as at 1 January 2018 (in accordance with IFRS 9).

Item in statement of financial position	measurement according to IAS 39	Carrying amount as at 31 Dec 2017 [IAS 39]	Carrying amount as at 1 Jan 2018 [IFRS 9]	measurement according to IFRS 9	Item in statement of financial position
Assets					**Assets**
Cash in hand and balances with the Central Bank	amortised cost	2 815.1	2 815.1	amortised cost	Cash in hand and balances with the Central Bank
Loans and other receivables to other banks	amortised cost	2 234.5	2 234.5	amortised cost	Loans and other receivables to other banks
Financial assets at fair value through profit or loss	FVtPL	530.1	530.1	FVtPL (mandatory)	Financial assets held for trading
Valuation of derivatives	FVtPL	784.7	784.7	FVtPL (mandatory)	Financial assets held for trading
Derivative hedge instruments	FVtPL	967.2	967.2	FVtPL (mandatory)	Derivative hedge instruments
Investments, of which:					
available-for-sale	FVtOCI	17 556.9	17 627.1	FVtOCI	Investment securities
held-to-maturity	amortised cost	8 350.5	8 275.6	amortised cost	Investment securities
Loans and other receivables to customers, of which:					
loans and other receivables	amortised cost	81 242.6	80 703.6	amortised cost	Loans and other receivables to customers
loans and other receivables failed SPPI test	amortised cost	0.0	278.7	FVtPL (mandatory)	Loans and other receivables to customers
corporate and municipal securities	amortised cost	2 532.2	2 532.2	amortised cost	Loans and other receivables to customers
treasury bonds in EUR	amortised cost	3 564.1	3 562.4	amortised cost	Investment securities
Receivables from customers under repo transactions	amortised cost	19.8	19.8	amortised cost	Loans and other receivables to customers
Investments in controlled entity		474.3	466.2		Investments in controlled entity
Other assets	amortised cost	64.4	56.4	amortised cost	Other assets
Total		**121 136.4**	**120 853.6**		
Other assets not covered by IFRS 9		1 202.6	1 254.4		
Total assets		**122 339.0**	**122 108.0**		
Liabilities					**Liabilities**
Liabilities to other banks	amortised cost	1 044.6	1 044.6	amortised cost	Liabilities to other banks
Financial liabilities at fair value through profit or loss	FVtPL	735.1	735.1	FVtPL (mandatory)	Financial liabilities at fair value through profit or loss
Valuation of derivatives	FVtPL	979.2	979.2	FVtPL (mandatory)	Financial liabilities at fair value through profit or loss
Derivative hedge instruments	FVtPL	699.2	699.2	FVtPL (mandatory)	Derivative hedge instruments
Liabilities to customers	amortised cost	104 075.8	104 075.8	amortised cost	Liabilities to customers
Liabilities under issue of debt securities	amortised cost	300.3	300.3	amortised cost	Liabilities under issue of debt securities
Subordinated liabilities	amortised cost	626.9	626.9	amortised cost	Subordinated liabilities
Total		**108 461.1**	**108 461.1**		
Other liabilities not covered by IFRS 9*		2 083.1	2 100.0		
Total liabilities		**110 544.2**	**110 561.1**		

*) in this item the provision for off-balance sheet liabilities, which was changed due to IFRS 9 implementation is included

1.2.2. Hedge accounting

Based on IFRS 9 transitional requirements, the Bank selected the policy which means that it will continue to apply IAS 39 on hedge accounting. On 1 Jan 2018, in annual financial statements the Bank applies new requirements for disclosures concerning the hedge accounting as per amended IFRS 7 'Financial Instruments: Disclosures'.

1.2.3. Impairment

Implementation of IFRS 9 had material impact on the impairment loss estimation methodology for the financial assets measured at amortized cost.

The expected credit loss concept is based on the forward-looking approach. Expected credit losses are measured in the manner factoring in unencumbered and probability-weighted amount set by assessing a series of possible results, considering rational and possible to document information on past events, current conditions and forecasts of future economic conditions. The value of expected credit losses mirrors the impact of a few (most frequently three) macroeconomic scenarios with different probabilities and factors in the change in the time value of money. The new estimation model for expected credit losses applies to financial assets measured at amortised cost, debt financial assets measured at fair value through other comprehensive income and off-balance sheet liabilities and financial guarantees.

To estimate the expected credit losses, the Bank uses the regulatory models of risk parameters estimation, which were built for the Advanced Internal Ratings Based Approach purposes and adapted to IFRS 9 requirements. For the portfolios using the Standard Approach to estimate the regulatory capital, the Bank developed new models to measure the expected credit losses as per IFRS 9.

Approach based on 3 stages

The Bank applies the 3-stage approach to calculate the expected credit losses:

- Stage 1: measurement of the impairment loss being the amount of 12-month expected credit losses versus the financial assets for which no significant credit risk increase was reported (probability of default – PD) from the initial recognition date. Impairment loss in Stage 1 is calculated based on the 12-month expected credit loss, reflecting the expected loss for assets, for which a specific probability of default may materialise within maximum 12 months.
- Stage 2: measurement of the impairment loss being the amount of the lifetime expected credit losses versus the financial assets for which a significant credit risk increase was reported from the initial recognition date. Impairment loss in Stage 2 is calculated based on the lifetime expected credit loss, reflecting the expected loss for assets for which it is probable that they will default in the remaining maturity period.
- Stage 3: measurement of the impairment loss being the amount of the lifetime expected credit losses versus the impaired assets, i.e. in default (PD=100%). Impairment loss in Stage 3 is calculated based on the lifetime expected credit loss.

Stages are defined for each single financial assets item.

Additionally, for POCI assets (*purchased or originated credit-impaired financial assets*) the expected losses are recognised for the lifetime of the instrument. As at the initial recognition date, POCI are recognised at fair value accounting for expected credit losses.

Determining significant increase in credit risk

At each reporting date, the Bank assesses whether credit risk on a given financial instrument has increased significantly since initial recognition. The Bank identifies a significant credit risk increase resulting in the classification of the exposure to Stage 2, based on the following triggers:

- A material increase in the probability of default in the lifetime of the exposure.

- Classification of the client exposure to the 'watch list',
- Forbearance,
- 30 days past due,
- Changed conditions of the issue of the client's bonds due to credit-related reasons,
- The Client has a CHF mortgage loan at ING BSK or another bank.

A material increase in the probability of default in the lifetime of the exposure is the key trigger for Stage 1 to Stage 2 migration. The trigger is set by comparing the probability of default from initial recognition to the probability of default at the reporting date based on the analysis of PD curves, which at the reporting date cover the period to maturity.

Criterion of classification of a financial asset to Stage 3: impairment

Criteria of financial assets classification to Stage 3 under IFRS 9 guidelines are the same as for classification of financial assets to impaired assets under IAS 39 requirements.

Macroeconomic scenarios

Under IFRS 9 requirements, the expected loss should be determined as a probability-weighted amount, which was realised by calculation of the expected credit loss as the weighted average from results for a number of macroeconomic scenarios (usually: optimistic, the best estimation and stress). The expected loss is calculated for each scenario separately and the average probability weighted EL value results from the weights assigned to each scenario

Measurement

Measurement of expected credit losses is based on the model parameters of the expected loss (PD, LGD, EAD) used at present to estimate the regulatory capital, internal capital and collective impairment losses under IAS 39. The models were adjusted by:

- removing prudential conservatism imposed on parameters (such as e.g. the minimum acceptable PD) and
- including expected changes in parameters in the future (PD, LGD, EAD) in the point-in-time approach depending on the changes of macroeconomic indicators, i.e. unemployment rate, GDP growth, real estate price index and interest rate and
- analysis of credit risk in the 12-month horizon or in the lifetime.

Expected credit loss parameters are defined on the basis of historical statistical correlations between the parameters and macroeconomic indicators based on the current macroeconomic forecasts for those indicators. PD, LGD and EAD model parameters were calibrated using the point-in-time approach.

To calculate the expected credit losses, the Bank applies the formula PD x LGD x EAD. For increased credit risk exposures (Stage 2), the lifetime expected loss (LEL) is calculated based on the PD, LGD and EAD parameters estimated also for the exposure lifetime. The Bank defines LEL as a discounted total of partial losses in the exposure lifetime, referring to the events of default in each 12-month time window. For impaired exposures (Stage 3), the PD parameter = 100%, while LGD and EAD parameters reflect the characteristics of the exposures which are in default.

Impact of changes in the impairment principles

Following the application of new IFRS 9 requirements, credit risk impairment loss increased by PLN 286.3 million (without the tax effect and except for adjustment to gross carrying amount described below), including PLN 16.9 million which concerns off-balance sheet items (Adjustment No. 1 in the table with impact below in section 1.2.4).

Gross carrying amount

As a result of IFRS 9 application, the Bank changed its approach to determination of the gross carrying amount for financial assets measured at amortised cost that were classified to Stage 3. The Bank continues to calculate the gross amortised cost for those assets by means of the effective interest rate and by the time those assets have been fully provisioned against expected losses. Due to the changed approach, as at 1 Jan 2018 the gross carrying amount of loans classified to Stage 3 increased by PLN 148.3 million; at the same time expected losses went up by the same amount. The change had no impact on the net value of loans classified to Stage 3 and, consequently, it had no impact on the equity as at the IFRS 9 transition date.

1.2.4. Summary of the IFRS 9 implementation impact on the statement of financial position as at 1 Jan 2018 versus IAS 39 data as at 31 Dec 2017

The table below shows the impact of elements described above on the statement of financial position of the Bank presenting the following adjustments:

- adjustment 1 - IFRS 9 impairment losses
- adjustment 2 - measurement of equity interests
- adjustment 3 - elimination of the impact of historical reclassification of financial instruments
- the amount presented in the column 'reclassification in assets structure' relates to changes in presentation of equity instruments

	31 Dec 2017 IAS 39	Adjustment 1	Adjustment 2	Adjustment 3	Reclassification in assets structure	Impact total	IFRS 9 1 Jan 2018
Assets							
Cash in hand and balances with the Central Bank	2 815.2					-	2 815.2
Loans and other receivables to other banks	2 234.5					-	2 234.5
Financial assets at fair value through profit or loss	530.1					-	530.1
Valuation of derivatives	784.7					-	784.7
Derivative hedge instruments	967.2					-	967.2
Investments	25 907.4		62.2	-74.9	8.0	-4.7	25 902.7
Loans and other receivables to customers	87 338.9	-260.3		-1.7		-262.0	87 076.9
Receivables from customers under repo transactions	19.8					-	19.8
Investments in controlled entities	474.3	-8.1				-8.1	466.2
Non-financial assets	961.3					-	961.3
Assets held for sale	11.1					-	11.1
Deferred tax assets	130.9	49.0	-11.8	14.6		51.8	182.7
Other assets	163.7				-8.0	-8.0	155.7
Total Assets	**122 339.0**	**-219.4**	**50.4**	**-62.0**	**0.0**	**-231.0**	**122 108.0**
Liabilities							
Liabilities to other banks	1 044.6					-	1 044.6
Financial liabilities at fair value through profit or loss	735.1					-	735.1
Valuation of derivatives	979.2					-	979.2
Derivative hedge instruments	699.2					-	699.2
Liabilities to customers	104 075.8					-	104 075.8
Liabilities under issue of debt securities	300.3					-	300.3
Subordinated liabilities	626.9					-	626.9
Provisions	89.9	16.9				16.9	106.8
Current income tax liabilities	220.2					-	220.2
Other liabilities	1 773.0					-	1 773.0
Total liabilities	**110 544.2**	**16.9**	**0.0**	**0.0**	**0.0**	**16.9**	**110 561.1**

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Equity							
Share capital	130.1					-	130.1
Supplementary capital – sale of shares over nominal value	956.3					-	956.3
Cumulative other comprehensive income	493.2		50.4	-40.3	-9.0	1.1	494.3
Retained earnings	10 215.2	-236.3		-21.7	9.0	-249.0	9 966.2
Total equity	**11 794.8**	**-236.3**	**50.4**	**-62.0**	**0.0**	**-247.9**	**11 546.9**
Total equity and liabilities	**122 339.0**	**-219.4**	**50.4**	**-62.0**	**0.0**	**-231.0**	**122 108.0**

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

	Carrying amount as at 31 Dec 2017 [IAS 39]	reclassification	remeasurement	Carrying amount as at 1 Jan 2018 [IFRS 9]
Financial assets				
Financial assets measured at amortized cost				
Cash in hand and balances with the Central Bank	2 815.1			2 815.1
Loans and other receivables to other banks	2 234.5			2 234.5
Investment securities				
opening balance	8 350.5			
reclassification from loans and other receivables		3 564.1		
remeasurement			-76.6	
closing balance				11 838.0
Loans and other receivables to customers				
opening balance	87 358.7			
reclassification to investments		-3 564.1		
reclassification to financial assets at fair value through profit or loss		-278.7		
remeasurement			-260.3	
closing balance				83 255.6
Other assets				
opening balance	64.4			
reclassification to equity instruments measured at fair value through other comprehensive income			-8.0	
closing balance				56.4
Total financial assets measured at amortized cost	**100 823.2**	**-278.7**	**-344.9**	**100 199.6**
Available-for-sale financial assets				
Investment securities				
opening balance	17 556.9			
reclassification to debt instruments measured at fair value through other comprehensive income		-17 551.6		
reclassification to equity instruments measured at fair value through other comprehensive income		-5.3		
Total available-for-sale financial assets	**17 556.9**	**-17 556.9**	**0.0**	**0.0**
Debt instruments measured at fair value through other comprehensive income				
Investment securities				
opening balance	0.0			
reclassification from available-for-sale financial assets		17 551.6		
closing balance				17 551.6
Equity instruments measured at fair value through other comprehensive income				
Investment securities				
opening balance	0.0			
reclassification from available-for-sale financial assets		5.3		
reclassification from other assets		8.0		
remeasurement			62.2	
closing balance				75.5
Total financial instruments measured at fair value through other comprehensive income	**0.0**	**17 564.9**	**62.2**	**17 627.1**

Financial assets measured at fair value through profit or loss				
Valuation of derivatives	784.7			784.7
Other financial assets held for trading	530.1			530.1
Derivative hedge instruments	967.2			967.2
Loans and other receivables to customers				
opening balance	0.0			
reclassification from financial instruments measured at amortized cost		278.7		
closing balance				278.7
Total financial assets measured at fair value through profit or loss	**2 282.0**	**278.7**	**0.0**	**2 560.7**
Investments in controlled entities (measured at equity method)				
opening balance	474.3			
remeasurement			-8.1	
closing balance				466.2
Total financial assets	**121 136.4**	**8.0**	**-290.8**	**120 853.6**
Financial liabilities				
Financial liabilities measured at amortized cost				
Liabilities to other banks	1 044.6			1 044.6
Liabilities to customers	104 075.8			104 075.8
Liabilities under issue of debt securities	300.3			300.3
Subordinated liabilities	626.9			626.9
Total financial liabilities measured at amortized cost	**106 047.6**	**0.0**	**0.0**	**106 047.6**
Financial liabilities at fair value through profit or loss				
Valuation of derivatives	979.2			979.2
Other financial liabilities at fair value through profit or loss	735.1			735.1
Derivative hedge instruments	699.2			699.2
Total financial liabilities at fair value through profit or loss	**2 413.5**	**0.0**	**0.0**	**2 413.5**
Total financial liabilities	**108 461.1**	**0.0**	**0.0**	**108 461.1**

The following table reconciles the closing impairment allowance for financial assets under IAS 39 and provisions for off-balance sheet liabilities as at 31 December 2017 with opening impairment for expected losses determined under IFRS 9 as at 1 January 2018.

	31 Dec 2017 [IAS 39]	reclassification	remeasurement	1 Jan 2018 [IFRS 9]
Impairment for expected losses / Impairment losses				
Loans and other receivables to other banks	**0.2**		**-0.2**	**0.0**
Loans and other receivables to customers, including:	**1 534.5**	**-0.7**	**260.6**	**1 794.4**
measured at amortised cost, including:	1 534.5	-12.6	260.6	1 782.5
loan portfolio, including:	1 533.8	-11.9	260.6	1 782.5
corporate banking (including corporate and municipal securities)	908.0	-11.9	41.3	937.4
retail banking	625.8		219.3	845.1
other receivables (including treasury bonds in EUR)	0.7	-0.7		0.0
measured at fair value through profit or loss *	-	11.9		11.9
Investments / Investment securities, including:	**1.5**	**0.7**	**-0.1**	**2.1**
Investment securities held-to-maturity	1.5	-1.5		0.0
Investment securities measured at amortised cost	-	2.2	-0.1	2.1
Provisions for off-balance sheet liabilities	**45.9**		**16.9**	**62.8**
Total	**1 582.1**	**0.0**	**277.2**	**1 859.3**

*) Loans and other receivables not meeting SPPI criteria as at 1 January 2018 r were reclassified to Loans and other receivables measured at fair value through profit or loss. The impairment loss was reflected as a credit risk component in the valuation of these loans to fair value.

1.2.5. Impact on the capital requirements

Application of IFRS 9 principles impact the regulatory capital of the Bank due to recognition of recording adjustments caused by changed accounting principles at the date of initial application. The Basel Committee pointed out that the approach to impairment losses both in the Standard Approach and Advanced Internal Ratings Based Approach remains unchanged. Nonetheless, for domestic jurisdictions, the application to impairment losses of the option of amortisation of impact of the implementation of new IFRS 9 principles is admitted.

On 12 Dec 2017, Regulation (EU) 2017/2395 of the European Parliament and of the Council amending Regulation (EU) No. 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State was published. The regulation is to apply a progressive transition period which would mitigate the impact of a new model of IFRS 9 provisions by reversing a part of a negative impact of IFRS 9 on the Tier 1 capital.

The transition period lasts 5 years at maximum and starts in 2018. Some forecasted provisions for credit losses which may be reversed in the Tier 1 capital should over time go down to zero to ensure the full implementation of IFRS 9 at the date immediately following the transition period (in 2018: 0.95; in 2019: 0.85; in 2020: 0.7; in 2021: 0.5; in 2022: 0.25).

Taking a decision to apply transitional solutions entails the need of adequate notification of a competent authority. In the transitional period, the decision made can be reversed once, provided a prior approval of the relevant authority thereof is obtained.

The Bank resolved to use the transitional solutions discussed hereinabove. In the transitional period, the Bank will make disclosures of own funds, capital ratios as well as the leverage ratio considering and not considering the impact on above-referred transitional solutions.

As at 1 Jan 2018 the total impact of application of new IFRS 9 principles on Tier 1 ratio (in bp) was 36 bp without a transition period applied. Considering the transition periods, the impact as at 1 Jan 2018 was 4 bp.

2. Going-concern

These annual financial statements of the ING Bank Śląski S.A. were prepared on a going-concern basis as regards the foreseeable future, namely as regards the period of minimum 12 months from the balance sheet date. As at the approval date hereof, the Bank Management Board have not identified any events that could pose a threat to the Bank continuing their operations

3. Discontinued operations

No material operations were discontinued during 2018 and 2017.

4. Financial statements scope and currency

The Bank is the parent company of ING Bank Śląski Group and besides these financial statements it also produces the consolidated financial statements compliant with IFRS.

These annual financial statements have been prepared in Polish Zloty ("PLN"). Unless provided for otherwise, all values were given rounded up to PLN million. Therefore, some totals and individual notes can be inconsistent in mathematical terms.

5. Reporting period and comparable data

These annual financial statements of the Bank cover the period from 1 January 2018 to 31 December 2018 and include the comparative data:

- the statement of financial position as at 31 December 2017 and 31 December 2016,

- items from the statement of financial position as at 31 December 2017,
- items in the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the period from 1 January 2017 to 31 December 2017.

In connection with the implementation from 1 January 2018 of IFRS 9 replacing IAS 39, the Bank took a decision to apply retrospectively the principles of classification, measurement and impairment through the adjustment of the opening balance sheet as at 1 Jan 2018, without adjusting comparative periods.

III. Significant accounting principles

IFRS provide for the selected accounting policies that may be applied. The key areas where IFRS allow the entity to select the policy and which refer to the Bank Accounting Policy are:

- selection of accounting policy to continue to apply the hedge accounting requirements of IAS 39,
- selection of accounting policy for valuation of buildings and land at revalued amount, being its fair value at the balance sheet date. Increase in fair value is recognised in the revaluation reserve (other comprehensive income). Decrease in fair value is carried through the income statement.

The Bank Accounting Policy complies with IFRS. Bank decisions as to the admissible policy selection are presented below.

1. Basis for preparation of consolidated financial statements

The concept of fair value has been applied in the statements for own real property as well as financial assets and liabilities measured at fair value, including derivative instruments, and financial assets classified as measured at fair value through other comprehensive income, excluding those for which the fair value cannot be determined in a reliable manner. Other items of financial assets are presented at amortized cost less impairment or at purchase price less impairment.

Non-current assets held for sale are recognised at the lower of their carrying amount and the fair value less sales costs.

2. Professional judgement

In the process of accounting principles application to the matters discussed hereinbelow, besides the booking estimates professional judgment of the management staff was of key significance.

2.1. Deferred tax assets

The Bank recognizes deferred tax assets, provided that it is probable that tax profit will be earned in future periods allowing their utilisation. The assumption would prove unjustified should tax results deteriorate in the future.

2.2. Classification of leases

Leases are classified by the Bank as operating or financial leases based on the extent whereto the risk and benefits due to holding of leased asset are attributable to lessor and lessee. The substance of each transaction is used to make the said assessment.

2.3. Classification of financial assets

Accounting principles in force prior to the 1 January 2018 (IAS 39)

Classification of financial assets as financial assets held to maturity

The Bank classifies debt securities as assets held to maturity, based on the assumption that they can be held until maturity.

Accounting principles in force from 1 January 2018 (IFRS 9)

The Bank classifies financial assets on the basis of both the business model for holding the financial assets and assessment whether under the contractual terms require solely payments of principal and interest on the principal amount outstanding.

The detailed information about assumptions in this regard is presented in item 7.

3. Accounting estimates

The development of financial statements in accordance with IFRS requires from the Bank the use of estimates and assumptions that affect the amounts reported in the financial statements and notes thereto.

Estimates and assumptions applied to the presentation of value of assets, liabilities, income and costs are made on the basis of historical data available and other factors considered to be relevant in given circumstances. The assumptions applied for the future and available data sources are the base for making estimates regarding the carrying amount of assets and liabilities, which cannot be determined explicitly on the basis of other sources. The estimates reflect the reasons for/ sources of uncertainties as at the balance sheet date. The actual results may differ from estimates.

The estimates and assumptions are reviewed on an on-going basis. Adjustments to estimates are recognized in the period when the estimate was changed provided that the adjustment applies to this period alone or in the period when the estimate was changed and in the following periods, should the adjustment impact both the current and future periods.

Below are the most significant booking estimates made by the Bank.

3.1. Impairment

The Bank assesses whether there is objective evidence of impairment of financial assets individual items or groups) and non-current assets as at balance sheet date.

Accounting principles in force prior to the 1 January 2018 (IAS 39)

Impairment of financial assets

Objective evidence of impairment of financial assets stems from occurrence of one or more events which have a direct impact on valuation of future asset-related cash flows.

The estimates can take into account observable data indicating occurrence of unfavourable payment situation on the part of borrowers from a certain group or unfavourable economic situation of a given country or its part, which translates into the problems sustained by this group of assets.

For significant assets classified to the ISFA portfolio (Individually Significant Financial Assets), impairment is calculated as a difference between the present value of a credit exposure and expected discounted future cash flows for a given exposure.

For assets from IBNR (Incurred But Not Reported) and INSFA (Individually Non-Significant Financial Assets) portfolios, current exposure is computed with the use of PD, EAD and LIP parameters.

To determine impairment (or reverse it), the present value of expected future cash flows has to be calculated.

The methodology and assumptions used to estimate both the amount and the time of future cash flows are regularly reviewed and adjusted as needed.

Accounting principles in force from 1 January 2018 (IFRS 9)

3.1.1. Impairment of financial assets

The Bank applies IFRS 9 requirements regarding impairment in order to recognize and measure the loss allowance for expected credit losses on financial assets that are measured at amortized cost or at fair value through other comprehensive income.

The expected losses are measured as the probability-weighted average from several macroeconomic scenarios with different probability. The final level of the provisions results from the sum of the expected credit losses estimated each year in the future till the maturity date including discount.

To determine impairment (or reverse it) in the ISFA (Individually Significant Financial Assets) portfolio, the present value of expected future cash flows has to be calculated. The amount of the future cash flows is determined among others taking account of the information about the current and forecasted economic standing of the borrower, the forecast value of the recovery amount form the legal collaterals of the credit exposure and the macroeconomic conditions.

The methodology and assumptions used to estimate both the amount and the time of future cash flows are regularly reviewed and adjusted as needed.

During the year, the Bank introduced changes to selected elements of estimating expected losses, including determination of behavioral maturity for revolving credit exposures and taking into account the pre-payment ratio. The total impact of the introduced changes on the level of expected loss amounted to PLN -8.5 million (reduction of allowances expected losses).

Some examples of impairment triggers for financial assets, methodology of impairment computation and the recording rules applied thereto are described in item 7.13 Impairment.

The reportable expected losses are significantly impacted by assumptions which require estimations and professional judgement, concerning in particular:

- criteria for identifying a significant increase in credit risk and
- macroeconomic forecasts used as inputs to expected losses estimation model and probability weights applied to each of macroeconomic scenarios.

Criteria for identifying a significant increase in credit risk

All assets in scope of IFRS 9 impairment and which are subject to collective expected losses assessment (ECL) are allocated a 12 month ECL if deemed to belong in Stage 1, or a lifetime ECL if deemed to belong in Stage 2. An asset belongs in Stage 2 if it is considered to have experienced a significant increase in credit risk since initial origination. The stage allocation depends mainly on the change of probability of default (PD) in relation to established threshold. As at 31 December 2018, the Bank reports total expected losses under collective-assessment in Stage 1 and 2 of PLN 520.3 million.

The setting of PD threshold requires management judgement, and is a key source of estimation uncertainty for expected losses. To demonstrate the sensitivity of the ECL to these PD threshold, the Bank estimated expected losses in Stage 1 and 2, which assumed:

- all assets were below the threshold, and apportioned a 12 month ECL and
- all assets were above the threshold and apportioned a lifetime ECL.

This gave rise to a hypothetical collective-assessment ECLs lower by ca. PLN 245 million and higher by ca. PLN 620 million, respectively.

It should be noted that the relative PD change is not the only driver of stage allocation among Stage 1 and 2. In addition, an asset can be transferred to Stage 2 by virtue of being a watchlist, being forborne, in arrears, etc. as described in Chapter II *Statement of compliance with International Financial Reporting Standards*, in point 1.2.3 *Impairment.*

Macroeconomic forecasts and probability weights applied to each of macroeconomic scenarios

GDP, unemployment rate and real estate price changes index are considered key macroeconomic factors that impact on the loan loss provisions. This is supported by statistical analysis made by the Bank. The forecasts of these macroeconomic factors are used in the estimation of un-weighted expected losses, which afterwards are assigned with the following weights, 20% for downside scenario, 60% for baseline scenario and 20% for upside scenario.

The table below presents the macroeconomic forecasts applied as at 31 December 2018 of key factors and the difference of expected losses in upside, baseline and downside scenarios to reported expected losses, which are weighted with scenario probability.

		2019	2020	2021	Un-weighted ECL– difference to reported ECL in %	Scenario weight	Reported ECL – collective ECL in Stage 1, 2 and 3
Upside scenario	GDP	4.4	6.2	5.1	-9%	20%	1 433.3
	Unemployment	3.1	2.4	1.9			
	RHP	9.0	9.8	8.1			
Baseline scenario	GDP	3.6	3.2	3.0	-2%	60%	
	Unemployment	3.5	3.5	3.4			
	RHP	8.2	5.7	5.6			
Negative scenario	GDP	1.5	-0.4	0.6	+14%	20%	
	Unemployment	5.0	6.2	7.0			
	RHP	3.7	1.3	5.4			

3.1.2. Impairment of other non-current assets

For non-current assets, valuation is based on estimating the recoverable amount of non-current assets being the higher of their value in use and net realisable value at the review date.

The value in use of an item of non-current assets (or a cash-generating unit when the recoverable amount of an asset item forming joint assets cannot be determined) is estimated, among others, through adoption of estimate assumptions for amounts, times of future cash flows which the Bank may generate from a given non-current assets item (or a cash-generating unit) and other factors. To determine the value in use, the estimated future cash flows are discounted to their present value at pre-tax discount rate, which reflects the current market expectations as regards value of money and the specific risk of a given assets item.

When estimating the fair value less costs of sale, the Bank makes use of relevant market data available or valuations made by independent appraisers which are based on estimates by and large.

The relevant recording rules were delineated in item 8.4. Impairment of other non-financial assets.

3.2. Credit risk connected with derivatives

The approach employed by the Bank to estimate credit risk for derivatives with future settlement date (active deals unsettled as at the balance sheet date) is consistent with its approach to assessing credit risk for financial markets products.

For details of fair value measurement of derivatives considering credit risk, see item 7.10. Derivatives and hedge accounting.

3.3. Measurement of financial instruments not quoted in active markets

The fair value of financial instruments not quoted in active markets is measured using valuation models. For non-option derivatives, the models based on discounted cash flows apply. Options are measured using appropriate option valuation models.

Valuation models used by the Bank are verified prior to their usage. Where possible, in models the Bank uses observable data from active markets. However, in certain circumstances, to choose the right valuation parameter, the Bank makes an estimate by comparing a given instrument to another one present in another market but having similar or identical features. Application of the prudence principle requiring to choose the lower value of assets and the higher value of liabilities as being more probable – especially in the conditions of lower liquidity or/and volatility in financial markets – is fundamental in the valuation made under this approach. Change of assumptions concerning these factors may impact valuation of some financial instruments.

3.4. Provisions for retirement and pension benefit

The Bank establishes the provisions for retirement and pension benefit in accordance with IAS 19. The provision for retirement and pension benefit awarded as part of the benefits under the Labour Code regulations is calculated using the actuarial method by an independent actuary as the present value of the future long-term Bank's obligations towards its employees considering the headcount and payroll status as at the update date.

The provisions are calculated based on a range of assumptions, relating to both discount rates and projected salary rises as well as to staff rotation, death risk and others. The assumptions are verified as at the end of the accounting year.

The table below shows model sensitivity to the values adopted for individual assumptions.

	Provisions for retirement and pension benefit		
	Lower bracket	**Base variant**	**Upper bracket**
Discount Rate (+1% / base variant / - 1%)	35.09	38.84	43.28
Salary raise (-0.25% / base variant/ +0.25)	37.83	38.84	39.89

3.5. Valuation of incentive schemes

3.5.1. Valuation of variable remuneration programme benefits

As at the balance sheet date, the Bank presents in the books the estimated present value of benefits to be rendered under the variable remuneration programme. Benefits will be granted to employees covered with the programme, based on their performance appraisal for a given year. The programme was launched in 2012.

Benefits granted as phantom stock are valued with the use of the median of closing prices of Bank's shares on the Warsaw Stock Exchange during a certain period.

The fair value of the deferred benefit element is adjusted with the reduction factor which accounts for probability of occurrence of an event requiring adjustment of the value of the granted benefit which the employee is not fully eligible to as at the balance sheet date. The catalogue of events has been defined in the programme assumptions.

The present value of the said benefits is determined at market discount rate.

3.5.2. Valuation of options granted under ING Group incentive scheme benefits

The fair value of the options granted under the ING Group incentive scheme was measured with the Monte Carlo simulation. The model takes the risk-free interest as well as the expected exercise date for the options granted, the option exercise price, the present option price, the expected volatility of ING Group's share certificates and the expected dividend yield.

The ING's incentive scheme determines the volatility used to price stock options, which is defined by the volatility of market data and not the historical volatility.

3.6. Residual value of leased assets

The expected residual value is usually the agreed future price of non-current asset purchase by the client after the end of the leasing term. The value is calculated as at the leasing commencement, based on the non-current asset initial value. The residual values are usually established based on certain contractual amount and recognized in net leasing investment position. Recovery of non-current asset residual value in leasing operations depends on the fulfilment of terms and conditions of leasing contract and completion thereof.

3.7. Amortisation period and method for intangible assets

The amortisation period and method for intangible assets are verified at the end of each accounting year. Changes to the useful life or expected pattern of consumption of the future economic benefits embodied in the intangible asset are recognised by changing the amortisation period and method, accordingly. The said changes are accounted as changes to estimates. The useful life for the intangible assets created under strategic projects was determined as 5 years.

Strategic applications are made under strategic projects that are key to the Bank's operations. The Bank established the capitalisation limit for purchase (PLN 440,000) or in-house production (PLN 10 million) of computer software.

3.8. Business combinations

3.8.1. Assumption of control over an entity subject to common control under IFRS 3

In order to recognise the fact of control assumption over the entity subject to common control under IFRS 3 in the financial statements the Bank applies the approach consistent with the terms and conditions of the approach whereunder shares are consolidated under the Accounting Act of 29 September 1994, following implementation of IAS 8 guidelines.

Under this approach, individual items of relevant assets and liabilities of the combined subsidiary are included in the standalone financial statements of the Bank according to values recognized in the consolidated financial statements of the dominant entity as at the combination date.

The Bank adopted the approach whereunder comparable data are not adjusted when control is assumed over an entity subject to common control under IFRS 3.

3.8.2. Assumption of control over an entity other than the ING Group member

The acquisition approach is applied when settling the purchase of entities from non-associated parties. At the acquisition date, the Bank recognizes, separately from goodwill, purchased identifiable assets and taken over identifiable liabilities, taking into account recognition criteria and all non-controlling interests in the acquired entity.

4. Measurement of investments in subsidiaries and associates in the separate financial statements

In the separate financial statements of the Bank, investments in subsidiaries and associates of the Bank are recognised at purchase price and then settled using the equity method. The Bank's investment includes goodwill (net of any accumulated impairment losses) identified upon acquisition.

The share of the Bank in the financial result of subsidiaries and associates since the date of acquisition is recognised in the income statement, whereas its share in changes in other capital since the date of

acquisition – in other comprehensive income. The carrying amount of the investment is adjusted by the total changes of different items of equity after the date of their acquisition.

When the share of the Bank in the losses becomes greater than the share of the Bank in that subsidiary or associate, the Bank discontinues the recognition of any further losses or creates provisions only to such amount it has assumed obligations or has settled payments on behalf of the respective company.

Unrealised profits on the transactions made by the bank with those units are eliminated pro rata to the Bank's share in those units. Unrealised losses are also eliminated, unless the transaction proves impairment occurrence for the assets item transferred.

At the end of each reporting period, the Bank always assesses whether there are impairment triggers in place for the investments made in subsidiaries and associates.

When a trigger is found, the Bank assesses the recoverable amount; i.e., the value in use of the investment or fair value less the costs of sale of the assets item, depending on which of the two is higher. If, the recoverable amount of an asset is less than its carrying amount, the Bank recognises the impairment loss in the income statement.

5. Foreign currency

5.1. The functional currency and the presentation currency

The items contained in presentations of particular units of the Bank are priced in the currency of the basic economic environment in which a given entity operates (the "functional currency"). These financial statements are presented in Polish Zloty, which is the functional currency and the presentation currency of the Bank.

5.2. Transactions in foreign currency

Transactions expressed in foreign currencies are translated at FX rate prevailing at the transaction date. The financial assets and liabilities, being result of the said transactions and denominated in foreign currencies are translated at the FX rate prevailing on a given day. The foreign exchange differences resulting from the settlements of the said transactions and the balance sheet valuation of the financial assets and liabilities denominated in foreign currency are recognized in the statement of profit or loss under the specific item FX result, which is an element of Net income on financial instruments at fair value through profit or loss and FX result.

Foreign exchange differences under changes to the fair value of financial instruments classified as financial assets at fair value through other comprehensive income are recognized in the revaluation reserve for the financial assets assigned to this financial category.

6. Financial assets and liabilities

6.1. Initial recognition

The Bank recognizes financial assets or liabilities on the statement of financial position when, and only when it becomes a party to the contractual provisions of the instrument.

Purchase and sale transactions of financial assets carried at amortized cost, at fair value through other comprehensive income and at fair value through profit or loss are recognized, in accordance with accounting policies applied to all transactions of a certain type, at the settlement date, the date on which the asset is delivered to an entity or by an entity. Loans and receivables are recognized upon disbursement of funds to the borrower.

When a financial asset or financial liability is recognized initially, it is measured at its fair value plus, in the case of a financial asset or financial liability not carried at fair value through profit or loss,

transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

6.2. Classification of financial assets

Accounting principles in force prior to the 1 January 2018 (IAS 39)

Classification

The Bank classifies financial instruments to the following categories: financial assets and liabilities at fair value through profit or loss, loans and receivables, investments held to maturity and available for sale financial assets.

Financial assets and liabilities valued at fair value through profit and loss

These are financial assets or financial liabilities that meet either of the following conditions:

- *are classified as held for trading. A financial assets item or financial liability is classified as held for trading if it is: acquired or incurred principally for the purpose of selling or repurchasing it in the near term or is a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also classified as held for trading (other than those that are designated and effective hedging instruments),*
- *upon initial recognition they are classified by the Bank as carried at fair value through profit or loss. Such designation can be made only if:*
  - *the designated financial asset or financial liability is a hybrid instrument containing one or many embedded derivatives, which qualify for separate recognition and embedded derivatives cannot change significantly the cash flows resulting from the host contract or separation of embedded derivative is forbidden;*
  - *usage of such classification of financial asset or liability eliminates or decreases significantly the inconsistency of measurement or recognition (so called accounting mismatch due to various methods of assets and liabilities valuation or various recognition of gains and losses attributable to them);*
- *the group of financial assets and liabilities or both categories is managed properly, and its results are measured using fair value, in accordance with documented risk management principles or the Bank's investment strategy.*

Investment held to maturity

Those are the financial assets other than derivatives with payments specified or possible to specify and with the maturity date specified, other than those defined as loans or receivables, which the Bank intends to and is able to hold by the maturity date.

In case of sale or reclassification of more than an insignificant amount of held-to-maturity investments in relation to the total held-to-maturity investments before maturity all the assets of this category are reclassified to the available for sale category. In such a case, the Bank must not classify any financial assets as investments held to maturity for 2 years.

The above mentioned sanction is not applied:

- *if sale was so close to maturity, that changes in the market rate of interest would not have a significant effect on the asset's fair value,*
- *if the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments, or*
- *for an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.*

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- *those that the entity intends to sell immediately or in the near term, which are classified as held for trading, and those that the entity upon initial recognition designates at fair value through profit or loss;*
- *those that the entity upon initial recognition designates as available for sale;*
- *those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available for sale.*

Loans and receivables include credit facilities and cash loans granted to other banks and clients including repurchased debt claims, debt securities reclassified from the portfolio of financial assets available for sale and debt securities not listed on the active market, that satisfy the definition of loans and receivables.

Financial assets available for sale

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Accounting principles in force from 1 January 2018 (IFRS 9)

The Bank classifies financial assets to one of the following categories:

- measured at amortised cost,
- measured at fair value through other comprehensive income and measured at fair value through profit or loss.

Financial assets measured at amortised cost

Financial asset shall be measured at amortised cost if both of the following conditions are met and is not designated to be measured at fair value through profit or loss:

- the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Debt financial assets measured at fair value through other comprehensive income

Financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met and it is not designated for measurement at fair value through profit or loss:

- the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and sell financial assets and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Equity instruments measured at fair value through other comprehensive income

Equity instruments shall be measured at fair value through other comprehensive income in case the Bank makes an irrevocable election at initial recognition for particular investment in equity instruments that it will be measured at fair value through other comprehensive income.

Financial assets measured at fair value through profit or loss

All financial assets that do not fulfil the conditions for classification to financial assets at amortised cost, debt financial assets at fair value through other comprehensive income or equity instruments measured at fair value through other comprehensive income, are classified to financial assets measured at fair value through profit or loss.

In addition, Bank may, at initial recognition, irrevocably designate a financial asset for measurement at fair value through profit or loss, even though it fulfils conditions for classification to financial assets at amortised cost or financial assets at fair value through other comprehensive income. The necessary condition is to confirm that such designation is aimed at elimination or significant reduction of an accounting mismatch that would otherwise arise.

6.2.1. Business model assessment

The Bank assesses the objectives of the business model at the level of the Bank's unit that manages financial assets and is a so-called business owner of the particular financial assets portfolio.

The following business models are identified for managing the financial assets i.e. in order to:

- collect contractual cash flows,

- collect contractual cash flows and sell financial assets,
- other (e.g.: in order to maximize profits on sales).

The business models are established at the level which is the best reflection of the Bank approach to management of financial assets in order to fulfil business objectives and generate cash flows.

During assessment, the Bank verifies all areas of Bank's units activities identified as business owners of a particular portfolio of financial assets and which may have influence on the decisions taken with regard to holding assets in the Bank's portfolio, including but not limited to:

- assumptions of the product offer,
- organisational chart of a Bank's unit,
- assumptions of assessment of the performance of the particular assets portfolio (e.g.: approach to planning, management information assumptions, key assessment indicators),
- approach to compensation of the key managers in relation to portfolio performance or cash flows generated on the portfolio,
- the risk generated by the assets portfolio and approach to management of those risks,
- assessment of sales activities from assets portfolio (frequency, volume and reasons for the sales), and
- assessment of expectations regarding sales activities in the future.

The Bank permits the sales of financial assets held to collect contractual cash flows, due to the following reasons:

- increase of credit risk,
- sales close to maturity,
- infrequent sales,
- sales insignificant in value,
- in response to regulatory/supervisory requirements,
- liquidity crisis (stress case scenario),
- change of the credit limit of the particular borrower.

The Bank took the following assumptions:

- Sales close to maturity means the sales of financial assets whose:
  - original maturity is more than 1 year and sales occurs less than 6 months before maturity date,
  - original maturity is less than 1 year and sales occurs less than 3 months before maturity date.
- Infrequent sales means the sales activities at level below 10% of sales transactions in relation to average number of sales transactions in a particular business model;
- Insignificant in value means sales activities at the level less than indicator computed based on a quotient of 10% and average maturity of the assets portfolio in relation to:
  - quotient of carrying amount of sold assets to carrying amount of the entire portfolio in a particular business model, or
  - quotient of realised result from sales transaction to net interest margin of the entire portfolio held within particular business model.

6.2.2. Assessment of cash flow characteristics

In order to assess the cash flow characteristics the Bank formulated the following definitions:

- principal – means fair value of the financial asset at initial recognition in Bank's books,
- interest – means the payment including consideration for:

- time value of money,
- credit risk resulting from principal amount outstanding within a specified period,
- other basic lending risks and costs (e.g. liquidity risk and administrative costs), and
- profit margin.

The assessment is to confirm that the realized cash flows are solely repayment of principal and interest on the principal amount outstanding. The Bank verifies the contractual terms, which have influence on the timing of realized cash flows and the amount of the cash flow realised on particular financial asset.

In particular Bank verifies the following conditions:

- contingent events which have influence on the timing and the amount of cash,
- leverage,
- prepayment or funding extension conditions,
- non-recourse conditions for the realized cash flows,
- terms that modified the consideration for time value of money.

The assessment of the conditions that modified the time value of money is conducted based on qualitative or quantitative analysis.

In case the qualitative assessment does not provide the conclusions as to the realized cash flow characteristics, the Bank performs a quantitative assessment. The quantitative assessment is based on comparison of the difference between:

- undiscounted contractual cash flows and
- undiscounted cash flows that would arise at benchmark asset that not include the conditions modifying consideration for time value of money.

If the difference between assessed cash flows is significant, then the verified asset will be obligatorily classified to measurement at fair value through profit or loss, as the realised cash flows are not solely repayments of principal and interest on principal amount outstanding.

6.3. Classification of financial liabilities

The Bank classifies financial assets to the one of the following categories:

- measured at fair value through profit or loss,
- measured at amortised cost,
- financial guarantees.

6.3.1. Financial liabilities at fair value through profit or loss

Derivatives that are liabilities and financial liabilities from short position in debt securities are measured at fair value through profit or loss after initial recognition.

6.3.2. Other financial liabilities

Financial liabilities being a contractual obligation to deliver cash or other financial asset to another entity not carried at fair value through profit or loss, being a deposit or loan received or a financial liability recognised in the result on financial asset sales transaction that cannot be derecognised from the balance sheet.

6.3.3. Financial guarantees

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss they incur because a specified debtor fails to make repayment when due in accordance with the original or modified terms of a debt instrument.

6.4. Derecognition

The Bank derecognizes a financial asset when, and only when: the contractual rights to the cash flows from the financial asset expire or the Bank transfers the financial asset and the transfer qualifies for derecognition.

The Bank transfers a financial asset if and only if in either:

- transfer the contractual rights to receive the cash flows or
- retains the contractual rights to receive the cash flows but assumes a contractual obligation to pay the cash flows.

When the Bank retains the contractual rights to receive the cash flows, but assumes a contractual obligation to pay those cash flows, the Bank treats the transaction as a transfer of financial assets if and only if, all the following tree conditions are met:

- the Bank has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset,
- the Bank is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipient for the obligation to pay them cash flows,
- the Bank has an obligation to remit any cash flows it collects from original asset during the short settlement period from the collection date to the date of required remittance to the eventual recipients.

On transferring the financial asset, the Bank evaluates the extent to which it retains the risks and rewards of ownership of the financial asset. Accordingly, where the Bank:

- transfers substantially all the risks and rewards of ownership of the financial asset, it derecognizes the financial asset,
- retains substantially all the risks and rewards of ownership of the financial asset, it continues to recognize the financial asset,
- neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, then the Bank determines whether it has retained control of the financial asset. In this case if the Bank has retained control, it continues to recognize the financial asset, and if the Bank has not retained control, it derecognizes the financial asset to the extent of its continuing involvement in the financial asset.

The Bank derecognizes a financial liability (or part of a financial liability) from its balance sheet when, and only when the obligation specified in the contract is satisfied or cancelled or expires.

The Bank derecognizes financial assets or their part, if the rights pertaining to the financial assets expire, the Bank waives such rights, sells those receivables, they are cancelled or as a result of significant modification of the loan or cash loan contractual terms.

The Bank most frequently directly reduce the gross carrying amount of a financial asset when the Bank has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof.

The amounts of receivables written down as loss and recovered thereafter reduce the value of impairment loss in the statement of profit or loss. The Bank does not conduct any significant activity related to with debt collection for derecognized receivables.

6.5. Modification of contractual cash flows

Accounting principles in force prior to the 1 January 2018 (IAS 39)

The Bank derecognizes loans and receivables or their part, if the rights pertaining to the loan agreement expire, the Bank waives such rights, sells the loan or when as a result of modification of the terms and conditions of the loan or cash loan agreement the current value of future cash flows of the primary exposure and the post-modification exposure differs by more than 10%.

Accounting principles in force from 1 January 2018 (IFRS 9)

When the terms of the loan and cash loan agreements are renegotiated and contractual cash flows of a financial asset are modified, the Bank assesses if such modification was significant and should result in the derecognition of that financial asset.

The Bank assumes that such significant modification of the terms of the agreement will take place in case of a:

- change of the debtor with the consent of the Bank
- change of the legal form/type of the financial instrument or
- change of loan currency unless it was included in contractual terms.

In case of non-significant modification which does not result in derecognition of financial assets, the Bank recalculates gross carrying amount of the financial asset and it recognises a modification gain or loss in profit or loss.

6.6. Measurement

Accounting principles in force prior to the 1 January 2018 (IAS 39)

After initial recognition, the Bank measures financial assets, including derivatives that are assets, at their fair values, except for the following financial assets:

- *loans and receivables which are measured at amortized cost using the effective interest method,*
- *held-to-maturity investments which are measured at amortised cost using the effective interest method,*
- *investments in equity instruments that do not have a quoted market price in an active market and their fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which are measured at cost.*

Accounting principles in force from 1 January 2018 (IFRS 9)

After initial recognition, the Bank measures financial assets, including derivatives that are assets, at their fair values, except for the financial assets at amortized cost using the effective interest method.

After initial recognition, all financial liabilities are measured at amortised cost using the effective interest method, except for:

- financial liabilities carried at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, are measured at fair value, in particular a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument,
- financial liabilities resulting from the transfer of a financial asset which do not qualify for derecognition or which are recognized on a continuing involvement basis.
- commitments to provide a loan at a below-market interest rate which it shall subsequently measure it at the higher of:
  - the amount of the loss allowance and
  - the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with principles of IFRS 15
- contingent consideration recognised by the Bank acting as an acquirer in a business combination to which IFRS 3 applies, which it shall subsequently be measured at fair value through profit or loss.

Other financial liabilities are measured at amortised cost or the amount of due payment.

Granted financial guarantees are measured at the higher of:

- the amount being the most appropriate estimate of the expenditures needed to fulfil the current obligation arising from the financial guarantee, upon consideration of the probability of materialisation thereof;

- the amount recognized at the initial recognition, adjusted with the settled amount of commission received for granting the guarantee.

6.7. Reclassification

Accounting principles in force prior to the 1 January 2018 (IAS 39)

A particular financial asset classified as available-for-sale may be reclassified from this category should it fulfil the definition of loans and receivables and should the Bank intend and be able to maintain this financial asset in the foreseeable future or until its maturity. Fair value of the financial asset on the reclassification date is deemed as its new cost or new amortised cost, respectively.

In the event of a maturing financial asset, the profits or losses recognized as equity until the date of reclassification are amortised and carried through the income statement for the remaining term until maturity. All differences between the new amortised cost and the amortisation amount are amortised for the remaining term until the instrument's maturity, similarly to the amortisation of premium or discount. Amortisation is based on the effective interest rate method.

Accounting principles in force from 1 January 2018 (IFRS 9)

A particular financial asset may be reclassified to another financial category only if the business model changes. In such case, that financial asset is transferred to financial category in accordance with current business model.

Reclassification shall apply prospectively (i.e. from reclassification date).

In case of reclassification of:

- financial asset at amortised cost to financial asset at fair value through profit or loss, its fair value is measured as at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognized in profit or loss;
- financial asset at fair value through profit or loss to financial asset at amortised cost, its fair value as at the reclassification date becomes its new gross carrying amount and will be amortised according to general rules;
- financial asset at amortised cost to financial asset at fair value through other comprehensive income, its fair value is measured as at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognized in other comprehensive income;
- financial asset at fair value through other comprehensive income to financial asset at amortised cost– the cumulative gain or loss previously recognized in other comprehensive income is removed from equity and adjusted against the fair value of the financial asset. The financial asset is measured at the reclassification date as if it had always been measured at amortised cost;
- financial asset at fair value through profit or loss to financial asset at fair value through other comprehensive income measurement category, the financial asset continues to be measured at fair value and the measurement is carried through equity;
- financial asset at fair value through other comprehensive income to financial asset at fair value through profit or loss – the cumulative gain or loss previously recognized in other comprehensive income is removed from equity to profit or loss as reclassification adjustment in accordance with IAS 1.

6.8. Gains and losses resulting from subsequent measurement

A gain or loss arising from a change in the fair value of a financial asset or financial liability that is not part of a hedging relationship is recognized, as follows:

- a gain or loss on a financial asset or financial liability classified as at fair value through profit or loss is recognised in the statement of profit or loss;

- a gain or loss on an asset at fair value through other comprehensive income is recognized directly in equity through statement of changes in equity.

Interest calculation using the effective interest rate method

Accounting principles in force prior to the 1 January 2018 (IAS 39)

The interest calculated using the effective interest rate method is recognised in the income statement.

As of impairment of items of financial assets or a group of financial assets, the Bank carries the amount of contractual interest not paid at the impairment date through profit or loss. Since then, the Bank accrues interest on the items of financial assets or a group of financial assets less the impairment charge. Interest is accrued at the interest rate used to calculate the impairment charge for the financial assets affected. Later, the value is adjusted with the contractual interest paid in a given period.

Accounting principles in force from 1 January 2018 (IFRS 9)

The interest income is calculated using the effective interest rate method. The relevant value is computed by applying the effective interest rate method to gross carrying amount of financial asset, except for:

- the purchased or originated credit-impaired financial assets. The Bank applies the credit risk adjusted effective interest rate to the value of amortised cost of a financial asset as of the initial recognition;
- financial assets that are not purchased or originated credit-impaired financial assets which subsequently became credit-impaired financial assets (Stage 3).

For those financial assets the Bank applies the effective interest rate to the value of amortised cost (net) of a financial asset in subsequent reporting periods.

Non-interest elements

Dividends on an equity instrument are recognised in the statement of profit or loss when the entity's right to receive payment is established.

Foreign exchange gains and losses arising from a change in the fair value of a financial asset at fair value through other comprehensive income denominated in foreign currency are recognized directly in equity only with regard to non-monetary assets. Foreign exchange gains and losses arising from monetary financial assets (e.g. debt securities) denominated in foreign currency are recognized directly in the statement of profit or loss.

At the moment of derecognition of financial assets from the balance sheet, cumulated gains and losses recognized previously in equity:

- regarding debt financial assets are recognised in profit or loss
- regarding equity instruments are recognised in the relevant equity item, in which it presentes retained earnings.

If any objective evidence exists that a debt financial asset at fair value through other comprehensive income is impaired, the Bank recognizes impairment in accordance with the provisions of the item concerning impairment of financial assets at fair value through other comprehensive income.

The fair value of financial assets and liabilities quoted in an active market (including securities) is determined on the basis of the bid price for long position and offer price for short position. Should there be no active market for a given instrument or for the securities not quoted on an active market, the Bank establishes the fair value with the use of valuation techniques that include using recent arm's length market transactions, discounted cash flow analysis and option pricing models and other techniques commonly used by market players. The fair value of financial assets and liabilities is determined with the use of the prudence principle. This approach aims at determining the fair value with a high, 90%, confidence level, considering uncertain market pricing and closing cost.

Market activity is assessed on the basis of frequency and the volume of effected transactions as well as access to information about quoted prices which by and large should be delivered on a continuous basis.

The main market and the most beneficial one at the same time is the market the Bank can access and on which in normal conditions it would enter into sale/purchase transactions for the item of assets or transfer of a liability.

Based on the employed methods of determining the fair value, financial assets/liabilities are classified to the following categories:

- Level 1: financial assets/liabilities measured directly on the basis of prices quoted in the active market
- Level 2: financial assets/liabilities measured on the basis of measurement techniques based on assumptions using data from an active market or market observations,
- Level 3: financial assets/liabilities measured on the basis of measurement techniques commonly used by the market players, the assumptions of which are not based on data from an active market.

The Bank verifies on a monthly basis whether any changes occurred to the quality of the input data used for individual measurement techniques and determines the reasons therefor and their impact on the fair value calculation for the financial assets/liabilities item. Each identified case is reviewed individually. Following detailed analyses, the Bank takes a decision whether its identification entails any changes to the approach for fair value measurement or not.

In justified circumstances, the Bank decides to make changes to the fair value measurement methodology and their effective date construed as the circumstances change date. Then, it assesses the impact of changes on the classification to the individual categories of the fair value measurement hierarchy. Any amendments to the measurement methodology and their rationale are subject to detailed disclosures in a separate note to the financial statements.

6.9. Cost basis of debt and equity securities

Estimation of fair value of and result on sale of securities requires application of a certain cost basis for investment. The cost basis for investment applied in that respect is based on the interpretation resulting in application by an analogy of the guidelines given in IAS 2 Inventories, however only as far as possible considering the unique nature of the financial instruments of this type.

The Bank applies the “weighted average purchase price” as the effective cost basis for investment to estimate fair value of and result on sale of securities with the capital rights.

The Bank applies the “first-in first-out” (FIFO) method as the cost basis for investment for debt securities.

6.10. Derivative instruments and hedge accounting

Derivative instruments are valued at fair value without cost of transactions, which are to be incurred at the moment of their sale. The base of initial fair value measurement of derivative instruments is the transaction price, i.e. fair value of received or paid amount.

The carrying amount of interest rate derivatives settled via the central counterparty reflects transaction settlement under the settled to market approach.

The credit risk component is included in the fair value measurement for derivative instruments through additional valuation adjustments. Valuation adjustments are estimated per counterparty considering the expected presettlement exposure credit risk and the same risk generated by the Bank. This approach provides for the possibility of occurrence of risk of bilateral value adjustments. The adjustment is made using the expected positive exposure estimated through numerous simulations (the results from the scenarios leading to a negative outcome are eliminated) and the

present market value (or its estimation through referencing to comparable data) of credit default swaps (CDS). Own risk of the Bank and the risk of materialisation of a scenario of concurrent client and Bank insolvency are calculated by analogy.

In addition, for receivables resulting from matured or terminated and unsettled transactions as at the balance sheet date, the Bank establishes impairment losses using the methodology applied to assessing the risk of impaired credit receivables.

The two types of fair value adjustments as mentioned above were differently reflected in the financial statements. Fair value adjustments due to risk for non-matured transactions were presented under the item Net income on instruments through profit or loss and FX result, whereas the impairments losses for matured transactions under the item Impairment losses for financial assets and provisions for off-balance-sheet liabilities.

If a transaction whose fair value was adjusted in the previous reporting period under the item Net income on instruments through profit or loss and FX result becomes mature or subject to restructuring, then the amount of the previous fair value adjustment is moved to the item Impairment losses and the added part of the impairment loss for such already matured transaction is presented in the statement of profit or loss in the item Impairment losses for financial assets and provisions for off-balance-sheet liabilities. Therefore the financial result is impacted only by the amount of surplus of the current impairment loss (or write-down) for a mature transaction above the amount of the fair value adjustment made before the transaction has matured.

Hybrid instrument contains the main agreement which is not a derivative and derivative which causes, that part or all of the cash flows resulting from the main agreement is modified based on specific interest rate, price of financial instrument, price of commodity, FX rate, price or interest rate index or other variable.

A hybrid (combined) instrument where the host contract is the Bank's asset is classified in full to financial assets at fair value through profit or loss.

The Bank separates and recognizes in the statement of financial position the derivatives being hybrid instruments components where the host contract is the Bank's liability. Embedded derivatives separated from the host contract are recognised analogically to other derivatives if economic features and risks related to embedded derivatives are not strictly connected to the economic features and risks relevant for the host contract, a derivative with the same terms as the embedded derivative fulfils the definition of a derivative and the host contract being the Bank's liability is not measured at fair value through profit or loss. Embedded derivatives are measured at fair value and its changes are recognised in the statement of profit or loss.

The Bank uses derivative instruments in order to hedge against FX and interest rate risk, arising from activity of the Bank. Those derivatives, which were not designated as hedge instruments pursuant to the principles of hedge accounting, are classified as instruments at fair value thorough profit or loss.

6.10.1. Hedge accounting

The Bank decided to continue to apply the hedge accounting requirements of IAS 39.

Hedge accounting presents the offset effects of fair value changes of both hedging instruments and hedged items which impact the statement of profit or loss.

The Bank designates certain derivative instruments as fair value hedge or cash flow hedge. The Bank uses hedge accounting, if the following conditions are met:

- formalised documentation of the hedging relationship was prepared when the hedging was established. The documentation sets out the purpose of risk management and the hedging strategy adopted by the Bank. In the documentation, the Bank designates the hedging instrument to hedge a given position or transaction, and specifies the type of risk to be hedged against. The Bank specifies the manner for assessing the effectiveness of the hedging instrument in offsetting changes in cash flows due to the hedged transaction in terms of mitigation of risk the Bank hedges against,

- the hedging instrument and hedged instrument are similar, especially nominal value, maturity date and sensitivity to interest rate and foreign exchange rate changes,
- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship,
- for cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss,
- the effectiveness of the hedge may be assessed credibly, so the fair value of the hedged item or the cash flows of the said item as well as fair value of a hedge instrument may be valued credibly,
- the hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

Fair value hedge

Fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or a firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect the statement of profit or loss.

A fair value hedge is accounted for as follows: the gain or loss from remeasuring the hedging instrument at fair value (i.e. for a derivative hedging instrument) is recognised in the statement of profit or loss; the gain or loss on the hedged item attributable to the hedged risk adjust the carrying amount of the hedged item and are recognised in the statement of profit or loss. In view of the above, any ineffectiveness of the strategy (i.e. lack of full offsetting for changes to the fair value of the hedged item and changes to the fair value of the hedged instrument) is immediately disclosed in the statement of profit or loss.

If a hedged item is a component of financial assets at fair value through other comprehensive income, the profit or loss resulting from the hedged risk is recognised in the statement of profit or loss, and the profit or loss resulting from non-hedged risk is recognised in equity.

The Bank applies the fair value hedge accounting in order to hedge changes in fair value of fixed-rate debt instruments classified to the portfolio of assets at fair value through other comprehensive income and fixed-rate debt instruments classified to the portfolio of assets at amortised cost against the risk resulting from interest rate changes.

Cash flow hedge

Cash flow hedge is a hedge of the exposure to volatility in cash flows that:

- is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction,
- could affect statement of profit or loss.

A cash flow hedge is accounted for as follows: the changes of the fair value of the hedge instrument, which are an effective part of hedging relationship, are recognised directly in equity through the statement of comprehensive income, while the ineffective portion of the gain or loss on the hedging instrument is recognised in the statement of profit or loss.

The associated gains or losses that were recognised directly in equity (effective hedge), at the moment of recognition of a financial asset and liability being a result of planned future transaction, are transferred into income statement in the same period or periods during which the asset acquired or liability assumed affects the statement of profit or loss.

The Bank applies cash flow hedge accounting in order to hedge the amount of future cash flows of certain portfolios of assets/liabilities of the Bank or the portfolio of highly probable planned

transactions against the interest rate risk and the highly probable planned transactions against the FX risk.

Further, the Bank applies the hedging strategy to hedge against FX risk and base risk being the consequence of funding the CHF or EUR- denominated or indexed loans portfolio with PLN liabilities using Currency Interest Rate Swaps (CIRS).

With one economic link between the concluded CIRS transactions and the extended CHF or EUR loans as well as PLN deposits used to fund them, the Bank sets two hedge relationships for cash flow hedge accounting purposes. The foregoing is made by separating the real CIRS transaction part hedging the portfolio of CHF or EUR-indexed loans against FX risk and interest rate risk and the real CIRS transaction part hedging PLN liabilities against interest rate risk.

6.10.2. Derivative instruments not qualifying as hedging instruments

Changes in fair value of derivatives that do not fulfil the criteria of hedge accounting are disclosed in the statement of profit or loss for the current period. Changes in fair value of interest rate derivatives arising from ongoing accrual of interest coupon are disclosed under Net interest income on derivatives, whereas the remaining part of changes in the fair value of interest rate derivatives is presented under Net income on financial instruments measured through profit or loss and FX result.

Changes in the fair value of FX derivatives are presented under Net income on financial instruments through profit or loss and FX result.

6.11. Offsetting financial instruments

The Bank offsets financial assets and financial liabilities and reports them in the net amount in the statement of financial position when and only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

In order to mitigate credit risk, the Bank concludes master agreements with contracting parties, with which the Bank concludes transactions. These master agreements provide for offsetting financial assets and liabilities in case of a breach of the master agreement.

6.12. Repo, reverse repo transactions

The Bank presents the financial assets sold with the repurchase clauses (repo, sell-buy-back transactions) in its statement of financial position, simultaneously recognising a financial liability under a repurchase clause. This is done in order to reflect the risks and benefits arising on this asset item that are retained by the Bank after the transfer.

For the securities purchased with a reverse repurchase clause (reverse repo, buy-sell-back), the financial assets held are presented as receivables arising from repurchase clause, hedged with securities.

6.13. Impairment

Accounting principles in force prior to the 1 January 2018 (IAS 39)

The assets are subject of the loss allowances, for which Bank recognised the objective evidences of impairment.

For assets without recognised the objective evidences of impairment, Bank recognize the IBNR provision for the losses that occurred as at the impairment date, but have not been documented yet (the so-called provision for incurred but not reported losses – IBNR).

Accounting principles in force from 1 January 2018 (IFRS 9)

Three stage approach

During the process of estimating credit provisions, the change of the credit quality for a particular credit exposure since initial recognition is described in the Bank based on three stages with various measurement approach to measurement of expected credit losses:

- Stage 1 includes performing exposures that have not had a significant increase in credit risk since initial recognition. A provision is measured based on 12-month expected credit losses (or till maturity date if such exposures will expire in less than 12 months).
- Stage 2 includes performing exposures that have had a significant increase in credit risk since initial recognition. A provision is measured based on lifetime of expected credit losses i.e. from reporting date till the maturity date (remaining maturity).
- Stage 3 – impaired exposures, which means non-performing loans. A provision is measured based on lifetime expected credit losses and PD = 100%.

The Bank qualifies the financial exposures to Stage 1, 2 or 3 using a cascade approach in the following order:

1) Identification of the impaired exposures and their classification to Stage 3.
2) Allocation to Stage 2 based on triggers of significant increase of credit risk.
3) Allocation of other exposures to Stage 1.

Accounting principles in force from 1 January 2018 (IFRS 9)

Triggers of the classification to Stage 2 - significant increase in credit risk (in force since 1 January 2018)

The Bank determines the significant increase in credit risk, which results in classification to Stage 2, based on one of the following triggers (where the first one is the leading one):

- significant increase in the lifetime PD at reporting date comparing to the lifetime PD at initial recognition occurring over the period from the reporting date till maturity date;
- watch list status;
- forbearance status;
- more than 30 days past due;
- borrower has a mortgage loan denominated in CHF at ING Bank Śląski S.A. or another bank.

Accounting principles applicable before 1 January 2018 (IAS 39) and as of 1 January 2018 (IFRS 9)

Triggers for classification of assets at amortized cost as impaired assets (in force before 1 January 2018)/to Stage 3 (in force since 1 January 2018)

At each balance sheet date, the Bank assesses whether a financial assets item or a group of financial assets is impaired. A financial asset item or a group of financial assets is impaired if and only if, there is evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset item (a 'loss event') and that loss event (or events) has (have) an impact on the expected future cash flows of the financial asset item or a group of financial assets that can be reliably estimated. The Bank recognizes the expected credit losses based on reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The evidence of impairment is:

- identification of an objective impairment evidence (for corporate and retail credit exposures) or
- the analysis (test) result showing impairment (for corporate credit exposures).

Objective impairment evidence of the corporate or retail credit exposure covers the occurrence of at least one of the following situations:

- the client has discontinued to repay the principal, pay interest or commissions, with the delay of more than 90 days past due, provided that the amount of arrears is higher than the materiality threshold defined for a given client segment or product,
- another forbearance has occurred or there is a delay of more than 30 days past due for corporate credit exposure with the forbearance status, however this does not apply to the exposures which were classified as serviced (working) since forbearance status assignment,
- a petition for bankruptcy with liquidation or conciliation bankruptcy has been filed or rehabilitation proceedings have been started by the Bank, a client or by another bank. For retail credit exposures, it applies only where it is the Bank that files the petition for the client bankruptcy,
- bankruptcy with liquidation is declared, conciliation bankruptcy or rehabilitation proceedings towards the client are approved – if they assume lack of full repayment towards the Bank,
- the credit exposure becomes due and payable as a consequence of the Bank's having terminated the loan agreement,
- the Bank cancels or writes off a significant amount of the client receivables, which leads to reduction in cash flows from a given financial assets item,
- the Bank initiates the debt enforcement proceedings,
- the client questions the balance sheet credit exposure in court,
- the client's whereabouts are unknown so the client is not represented in contacts with the Bank and the client's assets are not disclosed,
- serious financial problems of the client, including but not limited to:
  - for corporate credit exposure, the Bank has assessed with high probability (above 50%) that the client situation will preclude full repayment of the debt within the impairment analysis (test),
  - for retail credit exposure:
    - poor financial standing reflected in the worst risk rating of the client (applies to clients from the Entrepreneurs segment),
    - restructuring of the non-performing retail credit exposure,
    - impairment on other accounts – within the product segment the client has other credit exposures where impairment evidence has been identified,
- for retail credit exposures – justified suspicion of fraudulent obtainment of a loan.

For retail credit exposures, the objective impairment evidence applies if the materiality threshold of PLN 500 is exceeded. As regards corporate credit exposures without risk rating, the materiality threshold for overdraft facilities with more than 90 days past due amounts to PLN 1,000. For the remaining corporate credit exposures, the Bank does not use the materiality threshold.

For corporate credit exposures, the impairment analysis (test) result determines whether or not impairment is identified. The test is run upon identifying an impairment trigger. Impairment triggers for corporate credit exposures include:

- danger of bankruptcy or another financial reorganisation has been reported, both of which may lead to a failure to repay the financial asset or to delayed repayment,
- the client has discontinued to repay the principal, pay interest or commissions, with the delay of more than 45 days past due,
- the Bank assesses that the client will face difficulties in repaying the debt, that is the client is undergoing material financial problems which may lead to a failure to repay the financial asset or to delayed repayment,

- significant breach of contractual conditions by the client which may adversely impact future cash flows from a given financial assets item,
- disappearance of an active market for a given financial assets item held by the Bank due to the financial problems of the issuer/client, which may adversely impact future cash flows from a given financial assets item,
- credit debt restructuring for non-commercial reasons, that is due to client's material financial hurdles. This refers to the situation when the client for the aforementioned reasons has requested forbearance from the Bank or the Bank has already applied forbearance towards the client which would not have been applied had the client not sustained financial problems (forbearance included). These can be in particular such situations as: lending tenor extension, reduction of credit instalments, suspension of principal repayment or interest payment,
- client's rating has deteriorated considerably,
- major conflict among shareholders, loss of the sole/main counterparty, loss/death of a key person in the entity when there is no suitable succession, random incident leading to destruction of debtor's key assets.

During the impairment identification process, the Bank first assesses whether there exist impairment triggers for financial assets items.

The entire lending portfolio of retail, strategic and corporate network clients is tested for exposure impairment. The debtor's credit exposure is tested for impairment automatically on a daily basis for retail clients and at the monitoring dates in place for Stage 1 and Stage 2 and Stage 3 portfolios for strategic and corporate network clients. For each strategic or corporate credit exposure impairment trigger identified, the debtor has to be reclassified to Stage 3 portfolio and analysed (tested) for impairment based on the expected future cash flows.

Identification of the objective impairment evidence requires downgrading the client to the worst risk rating without the necessity to carry out the impairment analysis (test).

If after the assessment we find that for a given financial assets item there are no reasons for impairment, the item is included in the group of financial assets with similar credit risk characteristics, which indicate that the debtor is capable to repay the entire debt under to the contractual terms and conditions. Impairment loss for such groups is subject to collective assessment based on measurement of expected credit losses.

If there is any evidence of impairment loss for financial assets measured at amortised cost, then the amount of the impairment loss is the difference between the carrying amount of an asset and the present value of estimated future cash flows, discounted with the initial effective interest rate of a given financial instrument item.

Practically, for assets from ISFA portfolio, impairment is calculated per assets item using the discounted future cash flows of a given assets item; for INSFA assets – it is calculated collectively with use of lifetime expected credit losses. When estimating future cash flows, the available debtor data are considered; the debtor's capacity to repay the exposure is assessed in particular. For backed credit exposures, the expected future cash flows on collateral execution are also used in the estimation, considering the time, costs and impediments of payment recovery under collateral sale, among other factors.

If the existing evidence of impairment of an assets item or financial assets group measured at amortised cost indicate that there will be no expected future cash flows from the abovementioned financial assets, the impairment loss of assets equals their carrying amount.

Accounting principles applicable before 1 January 2018 (IAS 39) and as of 1 January 2018 (IFRS 9)

Triggers for classification of financial assets at fair value through other comprehensive income to impaired assets (in force before 1 January 2018)/ to Stage 3 (in force since 1 January 2018)

The Bank assesses as at each balance sheet date whether there is any objective evidence of impairment of debt financial assets classified as measured at fair value through other comprehensive income. Confirmation of the objective evidence of impairment is trigger for classification of an asset to Stage 3.

The evidence indicating that a financial asset or a group of financial assets have been impaired may result from one or more conditions which are presented hereinbelow:

- significant financial problems of the issuer (e.g. material negative equity, losses incurred in the current year exceeding the equity, termination of credit facility agreement of material value at other bank),
- breach of contractual terms and conditions, specifically with regard to default or delay in repayment of liabilities due (e.g. interest or nominal value), interpreted as materialisation of the issuer's credit risk,
- awarding the issuer with repayment facilities by their creditors, which would not be awarded in different circumstances,
- high probability of bankruptcy or other financial restructuring of the issuer,
- identification of financial assets impairment in the previous period,
- disappearance of the active market for financial assets that may be due to financial difficulties of the issuer,
- published analyses and forecasts of rating agencies or other units which confirm a given (high) risk profile of the financial asset,
- other tangible data pointing to determinable decrease in estimated future cash flows resulting from financial assets group which appeared upon their initial recognition in the Bank books. The data referred to hereinabove may concern unfavourable changes in the payment situation on the part of issuers from a certain group or unfavourable economic situation of a given country or its part, which translates into the repayment problems sustained by this group of assets.

Measurement of expected credit losses

Accounting principles in force prior to the 1 January 2018 (IAS 39)

The impairment loss calculated collectively is estimated on the basis of historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data (to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based), and also through elimination of the effects of conditions in the historical period that do not exist currently.

The Bank regularly verifies the methodology and assumptions adopted to estimate future cash flows in order to mitigate the differences between estimated and actual losses.

For the purposes of calculation of the provision for the balance sheet and off-balance sheet exposures shown as EAD, the probability of default (PD) method (modified PD parameter) is applied, among others.

The mode of PD parameter calculation makes it possible to take account of the specific features of individual products and related loss identification periods as well as the historical loss adjustments made using the currently available data (in line with the Point-in-Time philosophy). Interest and penalty payments are recognised using the cash-basis accounting method and they do not form the basis for creation of impairment losses.

For IBNR (Incurred But Not Reported) and INSFA (Individually Non- Significant Financial Assets) portfolios, calculations are made with the use of PD, EAD and LGD parameters plus the loss identification period as per the following formula:

$$\text{Impairment loss} = PD_{LIP} \times (EAD + EI) \times LGD$$

Where:

- *PD_{LIP} – probability of default over the LIP consistent with the approach accounting for the given portfolio current risk profile (Point-in-Time philosophy). A loss identification period (LIP) expressed in months, which depending on business segment is:*

- *8 months for small enterprises and consumer credits,*
- *9 months for strategic clients, mid-sized and mid corporates,*
- *12 months for retail mortgage loans.*

- *EAD (exposure at default) – current balance sheet exposure plus the projected balance sheet equivalent of unutilised credit lines and off-balance sheet liabilities including the conversion rate (the so called CCF or K-factor) in line with relevant EAD models,*
- *EI (effective interests) - contractual interest accrued and unpaid including outstanding commissions and effective interest rate adjustment for those exposures for which the effective interest rate is set and contractual interest accrued and unpaid for those exposures for which the effective interest rate is not set,*
- *LGD – the expected loss ratio, which is the complement to unity of the ratio of the recoverable amount and the basis for impairment losses including all direct costs incurred as of the impairment date until the end of the debt recovery process. Historical loss parameters are adjusted with the data coming from current observations in order to account for current market factors which were not present during the period covered with historical observations and exclusions of effects of past developments which are no longer present today.*

The PD parameter is 100% for impaired exposures (INSFA).

The LGD parameter for calculating the impairment loss under collective method for impaired exposures (with default) depends on the time for which the exposure is impaired. Moreover, for separated portfolios that comprise exposures defaulted for at least 2 or 3 years (depending on the segment) the LGD parameter is also 100%.

The Bank also verifies the conversion rate (the so-called CCF or K-factor) of utilisation of the free part of the credit limit in the period from the reporting date to the default date to assure compliance with IAS 37 concerning provisions for contingent off-balance sheet liabilities.

This approach allows specifically for identification of:

- *the losses that have already occurred, and*
- *the losses that occurred as at the impairment date, but have not been documented yet (the so-called provision for incurred but not reported losses – IBNR).*

Accounting principles in force from 1 January 2018 (IFRS 9)

Estimation of the loss allowances is based on the expected credit loss. This approach shall be applied to debt financial assets, credit exposures, lease receivables, irrevocable financial commitments and financial guarantees, except for investment in equity securities.

At each reporting date, the Bank measures the expected credit losses for a financial asset at an amount equal to the lifetime expected credit losses if the credit risk on that financial asset has increased significantly since initial recognition. If at the reporting date, the credit risk on the financial asset has not increased significantly since initial recognition, the Bank measures the expected loss allowance for that financial asset at an amount equal to 12-month expected credit losses.

The Bank estimates expected credit losses in a way that takes account of:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes,
- the time value of money, and
- reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

In order to measure the expected credit losses under collective approach, the Bank uses the adjusted to IFRS 9 requirements the existing regulatory capital models (PD, LGD, EAD) developed for the Advanced Internal Ratings Based (AIRB) approach. The models of risk parameters for the purpose of IFRS 9 follow the same structure as the models for regulatory capital purposes, however the manner of estimating the specified value of PD, LGD and EAD is adjusted to IFRS 9 requirements, in particular it includes reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecast of future economic conditions. The model's parameters were calibrated in accordance with the "point-in-time" approach and are programmed within 30 years' time-frame. EAD parameter includes the repayment schedules in accordance with credit agreements.

The Bank measures the lifetime expected credit losses (LEL – Lifetime Expected Loss) for the credit exposures that are not at default as the discounted sum of the portions of lifetime losses related to default events within each time window of 12 months till maturity, computed based on the following formula:

$$LEL = \sum_{t=0}^{T} \frac{PD_t^{PiT} \times EAD_t^{PiT} \times LGD_t^{PiT}}{(1+EIR)^{t+1/2}}$$

where:

- PD_t^{PiT} – marginal PD, the expected percentage of default events within time window of 12 months after "t";
- EAD_t^{PiT} – the expected exposure at default within time window of 12 months after "t";
- LGD_t^{PiT} – the expected loss given default to the EAD event within time window of 12 months after "t";
- EIR – Effective Interest Rate;
- T – remaining maturity
- t – the following year between the reporting date and the expected exposure maturity date.

For credit exposures classified to Stage 1, a 12-month expected credit loss computed based on the above mentioned formula is applied, however for T = 12 months.

For credit exposures in default at Stage 3 and for which the collective provision is computed, the Bank measured the lifetime expected credit losses based on the following formula:

$$LEL_{etap\ 3} = EAD_{in_default}^{PiT} \times LGD_{in_default}^{PiT}$$

where PD equals 100% and the $LGD_{in_default}^{PiT}$ and $EAD_{in_default}^{PiT}$ represent characteristics of defaulted exposures.

The time value of money was reflected in expected credit losses by two discount factors:

- the discount factor between the moment of default and the moment of debt recovery. It is used for the parameters of the regulatory LGD models;
- the discount factor between the reporting date and the moment of default, which is additionally taken into account for computing of the lifetime expected losses. The Bank assumes that for each time window of 12 months the event of default occurs on average in the middle of the period 0-12 months.

The Bank measures the expected credit losses as the probability weighted average of the few macroeconomic scenarios (usually: optimistic, the best estimation and stress) with different probability to occur. The expected loss is determined separately for each scenario and the probability weighted average results from the weights (probabilities) assigned to each scenario (sum of weights = 100%). Such approach fulfils IFRS 9 requirements that the provision (loss allowance) should reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.

The forecast (measurement) of the expected loss is conducted at each point in time in the future depending on the expected future economic conditions at a given point. Based on the data about past events, the Bank determined the relation between the observable parameters of expected loss (PD, LGD) and macroeconomic factors as functions, based on which – at predicted macroeconomic factors – Bank computes the predicted parameter values of expected loss in a given year in the future in accordance with forward looking "point in time" approach.

For the purpose of measurement of the expected credit loss, the Bank determines the level of EAD exposures only for irrevocable loan commitments through the use of CCF conversion factors (the range of utilization of the undrawn loan commitment during a period from the reporting date till the default

event) from regulatory EAD models (estimated in accordance with "through the cycle" approach). EAD decreases during the time according to payment schedule of the particular credit exposure.

For the financial exposures with determined maturity payment date, the expected lifetime is limited to 30 years. When the lifetime of the significant part of portfolio is more than 30 years, the length of the period to maturity equals the expected lifetime of such exposures

For the financial exposures without maturity payment date (e.g.: some revolving credit facilities and credit cards) the expected lifetime is determined by the statistical behavioural parameter.

The LGD parameter, which is a function of used technics for mitigation of credit risk and it is expressed as percentage of EAD, it is estimated on a product and exposure level based on the parameters of the regulatory LGD models (estimated according to "through the cycle" approach) which were properly calibrated for the purpose of IFRS 9.

The level of LGD which is used for the estimation of the amount of the loss allowances according to the collective method for defaulted exposures (PD = 100%), depends on the period during which the exposure was identified as defaulted. In addition, for corporate clients segment in the field of large and medium-sized companies, the Bank uses the so-called the Policy of full provision whereunder for defaulted exposures from at least 2 years, the value of LGD parameter equals 100%.

Accounting principles applicable before 1 January 2018 (IAS 39) and as of 1 January 2018 (IFRS 9)

Recognition of expected credit loss allowances for assets at amortized cost (in force before and after 1 January 2018)

The impairment is presented as a reduction of the carrying amount of the assets item through use of an impairment loss and the amount of the loss (the impairment loss formed) is recognised in the statement of profit or loss for the period.

If in a consecutive period, the amount of loss due to the impairment decreases as a result of an event that took place after the impairment (e.g. improved credit capacity assessment of the debtor), the previous impairment loss is reversed through the statement of profit or loss by a proper adjustment. With regard to strategic clients and corporate clients of the sales network the Bank determined the events whereunder it is possible to reverse credit exposure impairment (all of the below mentioned conditions have to be met jointly):

- the client's stay in the impaired portfolio (INSFA or ISFA) is not shorter than 12 months and minimum 3 calendar months have passed from the time the carrying amount of the exposure was recognised as equal to the present value of expected future cash flows. However, in the absence of impairment triggers, the exposure loss can be reversed immediately after an external significant event which in the Bank's opinion positively impacts client's situation has become probable or the Bank's exposure on the client has been considerably reduced, or the Bank has obtained new significant exposure collateral,
- no delays in repayment,
- the Bank assesses that the client will repay all their liabilities towards the Bank, and the impairment test carried out taking account of the expected future cash flows does not show impairment, and for the client having a forbearance exposure it is additionally required that it is classified to the portfolio of non-performing exposures for at least 12 months following forbearance identification.

6.14. Purchased or originated credit impaired financial assets

Accounting principles in force prior to the 1 January 2018 (IAS 39)

Lack of such finacial assets categries.

Accounting principles in force from 1 January 2018 (IFRS 9)

The Bank recognises as the separate category, the purchased or originated credit impaired financial assets at initial recognition.

Such assets may be recognized due to following reasons:

- purchase of credit impaired financial assets
- significant modification (described in item 7.5) due to derecognition of original loan or
- origination of new credit exposure for the client for which other exposures were classified to Stage 3.

Those assets are excluded from tree stage approach described in item 7.13 and are classified to impaired assets till the derecognition date.

The above means that the change in the cumulated lifetime expected credit losses, both positive and negative, is recognised as impairment gain or loss in profit or loss.

6.15. Forbearance and non-performing exposure

The Bank set the principles of identification of and reporting on forbearance and non-performing exposures under the Commission Implementing Regulation (EU) 2015/1278 of 09 July 2015 amending Implementing Regulation (EU) No. 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions as regards instructions, templates and definitions.

Pursuant to the definition adopted, forbearance refers to the following:

- the client's default on paying their financial liabilities has been confirmed or is expected in the short term;
- because of the above, the Bank has decided to extend forbearance to the client so as to enable them to pay the contractual liabilities or to prevent future default on payment;
- forbearance has been extended neither on commercial grounds nor on market conditions; it would not have been extended provided that the client had not suffered financial difficulties; the amended agreement contains the terms and conditions that are more favourable than the market ones, i.e. those that could be offered by the Bank at the same time to other debtors with a similar risk profile;
- the client accepted forbearance, i.e. the terms and conditions of the agreement binding so far have been changed or a refinancing agreement has been signed or an "embedded forbearance clause" has taken effect or the Bank has abandoned actions in the event of the client materially breaching the essential financial clause.

Forbearance is recognised in the above-said situations regardless of the client's compensation thereunder and the collateral accepted by the Bank.

For the retail segment – all exposures in restructuring are deemed forbearance exposures. As non-performing exposures the Bank recognises those exposures that meet at least one of the below criteria:

- significant exposure is overdue over 90 days,
- the Bank is of the opinion that there is little probability that the client will meet all their credit liabilities without the Bank having to take actions such as satisfaction from collateral (regardless of the overdue amount and the number of days past due),
- credit exposure impairment has been reported.

Exposures are also classified as non-performing exposures when arrears of more than 30 days past due occur for the forbearance exposure or when another forbearance is granted for such exposure, while that not refers to the cases when the client during credit lifetime was after obtaining that status in the performing portfolio.

The forbearance can:

- not significantly change the material conditions or expected future cash flows of an existing financial asset, or
- change significantly the material conditions or expected future cash flows versus the conditions or expected future cash flows of the existing financial asset.

Then, accordingly:

- the expected future cash flows for the changed financial asset subject to forbearance will be recognised in the valuation of the existing financial asset on the basis of the expected exercise period and the amounts discounted with the initial effective interest rate for the existing financial asset, or
- the existing financial asset is derecognised and the new financial asset is carried through the balance sheet at fair value as at the initial recognition date, while the difference between the existing and the new assets is carried through profit and loss. Such recognition is independent of the change or lack of change of the transaction legal form and is based on its economic content.

7. Non-financial assets

7.1. Property, plant and equipment

7.1.1. Own property, plant and equipment

Property, plant and equipment consist of controlled non-current assets and costs to construct such assets. Non-current assets include property, plant and equipment items with an expected period of use above one year, maintained to be used to serve the Bank's needs or to be transferred to other entities, based on the lease contract or for administrative purposes.

Property, plant and equipment, with the exception of land and buildings, are recorded at purchase price or production cost i.e. after initial recognition they are recorded at historical cost less depreciation and impairment.. The historical costs are made up of the purchase price/ production cost and the costs directly related to the purchase of assets.

Each component part of property, plant and equipment items, whose purchase price or production cost is material in comparison with the purchase price or production cost of the entire item, is depreciated separately. The Bank allocates the initial value of the property, plant and equipment into its significant parts.

Land and buildings are carried in accordance with the revaluation model, after initial recognition at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

The revaluation effect is reflected in other comprehensive income in case of the value increase, or carried through the statement of profit or loss in case of the balance sheet asset's value decrease. However, the increase of value is recognised as income insofar as it reverses the decrease of value due to revaluation of the same asset that was previously recognised as costs of a given period. Similarly, the decrease of the asset's value resulting from revaluation shall be set off against the relevant surplus resulting from the previous revaluation of the same asset. The entire revaluation surplus is carried through retained earnings at the time of withdrawing from use or selling the asset item.

The Bank recognizes under the balance sheet item property, plant and equipment the costs of replacement of certain elements thereof at the time they are incurred on proviso that the Bank is likely to earn any asset-related prospective economic benefits and the purchase price or the production cost may be measured reliably. Other costs are recognised in the statement of profit or loss at the time they are incurred.

7.2. Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. Intangible assets are deemed to include assets which fulfil the following requirements:

- they can be separated from an economic entity and sold, transferred, licensed or granted for use for a fee to third parties, both separately, and together with their accompanying contracts, assets or liabilities,
- arise from contractual titles or other legal titles, irrespective of whether those are transferable or separable from the business entity or from other rights and obligations.

7.2.1. Goodwill

Goodwill arising on acquisition of an entity is recognized at the acquisition price being the surplus of the aggregate of:

- provided payment,
- sums of all non-controlling interest in the acquired entity, and
- in the case of combining entities executed at fair value as at the day of acquiring interest in the capital of the acquired entity, previously belonging to the acquiring entity.

over the net amount determined as at the day of acquiring values of the identifiable acquired assets and assumed liabilities.

The goodwill recognized in the financial statements of the Bank was recognized pursuant to the requirements binding on the day of first application of IFRS i.e. at acquisition price being a surplus of the cost of combining the business entities over the interest of the acquirer's in the net fair value of all identifiable assets, liabilities and contingent liabilities. After the initial recognition, the goodwill is recognized at acquisition price less any accumulated impairment losses.

7.2.2. Computer software

Purchased computer software licences are capitalised in the amount of costs incurred for the purchase and adaptation for use of specific computer software.

Expenditures attached to the development or maintenance of computer software are recognised as costs when incurred.

7.2.3. Other intangible assets

Other intangible assets purchased by the Bank, are recognized at purchase price or production cost less amortization and total amount of impairment losses.

7.2.4. Subsequent costs

Subsequent costs incurred after initial recognition of acquired intangible asset are capitalised when it is probable that such expenditures will ensure future economic benefits for the Bank. In other cases, costs are recognised in the statement of profit or loss in the reporting period in which they were incurred.

7.3. Depreciation and amortization charges

The depreciation/amortization charge of property, plant and equipment and intangible assets is applied using the straight line method, using defined depreciation/amortization rates throughout the period of their useful lives. The depreciable/amortizable amount is the purchase price or production cost of an asset, less its residual value. The useful life, depreciation/amortization rates and residual values of property, plant and equipment and intangible assets are reviewed annually. Conclusions of the review may lead to a change of depreciation/amortization periods recognized prospectively from the date of application (the effect of this change is in accordance with IAS 8 carried through profit or loss).

In case of buildings at fair value, the accumulated depreciation balance at the revaluation date is removed from the carrying amount gross, and the net carrying amount is adjusted to the revalued amount.

Depreciation and amortization charges are recognized in the statement of profit or loss. At each balance sheet date goodwill and other intangible assets with indefinite useful life are regularly tested for impairment. The depreciation/amortization periods are as follows:

- lands and buildings — 50 years
- leaseholds improvements — rent and lease term of maximum 10 years
- devices — 3-7 years
- equipment — 5 years
- costs of development of software — 3 years
- software licenses — 3 years

7.4. Impairment of other non-financial assets

For each balance sheet date, the Bank assesses the existence of objective evidence indicating impairment of an asset. If such evidence exists, the Bank performs an estimation of the recoverable value. If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount.

As regards company goodwill, it is tested for impairment as at the balance sheet date regardless of whether or not there are conditions of impairment in place.

7.4.1. Recognition of impairment loss

If there are conditions of impairment of common property, i.e. the assets which do not generate cash independently from other assets or groups of assets, and the recoverable amount of the individual asset included among common property cannot be determined, the Bank determines the recoverable amount at the level of the cash-generating unit, to which the given asset belongs. An impairment loss is recognized if the book value of the asset or cash-generating unit exceeds its recoverable amount.

The goodwill impairment is determined by estimating the recoverable amount of the cash-generating unit the given goodwill applies to. Should the recoverable amount of the cash-generating unit be lower than the carrying amount, impairment loss is made. The impairment loss is recognized in the statement of profit or loss.

Impairment losses for cash-generating units reduce the goodwill of the cash-generating units (group of units) in the first place and then reduce proportionally the book value of other assets in the unit (group of units).

7.4.2. Reversing impairment loss

Goodwill impairment loss is not subject to reversal. An impairment loss of an asset other than goodwill is reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount.

An impairment loss can be reversed only up to the amount, at which the book value of impaired asset does not exceed its book value, which decreased by depreciation/amortization charge, would be established, if any impairment loss had not been recognized.

8. Lease contracts and factoring services

8.1. The Bank as lessor

The Bank is a party to lease contracts, on the basis of which it transfers for payable usufruct non-current assets or intangible assets for an agreed period.

Lease contracts are classified by the Bank based on the extent whereto the risk and benefits due to holding of leased asset are attributable to lessor and lessee.

A lease contract is considered as financial lease provided the following terms and conditions are met individually or jointly:

- the contract transfers the asset ownership to the lessee before the end of lease term,
- the contract includes the right of lessee to purchase the asset at the price which, as expected, is that lower than the fair value agreed as at the date when purchase right execution becomes feasible that at the leasing commencement date it is certain that the lessee shall take advantage of this right,
- the lease term corresponds in majority to the term of asset economic lifetime, even if the legal title is not transferred,
- the present value of minimum lease payments as at the lease commencement date in principle equals the leased asset fair value,
- the leased assets are specialised enough that only the lessee may take advantage thereof, without making major modifications thereto,
- the lessee may prolong the contract (or conclude a new one) for additional term for the fee which is materially lower compared to the market,
- the lessee may terminate the contract and any losses of the lessor arising therefrom shall be covered by the lessee,
- profits or losses related to fluctuation of asset residual value are attributable to the lessee.

The lease contracts whereunder the lessor basically retains all the risk as well as benefits arising from holding of leased asset are classified as operational lease contracts.

The lease contract shall be concluded for the term ranging from five to ten years, including transfer of the legal title to the beneficiary (lessee) after lease contract expiry. The ownership of leased asset is the collateral for the liabilities arising from lease contracts.

There are no contingent lease payments within the Bank. There are no unguaranteed residual values attributable to the lessor within the Bank.

In case of lease contracts, which result in transferring substantially all the risks and rewards following holding of the leased asset (financial lease), the subject of such lease contract is derecognized from the balance sheet. A receivable amount is recognized in an amount equal to the present value of minimum lease payments. Lease payments are divided into financial income and reduction of the balance of receivables in such a way as to achieve reaching a fixed rate of return from the outstanding receivables.

Interest on financial lease is presented in Interest income, in the item: Interest on loans and other receivables to customers, further split into Interest on leases.

Lease payments for contracts which do not fulfil requirements of a finance lease are recognized as income in the statement of profit or loss, using the straight-line method, throughout the period of the lease.

8.2. The Bank as lessee

The Bank is also a party to lease contracts, under which it takes another party's non-current assets for an agreed period for payable usufruct.

In case of lease contracts, under which essentially all risks and rewards resulting from holding of the leased assets are transferred, the leased object is recognized as a non-current asset, and a liability is recognized in the amount equal to the present value of minimum lease payments as at the date of commencement of the lease. Lease payments are divided into financial costs and reduction of the balance of the liability in such way as to achieve a fixed rate of interest on the outstanding liability. Financial costs are recognized directly in the statement of profit or loss.

Non-current assets which are the basis for the finance lease contract are depreciated in the manner defined for the Bank's non-current assets. However, if it is uncertain whether the ownership of a leased asset has been transferred, then non-current assets used pursuant to finance lease contracts are depreciated over the shorter of the two: the expected useful life or the period of lease.

Lease payments for contracts not classified as finance lease are recognized as costs in the statement of profit or loss on a straight-line basis throughout the period of the lease and are shown in the General and administrative expenses, in the item: Overheads.

8.3. Factoring services

The Bank provides factoring services in local and international trade. Handling and financing receivables as well as risk management are their essence. Further, as part of factoring, the Bank offers additional services being financial limits for debtors, debt recovery and takeover of trading risk. Local factoring without taking over risk (with recourse) prevails in the factoring operations of the Bank.

Factoring receivables are purchased by the Bank under agreements negotiated with clients case by case. The said receivables are recognized in the balance sheet as an increase in financial assets or decrease in cash, or increase in financial liabilities. Receivables can be held until maturity and maturity dates can be postponed.

Factoring receivables with recourse and without recourse are presented differently in the financial statements. Factoring receivables with recourse are presented in the balance sheet as net amounts due; i.e., only financed receivables less the amount of the security deposit. The factoring receivables without recourse are presented separately; i.e., all financial and non-financial receivables are presented as amounts due, while receivables excluded from funding and the security deposit are shown as liabilities.

The base income on factoring operations comprises commissions and interest on the advance payments made for the receivables purchased. Commission income is carried through profit or loss at the time of execution of activity under the factoring agreement concluded.

Income on provision of factoring services comprises factoring commissions, limit fees, preparation fees, insurance fees, handling fees and other fees as given in the price list.

Interest income includes regular and discount interest. Interest is accrued monthly on the actual factoring exposure. Discount interest is charged up-front on the amount of factoring receivables acquired, considering their maturity.

Interest income is shown in the statement of profit or loss, in item Net interest income, while commission income is shown in item Net commission income.

9. Other balance sheet items

9.1. Other trade receivables and other receivables

Other trade receivables and other receivables are recognized and carried at original invoice amount less the expected credit loos allowance.

The Bank introduced the simplified approach regarding to measurement of the expected credit loos for this receivables and recognise the loss allowance at an amount equal to lifetime expected credit losses.

If the effect of the time value of money is material, the value of receivable is determined by discounting the expected future cash flows to the present value, applying the discount rate that reflects the current market assessments of time value of money. If the discounting method has been applied, the increase of receivables due to time lapse is recognized as financial income.

Other trade receivables and other receivables embrace in particular settlements with off-takers. Budgetary receivables are recognized as part of other financial assets, except for corporate income tax receivables, which are a separate item on the balance sheet.

9.2. Liabilities

Other financial liabilities comprise in particular: payables for the benefit of tax office under VAT, settlements with suppliers and payables due to received prepayments which will be settled by means of delivering goods, services or non-current assets. Other financial liabilities are recognized in the amounts due.

9.3. Non-current assets held for sale

The Bank classifies a non-current asset (or group of assets) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or group of assets) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or group of assets) and its sale must be highly probable, i.e. the appropriate level of management must be committed to a plan to sell the asset (or group of assets), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its present fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets held for sale are priced at the lower of the two: its carrying amount or fair value less disposal cost. Assets classified in this category are not depreciated.

Where the criteria for classification as non-current assets held for sale are no longer met, the Bank will no longer classify that asset as an asset held for sale (or group of assets) but reclassify it as appropriate. In such a case, the Bank measures the asset that is no longer classified as an asset held for sale (or that is no longer part of a group of assets held for sale) at the lower of the following amounts:

- its carrying amount from the day before the asset (or a group of assets) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or group of assets) not been classified as held for sale,
- its recoverable amount at the date of the decision not to sell.

9.4. Cash and cash equivalents

Cash and cash equivalents for the purposes of a cash flow statement include: cash in hand and cash held at the Central Bank, and cash equivalents e.g. balances on current accounts and overnight deposits held by other banks.

10. Equity

Equity comprises of the share capital, share premium, other comprehensive income and retained earnings. All balances of capital and funds are recognized at nominal value

10.1. Share capital

Share capital is presented at nominal value, in accordance with the Articles of Association (the company's Charter) and entry into the commercial register of the dominant entity.

10.1.1. Acquired own shares

If the Bank acquires its own shares, then the paid amount together with the costs directly attributed to such purchase are recognized as a change in the equity. Acquired own shares are treated as own shares and disclosed as reduction of the equity.

10.1.2. Dividends

Dividends for the financial year which have been approved by the General Shareholders' Meeting, but not paid at the balance sheet date are disclosed under Dividend liabilities in the item Other liabilities.

10.1.3. Share premium

Share premium is formed from agio obtained from the issue of shares reduced by the attributable direct costs incurred with that issue.

10.2. Other comprehensive income

Other comprehensive income is created as a result of:

- valuation of financial instruments classified for measurement at fair value through other comprehensive income,
- valuation of derivatives for the element being the effective cash flow hedge,
- valuation of non-current assets at fair value
- actuarial gains and losses.

The deferred tax assets and liabilities resulting from above mentioned valuations are included in the other comprehensive income. The other comprehensive income is not subject to profit distribution.

10.3. Retained earnings

Retained earnings are created from profit write-offs and are allocated for purposes specified in the Articles of Association (the company's Charter) or other legal regulations. Retained earnings comprise of:

- other supplementary capital,
- other reserve capital,
- general banking risk fund,
- valuation of share-based payments
- undistributed result from previous years,
- net result attributable to dominant entity.

Other supplementary capital, other reserve capital and general banking risk fund are created from profit write-offs and are allocated for purposes specified in the Articles of Association (the company's Charter) or other legal regulations.

General banking risk fund is created in accordance with the Banking Law Act of 29 August 1997 as amended, from profit after tax.

The net financial result attributable to the dominant entity represents the gross result under the statement of profit or loss for the current year, adjusted with the corporate income tax and the result attributable to the minority shares.

11. Prepayments and deferred income

11.1. Prepayments

Prepayments comprise of particular expenses which will be settled against the profit or loss as being accrued over the future reporting periods. Deferred costs include primarily provisions for material costs due to services provided for the Bank by counterparties, as well as insurance costs paid in advance to be settled in the future periods. Prepayments are presented in the statement of financial position in Other assets item.

11.2. Deferred income

This item comprises mainly fees settled on a straight-line basis and other types of income collected in advance which will be settled against profit or loss t in future reporting periods. Deferred income is presented in the statement of financial position in Other liabilities item.

12. Employee benefits

12.1. Benefits under the Act on employee pension programmes

Expenses incurred due to a programme of certain contributions are recognised as costs in the statement of profit or loss.

12.2. Short-term employee benefits

Short-term employee benefits of the Bank (other than termination benefits) comprise of remuneration, bonus, paid annual leave and social security contributions.

The Bank recognizes the anticipated, undiscounted value of short-term employee benefits as an expense of an accounting period when an employee rendered service (regardless of payment date) in correspondence with other on-balance liabilities.

The amount of short-term employee benefits on the unused holidays to which Bank employees are entitled is calculated as the total of unused holidays to which particular Bank employees are entitled.

12.3. Long-term employee benefits

12.3.1. Benefits under the Labour Code regulations

Provisions for retirement benefits granted under benefits due to regulations of the Labour Code are estimated on the basis of the actuarial valuation. The provisions being the result of an actuarial valuation are recognised and adjusted on an annual basis.

Provisions for long-term employee benefits are recognised in the item Provisions from the statement of financial position in correspondence with remuneration costs in the statement of profit or loss.

The assumptions of the method used to compute and present actuarial gains and losses are given in the item concerning estimates on retirement and pension benefits provision.

12.3.2. ING Group long-term incentive system benefits

By 2012, the Bank was a participant of a long-term incentive system introduced by ING Group.

The system provides for the following rewards:

- share options cleared in shares or cash,
- share-based payments.

The rewards granted in the programme have a 10 years maturity and may be exercised after 3 years from their issue, provided that the option holder is an employee of the Bank (or another ING Group entity) or has retired. The value of the reward is set as the difference between the share price quoted by Euronext Amsterdam at the exercise date in the so-called "open" period and the initial price, guaranteed at award date (i.e. the option exercise price).

The fair value of options granted is recognised as personnel costs (and on the other side of the balance sheet under capital) and is allocated throughout the vesting period.

12.3.3. Variable remuneration programme benefits

Variable remuneration programme benefits are granted in two options:

- in the former, the benefit has two parts:
  - one paid in cash (no more than 50%), and
  - one granted as phantom stock (at least 50%, after rounding up to full instrument), making the holder eligible to obtain cash whose final amount will be conditional on the price of ING Bank Śląski's shares,
- in the latter, the entire benefit is granted as phantom stock.

The programme component paid in cash is recognised following the approach of projected unit rights and is settled over time throughout the vesting period (i.e., both during the appraisal period understood as the year of work for which employees obtain benefits and during the deferral period – adequate benefit components). The value of benefit is recognised as liability towards employees in correspondence with the statement of profit or loss.

As regards the benefits granted in the form of phantom stock a one-year retention period applies; it refers to both the part granted after the assessment year (non-deferred part) and to the deferred part of the benefit under the same principles as for the cash part (annual, two-year or three-year periods). The employee who was granted the benefit shall not exercise the phantom stock-related rights during the retention period.

The fair value of phantom stock determined using the principles adopted (i.e. based on the estimates made upon applying the reduction factor) is allocated throughout the vesting period. The value of benefit is recognised as liability towards employees in correspondence with the statement of profit or loss.

13. Provisions

Provisions, including provisions for off-balance sheet liabilities, are recognized in the balance sheet when the Bank has a legal or constructive obligation (common law) as a result of past events, as well as when it is probable that an outflow of resources will be required to settle the obligation. If the effect is material, the amount of provision is measured by discounted, expected cash flows using pre-tax rate that reflects current market assessments of the time value of money and those risks specific to the liability. This is also applicable to the recognition of provisions for risk-bearing off-balance sheet liabilities including guarantees, letters of credit and irrevocable unutilised credit lines.

Provisions for the irrevocable unutilised credit lines for corporate exposures are formed and recognised together with impairment losses for credit receivables.

The Bank establishes provisions for restructuring costs only on condition that the general criteria of recognising provisions under IAS 37 be fulfilled and in particular but not limited to the situation when the Bank is in possession of the specific, formal restructuring plan determining at least the operations or part thereof, basic locations, place of employment, the functions and estimated number of

employees entitled to compensation, the expenditure to be undertaken and the term of execution. The commencement of restructuring procedure or the public announcement thereof is the condition indispensable for establishing the provision. The established provisions comprise only the direct and necessary expenditures to be undertaken due to the restructuring procedure, which are not related to the current business operations nor cover the future operating costs.

The Bank maintains the detailed record of court cases and other amounts due under legal claims. Potential future settlements will be recognised under established provisions.

The Bank recognises the provisions for estimated losses where it is more likely than not that a present obligation exists. In certain justified cases, despite the fact that the Bank is entitled to reimbursement of the funds under the provisions established, because of the uncertainty whether the expected economic benefits will be earned or not, the Bank may decide not to recognise the assets thereunder in the financial statements.

14. Statement of profit or loss

14.1. Net interest income

Interest income and expenses are recognised in the statement of profit or loss for all financial instruments. Interest income on financial assets classified as measured at amortized cost and at fair value through other comprehensive income is recognized in the statement of profit or loss at amortized cost using the effective interest rate or credit-adjusted effective interest rate.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an estimate of cash flows is made considering all contractual terms of the financial instrument but future credit losses are not considered. The calculation includes all fees and commissions paid or received (external) between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

The expected credit losses are considered only in case of financial assets that are credit-impaired financial assets at initial recognition, in order to the estimate credit-adjusted effective interest rate.

Interest income comprises interest and commission (received or due) recognized in the calculation of the effective interest rate due to: loans with repayment schedule, intrabanking deposits and securities.

In case impairment is recognized for a financial asset or group of similar financial assets, interest income is accrued based on the present value of receivable (this is the value reduced by revaluation charge) with the use of the interest rate according to which future cash flows were discounted for impairment valuation.

Interest income on debt securities measured at fair value through profit or loss or designated at fair value through profit or loss are recognized under the item Interest income.

Interest income/ costs on derivatives designated as hedging instruments in the hedge accounting are recognized under Net interest income.

14.2. Commission income and costs

Commission income arises from providing financial services by the Bank and comprises i.a. fees for extending a loan, the Bank’s commitment to extend a loan, cards issue, cash management services, brokerage services, insurance products-related services and asset management services. Commission income comprises also margins on FX transactions i.e. the margins on all buy/sell transactions made with spot delivery value date or forward delivery value date.

Fees and commissions (both income and expenses) directly attributed to origination of financial assets with repayment schedule are recognised in the statement of profit or loss as effective interest rate component and are part of the interest income.

The Bank recognizes the following effective interest rate-adjusting commissions:

- commissions for application review and credit commitment letter issue;
- commissions for limit/ overdraft granted;
- commissions for loan or limit/ overdraft extension;
- commissions for receivables/ bills of exchange purchased, for bill of exchange discount;
- commission for restructured loan processing;
- commission for amending the credit agreement as to the amount, currency or schedule of repayments;
- costs of credit and cash loan agency commissions.

Other commissions attributed to origination of financial assets without the repayment schedule are settled using a straight-line method throughout the agreement term.

The Bank recognizes the following commissions as the ones cleared on a straight-line basis:

- the commissions described as the commissions adjusting the effective interest rate for the loans for whose commissions no cash flows can be estimated (first of all, current account overdrafts, working capital loans and revolving loans);
- commissions for issuing, confirming or prolonging the time and increasing the amount of the guarantee or letter of credit;
- commissions for multi-facility agreements;
- commissions for the loan or limit/ overdraft granted to start another lending year.

If during the life of the contract the terms and conditions of credit exposure are changed, the whole outstanding part of commission is recognised in the statement of profit or loss on the day when the terms and conditions are updated, provided that the outstanding amount of commission is insignificant.

Fees on commitment to extend a cash loan, which is likely to be taken, are deferred and as at the date of financial assets origination are settled as the component of effective interest rate or using straight-line method based on the abovementioned criterion.

Other fees and commissions relating to the financial services offered by the Bank – like cash management services, brokerage services and asset management services – are recognised in the statement of profit or loss including the five steps approach:

1) identify the contract with a customer,
2) identify individual performance obligations in the contract,
3) determine the transaction price,
4) allocate the transaction price to individual performance obligations,
5) recognise income when (or as) each performance obligation is satisfied.

Based on the performed analysis, the Bank recognized commission and fee income:

- once the service has been delivered (also for upfront fees) i.e. at transfer of the control over the goods or services;
- over time, if the service delivery is over time;
- at point-in-time, when the Bank performs a key operation;
- when there is an actual benefit from the perspective of the customer.

After (or during) satisfaction of the performance obligations, the Bank recognises as income the amount which equals the transaction price, that was allocated to this individual performance obligation.

Commission income that was accrued and is due but was not paid on time is derecognised from the Bank's financial result upon the lapse of 90 days.

14.2.1. Income and costs under bancassurance commission

Fees and commission related to insurance products are recognised in the statement of profit or loss according to their economic content and classified as:

- commissions being part and parcel of a fee under a financial instrument wherewith the insurance product is linked,
- fee for agency service, and
- fee for additional services after the insurance product sale.

Prior to implementation of the insurance product, in order to recognise it properly in the statement of profit or loss, the Bank analyses features of the insurance product and also the link between the insurance product and the banking product. In this analysis, the Bank takes account of the prevalence of the economic content over the legal form. The factors analysed by the Bank include but are not limited to:

- manner in which an insurance product is offered, option of purchasing a banking product without the insurance product as well as option of purchasing only the insurance product at the Bank,
- pricing conditions of the two products sold together and separately,
- profitability of the insurance and banking products sold together and separately,
- sales target of combined products versus sales target of the same banking products sold without insurance,
- option of concluding an insurance agreement outside the Bank,
- number of resignations and the value of refunded insurance premiums,
- settlement cycle with a client, and
- scope of activities performed by the Bank for the insurer and their duration.

Insurance products offered with loans are treated by the Bank as linked to lending products, mainly because of lack of the possibility to purchase at the Bank an insurance product without a loan or a cash loan.

For the absolute majority of insurance products linked with lending products functioning at the Bank, the income on insurance products is earned based on monthly settlements with both the insurer and the client. Since the client may resign at any time from the insurance coverage for the following month, the Bank treats such insurance as renewed each month and settled for each month separately.

Therefore, the income on insurance products settled monthly is recognised in the statement of profit or loss also on a monthly basis.

The Bank recognises the income on such insurance in the commission income on insurance products.

The Bank analogically presents the costs directly related to these insurance products.

Such an approach ensures compliance with the matching principle. At the same time, the Bank monitors the level of income on insurance products linked to the lending products in terms of legitimacy of division into interest income and commission income. At present such a division would not materially impact the Bank's statement of profit or loss. The Bank applies an analogical approach to real property insurance with mortgage loans. Taking account of the materiality principle, the Bank presents full income on this insurance in the net commission income.

Most insurance products linked with the Bank's deposit products (current accounts and savings accounts) use the monthly-settlement structure. Therefore, the income on insurance products settled monthly is recognised in the statement of profit or loss also on a monthly basis. The Bank recognises the income on such insurance in the commission income on insurance products.

Commissions under insurance products not linked to banking products are recognised in the statement of profit or loss:

- on a straight-line basis during the insurance policy term – if the Bank, apart from other sales operations, also provides additional services during the insurance term,
- on a one-off basis – if the Bank does not provide any additional services during the insurance policy term.

Should there be a risk of refund of the fee under the insurance product, the Bank decreases its income by the amounts of estimated provisions. The provisions for refunds are established based on the historical data on actual refunds made in the past and based on projections as to the amount of refunds in the future.

14.3. Net income on financial instruments measured at fair value through profit or loss and FX result

Net income on financial instruments measured at fair value through profit or loss and FX result includes gains and losses arising from disposal and change of fair value of assets and liabilities at fair value through profit or loss and designated at initial recognition at fair value through profit or loss.

Result on financial instruments through profit or loss and FX result also includes adjustments of fair value due to risk for unexecuted FX-options transactions.

Result from accrued interest and settlement of discount or premium on debt securities at fair value through profit or loss or designated at fair value through profit or loss is recognized as interest income.

14.4. Net income on investment securities

The net income on investment securities comprises gains and losses resulting from sale of debt securities at amortized cost or at fair value through other comprehensive income and earnings from dividends.

Dividend income is recognized in the statement of profit or loss when the shareholders' right to receive payment is established.

14.5. Net income on hedge accounting

This item includes the measurement of hedged and hedging transactions in fair value hedging accounting and the net income on measurement of hedging instruments in the ineffective part of hedge relationship of cash flows hedge accounting.

14.6. Net income on other basic activities

Net income on other basic activities includes cost and income not attributed directly to Bank's banking and brokerage activity. These include in particular: net income due to sale of assets (non-current assets and intangible assets), income on sales of other services, income due to recovered bad debts, received and paid damages, penalties and fines.

14.7. Net profit (loss) attributable to non-controlling interests

Net profit (loss) attributable to non-controlling interests comprises of that part of the profit or loss, net income for the period and net assets of entity subsidiary that can be attributed to shares not held by the dominant entity (directly or indirectly through subsidiaries).

15. Taxes

15.1. Income tax

Income tax is recognized as current and deferred tax. Current income tax is recognized in the statement of profit or loss. Deferred income tax is recognized in the statement of profit or loss or equity depending on the type of temporary differences.

Current tax is a liability calculated based on taxable income at the prevailing tax rate at the balance sheet date including adjustments of previous years' tax liability.

15.2. Deferred income tax

The Bank creates a provision for deferred tax in respect of a timing difference caused by different moment of recognising income as generated and costs as incurred in accordance with the accounting regulations corporate income tax provisions. A positive net difference is recognized in liabilities as Deferred tax provisions. A negative net difference is recognized under Deferred tax assets.

The deferred tax provision is created by using the balance sheet method for all positive timing differences as at the balance sheet date arising between tax value of assets and liabilities and their carrying amount disclosed in the financial statements, except for situations where deferred tax provision arises from:

- initial recognition of goodwill;
- goodwill the amortization of which is not a tax deductible expense;
- initial recognition of an asset or liability under a transaction which does not constitute a business combination and which on its origination has no impact on the gross financial result or taxable income or loss.

Deferred tax assets are recognized with respect to all negative timing differences as at the balance sheet date between the tax value of assets and liabilities and their carrying amount disclosed in the financial statements and unused tax losses. Deferred tax assets are recognized in such amount in which taxable income is likely to be earned allowing to set off negative timing differences, except for the situations when the component of deferred tax assets arises from the initial recognition of an asset or liability with a transaction which does not constitute a business combination and on its origination have no impact on the gross financial result or taxable income or loss.

The carrying amount of a deferred tax asset shall be verified for each balance sheet date and reduced if it is no longer likely to achieve taxable income sufficient for a partial or full realization of the deferred tax assets component.

Deferred tax assets and deferred tax provisions are estimated with the use of the tax rates which are expected to be in force when the asset is realized or provision released, assuming the tax rates (and tax provisions) legally or factually in force as at the balance sheet date.

Income tax pertaining to items directly recognized in equity is recognized in equity.

Deferred tax assets and provisions are recognized by the Bank in the statement of financial position after offsetting. The Bank offsets deferred tax assets and deferred tax provisions, where it has legal title to effect such offsetting, and the deferred assets and provisions pertain to the same taxpayer.

15.3. Tax on certain financial institutions

The tax on certain financial institutions (instituted by virtue of the Act of 15 January 2016, Journal of Laws 2016 item 68) is not income tax and is shown in the statement of profit or loss as Tax on certain financial institutions.

15.4. Other taxes

Income, costs and assets are recognised less the value added tax, tax on civil law acts, and other sales taxes, except where the sales tax, paid upon purchase of goods and services, is not recoverable from the tax authorities; in that case, the sales tax is recognized accordingly as part of the cost of acquisition of an asset, or as part of a cost item.

The net amount of sales tax recoverable from or payable to the tax authorities is recognized in the statement of financial position as part of receivables or liabilities.

IV. Comparability of financial data

When compared with the annual financial statements for previous periods, in the Annual Financial Statements for the period from 1 January 2018 to 31 Demeber 2018, the Bank amended the manner of presentation of individual items of the income statement, statement of financial position and cash flow statement. The amendments were made first and foremost in consequence of the implementation of IFRS 9 which superseded IAS 39 as of 1 January 2018. The Bank took a decision to apply retrospectively the principles of classification, measurement and impairment through the adjustment of the opening balance sheet as at 1 January 2018, without adjusting comparative periods.

Further, the Bank made a few presentation changes which were not directly caused by the implementation of IFRS 9, but which – in the Bank's opinion – enhanced the transparency and informative value of the income statement and statement of financial position. The changes required a restatement of the comparable data; they did not, however, impact on the level of the financial result or balance sheet total presented.

Changes to IFRS 9 implementation-resultant:

Changes to the income statement:

- split of interest income into interest income on assets measured at amortised cost and other interest income,
- isolation of the item 'net income on sale of securities measured at amortised cost',
- isolation of the 'net income on sale of securities measured at fair value through other comprehensive income and dividend income' in place of 'net income on investments' shown for previous periods,
- isolation of the item 'expected loss allowances' in place of 'impairment losses for financial assets and provisions for off-balance sheet liabilities' shown for previous periods..

Changes to the statement of financial position:

- isolation of the item 'investment securities' which shows the value of securities measured at fair value through other comprehensive income and other then corporate and municipal securities measured at amortised cost. This item replaced the 'investments' item presented for previous periods, which showed available-for-sale financial assets and financial assets held to maturity.

Changes in cash flow statement*:*

- isolation of the item 'purchase/disposal of instruments measured at amortised cost' in place of item 'purchase/disposal of held-to-maturity financial assets' shown for previous periods in investment activities,
- isolation of the item 'purchase/disposal of equity instruments measured at fair value through other comprehensive income' in investment activities,
- reclassification of changes in treasury bonds in euro measured at amortised cost from operating activities (the item 'change in loans and other receivables from customers') to investment activities (the item 'purchase/disposal of instruments measured at amortised cost').

Other changes:

Changes to the income statement*:*

- Changed accounting principles

a) change under implementation of the equity method for measurement of investments in subsidiaries and affiliated companies – in separate financial statements for previous periods the Bank presented investments in subsidiaries and affiliated companies at the purchase price,

- Other changes

b) changed manner of presenting costs under marketing fees (cashback); in previous periods these costs were recognised in Commission income/Commission costs; at present the Bank presents them in *General and administrative expenses,*

c) changed manner of presenting interest on securities and derivatives held for trading; in the previous periods they were presented in Interest income/expenses, currently in the Net income on financial instruments at fair value through profit or loss and FX result,

d) changed manner of presenting the amortisation of fair value adjustment for exposures, which were excluded from fair value hedge strategy; in the previous periods it was presented in Net income on hedge accounting, currently in Interest income/expenses.

The table below highlights the individual items of the income statement as they were presented in the interim financial statements for 2017 and in the current statements.

	the period from 1 Jan 2017 to 31 Dec 2017					
	in Financial Statements for 2017 (approved data)	change a)	change b)	change c)	change d)	in Financial Statements for 2018 (comparable data, IAS 39 non-transformed data)
Interest income	4 155.5			-41.1	-24.5	4 089.9
Interest expenses	837.2			-1.6		835.6
Net interest income	**3 318.3**	**0.0**	**0.0**	**-39.5**	**-24.5**	**3 254.3**
Commission income	1 285.5		4.7			1 290.2
Commission expenses	152.8		-8.5			144.3
Net commission income	**1 132.7**	**0.0**	**13.2**	**0.0**	**0.0**	**1 145.9**
Net income on financial instruments at fair value through profit or loss and FX result	79.5			39.5		119.0
Net income on investments	54.0					54.0
Net income on hedge accounting	-9.2				24.5	15.3
Net income on other basic activities	-5.8					-5.8
Net income on basic activities	**4 569.5**	**0.0**	**13.2**	**0.0**	**0.0**	**4 582.7**
General and administrative expenses	2 035.4		13.2			2 048.6
Impairment losses and provisions for off-balance sheet liabilities	399.6					399.6
Tax on certain financial institutions	330.1					330.1
Share of profit (loss) of subsidiaries and associates accounted for using the equity method	0.0	54.6				54.6
Gross profit (loss)	**1 804.4**	**54.6**	**0.00**	**0.0**	**0.0**	**1 859.0**
Income tax	455.9					455.9
Net profit (loss)	**1 348.5**	**54.6**	**0.00**	**0.0**	**0.0**	**1 403.1**

Changes to the statement of financial position

- Changed accounting principles

a) change under implementation of the equity method for measurement of investments in subsidiaries and associates – in separate financial statements for previous periods the Bank presented investments in subsidiaries and associates at the purchase price,

- Other changes

b) renaming of the item ‘financial assets measured at fair value through profit or loss’ as ‘financial assets held for trading’,

c) inclusion of ‘measurement of derivatives’, respectively: positive to ‘financial assets held for trading’ and negative to ‘financial liabilities measured at fair value through profit or loss’,

d) renaming of the item ‘investments’ as ‘investment securities’

e) inclusion of ‘receivables from customers due to repo transactions’ in the item ‘loans and other receivables extended to client’ and analogically ‘liabilities to customers due to repo transactions’ to item ‘liabilities to customers’

f) split of ‘property assets’ into two separate items ‘property, plant and equipment’ and ‘intangible assets’

g) split of ‘income tax assets’ into ‘deferred tax assets’ and ‘current tax receivables’ and analogically of ‘income tax liabilities’ into ‘deferred tax provisions’ and ‘current tax liabilities’,

h) renaming of the item ‘authorised capital’ as ‘share capital’ and ‘revaluation reserve’ as ‘cumulative other comprehensive income’,

i) reclassification of the provisions for unused holiday from the item ‘provisions’ to the item ‘other liabilities’.

The table below presents particular items from the statement of financial position according to the values presented in the annual financial statement for 2017 and the values presented in the current statement.

	As of 31.12.2017 in Financial Statements for 2017 (approved data)	Change a), i)	Changes b) - h)	As of 31.12.2017 in Financial Statements for 2018 (comparable data) IAS 39 - non-transformed data
Assets				
Cash in hand and balances with the Central Bank	2 815.1			2 815.1
Loans and other receivables to other banks	2 234.5			2 234.5
Financial assets at fair value through profit or loss	530.1		Financial assets held for trading	1 314.8
Valuation of derivatives	784.7			
Derivative hedge instruments	967.2			967.2
Investments	25 907.4		Investment securities	25 907.4
Loans and other receivables to customers	87 338.9		Loans and other receivables to customers	87 358.7
Receivables from customers under repo transactions	19.8			
Investments in controlled entities	240.5	233.8		474.3
Property assets	961.3		Property. plant and equipment	542.8
			Intangible assets	418.5
Assets held for sale	11.1			11.1
Tax assets	130.9		Deferred tax assets	130.9
Other assets	163.7			163.7
Total assets	**122 105.2**	**233.8**		**122 339.0**
Liabilities			**Liabilities**	
Liabilities to other banks	1 044.6			1 044.6
Financial liabilities at fair value through profit or loss	735.1		Financial liabilities at fair value through profit or loss	1 714.3
Valuation of derivatives	979.2			
Derivative hedge instruments	699.2			699.2
Liabilities to customers	104 075.8		Liabilities to customers	104 075.8
Liabilities to customers under repo transactions	0.0			
Liabilities under issue of debt securities	300.3			300.3
Subordinated liabilities	626.9			626.9
Provisions	97.3	-7.4		89.9
Tax liabilities	220.2		Current Tax liabilities	220.2
Other liabilities	1 765.6	7.4		1 773.0
Total liabilities	**110 544.2**	**0.0**		**110 544.2**
Equity				
Share capital	130.1		Share capital	130.1
Supplementary capital - issuance of shares over nominal value	956.3			956.3
Revaluation reserve	493.0	0.2	Accumulated other comprehensive income	493.2
Retained earnings	9 981.6	233.6		10 215.2
Total equity	**11 561.0**	**233.8**		**11 794.8**
Total euity and liabilities	**122 105.2**	**233.8**		**122 339.0**

V. Notes to the financial statements

1. Segment reporting

Segments of operation

The management of Bank's activity is conducted within the areas defined in the Bank's business model.

The Bank's business model, above all for the purpose of management reporting, includes division of clients into two main segments:

- retail banking segment,
- corporate banking segment.

The segments are separated based on the financial (especially turnover, level of collected assets) and subject-related criteria. The specific rules of putting clients to respective segments are governed by the clients segmentation criteria specified in the Bank's internal regulations.

The Bank has separated in organisational terms the operations performed by the Group Treasury. The Group Treasury manages short-term and long-term liquidity risk in line with the effective regulations and risk appetite internally set at the Bank, manages interest rate risk and invests surpluses obtained from business lines while maintaining the liquidity buffer in the form of liquid assets. The Group Treasury's net income on operations is allocated to the business lines considering its support function for the Bank's business lines.

Retail banking segment

Within the framework of retail banking, the Bank provides services for individual customers (segments of mass customers and wealthy customers) and for sole traders.

This activity is analysed by the leading products, including i.e.: credit products (overdraft on the savings and settlement account - ROR, loans related to cards, hire purchase loans, housing loans, mortgage loans), deposit products (current accounts, term deposits, savings accounts), structured product, ING fund units, brokerage services and bank cards.

Corporate banking segment

Corporate banking area encompasses as follows:

- providing services to institutional clients,
- Financial Markets products.

Services to institutional clients encompasses strategic clients, large corporate entities and mid-sized companies. For corporate activity, the Bank provides reporting broken down by leading products covering i.e. loan products (working loans, investment loans), deposit products (current accounts, term deposits and negotiated deposits, savings accounts), financial markets products, trust services and capital market operations.

Financial Markets products encompass operations performed in money and capital markets, conducted both on the proprietary basis as well as for the customers' benefit. Within the framework of this activity, currency, money and derivative instrument market products and securities operations (treasury securities, shares and notes) are specified.

Measurement

The measurement of the segment's assets and liabilities, segment's revenue and costs is based on the accounting standards applied by the Bank, included in notes describing applied accounting standards. In particular, both internal and external interest income and costs for individual segments are determined with the use of the transfer price system within the Risk Transfer System (RTS). Transfer prices are defined based on the yield curve for a given currency that is common for assets and liabilities. The transfer price that is determined for the products being assets and liabilities with the same position on the yield curve is identical. The original transfer price – coming from the product measurement regarding the yield curve can be modified and the factors adjusting the transfer price can be the following: a premium for obtainment of long-term liquidity, matching of the Bank's position, a hedging cost for sophisticated products and the pricing policy. Thereafter, based on quotation rates available at news services, yield curves are developed using mathematical equations.

Revenue, costs, results, assets and liabilities for a given segment account for elements that are directly attributable to the segment in question, as well as element that may be attributed to that

segment based on reasonable premises. The Bank presents segment's interest income reduced by the cost of the interest. In 12 months 2018, the Bank revised the allocation key for the ALCO's income. The data for previous periods presented herein were made comparable.

Geographical segments

The Bank pursues business within the territory of the Republic of Poland.

2018

	Retail banking segment	Corporate banking segment	TOTAL
Income total	**2 939.6**	**2 074.0**	**5 013.6**
net interest income	2 368.4	1 250.7	3 619.1
commission income, including:	506.9	886.6	1 393.5
transaction margin on currency exchange transactions	25.4	338.5	363.9
account maintenance fees	127.2	160.6	287.8
lending commissions	71.0	237.2	308.2
payment and credit cards fees	100.7	15.3	116.0
participation units distribution fees	0.7	98.9	99.6
insurance product offering commissions	91.0	0.4	91.4
other	90.9	35.7	126.6
commission expenses	72.6	84.3	156.9
net commission income	**434.3**	**802.3**	**1 236.6**
other income/expenses	136.9	21.0	157.9
General and administrative expenses	**1 374.3**	**838.6**	**2 212.9**
Segment result	**1 565.3**	**1 235.4**	**2 800.7**
Impairment losses and provisions for off-balance sheet liabilities	267.9	208.7	476.6
Tax on certain financial institutions	154.9	216.8	371.7
Share of profit (loss) of subsidiaries and associates accounted for using the equity method	0.1	59.2	59.3
Gross profit	**1 142.6**	**869.1**	**2 011.7**
Income tax	-	-	485.8
Net profit	**-**	**-**	**1 525.9**
Assets of the segment	60 530.9	75 390.6	135 921.5
Segment investments in subsidiaries and associates accounted for using the equity method	162.7	471.9	634.6
Other assets (not allocated to segments)	-	-	1 155.4
Total assets	**60 693.6**	**75 862.5**	**137 711.5**
Segment liabilities	80 642.8	41 912.0	122 554.8
Other liabilities (not allocated to segment)	-	-	1 820.4
Equity	-	-	13 336.3
Total equity and liabilities	**80 642.8**	**41 912.0**	**137 711.5**
Capital expenditure	-131.8	-80.4	-212.2
Net cash flow from operating activities	3 135.2	-5 011.1	-1 875.9
Net cash flow from operating activities (not allocated to segment)	-	-	-935.5
Net cash flow from operating activities total	3 135.2	-5 011.1	-2 811.4
Net cash flow from investment activities	53.4	119.9	173.3
Net cash flow from financial activities	-	-3.7	-3.7

2017

	Retail banking segment	Corporate banking segment	TOTAL
Income total	**2 651.5**	**1 931.2**	**4 582.7**
net interest income	2 119.1	1 135.2	3 254.3
commission income	479.4	810.8	1 290.2
commission expenses	69.0	75.3	144.3
net commission income	**410.4**	**735.5**	**1 145.9**
other income/expenses	122.0	60.5	182.5
General and administrative expenses	**1 273.9**	**774.7**	**2 048.6**
Segment result	**1 377.6**	**1 156.5**	**2 534.1**
Impairment losses and provisions for off-balance sheet liabilities	158.2	241.4	399.6
Tax on certain financial institutions	126.5	203.6	330.1
Share of profit (loss) of subsidiaries and associates accounted for using the equity method	3.2	51.4	54.6
Gross profit	**1 096.1**	**762.9**	**1 859.0**
Income tax	-	-	455.9
Net profit	**-**	**-**	**1 403.1**
Assets of the segment	52 584.6	68 236.4	120 821.0
Segment investments in subsidiaries and associates accounted for using the equity method	48.3	426.0	474.3
Other assets (not allocated to segments)	-	-	1 043.7
Total assets	**52 632.9**	**68 662.4**	**122 339.0**
Segment liabilities	69 670.7	38 790.4	108 461.1
Other liabilities (not allocated to segment)	-	-	2 083.1
Equity	-	-	11 794.8
Total equity and liabilities	**69 670.7**	**38 790.4**	**122 339.0**
Capital expenditure	96.4	58.7	155.1
Net cash flow from operating activities	2 228.6	3 384.5	5 613.1
Net cash flow from operating activities (not allocated to segment)	-	-	-15.1
Net cash flow from operating activities total	2 228.6	3 384.5	5 598.0
Net cash flow from investment activities	-1 580.5	-1 577.6	-3 158.1
Net cash flow from financial activities	-	-600.4	-600.4

2. Net interest income

	2018 [IFRS 9]	2017 [IAS 39 - non-transformed data]
Interest income, including:	**4 526.8**	**4 089.9**
Interest income calculated using effective interest rate method, including:	**4 521.5**	**n/a**
interest on loans and receivables to other banks measured at amortised cost	36.4	56.2
interest on loans and receivables to customers measured at amortised cost	3 808.7	3 389.5
interest on securities measured at amortised cost	280.6	n/a
interest on securities measured at fair value through other comprehensive income	395.8	n/a
interest on financial assets available-for-sale	n/a	436.7
interest on financial assets held-to-maturity	n/a	207.5
Other interest income, including:	**5.3**	n/a
interest on loans and receivables to other banks measured at fair value through profit or loss	5.3	n/a
Interest expense, including:	**907.7**	**835.6**
interest on deposits from other banks	50.9	47.9
interest on deposits from customers	836.1	753.3
interest on issue of debt securities	7.6	21.9
interest on subordinated liabilities	13.1	12.5
Net interest income	**3 619.1**	**3 254.3**

Interest income on financial assets is calculated on the basis of the net exposure amounts; i.e. the amounts including effective impairment losses.

In 2018, the amount of PLN 60.8 million represents interest income on financial assets for which impairment loss was recognised. In 2017, the amount reached PLN 60.6 million.

3. Net commission income

	2018	2017
Commission income, including:		
transaction margin on currency exchange transactions	363.9	343.1
account maintenance fees	287.8	278.6
lending commissions	308.2	272.1
payment and credit cards fees*	116.0	113.3
participation units distribution fees	99.6	101.4
insurance product offering commissions	91.4	67.7
fiduciary and custodian fees**	29.3	28.5
foreign commercial business	35.5	30.0
agency in financial instruments transactions	13.3	10.1
brokerage activity fees	21.4	24.0
other	27.1	21.4
Total comission income	**1 393.5**	**1 290.2**
Commission expenses		
intermediation in selling deposit products	45.7	42.2
disclosing credit information	16.2	15.7
cash handling services	13.6	12.9
brokerage activity fees	14.9	13.1
electronic banking services fees	12.7	9.7
costs of the National Clearing House (KIR)	10.1	9.1
agency in financial instruments transactions	7.5	10.7
trading in securities	8.4	10.2
other	27.8	20.7
Total commision expenses	**156.9**	**144.3**
Net commission income	**1 236.6**	**1 145.9**

*) The Bank presents net payment and credit cards fees. For the year 2018 the revenues from this title amounted to PLN 271.9 million and costs PLN 155.9 million (for the year 2017 PLN 240.5 million and 127.2 million respectively).

**) Fiduciary and custodian fees show the commissions earned on custody services, where the Bank keeps or invests assets for their clients.

4. Net income on financial instruments at fair value through profit or loss and FX result

	2018	2017
FX result and net income on interest rate derivatives, including:	**34.8**	**78.4**
FX result	116.5	60.9
currency derivatives	-81.7	17.5
Net income on interest rate derivatives	36.7	4.2
Net income on debt instruments held for trading	19.0	36.4
Result on measurement of loans to customers which are measured at fair value through profit or loss	0.1	0.0
Net income on financial instruments at fair value through profit or loss and FX result	**90.6**	**119.0**

Net income on debt instruments includes net income on trading in treasury securities and money market instruments (treasury bills) as well as result on fair value measurement of those instruments.

Net income on derivatives includes net income on trading and fair value measurement of IR derivatives (FRA, IRS/CIRS, cap options), FX derivatives (swaps and options) as well as stock exchange index options.

5. Net income on the sale of securities and dividend income / Net income on investments

	2018 [IFRS 9]	2017 [IAS 39 - non-transformed data]
Net income on the sale of securities measured at amortised cost	**1.0**	**n/a**
Net income on sale of securities measured at fair value through other comprehensive income and dividend income, including:	**54.3**	**n/a**
sale of debt securities	48.0	n/a
dividend income	6.3	n/a
Net income on investments, including:	**n/a**	**54.0**
sale of debt instruments	n/a	27.9
sale of equity instruments	n/a	12.0
dividend income	n/a	14.1

The sale of debt securities from the category of financial assets measured at amortised cost was realised near maturity; this complies with the business model in which they were held and with the Accounting Policy adopted by the Bank.

Dividend income received in 2018 come from entities whose shares the Bank maintained in its portfolio as at 31 December 2018.

6. Net income on hedge accounting

	2018	2017
Fair value hedge accounting for securities:	**10.9**	**17.0**
valuation of the hedged transaction	129.5	-99.2
valuation of the hedging transaction	-118.6	116.2
Cash flow hedge accounting:	**-3.0**	**-1.7**
ineffectiveness under cash flow hedges	-3.0	-1.7
Net income on hedge accounting	**7.9**	**15.3**

For details of the hedge accounting applied by the Bank, refer to the subsequent part of the financial statements, note no. 17 *Hedge accounting*.

7. Net income on other basic activities

	2018	2017
Sale of other services	7.6	1.6
Net income on disposal of property, plant and equipment and intangible assets	-1.9	-0.7
Banking activity-related compensations and losses	-5.4	-3.6
Other	3.8	-3.1
Total	**4.1**	**-5.8**

8. General and administrative expenses

	2018	2017
Personnel expenses, including:	**1 033.2**	**975.2**
wages and salaries, including:	843.9	807.9
variable remuneration programme	31.1	40.3
ING Group's incentive programme	0.3	1.0
retirement benefits	3.2	2.6
employee benefits	189.3	167.3
Cost of marketing and promotion	**117.2**	**106.1**
Depreciation and amortisation, including:	**190.0**	**181.3**
on property, plant and equipment	115.8	108.0
on intangible assets	74.2	73.3
Other general and administrative expenses, including:	**872.5**	**786.0**
IT costs	180.9	149.9
communication costs	50.0	42.3
transport and representation costs	42.2	40.6
maintenance, refurbishment and rental of buildings	191.4	199.3
obligatory Bank Guarantee Fund payments	165.2	145.6
advisory and legal services, audit costs	87.2	76.9
donations	3.7	5.7
disputed claims	11.6	3.7
other	140.3	122.0
Total	**2 212.9**	**2 048.6**

8.1. Employee benefits

8.1.1. Varaible Remuneration Programme

In 2018, the Variable Remuneration Programme initiated in 2012, was continued. The Programme is addressed to persons holding managerial positions having a material impact on the risk profile of the Bank (to satisfy the requirements under Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013, Commission Delegated Regulation (EU) No. 604/2014 of 04 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile).

Benefits are awarded to the employees covered with the Programme, based on their performance appraisal for a given year. The Programme description and characteristics are included in Chapter III. *Significant accounting principles* in item 13.3.3. *Variable Remuneration Programme benefits*.

The below table presents basic information about the Programme addressed to persons holding managerial positions having material impact on the Bank's risk profile.

Programme 2014

Number of shares	Value of shares (in PLN million)	Number of nondeferred shares - held 1 year (assigned in 2015 – payable in 2016)	Deferred shares total	*Phantom stock - 1 year of deferral (assigned in 2016 – payable in 2017)*	*Phantom stock - 2 years of deferral (assigned in 2017 – payable in 2018)*	*Phantom stock - 3 years of deferral (assigned in 2018 – payable in 2019)*
9 734	1.7	-	9 734	-	-	9 734

Programme 2015

Number of shares	Value of shares (in PLN million)	Number of nondeferred shares - held 1 year (assigned in 2016 – payable in 2017)	Deferred shares total	*Phantom stock - 1 year of deferral (assigned in 2017 – payable in 2018)*	*Phantom stock - 2 years of deferral (assigned in 2018 – payable in 2019)*	*Phantom stock - 3 years of deferral (assigned in 2019 – payable in 2020)*
28 225	4.8	-	28 225	-	14 100	14 125

Programme 2016

Number of shares	Value of shares (in PLN million)	Number of nondeferred shares - held 1 year (assigned in 2017 – payable in 2018)	Deferred shares total	*Phantom stock - 1 year of deferral (assigned in 2018 – payable in 2019)*	*Phantom stock - 2 years of deferral (assigned in 2019 – payable in 2020)*	*Phantom stock - 3 years of deferral (assigned in 2020 – payable in 2021)*
28 575	4.9	-	28 575	9 499	9 523	9 553

Programme 2017

Number of shares	Value of shares (in PLN million)	Number of nondeferred shares - held 1 year (assigned in 2018 – payable in 2019)	Deferred shares total	*Phantom stock 2 years of deferral (assigned in 2020 – payable in 2021)*	*Phantom stock 3 years of deferral (assigned in 2021 – payable in 2022)*	*Phantom stock 4 years of deferral (assigned in 2022 – payable in 2023)*	*Phantom stock 5 years of deferral (assigned in 2023 – payable in 2024)*	*Phantom stock 6 years of deferral (assigned in 2024 – payable in 2025)*
62 308	10.7	37 158	25 150	8 073	8 118	8 160	398	401

Programme 2018*

Number of shares	Value of shares (in PLN million)	Number of nondeferred shares - held 1 year (assigned in 2018 – payable in 2019)	Deferred shares total	*Phantom stock 2 years of deferral (assigned in 2020 – payable in 2021)*	*Phantom stock 3 years of deferral (assigned in 2021 – payable in 2022)*	*Phantom stock 4 years of deferral (assigned in 2022 – payable in 2023)*	*Phantom stock 5 years of deferral (assigned in 2023 – payable in 2024)*	*Phantom stock 6 years of deferral (assigned in 2024 – payable in 2025)*
100 528	17.2	58 987	41 541	13 223	13 263	13 292	880	883

*) 2018 data account for the provision established for the programme, the actual benefits will be awarded in 2019.

8.1.2. ING Group's incentive programme

To the end of 2012, the Bank participated in the long-term incentive programme of ING Group (LSPP– Longterm Sustainable Performance Plan), formerly known as LEO (Long-term Equity Ownership). Description of system variants is included in Chapter III. Significant accounting principles in item 13.3.2. *ING Group's long-term incentive system benefits.*

As at the balance sheet date, the Bank recognises in their books the measurement of instruments held by Bank employees. The fair value of options granted is recognised as personnel expenses (on the other side of the balance sheet – in capitals) and is allocated throughout the vesting period.

Parameters used in the valuation model

	2018		2017	
	min	*max*	*min*	*max*
risk-free interest rate	2.02%	4.62%	2.02%	4.62%
expected exercise term	5 years	9 years	5 years	9 years
current share price	2.9 EUR	25.42 EUR	2.9 EUR	25.42 EUR
expected volatility of share certificates	25%	84%	25%	84%
expected dividends	0.94%	8.99%	0.94%	8.99%

Changes in option rights outstanding

	Options outstanding (in numbers)		Weighted average exercise price (in euros)	
	2018	2017	2018	2017
Opening balance	**145 914**	**319 171**	**13.50**	**14.76**
transferred	16 618	-2 795	11.60	14.17
exercised	-3 939	-80 860	5.98	6.54
written off	0	-2 502	0.00	15.56
expired	-117 520	-87 100	16.40	24.51
Closing balance	**41 073**	**145 914**	**5.14**	**13.50**

All options as at 31 December 2018 are 31 December 2017 are settled through issue of shares.

The range of exercise prices and weighted average remaining contractual life of options outstanding and exercisable are presented in the below table:

2018

Range of exercise prices (in EUR)	**Options outstanding as at 31 Dec 2018**	Weighted average remaining contractual life	Weighted average exercise price (in EUR)	**Options excercisable as at 31 Dec 2018**	Weighted average remaining contractual life	Weighted average exercise price (in EUR)
0.00 - 5.00	20 431	0.21	2.90	20 431	0.21	2.90
5.00 - 10.00	20 642	1.20	7.35	20 642	1.20	7.35
	41 073			**41 073**		

2017

Range of exercise prices (in EUR)	**Options outstanding as at 31 Dec 2017**	Weighted average remaining contractual life	Weighted average exercise price (in EUR)	**Options excercisable as at 31 Dec 2017**	Weighted average remaining contractual life	Weighted average exercise price (in EUR)
0.00 - 5.00	19 351	1.21	2.90	19 351	1.21	2.90
5.00 - 10.00	19 168	2.21	7.35	19 168	2.21	7.35
10.00 - 15.00	7 209	0.71	14.36	7 209	0.71	14.36
15.00 - 20.00	100 186	0.20	16.66	100 186	0.20	16.66
	145 914			**145 914**		

The aggregate intrinsic value of options outstanding and exercisable as at 31 December 2018 was EUR 173 064 versus EUR 400 486 as at 31 December 2017.

9. Impairment for expected losses / Impairment losses and provisions for off-balance sheet liabilities

Result on impairment

	2018 [IFRS 9]	2017 [IAS 39 - non-transformed data]
Investment securities	**4.7**	**1.2**
at fair value through other comprehensive income	3.2	n/a
measured at amortized cost	1.5	n/a
held to maturity	n/a	1.2
Loans and other receivables measured at amortized cost	**457.1**	**378.9**
corporate banking	196.7	221.7
including corporate and municipal securities	-0.2	-1.0
retail banking	260.4	157.2
Provisions for off-balance sheet liabilities	**14.8**	**19.5**
Total	**476.6**	**399.6**

*) The values presented under the item *Loans and other receivables measured at amortised cost* cover i.a. repayments under previously derecognised liabilities which in 2018 were PLN 2.3 million (PLN 0.8 million in 2017).

Balance of impairment

	2018 [IFRS 9]	2017 [IAS 39 - non-transformed data]
Investment securities	**7.2**	**1.5**
at fair value through other comprehensive income	4.8	n/a
measured at amortized cost	2.4	n/a
held to maturity	n/a	1.5
Loans and other receivables measured at amortized cost	**2 110.8**	**1 534.5**
corporate banking	1 106.2	908.0
including corporate and municipal securities	0.5	16.1
retail banking	1 004.6	625.8
other receivables	0.0	0.7
Provisions for off-balance sheet liabilities	**78.5**	**45.9**
Total	**2 196.5**	**1 581.9**

10. Tax on certain financial institutions

Persuant to the Act on Tax on Certain Financial Institutions the Bank is obliged to pay the bank levy being 0.0366% of assets per month. For 2018, the tax totalled PLN 371.7 million (PLN 330.1 million for 2017).

11. Income tax

Income tax recognised in the income statement

	2018	2017
Current tax	507.7	450.6
Deferred tax, including:	-21.9	5.3
Recognised and reversed temporary differences	-21.9	5.3
Total income tax recognised in the income statement	**485.8**	**455.9**

Effective tax rate calculation

	2018	2017
A. Profit before tax	**2 011.7**	**1 804.4**
B. 19% of profit before tax	**382.2**	**342.8**
C. Increases – non-deductible expenses, including:	**116.2**	**115.9**
tax on certain financial institutions	70.6	62.7
fees in favour of BGF	31.4	27.7
provisions for disputable debt claims and other assets	4.8	3.8
impairment loss on receivables in a part not covered with the deferred tax	2.8	5.8
expenses due to loan and non-loan receivables written off	2.0	3.5
tax loss on the sale of receivables	1.4	3.6
State Fund for Rehabilitation of Disabled Persons (PFRON) payments	1.2	1.2
representation expenses	0.5	0.6
other	1.5	7.0
D. Decreases – tax exempt income, including:	**12.6**	**2.8**
investments insubsidiaries and associates measurement at equity method	11.2	0.0
release of provisions for disputable debt claims	1.4	1.3
revenues from received dividends	0.0	1.4
other	0.0	0.1
E. Income tax from the income statement (B+C-D)	**485.8**	**455.9**
Effective tax rate (E : A)*	**24.15%**	**25.27%**

*) The effective tax rate deviated above 19% in 2018 due to the tax on certain financial institutions in the amount of PLN 371.7 million (PLN 330.1 million in 2017) and payments to BGF (contribution to the guarantee fund of banks and contribution to the forced restructuring fund) in the amount of PLN 165.2 million (PLN 145.7 million in 2017).

12. Earning per ordinary share

Basic earnings per share

The calculation of basic earnings per share of the Bank for 2018 was based on net profit in the amount of PLN 1 525.9 million (2017: PLN 1 403.1 million) and the weighted average number of ordinary shares at the end of 2018 and 2017 in 130 100 000.

	2018	2017
Net profit	1 525.9	1 403.1
Weighted average number of ordinary shares	130 100 000	130 100 000
Earnings per ordinary share (in PLN)	**11.73**	**10.78**

Diluted earnings per share

In 2018 as well as in 2017, there were no factors that would dilute the profit per one share. In the described periods, ING Bank Śląski S.A. issued neither bonds convertible to shares nor options for shares. The share capital comprises ordinary shares only (no preference shares). Therefore, the diluted earnings per share are the same as the underlying profit per share.

13. Cash in hand and balances with the Central Bank

	2018	2017
Cash in hand	1 117.6	1 188.7
Balances with the Central Bank	119.8	1 626.4
Total	**1 237.4**	**2 815.1**

The Bank maintains a mandatory provision – 3.5% of the value of deposits received by the Bank – in its current account kept with the National Bank of Poland.

The arithmetic mean of balances of the mandatory reserve that the Bank is obliged to maintain during a given period in the current account with NBP amounts to:

- PLN 4 005.0 million for the period from 31 December 2018 to 31 January 2019 r.,
- PLN 3 546.3 million for the period from 30 November 2017 do 01 January 2018 r.

Required reserves fund held on the current account in the National Bank of Poland bear interest during the reserve period in the amount determined by the Monetary Policy Council. As at 31 December 2018, the interest rate was 0.5% compared to 1.35% as at 31 December 2017.

14. Loans and receivables to other banks

	2018	2017
	[IFRS 9]	[IAS 39 - non-transformed data]
Current accounts	378.4	331.9
Interbank deposits:	5.0	997.7
overnights	0.0	997.7
Loans and advances	52.6	451.6
Placed call deposits	340.6	453.5
Total (gross)	**776.6**	**2 234.7**
Impairment losses / impairment for expected losses, including:	-0.1	-0.2
concerning loans and advances	-0.1	-0.2
Total (net)	**776.5**	**2 234.5**

Loans and receivables to other banks by maturity

	2018	2017
up to 1 month	728.9	1 889.7
over 1 month and up to 3 months	0.2	2.5
over 3 months and up to 1 year	30.0	300.0
over 1 year and up to 5 years	17.5	42.5
Total (gross)	**776.6**	**2 234.7**

15. Financial assets held for trading

	2018	2017
Valuation of derivatives *	509.7	784.8
Other financial assets held for trading, including:	1 201.9	530.0
Debt securities:	1 201.9	469.5
Treasury bonds	1 183.0	422.6
European Investment Bank bonds	18.9	46.9
Repo transactions	0.0	60.5
Total	**1 711.6**	**1 314.8**

*) Detailed disclosures on the nominal values of derivatives and their valuation split by type of instrument are presented in note 16. *Valuation of derivatives*

Other financial assets held for trading by maturity

	2018	2017
up to 1 month	2.0	63.3
over 3 months and up to 1 year	18.0	45.7
over 1 year and up to 5 years	683.8	207.4
over 5 years	498.1	213.6
Total	**1 201.9**	**530.0**

Interest income on financial assets carried at fair value through profit or loss is recognised in the net interest income. Profits and losses due to movements in fair value of the said assets are recognised in *item Net income on financial instruments at fair value through profit or loss and FX result.*

16. Valuation of derivatives

The below table shows notional values for derivatives whose valuation is presented in assets held for trading (positive valuation) and in liabilities at fair value through profit or loss (negative valuation) of the Bank's statement of financial position.

Notional amounts of the same-currency transaction derivatives were presented in the amounts purchased, while two-currency transactions showed both purchased and sold amounts.

2018

	Fair value of derivatives		Notional amount of instruments with the remaining maturity			
	Assets	Liabilities	up to 3 months	over 3 months and up to 1 year	over 1 year	TOTAL
Interest rate derivatives, including:	**370.6**	**443.2**	**34 965.5**	**73 825.8**	**263 464.6**	**372 255.9**
Cleared by CCP	*56.4*	*48.9*	*34 071.3*	71 333.60	245 253.60	*350 658.5*
Forward rate agreements (FRA) - PLN	0.5	0.2	8 450.0	16 305.0	5 450.0	30 205.0
Interest rate swaps (IRS PLN) fixed - float	246.7	215.6	24 914.5	56 103.4	239 195.6	320 213.5
Interest rate swaps (IRS EUR) fixed - float	82.9	188.1	980.6	536.9	13 149.3	14 666.8
Interest rate swaps (IRS USD) fixed - float	34.3	33.1	620.4	206.8	3 599.5	4 426.7
CAP – EUR options	6.0	6.0	0.0	673.7	1 998.1	2 671.8
CAP – PLN options	0.2	0.2	0.0	0.0	72.1	72.1
FX derivatives, including:	**118.0**	**115.8**	**19 857.6**	**9 825.8**	**2 232.7**	**31 916.1**
FX contracts (swap, forward), including:	**96.5**	**89.4**	**18 478.2**	**7 212.9**	**1 049.6**	**26 740.7**
FX contracts (swap, forward) EUR/PLN	16.7	21.6	6 446.5	3 384.9	378.4	10 209.8
FX contracts (swap, forward) USD/PLN	38.9	52.4	5 231.7	2 422.7	5.8	7 660.2
FX contracts (swap, forward) EUR/USD	34.8	0.9	4 194.8	558.0	0.0	4 752.8
FX contracts (swap, forward) other	6.1	14.5	2 605.2	847.3	665.4	4 117.9
CIRS, including:	**13.3**	**16.9**	**809.8**	**1 409.8**	**1 168.3**	**3 387.9**
CIRS CHF/PLN (float-float)	3.2	5.0	0.0	0.0	184.8	184.8
CIRS EUR/PLN (float-float)	2.2	4.0	809.8	566.3	983.5	2 359.6
CIRS EUR/PLN (fixed-fixed)	7.9	7.9	0.0	843.5	0.0	843.5
Currency options (purchased), including:	**8.2**	**0.6**	**284.8**	**601.6**	**7.4**	**893.8**
CHF/PLN options	0.0	0.0	0.0	0.0	0.0	0.0
EUR/PLN options	7.9	0.6	284.7	600.1	6.8	891.6
USD/PLN options	0.3	0.0	0.1	1.5	0.6	2.2
Currency options (sold), including:	**0.0**	**8.9**	**284.8**	**601.5**	**7.4**	**893.7**
EUR/PLN options	0.0	8.6	284.7	600.1	6.8	891.6
USD/PLN options	0.0	0.3	0.1	1.4	0.6	2.1
Current off-balance sheet transactions, including:	**1.8**	**0.3**	**3 008.0**	**0.0**	**0.0**	**3 008.0**
FX operations	0.7	0.3	1 762.0	-	-	1 762.0
Securities operations	1.1	0.0	1 246.0	-	-	1 246.0
Fair value measurement of other financial instruments	**19.3**	**18.8**	-	-	-	-
Total	**509.7**	**578.1**	**57 831.1**	**83 651.6**	**265 697.3**	**407 180.0**

The amount of fair value measurement of derivatives includes the credit value adjustment for counterparty insolvency (CVA) and debt value adjustment for Bank insolvency (DVA).

2017

	Fair value of derivatives		Notional amount of instruments with the remaining maturity			
	Assets	Liabilities	up to 3 months	over 3 months and up to 1 year	over 1 year	TOTAL
Interest rate derivatives, including:	**352.5**	**544.2**	**44 402.7**	**72 368.8**	**218 207.7**	**334 979.2**
Cleared by CCP	*23.0*	*22.1*	*43 419.8*	*70 134.0*	*198 239.4*	*311 793.2*
Forward rate agreements (FRA) - PLN	0.7	0.7	30 440.0	29 840.0	7 030.0	67 310.0
Interest rate swaps (IRS PLN) fixed - float	209.9	210.9	13 498.6	40 800.4	192 110.4	246 409.4
Interest rate swaps (IRS EUR) fixed - float	74.6	262.1	42.8	1 157.9	12 994.6	14 195.3
Interest rate swaps (IRS USD) fixed - float	58.7	61.9	8.1	0.0	3 548.8	3 556.9
CAP – EUR options	8.4	8.4	213.2	570.5	2 447.7	3 231.4
CAP – PLN options	0.2	0.2	200.0	0.0	76.2	276.2
FX derivatives, including:	**428.5**	**431.2**	**29 421.4**	**17 643.6**	**4 696.5**	**51 761.5**
FX contracts (swap, forward), including:	**335.2**	**325.9**	**26 319.1**	**10 607.1**	**1 058.9**	**37 985.1**
FX contracts (swap, forward) EUR/PLN	103.0	112.2	10 362.2	3 132.3	958.1	14 452.6
FX contracts (swap, forward) USD/PLN	195.4	185.9	9 945.9	6 114.4	60.9	16 121.2
FX contracts (swap, forward) EUR/USD	29.4	16.0	4 598.6	1 161.3	0.0	5 759.9
FX contracts (swap, forward) other	7.5	11.8	1 412.4	199.1	39.9	1 651.4
CIRS, including:	**9.4**	**26.2**	**1 079.0**	**2 733.7**	**1 925.8**	**5 738.5**
CIRS CHF/PLN (float-float)	0.9	1.6	0.0	0.0	178.6	178.6
CIRS EUR/PLN (float-float)	7.3	11.0	1 079.0	437.1	916.6	2 432.7
CIRS EUR/PLN (fixed-fixed)	1.2	1.1	0.0	0.0	830.6	830.6
CIRS EUR/USD (float-float)	0.0	5.3	0.0	1 120.2	0.0	1 120.2
CIRS USD/CHF (float-float)	0.0	7.2	0.0	1 176.4	0.0	1 176.4
Currency options (purchased), including:	**82.0**	**1.1**	**1 092.3**	**2 151.4**	**855.9**	**4 099.6**
CHF/PLN options	0.0	0.0	161.3	0.0	0.0	161.3
EUR/PLN options	34.5	1.1	442.1	529.2	853.8	1 825.1
USD/PLN options	47.5	0.0	488.9	1 622.2	2.1	2 113.2
Currency options (sold), including:	**1.9**	**78.0**	**931.0**	**2 151.4**	**855.9**	**3 938.3**
EUR/PLN options	1.9	30.5	442.1	529.2	853.8	1 825.1
USD/PLN options	0.0	47.5	488.9	1 622.2	2.1	2 113.2
Current off-balance sheet transactions, including:	**1.2**	**1.4**	**3 282.5**	**0.0**	**0.0**	**3 282.5**
FX operations	1.1	1.4	2 579.2	-	-	2 579.2
Securities operations	0.1	0.0	703.3	-	-	703.3
Fair value measurement of other financial instruments	**2.5**	**2.4**	-	-	-	-
Total	**784.7**	**979.2**	**77 106.6**	**90 012.4**	**222 904.2**	**390 023.2**

Interest rate derivatives IRS/FRA settled to market

In 2017, the Bank joined the new service provided by the Regulation of the KDPW CCP in respect of the approach to the settlement of IRS and FRA instruments. Before the change, the net exposure under the KDPW CCP transactions was collateralised with the variation margin as per the collateralised to market approach. In line with the terms and conditions of the new service, the transaction exposure is settled daily based on changed market value of specific transactions (i.e. under the settled to market approach). Therefore, no variation margin is placed. The fair value of individual transactions includes the daily exposure settlement flows. Since 2016 the Bank has been using a similar service for settlement of derivatives sent to the London Clearing House (LCH).

Embedded derivatives

At the end of 2018 and 2017, the Bank had PLN deposits with embedded derivatives. Embedded instruments are FX options. As at 31 December 2018, embedded derivatives were valued at PLN -0.1 million versus PLN 0.1 million as at 31 December 2017.

17. Hedge accounting

In the financial statements prepared for 2018 (as in 2017), the Bank applies fair value hedge accounting and cash flow hedge accounting. The table below presents the valuation of hedging instruments, broken down into instruments securing the fair value of securities and cash flow hedging instruments. The valuation of hedging instruments is presented in the item Derivative hedge instruments in assets (positive valuation) and liabilities (negative valuation) of the statement of financial position of the Bank.

	2018		2017	
	Assets	Liabilities	Assets	Liabilities
Instruments hedging the fair value of securities	0.0	191.6	4.1	254.4
Cash flow hedging instruments	909.6	420.2	963.1	444.8
Total hedge instruments	**909.6**	**611.8**	**967.2**	**699.2**

Fair value hedge accounting

The hedged risk is the risk of the change of the fair value of the financial asset resulting from the change of the interest rates. The subject of hedging is the fair value of the fixed interest rate debt instrument, namely the position (or its part) on a given security in the held-to-collect and sale portfolio (HTC&S) that as of establishing the hedging relationship has a specific fair value recognised in the revaluation reserve and the position (or its part) on a given security in the loans and other receivables portfolio as the result of reclassification from the held-to-collect portfolio (HTC).

For the strategy purposes, the part of the fair value change under the hedged risk is separated with the use of valuation models based on the same assumptions as for interest rate derivatives ones. The valuation curves applied in the model are based on market rates corresponding to revaluation tenors of variable interest rate hedging instruments.

Interest Rate Swap, changing fixed interest rate into the floating one, is the hedging instrument. As a result, changes to the fair value of the hedging instrument show the opposite trend from the changes to the fair value of the hedged item. Therefore, owing to the established hedging relationship, the fair values of the hedging instrument and the hedged item offset one another in the income statement.

The sources of ineffectiveness of the strategy, which are visible in the income statement, may result from:

- differences in the cash flow realization dates of the hedged items in relation to the realization dates of the hedging derivatives,
- mismatch resulting from application of different valuation curves (i.e. interest rate derivatives measured using valuation curves made taking account of the OIS discounting)
- changes in credit risk - component of fair value measurement of the hedged item from the HTC&S portfolio.
- bilateral value adjustment of hedging instruments do not impact the presented values due to the fact that only the transactions concluded on the interbank market and additionally hedged with a margin made or received, depending on the exposure, as well as transactions forwarded for daily clearing through the agency of Central Counterparty (LCH and KDPW) were designated as the hedging instrument.

Since only one type of risk (interest rate risk) is hedged against, changes to the fair value of the hedged item included in the HTC&S portfolio and caused by other unsecured risks are carried through other comprehensive income.
From the economic point of view, as part of the hedging strategies currently existing in the Bank, two types of hedging relationships can be distinguished:

- hedging of the fair value of debt securities in PLN with a fixed interest rate coupon classified to the HTC&S portfolio by IRS transactions, "pay fixed, receive variables" denominated in PLN,
- hedging the fair value of debt securities in EUR with a fixed interest rate coupone classified to the HTC's portfolio by IRS transactions, "pay fixed, receive variables" denominated in EUR.

The table below presents fair values and nominal values of hedging instruments and hedged instruments in fair value hedge accounting.

2018

	position in the statement of financial position / note number	Fair value		unrealized valuation result	cumulative adjustment of the valuation for the hedged risk	cumulative part of the valuation due to unsecured risks recognized in other comprehensive income **	notional amounts of instruments with time remaining to maturity			
		Assets	**Liabilities**				**over 1 year and up to 3 years**	**over 3 year and up to 8 years**	**over 8 years**	**Total**
Instruments hedging the fair value of securities, including:	Derivative hedge instruments	**0.0**	**191.6**	-	-	-	**8 239.1**	**4 543.5**	**200.0**	**12 982.6**
Cleared by CCP		*0.0*	*3.3*	-	-	-	*7 536.0*	*3 877.0*	*200.0*	*11 613.0*
Interest rate swaps (IRS PLN) fixed - float		0.0	10.7	-	-	-	7 536.0	3 877.0	200.0	11 613.0
Interest rate swaps (IRS EUR) fixed - float		0.0	180.9	-	-	-	703.1	666.5	0.0	1 369.6
Hedged items, including:		**13 443.3**	**0.0**	42.3	**194.0**	**-34.5**	**8 254.1**	**4 534.9**	**200.0**	**12 989.0**
Investment securities measured at fair value through other comprehensive income, including:	Investment securities	11 885.2	0.0	42.3	76.8	-34.5	7 536.0	3 877.0	200.0	11 613.0
Treasury bonds PLN	Note no. 18	11 065.5	0.0	17.6	55.6	-38.0	7 536.0	3 065.0	200.0	10 801.0
European Investment Bank bonds PLN	Note no. 18	819.7	0.0	24.7	21.2	3.5	0.0	812.0	0.0	812.0
Investment securities measured amortised cost, including:	Investment securities	1 558.1	0.0	-	117.2	-	718.1	657.9	0.0	1 376.0
Treasury bonds EUR	Note no. 18	1 558.1	0.0	-	117.2	-	718.1	657.9	0.0	1 376.0
Instruments for which the hedging relationship has been annulled, including:										
Investment securities measured amortised cost, including:	Investment securities	927.0			63.1		580.5	352.6		933.1
Treasury bonds EUR	Note no. 18	927.0			63.1		580.5	352.6		933.1

*) presented in the statement of comprehensive income in the item: *Debt securities at fair value through other comprehensive income - revaluation gains / losses recognized in equity*

The Bank uses the service "settled to market" provided for by the Regulation of the KDPW CCP and London Clearing House in respect of the approach to the settlement of IRS and FRA instruments. For details, refer to explanatory note no. 16 *Valuation of derivatives.*

2017

	Fair value		Notional amounts of instruments with time remaining to maturity				
	Assets	**Liabilities**	**up to 1 year**	**over 1 year and up to 3 years**	**over 3 year and up to 8 years**	**over 8 years**	**Total**
Instruments hedging the fair value of securities, including:	**4.1**	**254.4**	**1 075.4**	**4 207.9**	**6 696.5**	**812.0**	**12 791.8**
Cleared by CCP	*4.1*	*0.4*	*450.0*	*3 526.0*	*6 050.0*	*812.0*	*10 838.0*
Interest rate swaps (IRS PLN) fixed - float	4.1	0.4	650.0	3 526.0	6 050.0	812.0	11 038.0
Interest rate swaps (IRS EUR) fixed - float	0.0	254.0	425.4	681.9	646.5	0.0	1 753.8
Hedged items, including:	**13 045.3**	**0.0**	**1 075.4**	**4 222.5**	**6 688.1**	**812.0**	**12 798.0**
Debt securities from available-for-sale portfolio, including:	11 031.1	0.0	650.0	3 526.0	6 050.0	812.0	11 038.0
Treasury bonds PLN	10 241.8	0.0	650.0	3 526.0	6 050.0	0.0	10 226.0
European Investment Bank bonds PLN	789.3	0.0	0.0	0.0	0.0	812.0	812.0
Debt securities from loans and other receivables portfolio, including:	2 014.2	0.0	425.4	696.5	638.1	0.0	1 760.0
Treasury bonds EUR	2 014.2	0.0	425.4	696.5	638.1	0.0	1 760.0

Distribution over time of nominal amounts and the corresponding average percentages of hedging instruments

2018

		Notional amounts of instruments with time remaining to maturity					
		over 1 year and up to 3 years		over 3 year and up to 8 years		over 8 years	
		Nominal amount (PLN)	**Avarage %**	**Nominal amount (PLN)**	**Avarage %**	**Nominal amount (PLN)**	**Avarage %**
Interest rate swaps (IRS PLN) fixed - float	Fixed %	7 536.0	1.85%	3 877.0	2.49%	200.0	2.84%
	Variable %		1.79%		1.79%		1.78%
Interest rate swaps (IRS PLN) fixed - float	Fixed %	703.1	4.34%	666.5	4.11%	-	-
	Variable %		-0.30%		-0.32%		-

Net interest income from the derivative hedging instruments is presented under *interest on securities measured at amortised cost and interest on securities measured through other comprehensive income*, under which the interest income from the items hedged as part of the described strategy is presented.

The measurement of hedging transactions and hedged transactions is presented in the profit and loss statement of the Bank under *Net income on hedge accounting* and in explanatory note no. 6. The breakdown of the result on the hedging transactions and hedged transactions measurements by the individual hedging strategies is presented in the table below.

Type of economic relationship	**Movement in fair value used for the assessment of the strategy effectiveness**		**Ineffective portion of hedge recognised in the P&L**
	Hedged item	Hedging instrument	
Hedging debt securities in PLN	177.0	-171.9	5.1
Hedging debt securities in EUR	-47.5	53.3	5.8
Total	**129.5**	**-118.6**	**10.9**

Cash flow hedge accounting

The Bank applied the rules of accounting of cash flow hedges with regard to a specific portfolio of assets/ liabilities/ highly probable planned financial transactions of the Bank (e.g. extrapolation of cash flows arising from revolving deposits/overdrafts). Hedging strategies are used to hedge the Bank's exposure against changes in the size of future cash flows arising from interest rate risk. The Bank also applies a strategy for hedging mortgage loans indexed to EUR or CHF against changes arising from interest rate risk and foreign currency risk at the same time.

The hedged item is the specified portfolio of assets and/or financial liabilities or the portfolio of planned transactions, which includes financial instruments with variable interest rate (financial products based on the WIBOR/EURIBOR/LIBORCHF market interest rate) that are therefore exposed to the risk of future cash flows arising from the change of the WIBOR/EURIBOR, EURIBOR/LIBORCHF market interest rate and in part of the portfolio denominated in CHF/EUR exposed to foreign exchange risk arising from changes in the exchange rate.

For the strategy purposes, as regards changes to the fair value calculation for the future cash flows of the portfolio being hedged, the Bank applies the hypothetical derivative approach (i.e. the method whereunder it is possible to reflect the hedged item and the nature of the risk hedged in the form of a derivative). The measurement principles are the same as for the interest rate derivatives.

The sources of strategy ineffectiveness that is evident at the level of the profit and loss account may derive from the following:

- differences in the execution dates of cash flows relating to the hedged items versus the execution dates of cash flows relating to the derivative hedging instruments,
- the mismatch caused by application of different valuation curves for the hedging instrument and the mortgage derivative (i.e. the hedging instruments for the interest rate derivatives measured using valuation curves made taking account of the OIS discounting),
- bilateral value adjustments of hedging instruments do not have a material impact on the presented values due to the fact that only the transactions concluded on the interbank market and additionally hedged with a margin made or received, depending on the exposure, were designated as the hedging instrument.

From the perspective of the economic relationship, the following types of hedging relationships may be distinguished as part of the hedging strategies currently effective in the Bank:

- The instrument hedging asset items in the strategy hedging the risk of interest rate changes are the Pay-Variable, Receive-Fixed Interest Rate Swaps, while the instrument hedging liabilities items are the Pay-Fixed, Receive-Variable Interest Rate Swaps and the separated parts of the Currency Interest Rate Swap that reflect the Pay-Fixed, Receive-Variable Interest Rate Swaps.
- The instrument hedging asset items in the strategy of hedging both the risk of interest rate changes and the currency risk are the separated parts of the Currency Interest Rate Swap that reflect the Pay-Variable in CHF/EUR, Receive-Fixed in PLN Currency Swaps.

Considering the fact that the hedging instrument being the object of individual strategies has impact on the income statement on a continuous basis (i.e. by measurement at the amortized cost), the net interest income on derivative instruments to hedge the portfolio of:

- financial assets is presented in the item *Interest on loans and other receivables to customers*,
- financial liabilities is presented in the item *Interest on deposits from customers*.

The table below presents fair values and notional amounts of hedging instruments in the cash flow hedge accounting and fair values and notional amounts of hedging instruments and hedged items in the fair value hedge accounting. Notional amounts of the same-currency transaction derivatives were presented in the amounts purchased, while two-currency transactions showed both purchased and sold amounts.

2018

	Fair value		Notional amounts of instruments with time remaining to maturity				
	Assets	**Liabilities**	**up to 1 year**	**over 1 year and up to 3 years**	**over 3 year and up to 8 years**	**over 8 years**	**Total**
Cash flow hedging instruments, including:	**909.6**	**420.2**	**22 320.0**	**32 075.8**	**48 527.8**	**13 841.2**	**116 764.8**
Cleared by CCP	*32.7*	*11.0*	*15 793.6*	*25 922.3*	*36 188.5*	*13 841.2*	*91 745.6*
Interest rate swaps (IRS PLN) fixed - float	751.0	234.8	20 272.0	29 697.9	39 191.5	10 857.0	100 018.4
Interest rate swaps (IRS EUR) fixed - float	158.6	136.8	1 795.3	2 305.7	8 398.8	2 984.2	15 484.0
CIRS CHF/PLN (float-float)	0.0	47.6	-	-	-	-	-
float CHF	-	-	133.6	38.2	267.2	0.0	439.0
float PLN	-	-	119.1	34.0	243.2	0.0	396.3
CIRS EUR/PLN (float-float)	0.0	1.0	-	-	-	-	-
float EUR	-	-	0.0	0.0	215.0	0.0	215.0
float PLN	-	-	0.0	0.0	212.1	0.0	212.1

2017

	Fair value		Notional amounts of instruments with time remaining to maturity				
	Assets	**Liabilities**	**up to 1 year**	**over 1 year and up to 3 years**	**over 3 year and up to 8 years**	**over 8 years**	**Total**
Cash flow hedging instruments, including:	**963.1**	**444.8**	**24 102.1**	**27 133.8**	**47 409.7**	**10 025.0**	**108 670.6**
Cleared by CCP	*5.1*	*14.7*	*21 221.2*	*18 107.1*	*31 603.4*	*10 025.0*	*80 956.7*
Interest rate swaps (IRS PLN) fixed - float	796.4	294.3	22 520.6	24 147.8	40 022.1	7 439.0	94 129.5
Interest rate swaps (IRS EUR) fixed - float	156.7	129.8	1 506.5	2 672.3	6 474.1	2 586.0	13 238.9
CIRS CHF/PLN (float-float)	4.4	20.7	-	-	-	-	-
float CHF	-	-	35.7	160.5	249.7	0.0	445.9
float PLN	-	-	39.3	153.2	243.2	0.0	435.7
CIRS EUR/PLN (float-float)	5.6	0.0	-	-	-	-	-
float EUR	-	-	0.0	0.0	208.5	0.0	208.5
float PLN	-	-	0.0	0.0	212.1	0.0	212.1

As at 31 December 2018, other comprehensive income included PLN 842.3 million (including tax) relating to the effective part of the hedging relationship in the cash flow hedge accounting (PLN 148.6 million as at 31 December 2017). In 2018, the ineffective part of the hedging relationship resulting from the mismatch in compensating changes in fair value of the hedging instrument and hedged item recognised in the income statement totalled PLN -3.0 million compared with PLN -1.7 million in 2017.

The impact of the cash flow hedge accounting application on the profit and loss account and other comprehensive income

2018

	Change in fair value of the hedged items used for the assessment of the strategy effectiveness	**Hedging instruments**						
		fair value		movement in fair value of the hedging instruments used for the assessment of the strategy effectiveness			Amount reclassified from other comprehensive income and recognised in the profit and loss account	
		Assets	Liabilities	unrealised result from measurement recognised in the period*	effective portion of hedge recognised in other comprehensive income in the period**	ineffective portion of the hedge recognised in the profit and loss statement***	net interest income resulting from the existing hedging relationships	amortisation of a completed hedging strategy
Hedging relationship, including:	**-864.5**	**909.6**	**420.2**	**862.0**	**864.9**	**-3.0**	**417.7**	**0.9**
Interest rate swaps (IRS) hedging the portfolio of financial assets in PLN	-952.1	715.8	35.4	948.7	952.7	-4.0	458.0	0.0
Interest rate swaps (IRS) hedging the portfolio of financial assets in EUR	-24.4	59.8	9.6	24.1	24.1	0.0	34.7	1.0
Interest rate swaps (IRS) hedging the portfolio of financial liabilities in PLN,	107.5	35.1	199.5	-107.0	-108.1	1.0	-75.4	-0.1
Interest rate swaps (IRS) hedging the portfolio of financial liabilities in EUR	6.0	98.8	127.2	-5.4	-5.4	0.0	-7.7	0.0
CHF/ PLN CIRS resulting from the decomposition of the actual CIRS transaction hedging the portfolio of financial assets in CHF	-1.9	0.0	47.6	1.9	1.9	0.0	8.1	0.0
IRS transactions arising from the decomposition of CHF/PLN CIRS and EUR/PLN CIRS transactions	7.7	0.0	0.0	-7.7	-7.7	0.0	0.0	0.0
EUR/ PLN CIRS resulting from the decomposition of the actual transaction hedging the portfolio of financial assets in EUR	-7.3	0.0	1.0	7.3	7.3	0.0	0.0	0.0

*) presented in the statement of financial position in the item *Derivative hedge instruments*
**) presented in the statement of financial position in the item *Skumulowane inne całkowite dochody* and in the note no. 34.2. (the amount in the table does not include tax)
***) presented in the income statement in the dedicated item *Net income on hedge accounting* and in the note no. 6.

The profile of notional amount timing and the corresponding average interest rates of hedging instruments

2018

		Face value of instruments with time remaining to maturity							
		below 1 year		from 1 year to 3 years		from 3 to 8 years		over 8 years	
		notional amount (PLN)	**average %**	**notional amount (PLN)**	**average %**	**notional amount (PLN)**	**average %**	**notional amount (PLN)**	**average %**
Interest rate swaps (IRS) hedging the portfolio of financial assets in PLN	fixed %	16 064.0	2.67%	25 581.0	2.66%	34 373.5	2.90%	10 682.0	2.92%
	variable %		1.77%		1.78%		1.78%		1.79%
Interest rate swaps (IRS) hedging the portfolio of financial liabilities in PLN	fixed %	4 208.0	2.81%	4 116.9	2.42%	4 818.0	3.27%	175.0	3.07%
	variable %		1.73%		1.79%		1.79%		1.78%
Interest rate swaps (IRS) hedging the portfolio of financial assets in EUR	fixed %	965.4	0.23%	1 355.4	0.32%	3 901.0	0.69%	1 775.9	0.80%
	variable %		-0.33%		-0.34%		-0.34%		-0.32%
Interest rate swaps (IRS) hedging the portfolio of financial liabilities in EUR	fixed %	829.9	0.80%	950.3	0.08%	4 497.8	1.02%	1 208.3	0.89%
	variable %		-0.25%		-0.26%		-0.26%		-0.27%
CHF/ PLN CIRS subject to decomposition into a CIRS transaction hedging the portfolio of financial assets in CHF and an IRS transaction hedging the portfolio of financial liabilities in PLN	% variable in CHF	133.6	-0.66%	38.2	-0.66%	267.2	-0.66%	0.0	0.00%
	% variable in PLN	119.1	1.79%	34.0	1.79%	243.2	1.79%	0.0	0.00%
EUR/ PLN CIRS subject to decomposition into a CIRS transaction hedging the portfolio of financial assets in EUR and an IRS hedging the portfolio of financial liabilities in PLN	% variable in EUR	0.0	0.00%	0.0	0.00%	215.0	-0.37%	0.0	0.00%
	% variable in PLN	0.0	0.00%	0.0	0.00%	212.1	1.79%	0.0	0.00%

The periods in which the Bank expects that the cash flows hedged within hedge accounting will appear and have impact on the financial result are presented below. Negative value of inflows results from negative interest rates in EUR and CHF currencies.

2018

	Cash flows in PLN million			Cash flows in EUR milion			Cash flows in CHF milion	
	Cash inflows (assets)	Cash outflows (liabilities)	**Net cash flows**	Cash inflows (assets)	Cash outflows (liabilities)	**Net cash flows**	Cash inflows (assets)	**Net cash flows**
up to 1 year	935.2	-156.3	**778.9**	-3.3	0.6	**-2.7**	-0.6	**-0.6**
over 1 year and up to 3 years	1 585.2	-264.7	**1 320.5**	-1.8	0.1	**-1.7**	-0.6	**-0.6**
over 3 year and up to 8 years	2 762.5	-270.4	**2 492.1**	19.9	-6.1	**13.8**	0.1	**0.1**
over 8 years	377.8	-0.6	**377.2**	4.1	-2.1	**2.0**	0.0	**0.0**

2017

	Cash flows in PLN million			Cash flows in EUR milion			Cash flows in CHF milion	
	Cash inflows (assets)	Cash outflows (liabilities)	**Net cash flows**	Cash inflows (assets)	Cash outflows (liabilities)	**Net cash flows**	Cash inflows (assets)	**Net cash flows**
up to 1 year	871.0	-186.5	**684.5**	-3.4	0.6	**-2.8**	-0.8	**-0.8**
over 1 year and up to 3 years	1 605.6	-370.7	**1 234.9**	0.3	-0.4	**-0.1**	-0.4	**-0.4**
over 3 year and up to 8 years	2 789.0	-458.1	**2 330.9**	22.4	-4.8	**17.6**	0.4	**0.4**
over 8 years	172.2	-17.1	**155.1**	4.0	-3.5	**0.5**	0.0	**0.0**

18. Investment securities / Investments

	2018			2017
	[IFRS 9]			
	Stage 1			[IAS 39 - non-transformed data]
	gross	expected credit loss allowance	net	
Measured at fair value through other comprehensive income (FVOCI), including:	**20 082.0**	**-4.7**	**20 077.3**	n/a
debt securities, including:	19 998.7	-4.7	19 994.0	n/a
treasury bonds	17 675.0	-4.6	17 670.4	n/a
treasury bonds in EUR	903.1	-0.1	903.0	n/a
European Investment Bank bonds	985.6	0.0	985.6	n/a
Austrian government bonds	435.0	0.0	435.0	n/a
equity instruments, including:	83.3	0.0	83.3	n/a
Biuro Informacji Kredytowej S.A.	57.7	0.0	57.7	n/a
Krajowa Izba Rozliczeniowa S.A.	11.9	0.0	11.9	n/a
other	13.7	0.0	13.7	n/a
Measured at amortised cost, including:	**11 862.3**	**-2.3**	**11 860.0**	n/a
debt securities, including:	11 862.3	-2.3	11 860.0	n/a
treasury bonds	5 938.0	-1.3	5 936.7	n/a
treasury bonds in EUR	3 144.5	-0.8	3 143.7	n/a
Bank Gospodarstwa Krajowego bonds	513.0	-0.1	512.9	n/a
European Investment Bank bonds	2 266.8	-0.1	2 266.7	n/a
Available-for-sale (AFS), including:	n/a	n/a	n/a	**17 556.9**
debt securities, including:	n/a	n/a	n/a	17 551.6
treasury bonds	n/a	n/a	n/a	16 347.3
Austrian government bonds	n/a	n/a	n/a	415.0
European Investment Bank bonds	n/a	n/a	n/a	789.3
equity instruments	n/a	n/a	n/a	5.3
Held to maturity (HTM), including:	n/a	n/a	n/a	**8 350.5**
debt securities, including:	n/a	n/a	n/a	8 350.5
treasury bonds	n/a	n/a	n/a	6 796.3
Bank Gospodarstwa Krajowego bonds	n/a	n/a	n/a	1 554.2
Total	**31 944.3**	**-7.0**	**31 937.3**	**25 907.4**

The value presented in the item *equity instruments* in the category of assets *measured at fair value through other comprehensive income (FVOCI)* includes investments in shares issued by entities that are considered to be material from the porspective of the Bank's operations. The approach to the fair value measurement of these instruments is described in the further part of the report in note 38. *The fair value*. The Bank received the related revenue in the form of a dividend in the amount of PLN 6.3 million, which was presented in the Income Statement in item *Net income on the sale of securities measured at fair value through other comprehensive income and dividend income.*

In 2018, the Bank sold the shares from the portfolio of investment securities measured at fair value through other comprehensive income and achieved a result on this transaction in the amount of PLN +0.3 million. In 2017, the Bank sold the shares of 1 company (Visa Inc) from the investment portfolio, posting the result on sale of PLN +11.9 million.

Changes in impairment for expected losses

	Investment securities measured at fair value through other comprehensive income	Investment securities measured at amortised cost	TOTAL
	[IFRS 9]		
	Stage 1		
Opening balance of impairment	0.0	0.0	0.0
the impact of changes to the accounting principles in connection with the implementation of IFRS 9	-	2.1	**2.1**
Impairment loss at the beginning of the period adjusted for changes to the accounting principles	**0.0**	**2.1**	**2.1**
Changes in the period, including:	**4.8**	**0.3**	**5.1**
establishment and release in the period	4.8	0.3	**5.1**
Closing balance of impairment	**4.8**	**2.4**	**7.2**

Investment securities / Investments by maturity

	2018		2017	
	Measured at fair value through OCI	Measured at amortised cost	Available for sale	Held to maturity
up to 1 month	0.0	0.0	0.0	1 299.7
from 3 months to 1 year	35.9	204.0	763.3	991.0
from 1 to 5 years	11 472.2	7 940.2	12 551.4	5 633.8
over 5 years	8 569.2	3 715.8	4 242.2	426.0
Total	**20 077.3**	**11 860.0**	**17 556.9**	**8 350.5**

19. Assets securing liabilities

Market value of assets securing liabilities

	2018	2017
From the assets measured at fair value through other comprehensive income portfolio:		
treasury bonds constituting collateral to the Bank Guarantee Fund	559.0	n/a
treasury bonds collateralising the loan received by the subsidiary of the European Investment Bank	246.6	n/a
Austrian government bonds to hedge settlements with the LCH	433.5	n/a
From the portfolio of available-for-sale financial assets:		
treasury bonds constituting collateral to the Bank Guarantee Fund	n/a	584.2
treasury bonds collateralising the loan received by the subsidiary of the European Investment Bank	n/a	338.8
Austrian government bonds to hedge settlements with the LCH	n/a	413.5

Securities are pledged on the terms provided for by:

- The Act on the Bank Guarantee Fund, Deposit Guarantee Scheme and Compulsory Resolution (Journal of Laws of 10 June 2016, item 996),
- Commercial Companies and Partnerships Code, Article 495 (Journal of Laws of 2000, no. 94, item 1037 as amended),
- agreements, and
- the nature of the transaction.

Besides the instruments indicated herein, assets limited as to use also include the mandatory provision which the Bank has to maintain in the current account with NBP. For mandatory provision details, see note no. *13 Cash in hand and balances with the Central Bank.*

The Bank has the call deposits which are collateral on derivative transactions. The receivables from this title are presented in the note no. 14. *Loans and receivables to other banks* and in the note no. 20. *Loans and receivables to customers.*

20. Loans and receivables to customers

	2018	2017
	[IFRS 9]	[IAS 39 - non-transformed data]
Measured at amortised cost	98 907.4	87 358.7
Measured at fair value through profit or loss	218.4	-
Total (net)	**99 125.8**	**87 358.7**

Loans and other receivables measured at amortised cost

	2018			2017		
	[IFRS 9]			[IAS 39 - non-transformed data]		
	gross	impairment for expected losses	**net**	gross	impairment losses	**net**
Portfolio of loans, including:	**100 067.6**	**-2 110.8**	**97 956.8**	**84 601.5**	**-1 533.8**	**83 067.7**
Households	46 917.5	-1 097.8	45 819.7	38 428.7	-691.1	37 737.6
Business entities	49 949.9	-1 012.9	48 937.0	43 324.7	-841.5	42 483.2
The government and self-government institutions' sector	3 200.2	-0.1	3 200.1	2 848.1	-1.2	2 846.9
Total (gross), including:	**100 067.6**	**-2 110.8**	**97 956.8**	**84 601.5**	**-1 533.8**	**83 067.7**
Corporate banking segment	**55 693.0**	**-1 106.2**	**54 586.8**	**47 787.1**	**-908.0**	**46 879.1**
loans in the current account	13 553.7	-460.1	13 093.6	11 970.4	-310.7	11 659.7
term loans and advances	39 329.5	-645.6	38 683.9	33 268.4	-581.2	32 687.2
corporate and municipal debt securities	2 809.8	-0.5	2 809.3	2 548.3	-16.1	2 532.2
Retail banking segment	**44 374.6**	**-1 004.6**	**43 370.0**	**36 814.4**	**-625.8**	**36 188.6**
mortgages	33 371.7	-224.9	33 146.8	27 959.4	-170.4	27 789.0
loans in the current account	1 329.2	-105.8	1 223.4	1 315.8	-75.2	1 240.6
other loans and advances	9 673.7	-673.9	8 999.8	7 539.2	-380.2	7 159.0
Other receivables, including:	**950.6**	**0.0**	**950.6**	**4 291.7**	**-0.7**	**4 291.0**
Eurobonds (T-bonds)*	n/a	n/a	n/a	3 564.8	-0.7	3 564.1
complex call deposits	733.0	0.0	733.0	540.1	0.0	540.1
receivables under repo transactions	0.0	0.0	0.0	19.8	0.0	19.8
other receivables	217.6	0.0	217.6	167.0	0.0	167.0
Total	**101 018.2**	**-2 110.8**	**98 907.4**	**88 893.2**	**-1 534.5**	**87 358.7**

*) The eurobonds that until 31 Dec 2017 were classified as 'Loans and other receivables', as of 1 Jan 2018, are presented in item 'Investment securities'.

Loans and other receivables to customer by maturity

	2018		2017
	Measured at amortised cost	**Measured at fair value**	**Measured at amortised cost**
up to 1 month	18 815.0	0.1	16 736.8
over 1 month and up to 3 months	3 872.5	11.4	3 055.8
over 3 months and up to 1 year	9 842.2	39.9	9 557.4
over 1 year and up to 5 years	32 313.7	111.9	30 525.2
over 5 years	34 830.5	44.5	27 809.9
overdue	1 344.3	10.6	1 208.1
Total	**101 018.2**	**218.4**	**88 893.2**

20.1 Quality of loan portfolio

2018 [IFRS 9]

	gross	impairment for expected losses	net
Corporate banking segment	**55 693.0**	**-1 106.2**	**54 586.8**
assets in stage 1	50 361.4	-49.6	50 311.8
assets in stage 2	3 643.7	-51.9	3 591.8
assets in stage 3	1 687.9	-1 004.7	683.2
including individually significant assets	1 242.6	-677.5	565.1
Retail banking segment	**44 374.6**	**-1 004.6**	**43 370.0**
assets in stage 1	37 821.8	-57.5	37 764.3
assets in stage 2	5 773.7	-361.3	5 412.4
assets in stage 3	779.1	-585.8	193.3
Total	**100 067.6**	**-2 110.8**	**97 956.8**
Total assets in stage 1	88 183.2	-107.1	88 076.1
Total assets in stage 2	9 417.4	-413.2	9 004.2
Total assets in stage 3	2 467.0	-1 590.5	876.5

Additionally, the Bank identifies POCI financial assets whose fair value as at 1 January 2018 and carrying amount as at 31 December 2018 are 0. This group covers exposures under impaired receivables purchased in connection with the takeover of Bieszczadzka SKOK in 2017 and exposures that arisen due to restructuring resulting in re-recognition of the assets item in the statement of financial position.

2017 [IAS 39 non-transformed data]

	gross	impairment	net
Corporate banking segment	**47 787.1**	**-908.0**	**46 879.1**
unimpaired portfolio (IBNR*)	46 356.8	-71.1	46 285.7
impaired portfolio, including:	1 430.3	-836.9	593.4
measured individually (ISFA*)	1 099.4	-606.0	493.4
measured as the portfolio (INSFA*)	330.9	-230.9	100.0
Retail banking segment	**36 814.4**	**-625.8**	**36 188.6**
unimpaired portfolio (IBNR*)	36 142.7	-163.2	35 979.5
impaired portfolio	671.7	-462.6	209.1
Total customer loan portfolio, including:	**84 601.5**	**-1 533.8**	**83 067.7**
unimpaired (IBNR) portfolio	82 499.5	-234.3	82 265.2
impaired portfolio	2 102.0	-1 299.5	802.5

**) IBNR – Incurred But Not Reported; ISFA – Individually Significant Financial Assets; INSFA – Individually Non- Significant Financial Assets*

Receivable sale

In 2018, the Bank made the following transactions of receivables sale:

- Corporate portfolio
  - On 22 February 2018, the Bank concluded an agreement on the sale of corporate receivables from the impaired portfolio. As a result of the transaction, the portfolio of non-performing receivables decreased by PLN 85.6 million. The positive impact of the transaction on the Bank's gross result amounted to PLN 1.1 million.
- Retail portfolio
  - On 31 August 2018, the Bank concluded an agreement on the sale of retail receivables from the impaired portfolio. As a result of the transaction, the portfolio of non-performing receivables decreased by PLN 166.9 million. The positive impact of the transaction on the Bank's gross result amounted to PLN 25.6 million.

In 2017, the Bank made the following transactions of receivables sale:

- Corporate portfolio
  - 21 December 2017 – the Bank concluded an agreement on the sales of a portion of corporate receivables from the impaired portfolio. As a result of the transaction, the portfolio of non-performing receivables decreased by PLN 51.3 million. The positive impact of the transaction on the Bank’s result before tax was PLN 25.4 million (total risk costs).
  - On 7 June 2017, the Bank concluded an agreement on the sales of a portion of corporate receivables from the impaired portfolio. As a result of the transaction, the portfolio of non-performing receivables decreased by PLN 78.1 million. The positive impact of the transaction on the Bank’s result before tax was PLN 12.1 million (including PLN 9.5 million of risk costs).
  - On 2 February 2017, the Bank concluded an agreement on the sales of a portion of corporate receivables from the impaired portfolio. The positive impact of the transaction on the Bank’s risk costs was PLN 1.2 million.
- Retail portfolio
  - On 26 July 2017, the Bank concluded an agreement on the sales of a portion of retail receivables from the impaired portfolio. As a result of the transaction, the portfolio of non-performing receivables decreased by PLN 69.8 million. The positive impact of the transaction on the Bank’s result before tax was PLN 14.7 million (including PLN 11.0 million of risk costs).

Collateral

In line with the lending policy, the Bank accepts collateral to secure repayment of the loans extended in the form of blocked borrower's account funds and the borrower's assets. More information about collaterals is presented in chapter *Risk and capital management*, in item II *Credit risk management*.

Changes in impairment for expected losses

	2018				2017
	[IFRS 9]				[IAS 39 - non-transformed data]
	Stage 1	Stage 2	Stage 3	**Total**	
Opening balance of impairment	234.4	0.0	1 299.4	**1 533.8**	**1 328.5**
the impact of changes to the accounting principles in connection with the implementation of IFRS 9	-118.5	339.0	147.8	**368.3**	-
Impairment loss at the beginning of the period adjusted for changes to the accounting principles	**115.9**	**339.0**	**1 447.2**	**1 902.1**	**1 328.5**
Changes in the period, including:	**-8.8**	**74.2**	**143.3**	**208.7**	**205.3**
impairments for granted loans during the period	62.8	0.0	0.0	**62.8**	n/a
transfer to Stage 1	5.1	-60.5	-8.6	**-64.0**	n/a
transfer to Stage 2	-25.3	237.6	-31.1	**181.2**	n/a
transfer to Stage 3	-6.5	-50.7	497.6	**440.4**	n/a
changed provisioning under expected losses	-45.2	-53.6	-62.4	**-161.2**	n/a
derecognition from the balance sheet (write-downs, sale)	0.0	0.0	-286.7	**-286.7**	n/a
calculation and write-off of effective interest	0.0	0.0	13.3	**13.3**	n/a
establishment and release in the period	n/a	n/a	n/a	n/a	379.5
write-offs and decreases under sale of debt claims	n/a	n/a	n/a	n/a	-172.4
other	0.3	1.4	21.2	**22.9**	-1.8
Closing balance of impairment	**107.1**	**413.2**	**1 590.5**	**2 110.8**	**1 533.8**

Movements in impairment losses / expected losses by client segment

2018 [MSSF 9]

	Corporate banking				Retail banking				**TOTAL**
	Stage 1	Stage 2	Stage 3	**Total**	Stage 1	Stage 2	Stage 3	**Total**	
Opening balance of impairment	**71.2**	**-**	**836.8**	**908.0**	**163.2**	**-**	**462.6**	**625.8**	**1 533.8**
the impact of changes to the accounting principles in connection with the implementation of IFRS 9	-13.5	50.5	71.5	**108.5**	-105.0	288.5	76.3	**259.8**	**368.3**
Impairment loss at the beginning of the period adjusted for changes to the accounting principles	**57.7**	**50.5**	**908.3**	**1 016.5**	**58.2**	**288.5**	**538.9**	**885.6**	**1 902.1**
Changes in the period, including:	**-8.1**	**1.4**	**96.4**	**89.7**	**-0.7**	**72.8**	**46.9**	**119.0**	**208.7**
impairments for granted loans during the period	25.3	0.0	0.0	**25.3**	37.5	0.0	0.0	**37.5**	**62.8**
transfer to Stage 1	1.6	-12.1	-1.0	**-11.5**	3.5	-48.4	-7.6	**-52.5**	**-64.0**
transfer to Stage 2	-7.5	35.4	-0.3	**27.6**	-17.8	202.2	-30.8	**153.6**	**181.2**
transfer to Stage 3	-4.0	-6.2	247.4	**237.2**	-2.5	-44.5	250.2	**203.2**	**440.4**
changed provisioning under expected losses	-23.8	-15.9	-43.6	**-83.3**	-21.4	-37.7	-18.8	**-77.9**	**-161.2**
derecognition from the balance sheet (write-downs, sale)	0.0	0.0	-133.6	**-133.6**	0.0	0.0	-153.1	**-153.1**	**-286.7**
calculation and write-off of effective interest	0.0	0.0	18.7	**18.7**	0.0	0.0	-5.4	**-5.4**	**13.3**
other	0.3	0.2	8.8	**9.3**	0.0	1.2	12.4	**13.6**	**22.9**
Closing balance of impairment	**49.6**	**51.9**	**1 004.7**	**1 106.2**	**57.5**	**361.3**	**585.8**	**1 004.6**	**2 110.8**

2017 [MSR 39]

	Corporate banking			Retail banking			TOTAL
	loans and advances	bonds	TOTAL	mortgages	other loans and advances	TOTAL	
Opening balance	**785.2**	**17.1**	**802.3**	**195.0**	**331.2**	**526.2**	**1 328.5**
Movements in impairment losses, including:	**106.7**	**-1.0**	**105.7**	**-24.6**	**124.2**	**99.6**	**205.3**
recognised and reversed during the period	223.2	-1.0	**222.2**	-16.1	173.4	**157.3**	**379.5**
receivables written off	-108.8	-	**-108.8**	-5.7	-57.9	**-63.6**	**-172.4**
other	-7.7	0.0	**-7.7**	-2.8	8.7	**5.9**	**-1.8**
Closing balance	**891.9**	**16.1**	**908.0**	**170.4**	**455.4**	**625.8**	**1 533.8**

Reconciliation of the gross carrying amount

Changes in the gross carrying amount of the loan portfolio affect the level of allowances for expected credit losses, primarily through origination of loans in the period, transfers between stages and repayments made by borrowers. The table below presents a reconciliation of changes in the gross carrying amount by stage.

	2018 [IFRS 9]			
	Stage 1	Stage 2	Stage 3	**Total**
Opening balance of gross carrying amount	82 499.5	-	2 102.0	**84 601.5**
the impact of changes to the accounting principles in connection with the implementation of IFRS 9	-8 559.6	8 245.7	143.5	**-170.4**
Gross carrying amount at the beginning of the period adjusted for changes to the accounting principles	**73 939.9**	**8 245.7**	**2 245.5**	**84 431.1**
Changes in the period, including:	**14 243.3**	**1 171.7**	**221.5**	**15 636.5**
loans granted in the period	24 793.0	0.0	0.0	**24 793.0**
repayment (total and partial) and the release of new tranches	-6 468.0	-1 307.9	-589.5	**-8 365.4**
transfer to Stage 1	1 509.7	-1 499.9	-9.8	**0.0**
transfer to Stage 2	-4 494.1	4 540.7	-46.6	**0.0**
transfer to Stage 3	-613.8	-320.1	933.9	**0.0**
derecognition from the balance sheet (write-downs, sale)	0.0	0.0	-286.7	**-286.7**
other	-483.5	-241.1	220.2	**-504.4**
Closing balance of gross carrying amount	**88 183.2**	**9 417.4**	**2 467.0**	**100 067.6**

Among loans granted during the year, the most important item are mortgage loans for individuals (PLN 6,815.7 million), moreover, financial loans for individuals (PLN 2,646.3 million). A significant part is also short-term loans: revolving loans (PLN 1 380.7 million), working loans (PLN 3 422.5 million) and overdrafts (PLN 1 502.7 million).

Additionally, during 2018 the penalty interest amounted to PLN 141.2 million were accrued to gross carrying amount of loans and other receivables to customers. All these interest were written off.

21. Investments in controlled entities

The Bank has shares in subsidiares and associated entities. All the Bank's subsidiaries operate in Poland.

Name	Type of capital relationship	% of the Bank share in equity	Balance sheet value (measurement at the equity method)	
			2018	2017
ING Investment Holding (Polska) S.A. (formerly ING ABL Polska S.A.)	subsidiary	100.00%	233.4	225.0
ING Lease (Polska) Sp. z o.o.*	subsidiary	100.00%	215.8	185.5
ING Commercial Finance Polska S.A.*	subsidiary	100.00%	47.8	35.9
ING Bank Hipoteczny S.A. (IBH)	subsidiary	100.00%	112.3	0.0
ING Usługi dla Biznesu S.A.	subsidiary	100.00%	7.6	9.7
Solver Sp. z o.o.	subsidiary	100.00%	16.4	16.6
Nowe Usługi S.A.	subsidiary	100.00%	0.3	0.3
Twisto	associated	20.00%	1.0	1.3
Total			**634.6**	**474.3**

*) ING Bank Śląski S.A. has an indirect share in the company via ING Investment Holding (Polska) S.A. The ING Lease (Polska) Sp. z o.o Group incorporates 9 special-purpose vehicles wherein ING Lease Polska Sp. z o.o holds 100% of shares.

On 16 January 2018, ING Bank Śląski S.A. obtained from the Polish Financial Supervision Authority ("PFSA") the permission to establish a mortgage bank under the name of "ING Bank Hipoteczny Społka Akcyjna" with its registered office in Katowice. ING Bank Hipoteczny Społka Akcyjna company (ING Bank Hipoteczny S.A.) was formed with the notarial deed on 26 February 2018.

On 2 January 2019, ING Bank Śląski S.A. obtained information that the Polish Financial Supervision Authority approved operations commencement by ING Bank Hipoteczny S.A., a Bank subsidiary. In their decision the PFSA stated that ING Bank Hipoteczny S.A. satisfied all the requirements set out in Article 36.3 of the Banking Law Act.

In 2017, ING Bank Śląski S.A. acquired 20% shares of Twisto Polska sp. o.o. The company's activities are services in the field of information and computer technologies. The Bank cooperates with Twisto Polska sp. o.o. in Poland on the development of the Twisto Now service, i.e. online payment methods, "buy now, pay later". The Bank recognizes shares as an investment in an associate and is measured using the equity method in accordance with IAS 28.

22. Property, plant and equipment

	2018	2017
Real estate and leasehold improvements	329.2	339.6
Computer hardware	103.5	70.2
Other property, plant and equipment	85.6	120.0
Construction in progress	32.1	13.0
Total	**550.4**	**542.8**

2018

	Real estate and Leasehold improvements	Computer hardware	Other property plant and equipment	Construction in progress	TOTAL
Opening gross value	**704.7**	**243.5**	**413.2**	**13.0**	**1 374.4**
Additions, including:	**30.1**	**71.7**	**24.2**	**131.5**	**257.5**
purchases	-	-	-	131.5	131.5
investment takeovers	20.5	71.7	20.2	-	112.4
reclassification to another group within PPE	-	-	2.6	-	2.6
reclassification to assets held for sale	9.6	-	1.4	-	11.0
Disposals, including:	**-37.7**	**-56.6**	**-58.6**	**-112.4**	**-265.3**
sale and liquidation	-12.7	-55.8	-50.2	-	-118.7
investment takeovers	-	-	-	-112.4	-112.4
reclassification to assets held for sale	-25.0	-	-4.9	-	-29.9
reclassification to another group within PPE	-	-0.8	-	-	-0.8
depreciation	-	-	-3.5	-	-3.5
Revaluation:	**7.7**	**0.0**	**0.0**	**0.0**	**7.7**
Included in profit or loss*	7.7	-	-	-	7.7
Closing gross value	**704.8**	**258.6**	**378.8**	**32.1**	**1 374.3**
Opening accumulated depreciation/amortisation	**-365.1**	**-173.3**	**-293.2**	**0.0**	**-831.6**
Movements, including:	**-10.5**	**18.2**	**0.0**	**0.0**	**7.7**
amortisation charges	-29.1	-37.8	-48.9	-	-115.8
sale and liquidation	12.5	55.3	48.2	-	116.0
reclassification to assets held for sale	11.4	-	2.7	-	14.1
reclassification from assets held for sale	-5.3	-	-1.3	-	-6.6
reclassification to another group within PPE	-	0.7	-0.7	-	0.0
Closing accumulated depreciation/amortisation	**-375.6**	**-155.1**	**-293.2**	**0.0**	**-823.9**
Closing net value	**329.2**	**103.5**	**85.6**	**32.1**	**550.4**

*) in line *General and administrative expenses*, in detailed item *Maintenance and rental of buildings*

2017

	Real estate and Leasehold improvements	Computer hardware	Other property plant and equipment	Construction in progress	TOTAL
Opening gross value	**687.3**	**253.8**	**411.0**	**12.2**	**1 364.3**
Additions, including:	**44.8**	**36.6**	**24.1**	**82.0**	**187.5**
purchases	-	-	-	82.0	82.0
investment takeovers	23.3	36.6	21.3	-	81.2
reclassification from assets held for sale	21.5	-	2.8	-	24.3
Disposals, including:	**-21.8**	**-46.9**	**-21.9**	**-81.2**	**-171.8**
sale and liquidation	-18.2	-46.9	-12.8	-	-77.9
investment takeovers	-	-	-	-81.2	-81.2
reclassification to assets held for sale	-3.6	-	-0.1	-	-3.7
other	-	-	-9.0	-	-9.0
Revaluation:	**-5.6**	**0.0**	**0.0**	**0.0**	**-5.6**
Included in profit or loss*	-5.6	-	-	-	-5.6
Closing gross value	**704.7**	**243.5**	**413.2**	**13.0**	**1 374.4**
Opening accumulated depreciation/amortisation	**-348.6**	**-183.4**	**-260.7**	**0.0**	**-792.7**
Movements, including:	**-16.5**	**10.1**	**-32.5**	**0.0**	**-38.9**
amortisation charges	-28.9	-36.2	-42.9	-	-108.0
sale and liquidation	18.1	46.3	12.0	-	76.4
reclassification to assets held for sale	2.6	-	0.1	-	2.7
reclassification from assets held for sale	-8.3	-	-1.7	-	-10.0
Closing accumulated depreciation/amortisation	**-365.1**	**-173.3**	**-293.2**	**0.0**	**-831.6**
Closing net value	**339.6**	**70.2**	**120.0**	**13.0**	**542.8**

*) in line *General and administrative expenses*, in detailed item *Maintenance and rental of buildings*

There are no legal constraints on property, plant and equipment.

Contractual obligations to purchase property, plant and equipment

In 2018, the Bank concluded agreements with counterparties that in the future will effect increase in the value of property, plant and equipment of PLN 13.9 million. These are framework agreements and their value will be estimated under cost overviews developed in performance thereof. The agreements refer to real properties (buildings and structures), leasehold improvements, non-current assets under construction and other non-current assets.

In 2017, the Bank concluded framework agreements concerning real properties (buildings and structures), leasehold improvements, non-current assets under construction and other non-current assets of PLN 3.5 million.

23. Intangible assets

	2018	2017
Goodwill	223.3	223.3
Software	180.6	167.5
Outlays for intangible assets	19.9	26.0
Other	1.2	1.7
Total	**425.0**	**418.5**

2018

	Goodwill	Software	Outlays for intangible assets	Other intangible assets	TOTAL
Opening gross value	**223.3**	**977.3**	**26.0**	**13.8**	**1 240.4**
Additions, including:	**0.0**	**85.7**	**80.7**	**1.1**	**167.5**
purchases	-	-	80.7	-	80.7
investment takeovers	-	85.7	-	1.1	86.8
Disposals, including:	**0.0**	**0.0**	**-86.8**	**0.0**	**-86.8**
investment takeovers	-	-	-86.8	-	-86.8
Closing gross value	**223.3**	**1 063.0**	**19.9**	**14.9**	**1 321.1**
Opening accumulated depreciation/amortisation	**0.0**	**-809.8**	**0.0**	**-12.1**	**-821.9**
Movements, including:	**0.0**	**-72.6**	**0.0**	**-1.6**	**-74.2**
amortisation charges	-	-72.6	-	-1.6	-74.2
Closing accumulated depreciation/amortisation	**0.0**	**-882.4**	**0.0**	**-13.7**	**-896.1**
Closing net value	**223.3**	**180.6**	**19.9**	**1.2**	**425.0**

2017

	Goodwill	Software	Outlays for intangible assets	Other intangible assets	TOTAL
Opening gross value	**223.3**	**906.7**	**26.4**	**11.8**	**1 168.2**
Additions, including:	**0.0**	**71.5**	**73.1**	**2.0**	**146.6**
purchases	-	-	73.1	-	73.1
investment takeovers	-	71.5	-	2.0	73.5
Disposals, including:	**0.0**	**-0.9**	**-73.5**	**0.0**	**-74.4**
investment takeovers	-	-	-73.5	-	-73.5
other	-	-0.9	-	-	-0.9
Closing gross value	**223.3**	**977.3**	**26.0**	**13.8**	**1 240.4**
Opening accumulated depreciation/amortisation	**0.0**	**-738.3**	**0.0**	**-10.3**	**-748.6**
Movements, including:	**0.0**	**-71.5**	**0.0**	**-1.8**	**-73.3**
amortisation charges	-	-71.5	-	-1.8	-73.3
Closing accumulated depreciation/amortisation	**0.0**	**-809.8**	**0.0**	**-12.1**	**-821.9**
Closing net value	**223.3**	**167.5**	**26.0**	**1.7**	**418.5**

Contractual obligations to purchase intangible assets

In 2018, the Bank concluded with counterparties the agreements that in the future will effect increase in the value of intangible assets of PLN 13.0 million. Since these are framework agreements, the said amount is not ultimate. As in the previous year, those agreements concern licence purchase and computer software implementation.
As at 2017 yearend, the Bank held the agreements for licence purchase and computer software implementation totalling PLN 12.2 million. These agreements were partly framework arrangements.

Impairment test of cash generating units with respective goodwill

The goodwill impairment test is carried out at least once every year, irrespective of identification of any objective evidence of impairment.

At the Bank, the impairment test is made for the goodwill created as a result of the in-kind contribution of ING Bank NV branch. The smallest identifiable cash-generating units were determined and goodwill totalling PLN 223.3 million was assigned thereto. No other additional elements of intangible value and indefinite useful life were identified that could be assigned to the identified cash-generating units.

The test input data cover the economic capital, risk-weighted assets and profit before tax per segment. The test is performed using the model that calculates and compares the current value of free cash flow of the unit to the estimated book value of the unit's funds. The free cash flows of the unit are defined as net profits less capital needed to maintain the solvency ratio at the required level. To discount the cash flows, the discount rate of 8.23 % is used that represents the average weighted cost of capital. Other assumptions are: projected income tax rates (26.37%), nominal growth rate after the forecast horizon (3%) and projected 3M WIBOR (1.73%).

The recoverable value was determined based on the estimation of the useable value of the assets component taking into account the estimated forecast of expected future cash flows generated during the continued use. The cash flow forecasts are based on rational assumptions that reflect the most accurate appraisal of the management regarding all the conditions that will appear during the remaining lifetime of the assets. The cash flow forecasts are based on mid-term plan approved by the Bank and the strategy covering the maximum period of the next three years. The data regarding the subsequent two years come from extrapolation. Extrapolation assumes that the cash flow generating centre will maintain the gross profit to risk weighted assets ratio at the level from the last year of the Bank's forecast and its profits will increase by previously determined growth rate. Legitimacy of the assumptions made is verified periodically, and any divergence between the cash flows estimated based on the future cash flows and the actual ones is analysed as appropriate.

As at 31 December 2018, net present value of cash flows was PLN 6,552.9 million. The test showed the surplus of present value over the net book value of the cash-generating unit, totalling PLN 4,613.4 million thus, no impairment was determined.

The table below shows discount rate sensitivity of the impairment test for the cash-generating units.

	as at 31 Dec 2018	Discount rate change	
		- 1 p.p.	+ 1 p.p.
Surplus of cash flows net value over the net book value (PLN million)	4 613.4	6 295.3	3 474.8

24. Assets held for sale

	2018	2017
Opening value	**11.1**	**31.8**
Additions, including:	**14.0**	**0.9**
reclassification from property, plant and equipment	14.0	0.9
Disposals, including:	**-14.2**	**-21.1**
sale	-9.8	-6.8
reclassification to property, plant and equipment	-4.4	-14.3
Revaluation:	**0.0**	**-0.5**
Included in profit or loss*	0.0	-0.5
Closing value	**10.9**	**11.1**

*) in line *General and administrative expenses*, in detailed item *Maintenance and rental of buildings*

As at 31 December 2018, the amount of *Property, plant and equipment held for sale* included 4 real estate properties which were reclassified from Property, plant and equipment. The real estate properties are available to be immediately sold in their current condition. The Bank intends to sell the abovementioned real estate properties using services of a specialized company that searches for potential buyers with the use of various, available sources (advertisements, direct mailing, contact with other real property agencies, etc.). The real estate property should be sold within 12 months from the reclassification date.

25. Deferred tax

Movements in temporary differences during the year

2018

	Opening balance	impact of changes in accounting principles implementation of IFRS 9	**Opening balance after accounting principles changes**	Changes carried through profit or loss	Changes carried through equity	**Closing balance**
Deferred tax asset						
impairment losses on credit receivables	-127.1	-55.9	**-183.0**	-81.1	-	**-264.1**
revaluation	-121.6	-5.5	**-127.1**	-11.7	-5.5	**-144.3**
other provisions	-50.1	-	**-50.1**	-7.5	-	**-57.6**
employee benefits	-40.6	-	**-40.6**	2.5	-	**-38.1**
correction due to effective interest rate	-12.3	-	**-12.3**	-	-	**-12.3**
other	-15.9	-	**-15.9**	-	-	**-15.9**
Total	**-367.6**	**-61.4**	**-429.0**	**-97.8**	**-5.5**	**-532.3**
Deferred tax provision						
revaluation	201.4	2.4	203.8	-	8.3	**212.1**
interest occured	6.5	-	6.5	73.3	-	**79.8**
settlement of the difference between tax and balance sheet depreciation	15.2	-	15.2	-3.0	-	**12.2**
settlement of prepayments/accruals due to depreciation/ amortisation resulting from the investment relief	4.0	-	4.0	-1.2	-	**2.8**
other	9.6	-	9.6	6.8	-	**16.4**
Total	**236.7**	**2.4**	**239.1**	**75.9**	**8.3**	**323.3**
Deferred tax disclosed in the balance sheet	**-130.9**	**-59.0**	**-189.9**	**-21.9**	**2.8**	**-209.0**

2017

	Opening balance	Changes carried through profit or loss	Changes carried through equity	**Closing balance**
Deferred tax asset				
impairment losses on credit receivables	**-112.8**	-14.3	-	**-127.1**
revaluation	**-122.7**	-	1.1	**-121.6**
other provisions	**-43.7**	-6.4	-	**-50.1**
employee benefits	**-39.8**	-0.8	-	**-40.6**
correction due to effective interest rate	**-12.3**	-	-	**-12.3**
interest occured	**-19.2**	19.2	-	**0.0**
other	**-15.9**	-	-	**-15.9**
Total	**-366.4**	**-2.3**	**1.1**	**-367.6**
Deferred tax provision				
revaluation	**184.4**	0.1	16.9	**201.4**
interest occured	**9.0**	6.2	-	**15.2**
settlement of the difference between tax and balance sheet depreciation	**4.4**	-0.4	-	**4.0**
settlement of prepayments/accruals due to depreciation/ amortisation resulting from the investment relief	**6.5**	-	-	**6.5**
other	**7.9**	1.7	-	**9.6**
Total	**212.2**	**7.6**	**16.9**	**236.7**
Deferred tax disclosed in the balance sheet	**-154.2**	**5.3**	**18.0**	**-130.9**

Deferred tax recognised directly in equity

	31 Dec 2018	01 Jan 2018	31 Dec 2017
Revaluation of financial asset measured at FVOCI – debt securities	64.6	69.1	n/a
Revaluation of financial asset measured at FVOCI – equity instruments	11.2	11.8	n/a
Revaluation of available-for-sale financial assets	n/a	n/a	78.6
Property, plant and equipment	1.7	2.6	2.6
Cash flow hedging instruments	75.7	66.6	66.6
Actuarial gains/losses	-0.7	-0.4	-0.4
Total	**152.5**	**149.7**	**147.4**

26. Other assets

	2018	2017
Prepayments, including:	**119.0**	**99.3**
accrued income	37.4	24.6
commission-related settlements	45.0	39.7
prepaid bank operating expenses	34.8	26.0
expenses to be settled	1.2	0.3
other	0.6	8.7
Other assets, including:	**64.4**	**64.4**
interbank settlements	19.3	16.7
settlements with customers	14.8	8.8
public and legal settlements	0.8	1.0
other	29.5	37.9
Total	**183.4**	**163.7**
Including financial assets	64.4	64.4

27. Liabilities to other banks

	2018	2017
Current accounts	324.0	257.7
Interbank deposits	876.1	102.3
Received call deposits	592.1	665.7
Other liabilities	15.5	18.9
Total	**1 807.7**	**1 044.6**

Liabilities to other banks by maturity

	2018	2017
up to 1 month	1 799.3	1 041.6
over 1 month and up to 3 months	8.4	3.0
Total	**1 807.7**	**1 044.6**

28. Financial liabilities at fair value through profit or loss

	2018	2017
Valuation of derivatives *	578.1	979.2
Other financial liabilities at fair value through profit or loss, including:	886.2	735.1
Book short position in trading securities	886.2	735.1
Razem	**1 464.3**	**1 714.3**

*) Detailed disclosures regarding the nominal value of derivatives and their valuation by individual types are presented in note 16. *Valuation of derivatives.*

Financial liabilities at fair value through profit or loss by maturity

	2018	2017
over 3 months and up to 1 year	22.7	0.0
over 1 year and up to 5 years	33.7	619.9
over 5 years	829.8	115.2
Total	**886.2**	**735.1**

29. Liabilities to customers

	2018	2017
Deposits, including:	**116 102.7**	**102 936.9**
Households	78 255.5	67 918.6
Business entities	35 929.7	33 244.4
Government and self-government institutions' sector	1 917.5	1 773.9
Total (gross), including:	**116 102.7**	**102 936.9**
Corporate banking	**37 784.7**	**34 887.3**
current accounts	25 613.6	23 645.6
savings accounts	9 982.1	8 566.6
term deposits	2 189.0	2 675.1
Retail banking	**78 318.0**	**68 049.6**
current accounts	18 051.1	14 792.0
savings accounts	57 948.1	49 935.0
term deposits	2 318.8	3 322.6
Other liabilities, including:	**1 191.1**	**1 138.9**
liabilities under cash collateral	329.5	274.0
other liabilities	861.6	864.9
Total	**117 293.8**	**104 075.8**

Liabilities due to customers by maturity

	2018	2017
up to 1 month	114 798.3	100 733.0
over 1 month and up to 3 months	1 020.8	1 926.3
over 3 months and up to 1 year	1 239.2	1 232.6
over 1 year and up to 5 years	87.3	82.0
over 5 years	148.2	101.9
Total	**117 293.8**	**104 075.8**

30. Liabilities under issue of debt securities

	2018	2017
Liabilities under issue of debt securities, including:	300.3	300.3
- Bonds issued by ING Bank Śląski S.A.	300.3	300.3
Total	**300.3**	**300.3**

Liabilities under issue of debt securities by maturity

	2018	2017
over 3 months to 1 year	300.3	0.0
over 1 year to 5 years	0.0	300.3
Total	**300.3**	**300.3**

The Bank holds liabilities due to the issue of bonds under the Own Debt Securities Issuance Programme of ING Bank Śląski S.A. ("Programme"). The Programme was established to enable the Bank to obtain long-term funding to use for further growth of non-current assets and diversify funding sources. The programme was set in 2012. Two programme issues of bonds were made so far. The bonds from first issue were redeemed in December 2017.

The second issue was made on 19 December 2014 (INGBS191219 series bonds). As in the first issue, the bonds were issued as bearer bonds of 5 years maturity. They were offered in private placement. The nominal value of bonds in the second issue totalled PLN 300.0 million. Bonds will be redeemed through payment of the amount of cash equal to the bonds' nominal value. The redemption date for bonds is 19 December 2019. Bonds bear floating interest, paid every 6 months. Interest is determined using 6M WIBOR plus margin of 0.75% per annum. On 19 December 2018, a new, nineth, coupon period started; the current bond coupon is 2.54% per annum.

31. Subordinated liabilities

ING Bank Śląski concluded 2 subordinated loan agreements with ING Bank N.V. based in Amsterdam:

- Agreement concluded on 23 February 2016 for the amount of EUR 150.0 million. By decision of the Polish Financial Supervision Authority of 19 April 2016, the Bank obtained permission to recognize loan amount under Tier 2 capital.
- Agreement concluded on 30 October 2018 for the amount of EUR 100.0 million. After signing the loan agreement, the Bank applied to the Polish Financial Supervision Authority for permission to recognize the amount of the loan under Tier 2 capital. The permission was obtained on 30 January 2019.

Both loans were loan was granted for 10 years. The Bank has the right to prepay of each loan after the lapse of 5 years, provided the relevant approval of the Polish Financial Supervision Authority (PFSA) is obtained. Interest will be paid quarterly at the 3M EURIBOR rate plus margin (1.22% for loan from 2018 and 2.25% for loan from 2016). The financial terms and conditions of the loan were set on an arm's length basis. ING Bank N.V. is the parent company, holding 75% of shares and votes at the Bank General Meeting.

As at 2018 yearend, the carrying amount of the subordinated loan was PLN 1,076.9 million (as at 2017 yearend PLN 626.9 million).

32. Provisions

	2018 [IFRS 9]	2017 [IAS 39 - non-transformed data]
Provision for off-balance sheet liabilities	78.5	45.9
Provision for retirement benefits	38.8	37.0
Provision for disputes	32.2	7.0
Total	**149.5**	**89.9**

2018

	Provision for off-balance sheet liabilities				Provision for retirement benefits	Provision for issues in dispute	TOTAL
	Stage 1	Stage 2	Stage 3	Total`			
Opening balance	20.5	-	25.4	**45.9**	37.0	7.0	**89.9**
The impact of changes to the accounting principles in connection with the IFRS 9	5.8	12.1	-0.2	**17.7**	-	-	**17.7**
Opening balance adjusted for changes to the accounting principles	**26.3**	**12.1**	**25.2**	**63.6**	**37.0**	**7.0**	**107.6**
provisions recognised/ reversed	0.2	5.8	8.8	**14.8**	0.8	11.4	**27.0**
provisions utilised	-	-	-	**0.0**	-	-0.1	**-0.1**
actuarial gains/losses	-	-	-	**0.0**	1.0	-	**1.0**
settlement of the return of the penalty from UOKiK	-	-	-	**0.0**	-	14.1	**14.1**
other	0.1	-0.1	0.1	**0.1**	-	-0.2	**-0.1**
Closing balance	**26.6**	**17.8**	**34.1**	**78.5**	**38.8**	**32.2**	**149.5**
Expected provision settlement period:							
up to 1 year				0.0	3.8	11.8	**15.6**
over to 1 year				78.5	35.0	20.4	**133.9**

2017

	Provision for off-balance sheet liabilities	Provision for retirement benefits	Provision for issues in dispute	TOTAL
Opening balance	26.8	28.0	4.2	**59.0**
provisions recognised/ reversed	19.6	1.2	3.4	**24.2**
provisions utilised	0.0	0.1	-0.6	**-0.5**
actuarial gains/losses	0.0	7.7	0.0	**7.7**
exchange rate changes	-0.5	0.0	0.0	**-0.5**
Closing balance	**45.9**	**37.0**	**7.0**	**89.9**
Expected provision settlement period:				
up to 1 year	0.0	4.1	1.4	**5.5**
over to 1 year	45.9	32.9	5.6	**84.4**

Provision for issues in dispute

The value of the proceedings conducted in 2018 concerning liabilities and debt claims did not exceed 10% of the Bank's equity. The Bank is of the opinion that none of the proceedings conducted in 2018 before court, competent authority for arbitration proceedings or public administration authority, pose a risk to the Bank's financial liquidity, individually or in total.

Proceedings before the President of the Office of Competition and Consumer Protection (UOKiK)

- *Proceedings regarding the application of practices violating collective consumer interests*
  - Before the President of the Office of Competition and Consumer Protection there are the proceedings pending which were initiated *ex officio* by the Office President on 30 December 2015 regarding the application of the practices infringing collective consumer interests by the ING Bank Śląski. The practices consist in: informing the consumers being parties to the payment service agreement or having access to the online banking system about the amendments proposed to the terms and conditions of the payment service agreement during its term solely via electronic messages sent through the internet banking system which is not a durable medium under the Act on Payment Services; failure to include – in the messages sent to consumers regarding unilateral change of contractual terms, made during its term, wherewith certain documents are enclosed (regulations, general terms and conditions, the table of fees and commissions) regarding personal accounts, savings accounts, prepaid cards, credit cards and online banking – material information enabling consumers to establish that

the changes made are admissible, i.e. failure to provide the contractual legal basis for the said changes and their triggers (factual circumstances), whereby consumers cannot verify that the changes to the contractual terms made by the Bank during the obligation-based relationship are admissible; informing the consumers of unilateral modification of modification clauses enabling amendment to regulations and general terms and conditions regarding personal accounts, savings accounts, prepaid cards, credit cards and online banking under the circumstances where there were no legal grounds for modifying the contractual terms in that manner during the obligation-based relationship with consumers.

On 8 August 2018, the President of the UOKiK issued a decision obliging to take specific actions. In connection with this decision, the Bank committed in particular to:

- concluding with customers annexes to the agreement accounts or the agreement on the cards issued to the account and make individual settlement of fees and commissions, which entered into force between 1 January 2014 and 1 March 2017 and refunding to the clients the difference in the fee or commission charged resulting from its increase, calculation changes or newly introduced fee or commission charged,
- grant public compensation to clients in the form of exemption from collecting cash withdrawal fees from all ATMs in the country, made with a debit card issued to the account, pre-paid or credit card - from 29 October to 28 November 2018.

Liabilities due to clients resulting from the decisions of UOKiK were made until 3 January 2019. In the 4th quarter 2018 the Bank incurred costs from this title in the amount of PLN 16.4 million. The Authority also imposed an obligation to submit a report on the implementation of the above commitments.

- Before the President of the UOKiK there are the proceedings pending which were initiated *ex officio* by the Office President on 9 July 2014 regarding the application of the practices infringing collective consumer interests by the Bank. The practices consist in: making cards replacement during the payment card contract from cards which are not equipped with the contactless function to the contactless cards without changing the content of the contract, derive the legal consequences from Announcement to General terms and conditions of providing by ING Bank Śląski S.A. services as part of maintaining personal accounts and savings accounts for individuals, not provided consumers with information about the opportunities and principles for using payment cards to contactless transactions, spending limits for payment transactions executed by these cards, on paper or on another durable medium, in time before conclusion of the contract. All proposals of the bank's liabilities towards UOKiK in the framework of the above-mentioned proceedings have already been implemented. On 18 December 2018, UOKiK extended the proceedings until 30 April 2019.

- *Proceedings regarding the allegation of practices limiting competition on the market of acquiring services for the payments made with payment cards in Poland*

Following the antimonopoly proceedings conducted against ING Bank Śląski S.A. and other banks upon the request of the Polish Trade and Distribution Organization – Employers' Confederation, on 29 December 2006, the President of the Office of Competition and Consumer Protection issued a decision stating that the Bank applied the practices limiting competition. The Office of Competition and Consumer Protection deemed as competition limiting the practice whereby various Polish banks, the Bank included, participated in the arrangement limiting competition on the market of acquiring services for clearance of consumer liabilities towards merchants under the payment of goods and services acquired by consumers using payment cards in Poland by setting together the interchange fees charged on the transactions made using the Visa and MasterCard system cards in Poland. In consequence of recognition of the practices limiting competition, the Office of Competition and Consumer Protection imposed fines on banks, the Bank included – of PLN 14,088,270.

The decision was appealed against inter alia by the Bank with the Court of Competition and Consumer Protection. With its judgement of 12 November 2008, the Court of Competition and Consumer Protection changed the decision of the Office of Competition and Consumer Protection in that it did not recognise the practice limiting competition. On 22 April 2010, the judgement was repealed with the judgement of the Court of Appeal which referred the case for re-review.

With its judgment of 21 November 2013, the Court did not change the decision of the Office of Competition and Consumer Protection on the allegation of limiting competition, but reduced the Bank's fine to PLN 403,209. Nonetheless, the judgement of the Court of Competition and Consumer Protection was changed with the judgment of the Court of Appeal of 6 October 2015 which ruled to change the judgment of the Court of Competition and Consumer Protection in that all appeals were dismissed in their entirety.

Following the ruling, the President's decision became final and binding and in October 2015 the Bank paid the fine of PLN 14.1 million as ruled.

The Bank and other banks participating in the proceedings alike lodged a complaint for annulment of the judgment of the Court of Appeal. On 25 October 2017, the Supreme Court repealed the judgment of the Court of Appeal and referred the case thereto for re-review. In line with the position of the Office of Competition and Consumer Protection, the fine paid was refunded to the Bank.

The Court of Appeal set the date of another hearing for 24 October 2018. As final decisions have not been taken yet, the amount of the reimbursed fine was not recognised in the income statement. As at 31 December 2018, the Bank holds the provision of PLN 14.1 million.

Provision for retirement benefits

Provisions for retirement severance pay are estimated on the basis of actuarial valuation with discount rate, which at the end of 2018 stood at 3.2% (3.3% at the end of 2017). The actuarial valuation-based provision is recognised and reviewed per annum.

Provision for retirement benefits –revision of the balance-sheet liability

	2018	2017
Opening balance	37.0	28.0
Costs included in the income statement, including:	3.3	2.5
regular employment costs	2.2	1.6
past service cost	0.0	0.0
costs of interest	1.1	0.9
Actuarial gains / losses	1.0	7.7
Paid benefits	-2.5	-1.2
Closing balance	**38.8**	**37.0**

33. Other liabilities

	2018	2017
Accruals, including:	**375.8**	**392.6**
due to employee benefits	239.5	261.0
variable remuneration programme	60.1	71.2
due to commissions	129.3	119.5
other	7.0	12.1
Other liabilities, including:	**1 030.6**	**1 380.4**
interbank settlements	522.8	1 061.5
settlements with suppliers	222.2	175.7
public and legal settlements	73.0	65.5
other	212.6	77.7
Total	**1 406.4**	**1 773.0**

34. Equity

34.1. Share capital

The Bank's share capital is PLN 130,100,000 and is sub-divided into:

- 92,600,000 A-series ordinary bearer's shares with face value of PLN 1.00 each, and
- 37,500,000 B-series ordinary bearer's shares with face value of PLN 1.00 each.

Each ordinary share entitles its holder to dividend and one vote during the general meeting. All shares are fully paid.

34.2. Accumulated other comprehensive income

	2018	2017
Revaluation of financial assets measured at fair value through OCI - debt securities	275.3	nd
- including deferred tax	-64.6	nd
Revaluation of financial assets measured at fair value through OCI - equity instruments	47.7	nd
- including deferred tax	-11.2	nd
Revaluation reserve from measurement of available-for-sale financial assets	nd	335.3
- including deferred tax	nd	-78.6
Property, plant and equipment	7.4	11.4
- including deferred tax	-1.7	-2.6
Cash flow hedging instruments	842.3	148.6
- including deferred and current tax*	-197.6	-34.9
Actuarial gains / losses	-3.0	-2.1
- including deferred tax	0.7	0.4
Total	**1 169.7**	**493.2**

*) The Bank uses the service “settled to market”, or “STM”, provided for by the Regulation of the KDPW CCP and London Clearing House Clearnet (LCH) in respect of the approach to the settlement of IRS and FRA instruments. Even though the effective portion of the hedging relationship resulting from the measurement of derivative hedging instruments is recognised in other comprehensive income, due to the STM mechanism it is settled in cash and the amount paid to/ received from LCH and KDPW CCP represents tax income/ expense for the purpose of the corporate income tax (CIT). That is why the current tax is recognised in other comprehensive income. Details on the STM services are presented in explanatory note no. 16. *Valuation of derivatives.*

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2018

	Revaluation of FVOCI debt securities	Revaluation of FVOCI - equity instruments	Revaluation reserve from measurement of available-for-sale financial assets	Property, plant and equipment	Cash flow hedging instruments	Actuarial gains / losses	TOTAL
Opening balance	**0.0**	**0.0**	**335.3**	**11.4**	**148.6**	**-2.1**	**493.2**
The impact of changes to the accounting principles in connection with the implementation of IFRS 9	295.0	41.4	-335.3	0.0	0.0	0.0	**1.1**
Opening balance adjusted for changes to the accounting principles	**295.0**	**41.4**	**0.0**	**11.4**	**148.6**	**-2.1**	**494.3**
financial assets measured at fair value through OCI – gains / losses from revaluation carried through equity	12.1	6.3	-	-	-	-	**18.4**
financial assets measured at fair value through OCI – reclassification to the financial result due to the sale	-31.8	0.0	-	-	-	-	**-31.8**
cash flow hedging – revaluation gains / losses carried through equity			-	-	1 033.1	-	**1 033.1**
cash flow hedging - reclassification to the financial result			-	-	-339.4	-	**-339.4**
disposal of fixed assets	-	-	-	-4.0	-	-	**-4.0**
actuarial gains / losses	-	-	-	-	-	-0.9	**-0.9**
Closing balance	**275.3**	**47.7**	**0.0**	**7.4**	**842.3**	**-3.0**	**1 169.7**

2017

	Revaluation reserve from measurement of available-for-sale financial assets	Property, plant and equipment	Cash flow hedging instruments	Actuarial gains / losses	TOTAL
Opening balance	**206.4**	**11.5**	**354.6**	**4.3**	**576.8**
effect of changes in accounting policy from the implementation the equity method for valuation controlled entities	0.0	0.2	0.0	0.4	**0.6**
Opening balance adjusted for changes to the accounting principles	**206.4**	**11.7**	**354.6**	**4.7**	**577.4**
gains/losses on revaluation of available- for-sale financial assets carried through equity	192.9	-	-	-	**192.9**
reclassified to the financial result as a result of sale of available-for-sale financial assets	-31.7	-	-	-	**-31.7**
settlement of the valuation of securities reclassified from the portfolio available for sale to the portfolio of loans and receivables	-0.2	-	-	-	**-0.2**
settlement of the valuation of securities reclassified from the portfolio available for sale to the portfolio of financial assets held to maturity	-32.1	-	-	-	**-32.1**
effective part of cash flow hedging relationship	-	-	-206.0	-	**-206.0**
disposal of fixed assets	-	-0.3	-	-	**-0.3**
actuarial gains / losses	-	-	-	-6.8	**-6.8**
Closing balance	**335.3**	**11.4**	**148.6**	**-2.1**	**493.2**

34.3. Retained earnings

	2018	2017
Other supplementary capital	314.7	272.9
Reserve capital	8 232.9	7 243.7
General risk fund	1 215.2	1 215.2
Valuation of share-based payments	51.6	51.6
Retained earnings	-260.1	28.7
Result for the current year	1 525.9	1 403.1
Total	**11 080.2**	**10 215.2**

2018

	other suppleme ntary capital	reserve capital	general risk fund	valuation of share-based payments	retained earnings	result for the current year	TOTAL
Opening balance	**272.9**	**7 243.7**	**1 215.2**	**51.6**	**1 431.8**	**0.0**	**10 215.2**
The impact of changes to the accounting principles in connection with the IFRS 9	0.0	0.0	0.0	0.0	-249.0	0.0	**-249.0**
Opening balance adjusted for changes to the accounting principles	**272.9**	**7 243.7**	**1 215.2**	**51.6**	**1 182.8**	**0.0**	**9 966.2**
net result for the current period	-	-	-	-	-	1 525.9	**1 525.9**
profit allocation, including:	41.8	989.2	-	-	-1 447.2	-	**-416.2**
profit written off to supplementary capital	41.8	-	-	-	-41.8	-	**0.0**
profit written off to reserve capital	-	989.2	-	-	-989.2	-	**0.0**
dividend	-	-	-	-	-416.2	-	**-416.2**
disposal of fixed assets	-	-	-	-	4.0	-	**4.0**
Valuation of share-based payments	-	-	-	-	0.3	-	**0.3**
Closing balance	**314.7**	**8 232.9**	**1 215.2**	**51.6**	**-260.1**	**1 525.9**	**11 080.2**

2017

	other suppleme ntary capital	reserve capital	general risk fund	valuation of share-based payments	retained earnings	result for the current year	TOTAL
Opening balance	**66,1**	**6 089,8**	**1 160,2**	**50,3**	**1 265,3**	**0,0**	**8 631,7**
effect of changes in accounting policy from the implementation the equity method for valuation controlled entities	160,0	0,2	0,0	0,3	18,8	0,0	**179,3**
Opening balance adjusted for changes to the accounting principles	**226,1**	**6 090,0**	**1 160,2**	**50,6**	**1 284,1**	**0,0**	**8 811,0**
net result for the current period	-	-	-	-	-	1 403,1	**1 403,1**
profit allocation, including:	47,0	1 153,7	55,0	0,0	-1 255,7	0,0	**0,0**
profit written off to supplementary capital	47,0	-	-	-	-47,0	-	**0,0**
profit written off to reserve capital	-	1 153,7	-	-	-1 153,7	-	**0,0**
profit written off to general risk fund	-	-	55,0	-	-55,0	-	**0,0**
settlement of acquisition of shares in subsidiary	-0,2	-	-	-	-	-	**-0,2**
disposal of fixed assets	-	-	-	-	0,3	-	**0,3**
valuation of share-based payments	-	-	-	1,0	-	-	**1,0**
Closing balance	**272,9**	**7 243,7**	**1 215,2**	**51,6**	**28,7**	**1 403,1**	**10 215,2**

Supplementary capital

Supplementary capital is formed from appropriations from profit after tax, surpluses generated under issue of shares above their face value and extra contributions paid up by the shareholders to be used for covering balance-sheet losses. The decision on the use of the supplementary capital is taken at the General Meeting.

Reserve capital

The reserve capital is created irrespective of the supplementary capital from profit after tax write-offs, in the amount passed by the General Meeting. The reserve capital may be allocated to cover special costs and expenses, and also to increase the share capital from the Bank's funds. The decision on activation of the reserve capital is taken by the General Meeting.

General Risk Fund

The General Risk Fund is established in accordance with the Banking Law Act from the post-tax profits and is used for unidentified risk of banking activity. The decision on the use of the Fund is taken by the Management Board.

Dividend payout

Details of the Bank's dividend policy and divided payout constraints are included in the risk management part of this report, in chapter VI *Risk and Capital Management, in item 9. Dividend Policy.*

35. FX structure of assets and liabilities

Herein below, the statement of financial position of the Bank and contingent liabilities were presented per base currencies. The following currency rates were applied to calculate values in original currency:

	31.12.2018	31.12.2017
EUR	4.3000	4.1709
USD	3.7597	3.4813
CHF	3.8166	3.5672

2018

STATEMENT OF FINANCIAL POSITION	PLN	EUR		USD		CHF		Other currencies (after translation into PLN)	TOTAL
		after translation into PLN	*in currency*	*after translation into PLN*	*in currency*	*after translation into PLN*	*after translation into PLN*		
Assets									
Cash in hand and balances with the Central Bank	878.3	264.9	*61.6*	47.8	*12.7*	6.8	*1.8*	39.6	**1 237.4**
Loans and other receivables to other banks	349.0	361.7	*84.1*	21.3	*5.7*	2.3	*0.6*	42.2	**776.5**
Financial assets held for trading	1 528.0	105.9	*24.6*	69.7	*18.5*	3.4	*0.9*	4.6	**1 711.6**
Derivative hedge instruments	751.0	158.6	*36.9*	0.0	*0.0*	0.0	*0.0*	0.0	**909.6**
Investment securities	27 012.3	4 925.0	*1 145.3*	0.0	*0.0*	0.0	*0.0*	0.0	**31 937.3**
Loans and other receivables to customers	86 155.0	10 609.5	*2 467.3*	774.8	*206.1*	974.2	*255.3*	612.3	**99 125.8**
Investments in controlled entities	634.6	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**634.6**
Property, plant and equipment	550.4	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**550.4**
Intangible assets	425.0	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**425.0**
Assets held for sale	10.9	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**10.9**
Deferred tax assets	209.0	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**209.0**
Other assets	164.9	17.5	*4.1*	0.8	*0.2*	0.0	*0.0*	0.2	**183.4**
Total assets	**118 668.4**	**16 443.1**	***3 823.9***	**914.4**	***243.2***	**986.7**	***258.6***	**698.9**	**137 711.5**

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STATEMENT OF FINANCIAL POSITION	PLN	EUR		USD		CHF		Other currencies (after translation into PLN)	TOTAL
		after translation into PLN	*in currency*	*after translation into PLN*	*in currency*	*after translation into PLN*	*in currency*		
Liabilities									
Liabilities to other banks	1 207.7	587.7	*136.7*	2.8	*0.7*	0.0	*0.0*	9.5	**1 807.7**
Financial liabilities at fair value through profit or loss	1 196.9	205.3	*47.7*	34.8	*9.3*	0.6	*0.2*	26.7	**1 464.3**
Derivative hedge instruments	294.1	317.7	*73.9*	0.0	*0.0*	0.0	*0.0*	0.0	**611.8**
Liabilities to customers	101 632.2	12 094.9	*2 812.8*	2 747.0	*730.6*	13.8	*3.6*	805.9	**117 293.8**
Liabilities under issue of debt securities	300.3	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**300.3**
Subordinated liabilities	0.0	1 076.9	*250.4*	0.0	*0.0*	0.0	*0.0*	0.0	**1 076.9**
Provisions	140.7	7.3	*1.7*	1.5	*0.4*	0.0	*0.0*	0.0	**149.5**
Current income tax liabilities	264.5	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**264.5**
Other liabilities	1 363.5	40.2	*9.3*	1.1	*0.3*	1.5	*0.4*	0.1	**1 406.4**
Total liabilities	**106 399.9**	**14 330.0**	***3 332.5***	**2 787.2**	***741.3***	**15.9**	***4.2***	**842.2**	**124 375.2**
Equity									
Share capital	130.1	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**130.1**
Supplementary capital - issuance of shares over nominal value	956.3	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**956.3**
Accumulated other comprehensive income	1 115.0	54.7	*12.7*	0.0	*0.0*	0.0	*0.0*	0.0	**1 169.7**
Retained earnings	11 080.2	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**11 080.2**
Total equity	**13 281.6**	**54.7**	***12.7***	**0.0**	***0.0***	**0.0**	***0.0***	**0.0**	**13 336.3**
Total equity and liabilities	**119 681.5**	**14 384.7**	***3 345.2***	**2 787.2**	***741.3***	**15.9**	***4.2***	**842.2**	**137 711.5**

Contingent liabilities granted	26 668.6	4 056.4	*943.3*	1 218.6	*324.1*	0.0	*0.0*	15.2	**31 958.8**
Contingent liabilities received	73 763.9	17 569.9	*4 086.0*	963.8	*256.4*	39.8	*10.4*	146.9	**92 484.3**

2017

STATEMENT OF FINANCIAL POSITION	PLN	EUR		USD		CHF		Other currencies (after translation into PLN)	TOTAL
		after translation into PLN	*in currency*	*after translation into PLN*	*in currency*	*after translation into PLN*	*in currency*		
Assets									
Cash in hand and balances with the Central Bank	2 431,8	296,2	*71,0*	49,7	*14,3*	5,7	*1,6*	31,7	**2 815,1**
Loans and receivables to other banks	754,3	525,2	*125,9*	883,5	*253,8*	0,3	*0,1*	71,2	**2 234,5**
Financial assets held for trading	1 058,6	115,5	*27,7*	136,8	*39,3*	1,1	*0,3*	2,8	**1 314,8**
Derivative hedge instruments	810,5	156,7	*37,6*	0,0	*0,0*	0,0	*0,0*	0,0	**967,2**
Investments	24 997,5	909,9	*218,2*	0,0	*0,0*	0,0	*0,0*	0,0	**25 907,4**
Loans and receivables to customers	73 060,9	11 806,4	*2 830,7*	948,8	*272,5*	1 051,1	*294,7*	491,5	**87 358,7**
Investments in controlled entities	474,3	0,0	*0,0*	0,0	*0,0*	0,0	*0,0*	0,0	**474,3**
Property, plant and equipment	542,8	0,0	*0,0*	0,0	*0,0*	0,0	*0,0*	0,0	**542,8**
Intangible assets	418,5	0,0	*0,0*	0,0	*0,0*	0,0	*0,0*	0,0	**418,5**
Assets held for sale	11,1	0,0	*0,0*	0,0	*0,0*	0,0	*0,0*	0,0	**11,1**
Deferred tax assets	130,9	0,0	*0,0*	0,0	*0,0*	0,0	*0,0*	0,0	**130,9**
Other assets	150,6	13,1	*3,1*	0,0	*0,0*	0,0	*0,0*	0,0	**163,7**
Total assets	**104 841,8**	**13 823,0**	***3 314,2***	**2 018,8**	***579,9***	**1 058,2**	***296,7***	**597,2**	**122 339,0**

2017

STATEMENT OF FINANCIAL POSITION	PLN	EUR		USD		CHF		Other currencies (after translation into PLN)	TOTAL
		after translation into PLN	*in currency*	*after translation into PLN*	*in currency*	*after translation into PLN*	*in currency*		
Liabilities									
Liabilities to other banks	367.5	659.9	*158.2*	7.2	*2.1*	3.3	*0.9*	6.7	**1 044.6**
Financial liabilities at fair value through profit or loss	1 255.6	312.0	*74.8*	138.3	*39.7*	0.0	*0.0*	8.4	**1 714.3**
Derivative hedge instruments	322.3	376.9	*90.4*	0.0	*0.0*	0.0	*0.0*	0.0	**699.2**
Liabilities to customers	89 080.6	10 904.0	*2 614.3*	3 364.1	*966.3*	23.1	*6.5*	704.0	**104 075.8**
Liabilities under issue of debt securities	300.3	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**300.3**
Subordinated liabilities	0.0	626.9	*150.3*	0.0	*0.0*	0.0	*0.0*	0.0	**626.9**
Provisions	84.0	5.0	*1.2*	0.9	*0.3*	0.0	*0.0*	0.0	**89.9**
Current income tax liabilities	220.2	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**220.2**
Other liabilities	1 745.0	26.9	*6.4*	1.1	*0.3*	0.0	*0.0*	0.0	**1 773.0**
Total liabilities	**93 375.5**	**12 911.6**	***3 095.6***	**3 511.6**	***1 008.7***	**26.4**	***7.4***	**719.1**	**110 544.2**
Equity									
Share capital	130.1	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**130.1**
Supplementary capital - issuance of shares over nominal value	956.3	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**956.3**
Accumulated other comprehensive income	438.4	54.8	*13.1*	0.0	*0.0*	0.0	*0.0*	0.0	**493.2**
Retained earnings	10 215.2	0.0	*0.0*	0.0	*0.0*	0.0	*0.0*	0.0	**10 215.2**
Total equity	**11 740.0**	**54.8**	***13.1***	**0.0**	***0.0***	**0.0**	***0.0***	**0.0**	**11 794.8**
Total equity and liabilities	**105 115.5**	**12 966.4**	***3 108.7***	**3 511.6**	***1 008.7***	**26.4**	***7.4***	**719.1**	**122 339.0**

	PLN	EUR after translation into PLN	EUR in currency	USD after translation into PLN	USD in currency	CHF after translation into PLN	CHF in currency	Other currencies	TOTAL
Contingent liabilities granted	24 717.4	3 030.6	*726.6*	1 082.0	*310.8*	0.0	*0.0*	14.2	**28 844.2**
Contingent liabilities received	69 483.8	11 652.9	*2 793.9*	576.6	*165.6*	35.3	*9.9*	73.7	**81 822.3**

36. Contingent liabilities

36.1. Contingent liabilities granted

	2018	2017
Undrawn credit facilities	24 097.0	21 598.6
Guarantees	4 943.8	4 439.9
Undrawn overdrafts in current account	1 371.2	1 336.1
Credit card limits	1 251.7	1 079.4
Letters of credit	295.1	390.2
Total	**31 958.8**	**28 844.2**

The Bank discloses obligations to grant loans. These obligations include approved loans, credit card limits and overdrafts in current accounts.

The Bank issues guarantees and letters of credits to secure fulfilment of obligations of the Bank's customers to third parties. The value of guarantees and letters of credit disclosed above reflects the maximum loss that can be incurred and that would be disclosed as at the balance sheet date should the customers fail to fulfil their obligations in full.

The Bank charges commissions for contingent liabilities granted, which are settled in line with the specific nature of the particular instrument.

Financial guarantee contracts by maturity

	2018	2017
up to 1 month	113.8	191.7
over 1 month and up to 3 months	560.1	396.4
over 3 months and up to 1 year	2 067.5	1 806.9
over 1 year and up to 5 years	1 491.1	1 568.6
over 5 years	711.3	476.3
Total	**4 943.8**	**4 439.9**

Information on issue underwriting for other issuers

As at the end of 2018, the Bank underwrote to purchase bonds issued by five issuers. The total amount of the obligation (understood as the unused limit of the total nominal underwriting facility) was PLN 1,293.0 million. As at the end of 2017, the Bank underwrote to purchase bonds issued by six issuers, totalling PLN 820.0 million.

36.2. Contingent liabilities received

	2018	2017
Guarantees received	92 315.1	81 627.9
Financing	169.2	194.4
Total	**92 484.3**	**81 822.3**

37. Fair value

Fair value, which is best reflected by a market price, if available is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in a direct transaction, other than forced sale or liquidation.

37.1. Financial assets and liabilities at fair value in statement of financial position

Based on the employed methods of determining the fair value, financial assets/liabilities are classified to the following categories:

- Level 1: financial assets/liabilities measured directly on the basis of prices quoted in the active market.
- Level 2: financial assets/liabilities measured using the measurement techniques based on assumptions using data from an active market or market observations.
- Level 3: financial assets/liabilities measured using the measurement techniques commonly used by the market players, the assumptions of which are not based on data from an active market.

The table below presents the balance-sheet figures for financial assets and liabilities per individual measurement levels.

2018

	Level 1	Level 2	Level 3	TOTAL
Financial assets, including:	**21 195,9**	**1 419,3**	**301,7**	**22 916,9**
Valuation of derivatives	**0.0**	**509.7**	**0.0**	**509.7**
Financial assets held for trading, including:	**1 201.9**	**0.0**	**0.0**	**1 201.9**
debt securities, including:	1 201.9	0.0	0.0	1 201.9
treasury bonds	1 183.0	0.0	0.0	1 183.0
European Investment Bank bonds	18.9	0.0	0.0	18.9
Derivative hedge instruments	**0.0**	**909.6**	**0.0**	**909.6**
Financial assets measured at fair value through other comprehensive income, including:	**19 994.0**	**0.0**	**83.3**	**20 077.3**
debt securities, including:	19 994.0	0.0	0.0	19 994.0
treasury bonds	17 670.4	0.0	0.0	17 670.4
treasury bonds in EUR	903.0	0.0	0.0	903.0
European Investment Bank bonds	985.6	0.0	0.0	985.6
Austrian Government bonds	435.0	0.0	0.0	435.0
equity instruments	0.0	0.0	83.3	83.3
Loans and other liabilities measured at fair value through profit or loss	**0.0**	**0.0**	**218.4**	**218.4**
Financial liabilities, including:	**886.2**	**1 189.9**	**0.0**	**2 076.1**
Valuation of derivatives	**0.0**	**578.1**	**0.0**	**578.1**
Other financial liabilities measured at fair value through profit or loss, including:	**886.2**	**0.0**	**0.0**	**886.2**
book short position in trading securities	886.2	0.0	0.0	886.2
Derivative hedge instruments	**0.0**	**611.8**	**0.0**	**611.8**

2017

	Level 1	Level 2	Level 3	TOTAL
Financial assets, including:	**18 021.1**	**1 812.5**	**5.3**	**19 838.9**
Valuation of derivatives	**0.0**	**784.8**	**0.0**	**784.8**
Financial assets held for trading, including:	**469.5**	**60.5**	**0.0**	**530.0**
debt securities, including:	469.5	0.0	0.0	469.5
treasury bonds	422.6	0.0	0.0	422.6
European Investment Bank bonds	46.9	0.0	0.0	46.9
repo transactions	0.0	60.5	0.0	60.5
Derivative hedge instruments	**0.0**	**967.2**	**0.0**	**967.2**
Financial assets available-for sale, including:	**17 551.6**	**0.0**	**5.3**	**17 556.9**
debt securities, including:	17 551.6	0.0	0.0	17 551.6
treasury bonds	16 347.3	0.0	0.0	16 347.3
Austrian government bonds	415.0	0.0	0.0	415.0
European Investment Bank bonds	789.3	0.0	0.0	789.3
equity instruments	0.0	0.0	5.3	5.3
Financial liabilities, including:	**735.1**	**1 678.4**	**0.0**	**2 413.5**
Valuation of derivatives	**0.0**	**979.2**	**0.0**	**979.2**
Other financial liabilities measured at fair value through profit or loss, including:	**735.1**	**0.0**	**0.0**	**735.1**
book short position in trading securities	735.1	0.0	0.0	735.1
Derivative hedge instruments	**0.0**	**699.2**	**0.0**	**699.2**

Movements between valuation levels

In 2018, there were no movements between valuation levels.

Valuation of financial instruments classified to level 2

The Bank classifies derivatives, cash bills of the National Bank of Poland and repo transactions to level 2 of valuation.

Derivatives

The following models are applied for non-linear transactions (FX options), depending on the product type:

- the European vanilla option – the Garman-Kohlhagen model,
- the European digital option – the Garman-Kohlhagen model adjusted by the call spread,
- Cap/Floor (back-to-back transactions) – the Black's model.

The following are the input data for the models:

- the foreign exchange rate – obtained by the parties from the National Bank of Poland's website,
- implied volatilities – obtained from Bloomberg BGN or Bloomberg Synthetic for currency pairs with lower liquidity, and
- profitability curves similar to those for linear derivatives.

Fair value for linear instruments (other derivatives) is determined based on discounted future cashflows at the transaction level. The fair value determined in that manner is the PV of those cash flows. All input data used for the creation of the revaluation curves are observed on the market, and include: deposit market rates, forward points, FRA rates, IRS rates, OIS rates, FX basis points, basis points among the indexes for variable rates, and FX rates. The data come from the Reuters system and come mainly from brokers. Market data quality is controlled during the daily contribution process for revaluation rates.

Derivative instruments are valued according to the OIS curve concept on the assumption that the transaction valuation is hedged with a deposit at the EONIA rate. PLN transactions settled in central clearing houses (London Clearing House, Central Securities Depository of Poland) are exception, where NPV settlement is in the original currency which is reflected in the applied valuation curves (initial zero curve based on WIBOR and IRS quotations).

Repo transactions

Fair value for repo transactions is determined based on future payment flows discounted according to the profitability curve for the so-called cash instruments.

Measurement adjustment

The Bank adopted prudent valuation for financial assets and liabilities measured at fair value and based the said measurement on the guidelines provided for in the Technical Standards of the European Banking Authority (i.e.: EBA – Article 105(14) of the Regulation EU 575/2013 published in March 2014). This approach aims at determining the fair value with a high, 90%, confidence level, considering uncertain market pricing and closing cost.

As at 2018 yearend, the prudent valuation adjustment totalled PLN 82.3 million (PLN 73.2 million for 2017), out of which PLN 72.2 million (PLN 73.2 million for 2017) reduced the revaluation reserve of cash flow hedging instruments, whereas PLN -0.2 million (PLN 2.6 million for 2017) encumbered the financial result (including: PLN +0.5 million was recognised under the item Net income on hedge accounting while PLN -0.7 million under the item Net income on financial instruments measured through profit and loss and FX result for 2017 PLN +1.1 million and +1.5 million respectively).

Valuation of financial instruments classified to the level 3

Financial assets classified to level 3 of the valuation as at 1 January 2018 and as at 31 December 2018 include unlisted equity instruments and loans that did not meet the SPPI criterion in accordance with IFRS 9. As at 31 December 2017, these loans were measured at amortized cost. Detailed information on the changes that the Bank implemented in connection with the entry into force of the IFRS 9 are presented in Chapter II. *Statement of compliance with International Financial Reporting Standards,* in point 1.2. *Impact of IFRS 9 Financial instruments implementation on the Group's financial statements*.

Fair value measurement of unlisted shares in other companies is based on the dividend discount model. The estimates concerning future dividend payments were prepared on the basis of mid-term profitability forecasts prepared by the management boards of those companies. The discount rate is based on the cost of equity which is estimated according to the CAPM, or the Capital Asset Pricing Model.

The sensitivity analysis of the equity instruments valuation shows that 1) upon adoption of a target dividend payout rate that is +10p.p. / -10p.p. versus the baseline scenario, the valuation would, respectively, increase/ decrease by 8%; 2) upon adoption of the cost of equity that is -0.5% / +0.5% versus the baseline scenario, the valuation would, respectively, increase by 5%/ decrease by 6%; 3) upon combining the effects of 1) and 2), the valuation would, respectively, increase by 15%/ decrease by 13%.

Methodology of the fair value measurement of the lending portfolio is based on the discounted cash flow method. In this method, the expected cash flows and individual payment dates discount factors are estimated for each measured contract; the value of the discounted cash flows as at the measurement date is also determined. Pricing models are fed with business parameters for individual contracts and parameters observable by the market such as interest rate curves, liquidity cost and

capital cost. The change of the parameters used in the measurement did not have a material impact on the measurement as at 31 December 2018.

The sensitivity analysis of the fair value of the above loans as at 31 December 2018 indicates that when the discount rate changes by + 1 / -1 p.p. in the absence of a change in the expected cash flows, the fair value changes by about +/- 3%.

In 2018, the revaluation of the equity instruments classified to measurement stage 3 recognised in the comprehensive income totalled PLN 16.1 million. The measurement impact for the loans classified to measurement stage 3 totalled PLN 0.1 million and was recognised in the income statement in the item: *'Net income on financial instruments measured at fair value through profit or loss and FX result'.*

Movements in financial assets/liabilities classified to the level 3 of measurement

	2018		2017
	Equity instuments measured at fair value through OCI	Loans and other receivables	Equity instruments from the AFS financial assets portfolio
Opening balance	**5.3**	**0.0**	**48.8**
the impact of changes to the accounting principles in connection with the IFRS 9	62.1	278.7	0.0
Opening balance adjusted for changes to the accounting principles	**67.4**	**278.7**	**48.8**
Increases, including:	**16.1**	**0.0**	**11.9**
valuation recognized in accumulated other comprehensive income	16.1	0.0	0.0
net income on sale of VISA Inc.	0.0	0.0	11.9
Disposals, including:	**-0.2**	**-60.3**	**-55.4**
repayment of loans	0.0	-60.2	0.0
valuation recognized in the income statement *	0.0	-0.1	0.0
sale of SWIFT shares	-0.2	0.0	0.0
sale of VISA Europe shares	0.0	0.0	-46.2
valuation recognized in accumulated other comprehensive income	0.0	0.0	-5.5
FX changes	0.0	0.0	-3.7
Closing balance	**83.3**	**218.4**	**5.3**

*) In item *Net income on financial instruments at fair value through profit or loss and FX result*

37.2. Non-financial assets at fair value in statement of financial position

2018

	Level 1	Level 2	Level 3	TOTAL
Own real property	-	-	260.1	**260.1**
Property, plant and equipment held for sale	-	-	10.9	**10.9**

2017

	Level 1	Level 2	Level 3	TOTAL
Own real property	-	-	266.2	**266.2**
Property, plant and equipment held for sale	-	-	11.1	**11.1**

Changes in non-financial assets classified to level 3 of the measurement is presented in this statement, note no. 22. Plant, property and equipment and 24. Assets held for sale.

Fair value measurement

Own real estate properties

The Bank measures its property at fair value. Valuation is carried out by an independent appraiser using the income method in accordance with the applicable rules of property valuation.

In 2018, the following real estate properties were appraised:

- ING Bank Śląski S.A. Head Office in Katowice (Sokolska) – as at 31 December 2018, the building's value was PLN 100.8 million; the change in the value of this real property for the year 2018 decreased the financial result by PLN 2.6 million (PLN 2.1 million including the deferred tax),
- ING Bank Śląski S.A. Head Office in Katowice (Chorzowska 50) – as at 31 December 2018, the building's value was PLN 123.3 million; the change in the value of this real property for the year 2018 increased the financial result by PLN 3.2 million (PLN 2.6 million including the deferred tax), and
- 18 other real estate properties located across Poland; change in the value of the real properties for the year 2018 decreased the revaluation reserve by PLN 0.05 million (PLN 0.04 million including the deferred tax) and reduced the financial result for 2018 by PLN 0.05 million (PLN 0.04 million including the deferred tax).

The sensitivity analysis of the own real estate valuation shows that upon adoption of a capitalisation rate that is -0.5% / +0.5% versus the baseline scenario, the valuation would, respectively, increase by 11% (PLN 21.7 million) / decrease by 6% (-PLN 11.0 million).

In 2017, the following real estate properties were appraised:

- ING Bank Śląski S.A. Head Office in Katowice (Sokolska) – as at 31 December 2017, the building's value was PLN 103.6 million; the change in the value of this real property for the year 2017 decreased the financial result by PLN 4.4 million (PLN 3.6 million including the deferred tax),
- ING Bank Śląski S.A. Head Office in Katowice (Chorzowska 50) – as at 31 December 2017, the building's value was PLN 123.4 million; the change in the value of this real property for the year 2017 decreased the financial result by PLN 1.7 million (PLN 1.5 million including the deferred tax), and
- 13 other real estate properties located across Poland; change in the value of the real properties for the year 2017 decreased the revaluation reserve by PLN 0.5 million (PLN 0.4 million including the deferred tax) and reduced the financial result for 2017 by PLN 0.6 million (PLN 0.5 million including the deferred tax).

The results of real properties appraisals were presented in the income statement in the item Operating costs (in note no. 8 in detailed item *Maintenance and rental of buildings*).

As at 31 December 2018, PLN 7.4 million, which amount (including deferred tax) refers to the real estate properties assessed at fair value, was recognised in the accumulated other comprehensive income / revaluation reserve. As at 31 December 2017, the same item amounted to PLN 11.4 million.

The value of the appraised real properties estimated at the historical cost upon including impairment loss and depreciation would amount to PLN 324.9 million as at 31 December 2018 against PLN 330.8 million as at 31 December 2017.

37.3. Financial assets and liabilities not carried at fair value in statement of financial position

2018

	Carrying amount	Fair value			TOTAL
		Level 1	Level 2	Level 3	
Assets					
Cash in hand and balances with the Central Bank	1 237.4	1 237,4	-	-	**1 237.4**
Loans and receivables to other banks	776.5	-	776.5	-	**776.5**
Investment securities	11 860.0	-	11 976.0	-	**11 976.0**
Loans and receivables to customers	98 907.4	-	-	98 957.7	**98 957.7**
Investments in controlled entites	634.6	-	-	634.6	**634.6**
Other assets	64.4	-	-	64.4	**64.4**
Liabilities					
Liabilities due to other banks	1 807.7	-	1 807.7	-	**1 807.7**
Liabilities due to customers	117 293.8	-	-	117 296.9	**117 296.9**
Liabilities under issue of debt securities	300.3	-	-	300.7	**300.7**
Subordinated liabilities	1 076.9	-	-	1 118.3	**1 118.3**

2017

	Carrying amount	Fair value			TOTAL
		Level 1	Level 2	Level 3	
Assets					
Cash in hand and balances with the Central Bank	2 815.1	2 815,1	-	-	**2 815.1**
Loans and receivables to other banks	2 234.5	-	2 234.5	-	**2 234.5**
Financial assets held to maturity	8 350.5	8 339.6	-	-	**8 339.6**
Loans and receivables to customers	87 358.7	-	3 570.4	83 463.7	**87 034.1**
Investments in controlled entites	474.3	-	-	474.3	**474.3**
Other assets	64.4	-	-	64.4	**64.4**
Liabilities					
Liabilities due to other banks	1 044.6	-	1 044.6	-	**1 044.6**
Liabilities due to customers	104 075.8	-	-	104 079.4	**104 079.4**
Liabilities under issue of debt securities	300.3	-	-	301.1	**301.1**
Subordinated liabilities	626.9	-	-	626.9	**626.9**

The Bank discloses the data on the fair value of loans and deposits recognised respectively in the groups of financial assets and financial liabilities carried at amortised cost considering the effective interest rate.
For calculation purposes, the yield curve is applied with transfer prices calculated on the basis of:

- PLN: BID rates up to 9M (inclusive) being WIBID and over 1Y adequate IRS rates; OFFER rates up to 9M (inclusive) being WIBOR and over 1Y adequate IRS rates.
- EUR: BID rates up to 9M (inclusive) being EURIBOR and over 1Y adequate IRS rates; OFFER rates up to 9M (inclusive) being EURIBOR and over 1Y adequate IRS rates.
- USD and CHF: BID rates up to 9M (inclusive) being LIBOR and over 1Y adequate IRS rates; OFFER rates up to 9M (inclusive) being LIBOR and over 1Y adequate IRS rates.

To compute fair value of other assets and deposits measured at amortized cost and financial liabilities measured at amortized cost considering the effective interest rate the transfer price is applied. The transfer price is calculated as:

- PLN: BID rates being WIBID overnight, OFFER rates being WIBOR overnight.
- EUR: BID rates being EURIBOR overnight, OFFER rates being EURIBOR overnight.
- USD and CHF: BID rates being LIBOR overnight, OFFER rates being LIBOR overnight.

BID rates are used to compute fair value of financial liabilities measured at amortized cost; in the case of financial assets measured at amortized cost OFFER rates are applied. All intermediate points on the curves are interpolated linearly.

Credit loss estimations reflect the loan loss provisioning model in place at the Bank.

In certain aspects, the model adopted by the Bank is based on the assumptions that do not confirm the prices of verifiable current market transactions referring to the same instrument – the model does not take into account restructuring-based changes either.

Loans and other receivables

The credit portfolio including securities classified to financial assets measured at amortised cost is divided into sub-portfolios according to the product type, client segment and the currency.

For mortgage portfolio, the prepayment model is applied. Data on the maturity of PLN and CHF mortgage portfolios are used to determine the estimated prepayments according to the model maturity structure. On the basis thereof, the average interest rate weighted with unmatured principal is calculated separately for PLN and CHF portfolios. A model schedule of principal and interest payments is aggregated on the basis of the model maturity structure and future interest flows measured at average interest rate separately for PLN and CHF.

In the case of those sub-portfolios, the discounting factor is used for each cash flow.

For loans/securities, the discounting factor is assumed as the total of:

- the market rate based on the yield curve as at the balance sheet date, and
- the average margin based on the portfolio of loans granted in the last two-month period.

For that purpose, the following assumptions are adopted:

- use of the loans granted in the last two months for calculation,
- division into the abovementioned product groups, and
- the spot at the yield curve on the basis of which the relevant market rate is set is reflected by the revaluation date for each loan.

To estimate the fair value of CHF mortgage loans portfolio, an average margin used when extending EUR mortgage loans adjusted with swap instruments quotations for CHF/EUR currencies was applied on account of active market dissaperance.

As a result, the fair value is the total of the net present value of cash flows of a single loan/ security (in the case of the mortgage portfolio, the fair value is the total of the net present value of cash flows of the aggregated mortgage portfolio calculated separately for PLN and CHF).

For FX loans, fair value is measured without impact of potential future regulatory changes.

In the case of loans without any repayment schedules and loans from the impaired group, it is assumed that the fair value for those loans equals their book value.

Liabilities due to other banks and to customers

The deposit portfolio is divided according to the product type, client segment and the currency. For deposits paid on demand, it is assumed that the fair value equals their book value.

Another phase involves the calculation of future cash flows as the total of principal- and interest cash flows. After that, by applying the discounting factor for each cash flow one receives the fair value of individual deposits. The sum of fair values of individual deposits represents the fair value of the portfolio of deposits reviewed.

For deposits, the discounting factor represents the total of:

- the market rate based on the yield curve as at the balance sheet date, and
- the average margin based on the portfolio of deposits accepted in the last two months.

For that purpose, the following assumptions are adopted:

- use of the deposits accepted in the last two months for calculation,
- division into the abovementioned product groups, and
- the spot at the yield curve on the basis of which the relevant market rate is set is reflected by the revaluation date for each deposit.

Liabilities under issue of securities, Subordinated liabilities

Fair value is calculated with the use of the discounting factor for each cash flow. Accordingly, the discounting factor is the total of:

- the market rate based on the yield curve from the balance sheet date, and
- the estimated margin applied should the securities be bought.

For that purpose, it is assumed that the spot at the yield curve on the basis of which the relevant market rate is set reflects the bond repricing date.

Cash in hand and balances with the Central Bank, Other assets

As the financial assets recognised in the above item are of short-term nature, it was assumed that the carrying amount is approximately the same as the fair value.

Investment securities measured at amortized cost

In the case of financial assets classified into the portfolio held to maturity used an approach that for the purpose of determining the fair value measurement parameters were adopted, which would be applied if these assets were included in the portfolio of financial assets measured at fair value through other comprehensive income.

Below the comparison of the carrying amount with the fair value of the lending portfolio and deposits by segment is presented:

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Lending portfolio, including:	**97 956.8**	**98 007.1**	**83 627.3**	**83 316.2**
Corporate banking segment, including:	**54 586.8**	**54 427.4**	**47 438.7**	**47 171.8**
- loans and advances (in the current account and term ones)	51 777.5	51 680.3	44 906.5	44 758.7
- corporate and municipal debt securities	2 809.3	2 747.1	2 532.2	2 413.1
Retail banking segment, including:	**43 370.0**	**43 579.7**	**36 188.6**	**36 144.4**
- mortgages	33 146.8	32 957.7	27 775.9	27 673.0
- other loans and advances	10 223.2	10 622.0	8 412.7	8 471.4
Deposits, including:	**116 102.7**	**116 105.8**	**102 936.9**	**102 940.5**
deposits of customers from corporate banking segment	37 784.7	37 784.7	34 887.3	34 887.1
deposits of customers from retail banking segment	78 318.0	78 321.1	68 049.6	68 053.4

38. Offseting financial instruments

The below disclosure concerns offsetting of financial assets and liabilities subject to enforceable master agreements. ISDA agreements (for derivative transactions) and GMRA (for securities repo and reverse repo transactions) are the main framework agreements concluded by the Bank.

Margins additionally hedge derivative exposures; the Bank deposits and receives them under the Credit Support Annex (CSA), an annex to the ISDA agreement.

Financial assets

2018

	Gross amounts of recognised financial assets	Net amounts of financial assets presented in the statement of financial position	Related amounts not offset in the statement of financial position		Net amount
			Financial instruments	Cash collateral received	
Derivatives, including:	1 419.3	1 419.3	-602.0	-600.7	216.6
valuation of derivatives	509.7	509.7	-233.1	0.0	276.6
derivative hedge instruments	909.6	909.6	-368.9	0.0	540.7
derivatives collateral	0.0	0.0	0.0	-600.7	-600.7
Total					**216.6**

2017

	Gross amounts of recognised financial assets	Net amounts of financial assets presented in the statement of financial position	Related amounts not offset in the statement of financial position		Net amount
			Financial instruments	Cash collateral received	
Derivatives, including:	1 751.9	1 751.9	-868.8	-667.0	216.1
valuation of derivatives	784.7	784.7	-468.2	0.0	316.5
derivative hedge instruments	967.2	967.2	-400.6	0.0	566.6
derivatives collateral	0.0	0.0	0.0	-667.0	-667.0
Reverse sale and repurchase agreements, including:	80.3	80.3	0.0	-80.3	0.0
transactions classified to category of financial assets held for trading	60.5	60.5	0.0	-60.5	0.0
transactions classified to category of loans and other receivables	19.8	19.8	0.0	-19.8	0.0
Total					**216.1**

Financial liabilities

2018

	Gross amounts of recognised financial liabilities	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not offset in the statement of financial position		Net amount
			Financial instruments	Cash collateral pledged	
Derivatives, including:	1 189.9	1 189.9	-602.0	-341.6	246.3
valuation of derivatives	578.1	578.1	-233.1	0.0	345.0
derivative hedge instruments	611.8	611.8	-368.9	0.0	242.9
derivatives collateral	0.0	0.0	0.0	-341.6	-341.6
Total					**246.3**

2017

	Gross amounts of recognised financial liabilities	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not offset in the statement of financial position		Net amount
			Financial instruments	Cash collateral pledged	
Derivatives, including:	1 678.4	1 678.4	-868.8	-469.2	340.4
valuation of derivatives	979.2	979.2	-468.2	0.0	511.0
derivative hedge instruments	699.2	699.2	-400.6	0.0	298.6
derivatives collateral	0.0	0.0	0.0	-469.2	-469.2
Total					**340.4**

39. Custody activities

As at 31 December 2018, the Bank maintained 781 (790 as at 31 December 2017) customer accounts used to hold customers securities. The accounts do not meet the definition of assets and are not recognised in the financial statements of the Bank.
As at the end of 2018, the Bank acted as the custodian bank for 149 mutual funds and subfunds, 2 pension funds, 1 staff fund and measured the net asset value and net asset value per participation unit of 8 insurance capital funds (160 funds in total). To compare, as at the end of 2017, the Bank acted as the custodian bank for 156 mutual funds and subfunds, 2 pension funds, 1 staff fund and measured the net asset value and net asset value per participation unit of 8 insurance capital funds (167 funds in total).

40. Operating leases

40.1. Bank as a lessee

The Bank cooperates with a lease company in respect of car leasing and fleet management. The Bank also incurs costs under the lease of dwelling units, recognised as operating leases. Those agreements do not provide for any contingent fees to be paid by the lessee; no constraints arise from the provisions of the lease agreements. In some cases, the agreements provide for the option of their prolongation or price change.
Gross lease payments by maturity are disclosed in the table below:

	2018	2017
up to 1 year	110.5	132.6
over 1 year and up to 5 years	267.9	301.1
over 5 years	105.1	87.8
Total	**483.5**	**521.5**

40.2. Bank as a lessor

The Bank earns income from renting own real estate. Those agreements are treated as operating lease agreements. They do not provide for any contingent fees to be paid by the lessee; no constraints arise from the provisions of the lease agreements. In some cases, the agreements provide for the option of prolongation or price change; however they do not warrant the purchase option.
Gross lease payments by maturity are disclosed in the table below:

	2018	2017
up to 1 year	0.6	1.8
over 1 year and up to 5 years	5.2	1.1
over 5 years	0.0	2.3
Total	**5.8**	**5.2**

41. Additional information on cash flow statement

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents include cash disclosed in the statement of financial position as well as current accounts and overnight deposits in other banks.

	2018	2017
Cash in hand (presented in note 13)	1 117.6	1 188.7
Balances with the Central Bank (presented in note 13)	119.8	1 626.4
Current accounts in other banks (presented in note 14)	378.4	331.9
Overnights in other banks (presented in note 14)	0.0	997.7
Current receivables in other banks (presented in note 14)	340.6	453.5
Total	**1 956.4**	**4 598.2**

Explanation of the classification of the Bank's activities into operating, investment and financial activities in the cash flow statement

Operating activity includes the core activities of the Bank, not classified as investment or financial activities.

Investment activity covers purchase and sale of shares and holdings in subordinated and associated entities, intangible assets and property, plant and equipment, equity instruments measured at fair value through other comprehensive income, as well as debt securities measured at amortized cost. Investment activity proceeds also comprise dividends received under shares and holdings in other entities.

Financial activity pertains to long-term financial transactions (over one year) with financial entities. Inflows from financial activity indicate sources of financing of the Bank, including, for example, longterm loans and cash loans from other banks as well as financial entities other than banks and issuance of debt securities. Outflows from financial activity are mainly due to repayment of longterm liabilities (e.g. repayment of received loans including interest, interest on debt securities issued) by the Group and payment of dividends to the owners and other outflows due to profit distribution.

Reasons for differences between changes in certain items recognised in statement of financial position and in cash flow statement

2018

	change of balance												
	in consolidated statement of financial position	IFRS 9 implementation opening balance change	in consolidated cash flow statement	**difference, including:**	1)	2)	3)	4)	5)	6)	7)	8)	9)
Change in loans and other receivables to other banks	1 458.0		387.3	**-1 070.7**	-6.5	-1 064.2							
Change in other financial assets held for trading	-396.8		-396.1	**0.7**	0.7								
Change in derivative hedging instruments	-29.8		663.9	**693.7**			693.7						
Change in investment securities / investments	-6 029.9	-4.7	-6 363.1	**-328.5**	171.9			-13.4	-487.0				
Change in loans and other receivables to customers	-11 767.1	-262.0	-12 039.0	**-9.9**	-9.9								
Change in other assets, including:	n/a		-19.9	**-**									
change in the item in the statement of financial position: "other assets"	-19.7	-8.0	-27.7	**0.0**									
other changes	-		7.8	**7.8**						10.9	-3.1		
Change in liabilities due to other banks	763.1		761.0	**-2.1**	-2.1								
Change in financial liabilities measured at fair value through profit or loss	-250.0		-249.2	**0.8**	0.8								
Change in liabilities due to customers	13 218.0		13 216.9	**-1.1**	-1.1								
Change in provissions	59.6	-16.9	42.7	**0.0**									
Change in other liabilities; including:	n/a		-350.5	**-**									
change in the item in the statement of financial position: "other liabilities"	-366.6		-367.2	**-0.6**								-0.6	
other changes	-		16.7	**16.7**									16.7

*) each difference is explained on the next page

The reasons for differences between changes recognised in statement of financial position and in cash flow statement are as follows:

1) Changes in the individual assets and liabilities were adjusted with interest disclosed in the position *Interest received/ paid*.
2) Change in the receivables being an equivalent of cash (deposits at other banks) was excluded from the position *change in loans and other receivables to other banks*; it was disclosed in the position *net increase/decrease in cash and cash equivalents*.
3) *Change in derivative hedging instruments* includes changes concerning hedging derivatives which are included in the other comprehensive income.
4) *Change in investment securities* (2017: change in *available-for-sale financial assets*) does not account for the part of financial assets valuation that was carried through other comprehensive income.
5) The change in securities presented in investment activity was excluded from the *change in investment securities*.
6) The amount of PLN 10.9 million relates to change in the balance sheet value of *investments in controlled entities* that is connected with measurement at equity method .
7) The amount of PLN -3.1 million relates to changes in the balance sheet value of property, plant and equipment and intangible assets that are not related to cash flows or depreciation.
8) The changes in valuation of share-based payments and in actuarial gains/losses included in the other comprehensive income were excluded from the *change in other liabilities*.
9) The amount of PLN 16.7 million relates to changes in the balance sheet value of subordinated liabilities that are not related to cash flows (accrued and unpaid interest, FX differences).

2017

	Change of balance					
	in statement of financial position	in cash flow statement	**Differece:**	1)	2)	3)
Change in loans and other receivables to other banks	-1 121.1	-269.2	**851.9**	2.4	849.5	
Change in financial assets at fair value through profit or loss	2 296.7	2 296.8	**0.1**	0.1		
Change in available-for-sale financial assets	3 000.3	3 070.4	**70.1**	-58.8		128.9
Change in loans and other receivables to customers	-9 320.7	-9 260.2	**60.5**	60.5		
Change in liabilities due to customers	8 907.4	8 914.0	**6.6**	6.6		

42. Related entities

The Bank has shares in subsidiares and associated entities:

- ING Investment Holding (Polska) S.A. (formerly ING ABL Polska S.A.) – it owns 100% shares in ING Commercial Finance S.A. and ING Lease (Polska) Sp. z o.o.,
- ING Usługi dla Biznesu S.A.,
- Solver Sp. z o.o.,
- Nowe Usługi S.A.,
- Twisto Polska Sp. z o.o. (associated entity)

ING Bank Śląski S.A. is a subsidiary of ING Bank NV, which as at 30 June 2017 held 75% share in the initial capital of ING Bank Śląski and 75% shares in the total number of votes at the General Meeting of Shareholders.

ING Bank Śląski performs operations with ING Bank NV and its subsidiaries on the inter-bank market. These are both short-term deposits and loans, as well as operations in derivatives.

There were also other transactions between the related entities and ING Bank Śląski. These are both short-term deposits and loans, as well as operations in derivatives. The Bank keeps also ING Group's entities bank accounts. The abovementioned transactions are carried out on an arm's length basis.

They originated from agreements concluded as to co-operation, sublease of premises, lease of equipment, data processing as well as employees' insurance contributions.

Costs are presented as per their net value (VAT excluded).

As at 31 December 2018, ING Bank Śląski S.A. had no financial exposure to the Supervisory Board Members (in the composition as at the end of 2018) or any entities connected with them in equity or organisational terms.

Transactions between related entities (PLN million)

	ING Bank NV	Other ING Group entities	Associates	Subsidiaries	ING Bank NV	Other ING Group entities	Subsidiaries
	as at 31 Dec 2018				as at 31 Dec 2017		
Receivables							
Nostro accounts	1.9	37.6	-	-	907.0	1.0	-
Loans	-	0.2	8 611.1	-	-	0.1	7 139.5
Positive valuation of derivatives	48.5	48.3	1.8	-	181.2	76.7	1.5
Other receivables	5.4	2.4	0.1	-	11.4	2.0	1.2
Liabilities							
Deposits received	48.7	33.1	194.7	4.3	11.9	20.4	87.9
Subordinated loan	1 076.9				626.9	-	-
Loro accounts	21.4	23.9	-	-	11.7	55.8	-
Negative valuation of derivatives	45.0	45.8	-	-	185.8	71.8	-
Other liabilities	64.7	1.5	1.8	-	62.8	1.4	1.1
Off-balance-sheet operations							
Off-balance sheet liabilities granted	478.6	472.1	1 394.8	-	417.0	232.0	2 065.3
Off-balance sheet liabilities received	449.5	483.9	-	-	421.1	246.9	-
FX transactions	7 210.2	140.9	-	-	10 110.3	40.7	-
Forward transactions	116.1	-	-	-	535.1	-	-
IRS	2 768.7	2 575.8	64.1	-	3 151.1	2 410.3	66.5
Options	1 732.8	37.6	-	-	3 591.8	43.4	-
	2018 YTD the period from 01 Jan 2018 to 31 Dec 2018				2017 YTD the period from 01 Jan 2017 to 31 Dec 2017		
Income and expenses							
Income, including:	77.8	-0.9	180.5	-0.1	57.3	6.8	149.9
interest and commission income/ expenses	0.5	-1.7	179.5	-0.1	-10.8	4.3	151.2
income on financial instruments	74.9	-6.0	1.0	-	55.9	1.0	-1.3
net income on investment assets	-	-	-	-	11.9	-	-
net income on other basic activities	2.4	6.8	-	-	0.3	1.5	-
General and administrative expenses	64.8	4.1	5.8	-	60.5	3.6	4.4
Outlays for non-current assets							
Outlays for intangible assets	-	6.1	1.8	-	-	-	1.3

43. Transactions with the management staff and employees

Loans to Bank employees and senior management

Employees of the ING Bank Śląski are granted loans on the same terms and conditions as the customers of the Bank (no preferential loans for employees exist). Loans for employees disclosed in the amount of loans for customers as at 31 December 2018 amounted to PLN 167.5 million excluding loans from the In-House Social Benefits Fund. As at 31 December 2017, their value amounted to PLN 155.4 million.

Granting of a loan, cash loan, bank guarantee and surety for the Bank's senior management group is regulated in a separate procedure and monitored in accordance with the Ordinance of the President of ING Bank Śląski S.A.

The financial statements for 2018 cover loans, cash loans, bank guarantees and sureties for the Bank's senior management (within the meaning of Article 79 of the Banking Law) amounting to PLN 34.3 million. As at 31 December 2017, their value amounted to PLN 32.6 million.

Remuneration of ING Bank Śląski S.A. Management Board Members (PLN million)

The composition of ING Bank Śląski S.A. Management Board as at the end of 2018 was presented in the chapter I. Bank details in point 5. ING Bank Śląski S.A. Management Board and Supervisory Board composition.

Emoluments of ING Bank Śląski S.A. Management Board Members (PLN million)

	2018	2017
Short-term employee benefits, including:	12.4	13.5
- remuneration	9.9	9.6
- benefits	2.5	3.9
Total	**12.4**	**13.5**

Short-term employee benefits comprise: base remuneration, insurance, mutual fund contributions, medical care and other benefits awarded by the Supervisory Board.

Emoluments of ING Bank Śląski S.A. Management Board Members under the Variable Remuneration Programme (PLN million)

	2018		2017	
	Short-term benefits	Long-term benefits	Short-term benefits	Long-term benefits
Cash payments	2.5	2.1	2.6	2.1
Phantom stock	2.5	2.1	2.6	2.1
Total	**5.0**	**4.2**	**5.2**	**4.2**

Short-term benefits comprise the benefits under the Variable Remuneration Programme – the non-deferred part.

Long-term benefits comprise the benefits under the Variable Remuneration Programme – the deferred part.

Emoluments of Members of the ING Bank Śląski S.A. Management Board for 2018 under the Variable Remuneration Programme have not yet been awarded.

Under the remuneration system in place at the Bank, the Bank Management Board Members may be entitled to the 2018 bonus; some part of it will be paid out in 2019, and some part will be deferred for the upcoming years (2020-2026). The maximum obtainable amount of the bonus for 2018,

for which a reserve was established, arrives at PLN 9.2 million, including cash pay-out in 2018 of PLN 2.5 million, and for the deferred part of the bonus PLN 6.7 million. The Bank Supervisory Board will take the final decision on the bonus amount.

As at 31 December 2016, the reserve for the cash payment under the bonus for the Bank Management Board Members was PLN 9.4 million. The bonus for 2017 approved in 2018 by the Bank Supervisory Board was PLN 6.6 million.

In the years ended 31 December 2018 and 31 December 2017, there were no post-employment benefits paid out to the Bank Management Board Members.

The Members of the Management Board have signed non-competition agreements after they stop holding their function on the Bank's Management Board. In the event that a Management Board Member is not reappointed for another term of office or is recalled from his/ her function, he or she is entitled to severance pay. Information on severance pay for the Management Board Members is contained in their employment contracts and shall be paid only in case of termination of the employment contract by the Bank due to other reasons than those giving rise to termination without notice.

Remuneration of ING Bank Śląski S.A. Supervisory Board Members (PLN million)

The composition of ING Bank Śląski S.A. Supervisory Board as at the end of 2018 was presented in the chapter I. Bank details in point 5. ING Bank Śląski S.A. Management Board and Supervisory Board composition.

Emoluments of ING Bank Śląski S.A. Supervisory Board Members (PLN million)

	2018	2017
Short-term employee benefits, including:	0.8	0.7
- remuneration	0.8	0.7
Total	**0.8**	**0.7**

The Management Board Members and other persons employed by ING Bank Śląski S.A. do not receive any remuneration or awards for performing functions in the governing bodies of subsidiaries and affiliated entities of the ING Bank Śląski S.A. Group.

Volume of ING Bank Śląski shares held by Bank Management Board and Supervisory Board Members

As at 31 December 2018, neither Management Board nor Supervisory Board Members held shares of ING Bank Śląski S.A., similarly as at the date of rendering the annual financial statements of the ING Bank Śląski S.A. for 2018 into the public domain.

In-House Social Benefits Fund

The employees may use various forms of social assistance within the framework of In-House Social Benefits Funds established in the Bank. The balance of money advances granted from the In-House Social Benefits Fund as at 31 December 2018 amounts to PLN 3.7 million versus PLN 5.0 million as at 31 December 2017. The balance of the In-House Social Benefits Fund as at 31 December 2018 was PLN 7.8 million versus PLN 6.9 million as at 31 December 2017.

44. Headcount

The headcount in the Bank as at 31 December was as follows:

	2018	2017
Individuals	7 665	7 661
FTEs	7 615.7	7 612.4

45. Significant events after the balance sheet date

- *Polish Financial Supervision Authority's approval of operations commencement by ING Bank Hipoteczny S.A.*

On 2 January 2019 ING Bank Śląski has obtained information that the Polish Financial Supervision Authority ("PFSA") approved operations commencement by ING Bank Hipoteczny S.A., a Bank subsidiary.

In their decision the PFSA stated that ING Bank Hipoteczny S.A. satisfied all the requirements set out in Article 36.3 of the Banking Law Act.

- *Polish Financial Supervision Authority notice of the individual add-on ST used in the dividend policy*

On 18 January 2019 ING Bank Śląski has received a letter from the Polish Financial Supervision Authority ("PFSA") on the criteria for the dividend policy of commercial banks in 2019. In their letter, the PFSA communicated the individual add-on ST for the Bank to be taken account of in the event of dividend payout of over 75% of earned net profit.

The add-on ST measures the Bank's sensitivity to an adverse macroeconomic scenario. It is defined as the difference between the total capital ratio ("TCR") in the baseline scenario and TCR in the stress scenario as at the 2020 yearend, considering supervisory adjustments. Due to the assumption of stable balance sheet, applicable to this year; i.e., banks' inability to respond to negative developments in their external landscape, the ST indicator was reduced by the conservation buffer in place since 1 January 2019; i.e. 2.5 p.p.

As a result of analyses made during the stress tests conducted by the PFSA Office, the individual add-on ST for ING Bank Śląski S.A. was set, upon reduced by the conservation buffer, at 3.34%.

- *Polish Financial Supervision Authority's approval of the subordinated loan amount recognition under Tier II capital*

On 30 January 2019, the Polish Financial Supervision Authority's approval to recognise, in the Bank's Tier II capital, the funds available under the subordinated loan received from ING Bank N.V. in the amount of EUR 100 million.

Risk and capital management

I. Risk and capital management system

1. Risk management system

The risk management system is an integrated collection of rules, tools and mechanisms (including but not limited to policies and procedures) for risk processes. The role of the risk management system is to continuously identify, measure or estimate as well as monitor the Bank's risk and secure against potential losses through adequate controls, system of limits and adequate level of provisions (impairment charges) as well as of capitals and liquidity buffers.

Under the risk management system, the Bank:

- applies formal risk tolerance determination rules and risk management rules,
- applies formal procedures intended to identify, measure or estimate and monitor risk, also accounting for projected future risk,
- applies formal risk limits and rules of conduct in the event of limit overrun,
- applies the approved management reporting system that allows risk level monitoring,
- has the organisational framework matching the amount and profile of risk borne by the Bank.

2. Risk management rules

ING Bank Śląski S.A. manages credit, market and operational risk as required by the Polish law, regulations of the Polish Financial Supervision Authority and other competent bodies, and also in compliance with the ING Group standards as far as admissible under the aforementioned regulations and best practice documents.

Irrespective of the need to ensure legal and regulatory compliance, the Bank does not treat credit, market and operational risk management as a compliance issue mainly, but sees it as a fundamental and integral part of the end-to-end Bank management process.

3. Internal capital adequacy assessment process

At ING Bank Śląski S.A., the Capital Management Policy at ING Bank Śląski S.A. governs the process of material risks identification, the key elements regarding risk quantification as well as the capital adequacy management principles.

Based on the above-referred document, the following risks are identified at the Bank:

- permanently material risk – the risk which due to the nature of the Bank's operations is material now and will be such in the future. Under the nature of the Bank's operations we construe the business being provision of deposit and credit services and the related operations: financial performance, liquidity management, interest rate and FX risk management, as well as risk management with regard to mismatch or unreliability of internal processes, people and technical systems or external events;
- material risk – the risk which may trigger potential losses, with the frequency of occurrence of the values that qualify them as material in line with the table:

Frequency	At least once a year	immaterial	material	material	material
	At least every 5 years	immaterial	immaterial	material	material
	Less often than every 5 years	immaterial	immaterial	immaterial	material
	Potential loss (PLN)	up to 0.2% of own funds	from 0.2% to 1% of own funds	from 1% to 5% of own funds	above 5% of own funds

Every month, standalone and consolidated reports are compiled by the Bank; they read the realised capital requirements for all material risks and planned metrics values. Reports are delivered to the Assets and Liabilities Committee (ALCO) and the Bank Management Board. The Supervisory Board is advised every quarter of capital adequacy of the Bank, internal capital adequacy included.

The ICAAP is reviewed once a year. The review report is delivered to the Management Board and Supervisory Board of ING Bank Śląski S.A. Further, the internal audit function performs an independent audit of the ICAAP process on an annual basis.

4. Risk categories

In 2018, the workshops on risk materiality assessment were carried out in the first quarter. As a result, the interest rate risk in the banking book was identified: the residual convexity risk as material risk and the notion of "difficult-to-measure risk" was abandoned.

Risk		Permanently material	Material	Immaterial
Credit risk				
Default risk and counterparty risk*		✓		
Residual risk**		✓		
Concentration risk		✓		
Residual value risk		✓		
Transfer risk				✓
Risk of other non-credit obligation assets			✓	
"Default" definition risk				✓
Market risk				
Financial Markets operations risk	FX risk	✓		
	Trading book high-level and specific interest rate risk	✓		
	Banking book interest rate risk: total mismatch	✓		
	Banking book interest rate risk: residual convexity risk		✓	
	Banking book interest rate risk: underlying risk			✓
	Banking book interest rate risk: option risk			✓
Risk of investments in commercial real property and real property owned for own purposes				✓
Equities risk	Banking book equities risk			✓
	Trading book high-level and specific equities risk			✓
Client behaviour risk			✓	
Business risk				
Financial result risk		✓		
Macroeconomic risk			✓	
FX mortgage portfolio risk			✓	
Excessive financial leverage risk				✓
Funding and liquidity risk		✓		
Operational risk* **		✓		
Model risk			✓	

*) The risk definition covers the delivery settlement risk; **) Capital requirement quantified in the approach for the default risk and counterparty risk; ***) It includes, inter alia, the compliance risk and legal risk as well as the IT risk managed within that risk.

5. Risk appetite

The risk appetite sets the maximum risk the Bank is willing to accept while supporting its stability and further growth. As part of capital and risk management at the Bank, the risk appetite parameters are set within the so-called Risk Appetite Statement (RAS) in the following areas:

- RAS for capital adequacy,
- RAS for liquidity and funding plus market risk,

- RAS for credit risk, and
- RAS for operational risk.

RAS for Bank capital adequacy is set for the following capital ratios[1]:

- Common Equity Tier 1 ratio (CET1) – at least 9.875%,
- Tier 1 ratio (T1) – at least 10.375%, and
- Total Capital Ratio (TCR) – at least 13.375%

The capital adequacy RAS results from the obligation to maintain the minimum levels of capital ratios resulting from the following external regulations:

- Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 (4.5% for CET1, 6% for T1 and 8% for TCR),
- Act on macroprudential supervision over the financial system and crisis management in the financial system of 5 August 2015 sanctioning additional capital buffers, including:
  - capital conservation buffer which was at 1.875% in 2018,
  - buffer of other systemically-important institution (O-SII) at 0.5% imposed by the PFSA decision of 19 December 2017 and upheld with the PFSA letter of 2 August 2018,
  - a countercyclical buffer applied to exposure to which such buffer was imposed by competent authorities. The countercyclical buffer varies over time depending on the structure of the relevant exposures and the levels of countercyclical buffer rates imposed on the relevant exposures (as at December 2018 the countercyclical buffer was effectively 0.006%);
- Regulation of the Minister for Economic Development and Finance of 1 September 2017 on the systemic risk buffer introducing a systemic risk buffer of 3% of the total risk exposure amount for all exposures located in the territory of the Republic of Poland (because the Bank has a small pool of the so-called foreign exposure, the effective level of systemic risk buffer is variable over time (as at 31 December 2018 it was 2.961%).

As part of the RAS for the capital adequacy, capital limits on risk categories are set too. The RAS for credit risk and operational risk is set every year.

6. Economic capital, own funds and capital requirement

6.1. Economic capital

ING Bank Śląski S.A. quantifies capital for the following types of risk:

- <u>default risk and counterparty risk as well as residual risk</u> – the risk of losses due to counterparty or debtor failure to fulfil their obligations towards the Bank (including delivery and settlement risk) and the risk of the credit exposure value decrease due to deterioration of the counterparty debt repayment capacity. The economic capital is determined using the modified AIRB Approach (INCAP) considering the capital for the credit risk of the central counterparty and the credit valuation adjustment risk, and also the requirement due to settlement and delivery risk which are computed according to Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013. Since June 2014, the LGD parameter for recession (residual risk) has been factored in in the capital computations;
- <u>other non-credit obligation assets risk</u> – the risk of loss of the BS value of non-credit obligation assets by the Bank (DTA, capital exposures and other items). The capital is set in line with the

[1] The reference levels specified in the RAS are based on nominal levels of individual capital buffers. The applied approach means that RAS for capital adequacy is slightly higher than it would result from regulatory minimum levels of capital ratios based on effective and time-varying levels of some capital buffers.

rules adopted in Regulation of the European Parliament and of the Council (EU) No. 575/2013 of 26 June 2013;

- concentration risk – the risk related to the excessive exposure against a single entity, related entities or groups of entities of similar characteristics that increases credit risk (e.g. sector concentration). Capital requirement is quantified on the following terms and conditions:
  - for individual entities or entities related in capital or organisational terms – in line with the rules of capital requirement quantification following the requirements of Regulation of the European Parliament and of the Council (EU) No. 575/2013 of 26 June 2013;
  - for the companies from one sector or industry or for those running the same business or trading in similar goods – as exposure surplus over the concentration limit set for that group of exposures, less impairment losses;
- FX risk – the risk of loss due to exchange rate fluctuations. The capital requirement is computed using the VaR method;
- trading book high-level and specific interest rate risk – the risk of loss on positions in trading books due to interest rate movements. The capital requirement is computed using the VaR method;
- banking book interest rate risk: residual convexity risk – the risk of loss due to unexpected non-linear shift of the interest rate curve. The capital requirement is calculated using simulation of interest rate changes.
- banking book interest rate risk: total mismatch – the risk of loss on positions in banking books due to interest rate movements. The capital requirement is computed using the VaR method;
- client behaviour risk – the risk of potential loss caused by uncertainty of client behaviour for the products with embedded options. The capital requirement for that risk is quantified as a combination of two elements: Monte Carlo simulation and the measurement of the held replicating portfolio;
- financial result risk – the risk associated with taking adverse or erroneous business decisions, the lack of or faulty execution of taken assumptions/actions and changes in the external environment plus an inappropriate response to these changes which results in the financial result being below the requirements arising from the need to conduct ongoing operations and grow, mainly in order to supply the capital base. The capital requirement is estimated based on potential losses vis-à-vis the planned financial result;
- macroeconomic risk – the risk due to macroeconomic changes and their impact on the minimum capital requirements. The capital requirement quantification methodology is based on in-house stress tests for the mild recession scenario and desired capital adequacy ratios;
- FX mortgage portfolio risk – the risk of financial losses connected with FX mortgage loans conversion into PLN mortgage loans. The risk is valued using the estimated implementation costs of the solutions proposed and the legislation stage of the regulation;
- funding and liquidity risk – the risk of inability to repay, at a reasonable price, cash liabilities under on- and off-balance sheet items. The Bank maintains liquidity so that its cash liabilities could be repaid at all times from the available funds and inflows from maturing transactions, available funding sources at market prices and/or from sale of disposable assets. The economic capital is the value of excess of internal supervisory levels for liquidity limits;
- model risk – the risk of loss that the Bank may incur as a result of decisions which may have substantially been based on data obtained using models in the Bank internal processes, due to errors in the development, implementation or application of such models. The capital requirement is quantified for material and medium material models of increased or high model risk and is based on expert judgment;
- operational risk – the risk of direct or indirect tangible loss from inadequate or failed internal processes, people and systems, or from external events. Reputation and business risk factors

and the consequent impact are also watched within the operational risk domain. To calculate the economic capital, the Bank applies the Advanced Measurement Approach. The model applied is a hybrid model allowing the Bank to measure risk on the basis of internal and external data on operational risk events, scenario analysis as well as business environment and internal control factors.

Every month, standalone and consolidated reports are compiled; they read the realised economic capital values for all material risks and planned metrics values. Reports are delivered to the Assets and Liabilities Committee (ALCO), the Non-Financial Risk Committee (NFRC) and the Management Board. The Supervisory Board is advised of capital adequacy, internal capital adequacy included, on an ongoing basis.

In 2018, own funds were above the internal capital.

6.2. Own funds

The own funds of the Bank encompass:

- Tier 1 capital which as at 2018 yearend was PLN 11,317.3 million,
- Tier 2 capital which as at 2018 yearend was PLN 645.0 million.

As at 31 December 2018, the Bank did not identify additional Tier 1 capital (AT1).

Own funds

	2018	2017
Own funds		
A. Tier 1 capital (T1)	**11 317.3**	**10 130.0**
A.I. Common equity Tier 1 capital (CET1)	**11 317.3**	**10 130.0**
capital instruments eligible as CET1 Capital	130.1	130.1
share premium	956.3	956.3
retained earnings	533.7	773.8
- previous years retained earnings	-208.5	108.4
- profit or loss eligible	742.2	665.4
accumulated other comprehensive income	327.4	274.9
other reserves	8 547.6	7 309.5
funds for general banking risk	1 215.2	1 215.2
intangible assets	-425.0	-418.5
IRB shortfall of credit risk adjustments to expected losses	-178.1	-111.2
adjustment in the transitional period due to adaptation to IFRS 9 requirements	213.4	n/a
value adjustment due to the requirements for prudent valuation	-3.3	-0.1
A.II. Additional Tier 1 capital (AT1)	**0.0**	**0.0**
B. Tier 2 capital (T2)	**645.0**	**613.3**
subordinated liabilities	645.0	625.6
IRB shortfall of credit risk adjustments to expected losses	0.0	-12.3
Own funds taken into account in total capital ratio calculation	**11 962.3**	**10 743.3**

6.3. Capital requirement

For the purpose of 2018 reporting, the Bank calculated the credit risk capital requirement using Advanced Internal Ratings Based approach as well as the Standardised Approach. The Bank received the approval from the Polish Financial Supervision Authority and De Nederlandsche Bank to apply AIRB approach for exposure classes: corporates and credit institutions. For operational risk, the Bank uses the Basic Indicator Approach. For market risk, the Bank uses the Standardised Approach. The Bank also sets the capital requirements for concentration risk, settlement and delivery risk and credit value adjustment risk (CVA). In all the cases, the requirements are set in compliance with the Capital Requirements Regulation.

The total capital requirement is dominated by the credit risk capital requirement. As at 2018 yearend, its share accounted for as much as 87%.

6.4. Capital adequacy

As at 31 December 2018, the TCR for the ING Bank Śląski S.A. was 17.19% versus 18.39% as at 2017 yearend and the Tier 1 ratio was at 16.26% versus 17.34% as at the end of December 2017. The capital ratios changes were due to:

- recognition in own funds of part of the 2017 net profit less the amount following the General Meeting's resolution on 2017 profit distribution less the amount which the Bank included in own funds in 2017 (PLN 285 million) and a portion of Bank's profit for the first 9 months of 2018 (PLN 742 million),
- accounting for IFRS9 impact,
- increased business volumes and operations,
- lowered effective risk weight on retail mortgage portfolio (covering a bigger part of the portfolio with the preferential risk weight of 35%),
- imposing additional mark-ups on risk-weighted assets in the IRB models used, in connection with the model management process in place.

Total capital ratio

	2018	2017
Own funds taken into account in total capital ratio calculation	**11 962.3**	**10 743.3**
Capital requirements		
capital requirements for credit risk, counterparty credit risk, dilution risks and free deliveries risk	4 834.9	4 018.9
capital requirements for position, foreign exchange and commodities risks	130.6	103.0
capital requirements for operational risk	598.2	540.8
capital requirements for credit valuation adjustment risk	4.7	10.8
Total capital requirements	**5 568.4**	**4 673.5**
Total capital ratio	**17.19%**	**18.39%**
Tier 1 ratio	**16.26%**	**17.34%**

When calculating the capital ratios, the Bank was using the transitional provisions concerning alleviation of the IFRS 9 implementation impact on own funds. More information about the transition period was presented in these financial statements in part *Accounting policy and additional notes*, chapter II, item 1.2. *Impact of IFRS 9 Financial Instruments implementation for Bank's financial statements – Impact on capital requirements*. If the IFRS 9 implementation impact had been recognised in full, the total capital ratio would have arrived at 16.88% and the Tier I capital ratio at 15.95%.

In October 2018 the Bank concluded the subordinated loan agreements with ING Bank N.V. based in Amsterdam and applied to the Polish Financial Supervision Authority for permission to recognize the amount of the loan under Tier 2 capital. The permission was obtained on 30 January 2019. If the subordinated lons was included in the amount of Tier 2 capital as at 31 December 2018 the level of total capital ratio would have increased by 0.6 p.p..

7. Leverago ratio

The calculation of regulatory leverage ratio in the ING Bank Śląski S.A. as at 31 December 2018, was based on provisions of Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No. 575/2013 of the European Parliament and of the Council with regard to the leverage ratio (hereinafter referred to as the "Regulation 2015/62").

Leverage ratio is calculated as Tier 1 capital measure divided by the total exposure measure and expressed as a percentage. Total exposure measure is the sum of the exposure value calculated in accordance with the Regulation 2015/62 of all assets and off-balance sheet items not deducted when calculating the Tier 1 capital measure.

Calculation of the leverage ratio for the ING Bank Śląski S.A.

	2018	2017
Tier 1 capital	11 317.3	10 130.0
Total leverage ratio exposures	138 108.8	119 616.4
Leverage ratio (%)	**8.19**	**8.47**

On the basis of CRD IV Directive and implementing standards, the Group prepared and implemented "The procedure of preparing the report: Leverage Ratio". This document describes the recipients and detailed rules of leverage ratio calculation in LIREP application for NBP reporting.

The Bank implemented management process, including: "Excessive financial leverage risk management policy" and "Leverage ratio planning procedure". The documents provision responsibilities of departments and ALCO Committee. In the Policy, the limit of leverage ratio level was also set and the actions to maintain the ratio on required level are defined. The Bank also included the leverage ratio in stress tests.

In 2018 the leverage ratio was at the level above internal and regulatory minimum.

8. Stress tests

According to the ING Bank Śląski S.A. Stress-Testing Policy, the Bank performs the stress tests for economic capital and capital requirement. The report with the stress-tests results is presented to the Assets and Liabilities Committee, Bank Management Board and Bank Supervisory Board.

As at 30 June 2018, the Bank conducted consolidated stress tests based on the scenarios prepared by the Chief Economist and using the in-house tools, the new tool for the credit risk included. Stress tests covered:

- scenario tests: a mild recession scenario and a long-term recession scenario;
- sensitivity tests (interest rate increase by 400 bps and 200 bps; real property price decline by 30%; PLN depreciation by 30% and 50%; GDP growth rate fall to -5%; unemployment rise to 20% and wage decline by 10%);
- concentration tests;
- financial leverage ratio tests.

The stress tests performed enable the Bank to learn the behaviour of capital requirements, economic capital and own funds should the set macroeconomic parameters materialise.

9. Dividend policy

On 15 September 2016, the Supervisory Board approved the ING Bank Śląski S.A. Dividend Policy as recommended by the Bank Management Board. On 9 March 2018, the Supervisory Board approved the amended Dividend Policy. The main assumptions of the dividend policy are the following:

- a long-term stable process of dividend payout in adherence to the rules of prudent management and any and all regulatory requirements which the Bank shall comply with, and
- the option to pay dividend from the capital surplus over the minimum capital adequacy ratios and over the minimum Tier 1 capital ratio of 12.875% and the minimum Total capital ratio of 14.875% set for the Bank by the Polish Financial Supervision Authority for dividend payout purposes.

When determining the recommended dividend amount to be paid out, the Management Board will review in particular:

- the current financial standing of the Bank and the Bank Group, including limitations in the case of sustaining financial loss or low profitability (low ROA/ROE),
- assumptions of the Bank's and Bank Group's management strategy, including risk management strategy,
- PFSA's stance on the banks' dividend policy,
- the limitations under Article 56 of the Act on macroprudential supervision over the financial system and crisis management in the financial system of 5 August 2015.

PFSA guidance on 2018 dividends

On 15 January 2019, the Polish Financial Supervision Authority adopted a stance on the banks dividend policy in 2019 (dividend for 2018). The PFSA recommends, in particular, that the dividend of up to 75% from the profit earned in 2018 be paid out solely by banks meeting all the below criteria:

- the banks which do not pursue the recovery programme;
- their SREP final score is not worse than 2.5;
- their financial leverage is above 5%;
- banks whose Common Equity Tier 1 (CET1) ratio is not lower that the required minimum plus 1.5 p.p.: 4.5% + 56%*add-on + combined buffer requirement effective in 2019 + 1.5%
- banks whose Tier 1 capital (T1) ratio is not lower that the required minimum plus 1.5 p.p.: 6% + 75%*add-on + combined buffer requirement effective in 2019 + 1.5%;
- banks whose Total Capital ratio (TCR) is not lower that the required minimum plus 1.5 p.p.: 8% + add-on + combined buffer requirement effective in 2019 + 1.5%;

Furthermore, the Polish Financial Supervision Authority indicated the option of payout of up to 100% of the profit earned in 2018 by the banks meeting all the above criteria and accounting for the bank's sensitivity to the stress scenario (ST) in their capital criteria. Bank's sensitivity to stress scenario measured with the results of regulatory stress tests defined as: the difference between the TCR in the reference scenario and the TCR in the adverse scenario at the end of the forecast period (2020) including regulatory adjustments, less the capital conservation buffer value at the target level (2.5%).

In line with the guidelines, the PFSA requirements applicable to ING Bank Śląski S.A. as regards the 2018 dividend payout of up to 75% of net result are the following (taking account of nominal capital buffer values):

- CET1 >= 12.0% (and 15.34% with the dividend over 75%)
- T1 >= 13.5% (and 16.84% with the dividend over 75%)
- TCR >= 15.5% (and 18.84% with the dividend over 75%)

Dividends declared and paid out

The Bank Management Board intends to recommend to the General Meeting the dividend for 2018 totalling PLN 455.4 million or 29.8% of the standalone net result of ING Bank Śląski S.A. The proposed dividend per share is PLN 3.50 gross. The proposed record date is 18 April 2019 and the proposed dividend payout date is 6 May 2019. The dividend proposal takes account of the current financial standing of the Bank and its development plans.

10. Recovery and resolution plans

On 4 October 2017, the ING Bank Śląski S.A. received a positive administrative decision from the PFSA for the developed Recovery Plan as one of the first banks in Poland. The Bank Guarantee Fund was involved in the process of decision issue by the PFSA as the advising party. The Recovery Plan is compliant with the provisions of the Polish law transposing the requirements of the BRR Directive, i.e. with the Bank Guarantee Fund Act of 10 June 2016 and the implementing provisions thereof.

While the Bank is working on the Recovery Plan, the BGF is required – as part of their tasks described in the Act – to prepare, update and assess the feasibility of Resolution Plans for domestic entities. Based on the information obtained from the PFSA and the Bank, in 2017 the BGF ran the first preparation and update stage of the Resolution Plan. For ING Bank Śląski S.A., the BGF drafted the restructuring strategy based on the bail-in mechanism to cover the losses sustained and to recapitalize the Bank, and also to reinstitute the market trust to the Bank as regards its ability to satisfy its obligations. The BGF set the MREL for the Bank too. The Bank will be required to satisfy it as of 1 January 2023. The MREL can change in the future, notably due to the pending EU and local legislation works.

The BGF set the MREL for the Bank at 20.7% of risk-weighted assets (11.8% of total own funds and total liabilities). The MREL according to the current BGF methodology for the bail-in strategy for risk-weighted assets may be estimated using the following formula:

$$(CRR_{TCR} + BFX + OSII) + [\, 1 - (CRR_{TCR} + BFX + OSII) \,] * (CRR_{TCR} + BFX + OSII + BZ + BRS + BA)$$

- CRR_{TCR} – TCR minimum required under CRR,
- BFX – pillar 2, i.e. add-on for FX mortgage exposure,
- OSII – buffer of other systemically-important institution,
- BZ – capital conservation buffer,
- BRS – systemic risk buffer.
- BA – countercyclical capital buffer.

II. Credit risk

1. Introduction

Credit risk is understood as:

- the risk of incurring a financial loss by the Bank due to a debtor's failure to perform their obligations towards the Bank under credit exposure in full, or
- the risk of lowering the economic value of credit exposure or a group of credit exposures due to deterioration of the debtor's capacity to service their debt as agreed.

Maximum exposure to credit risk

	2018	2017
Loans and other receivables to other banks	776.5	2 234.5
Financial assets held for trading	1 711.6	1 314.8
Derivative hedge instruments	909.6	967.2
Investment securities / Investments (excluding equity instruments)	31 854.0	25 902.1
Loans and other receivables to customers	99 125.8	87 358.7
Receivables presented in other assets	64.4	64.4
Off-balance sheet liabilities granted, including:	31 958.8	28 844.2
- unused credit facilities	24 097.0	21 598.6
- guarantees	4 943.8	4 439.9
- unused overdraft facilities	1 371.2	1 336.1
- credit card limits	1 251.7	1 079.4
- letters of credit	295.1	390.2
Total	**166 400.7**	**146 685.9**

The Bank's policy on the risk of credit exposure portfolio factors in the fact that the business generating credit risk can entail other risks as well. These are liquidity risk, market risk, operational risk, environmental risk, social risk, legal risk and reputational risk which may intensify one another.

Lending-related losses are a consequence of the above risks and the Bank's mitigation actions in that regard. The Bank impacts the loss level using accepted risk limits, risk exposure amounts plus risk hedging instruments and in case the risk materializes, by direct loss mitigation measures.

Primary goal of the Bank in the credit risk management process is to support effective accomplishment of business goals through proactive risk management and organic growth-oriented activities, with:

- solvency and liquidity kept at a safe level and provisions retained at a proper level, and
- legal and regulatory compliance ensured.

The Bank manages credit risk end to end based on:

- strategic planning,
- a consistent system of limits, policies and procedures as well as
- the risk management tools, including risk identification, measurement and control.

This integrated system combines all the lending-related processes at our Bank.

Detailed credit risk management objectives are:

- supporting business initiatives,
- keeping credit losses at the assumed level,
- verifying and assessing the adequacy and development of applied procedures, models and other elements of the risk management system on an ongoing basis,
- adapting business to the changing environment,
- keeping adequate capital requirements for credit risk and provisions, and
- ensuring regulatory compliance.

2. Risk management strategy and risk appetite parameters

We treat credit risk management as a fundamental and integral part of the end-to-end Bank management process. Setting the Risk Appetite Statement strategy and parameters as well as monitoring of their delivery are key elements of the risk management process.

Credit risk management strategy

The credit risk management strategy supports delivery of business goals while maintaining safe solvency and liquidity of the Bank and adequate provisions. We define the strategy to warrant optimum development of the lending portfolio while keeping adequate quality and profitability of credit operations and capital allocation. The primary objective of the credit risk management strategy is to optimise the ratio of risk to ROE, considering the information about the current and prospective macroeconomic landscapes, the Bank's portfolio and RAS limits utilisation.

The credit risk management strategy sets out short-, mid- and long-term goals as well as their accomplishment manner. It factors in the outlook, including the need to keep the Bank's offer competitive and attractive while expanding it.

Risk appetite (RAS) determination

The RAS stands for the risk appetite of the Bank. We define it by setting high-level and specific limits. Setting and monitoring of the risk appetite (RAS parameters) is an integral part of the planning process and concentration risk management at the Bank.

RAS limits on credit risk:

- portfolio limits,
- limits on portfolio and new production risk parameters, and
- concentration limits, including limits on mortgage-backed credit exposures under PFSA Recommendation S.

Besides RAS limits, credit risk limits are set in the Bank for individual areas, business lines and products as well as transactional limits which are accepted by the competent credit approver. Further, we set internal concentration limits on the sectors and collateral accepted and monitor on an ongoing basis the concentration in the geographical areas of our business (current utilisation of RAS limits during the year is monitored and reported on a monthly basis).

Concentration of exposures to corporate clients in national economy sectors

industry	gross exposure (on-balance and off-balance)			
	2018		2017	
	exposure in PLN million	share in total exposure (%)	exposure in PLN million	share in total exposure (%)
financial intermediation	14 597.9	17.9%	12 333.7	17.2%
wholesale trade	9 120.3	11.1%	8 502.2	11.9%
real estate service	7 340.4	9.0%	6 137.0	8.6%
constructions industry	3 966.0	4.9%	3 552.1	5.0%
power industry	3 713.7	4.5%	3 790.7	5.3%
public administration and national defence	3 598.7	4.4%	3 037.2	4.2%
foodstuff and beverage production	3 330.2	4.1%	3 055.1	4.3%
ready-made metal goods productions	3 107.6	3.8%	2 118.2	3.0%
remaining business activities interests	3 022.9	3.7%	2 159.0	3.0%
retail trade	2 774.0	3.4%	2 674.8	3.7%
rubber industry	2 296.8	2.8%	1 706.6	2.4%
equipment rent	1 756.9	2.2%	1 332.4	1.9%
wood and paper industry	1 752.6	2.1%	1 497.0	2.1%
post and telecommunications	1 646.5	2.0%	1 202.0	1.7%
agriculture, forestry, fishery	1 550.0	1.9%	1 661.4	2.3%
remaining non-metal raw materials industries	1 469.1	1.8%	1 507.8	2.1%
sale, repair and service of motor vehicles	1 421.8	1.7%	1 117.4	1.6%
machine industry	1 348.8	1.6%	1 168.1	1.6%
chemicals and chemical good production	1 224.2	1.5%	1 115.8	1.6%
other	12 805.7	15.6%	11 939.7	16.5%
Total	**81 844.1**	**100.0%**	**71 608.2**	**100.0%**

Bank's large exposures

The table below presents the breakdown of 20 largest Bank exposures towards entities/ related entities (inclusive of groups of entities wherefore the bank is a parent entity). The amount of exposures takes account of the value of the balance sheet assets (extended loans, deposits made and debt securities), extended off-balance sheet exposures and the value of balance sheet equivalent of derivatives. Exposures were reduced by the amounts of exclusions admissible under the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 and the Finance Minister Regulation 1018 of 1 July 2016.

Client	exposure in PLN million	
	2018	2017
Group 1	1 797.1	1 246.7
Group 2 (banking)	1 413.0	1 212.5
Group 3 (banking)	1 058.9	1 649.5
Group 4	878.5	1 058.9
Group 5	874.4	509.3
Group 6	861.9	863.5
Group 7	858.6	725.0
Group 8	805.0	529.0
Group 9	792.6	504.2
Group 10	779.8	757.1
Group 11	710.0	615.0
Group 12	705.3	665.0
Group 13	622.3	1 074.4
Group 14	600.5	300.0
Group 15	550.2	301.9
Group 16	521.1	-
Group 17	493.1	467.8
Group 18	483.4	270.1
Group 19	479.7	203.8
Group 20	472.9	458.8

3. Credit risk management process

Credit risk management is a constant process. It encompasses all lending activities of the Bank. All units and employees performing tasks in the lending process cooperate closely with one another to:

- make the risk management process more efficient and
- keep risk at the level set in the strategy, risk appetite and financial plans of the Bank as well as in the approved RAS.

At our Bank, the credit risk management process is carried out within three lines of defence which are independent in organisational and functional terms from one another.

- **1st line of defence**: business and operational units of the Bank. They pursue day-to-day business under the approved lending policy and risk limits.
- **2nd line of defence:**
  - Credit risk. It identifies and measures the risk stemming from the commercial operations on an ongoing basis and controls its materialisation within the approved risk parameters.
  - Credit inspection. It conducts an unbiased assessment of efficiency, adequacy and effectiveness of the actions taken in the lending process and their compliance with the internal regulations of the Bank.
- **3rd line of defence** – internal audit. It conducts a detailed periodical verification of compliance of the actions of the 1st and 2nd lines of defence with the regulatory requirements and best banking standards.

At the Bank, we apply the organisational solutions which account for separation of the bank products sales forces from the risk acceptance ones across the organisational structure, the Bank Management Board included. We keep separation of the function of credit exposure risk (concentration risk included) control and monitoring from the bank products sales forces and the risk acceptance ones at all layers of the organisational structure of the Bank below the Management Board; for retail credit exposures – at the Bank Management Board level too.

For fast-track, automated lending paths, we base separation of bank products sales forces from the credit exposure risk acceptance ones on the independence of the process of development and validation of risk acceptance process assisting tools from the sales and operational functions. The credit approval authorities pertaining to individual credit transactions are isolated from the credit approval authorities involved in the formulation of the lending policy and credit risk management rules.

4. Credit risk management framework

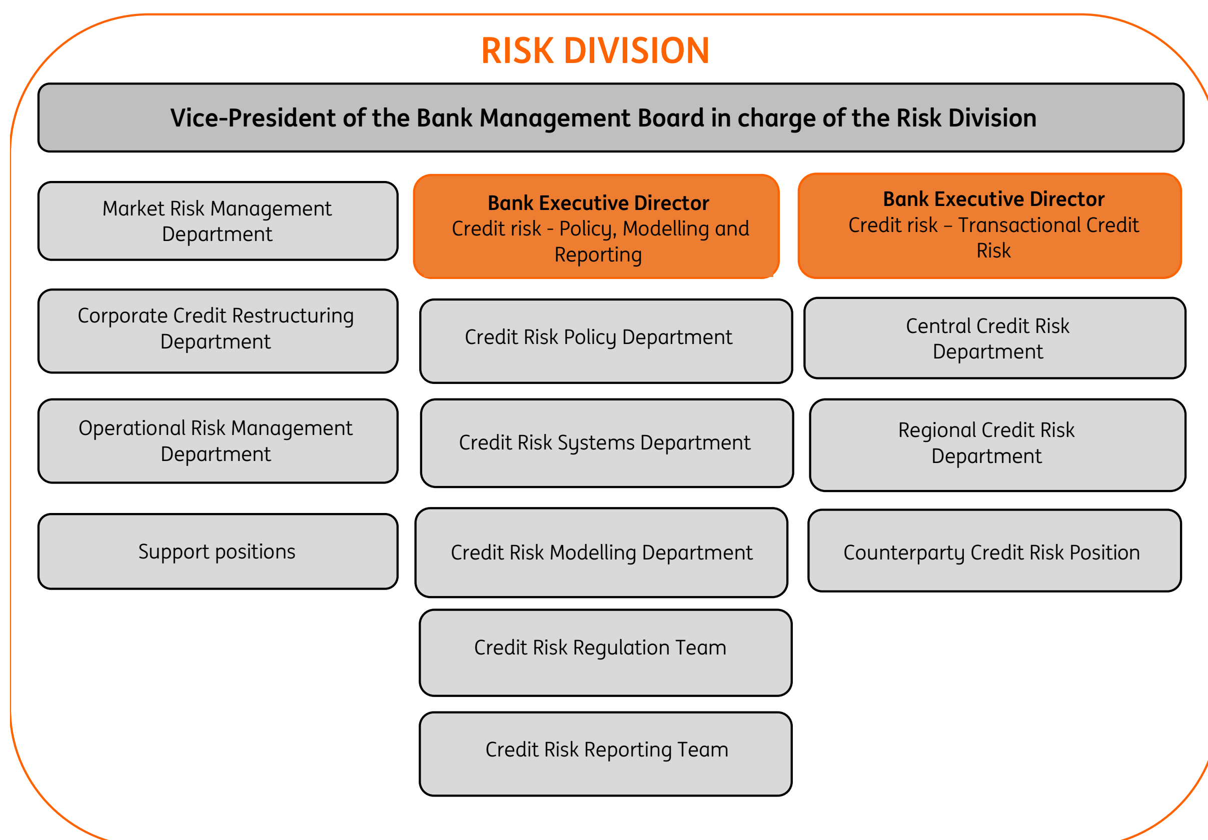
Within the Risk Division, the Bank isolated two credit risk areas reporting to the Bank Executive Directors:

- Credit Risk – Transactional Credit Risk, composed of:
  - Central Credit Risk Department,
  - Regional Credit Risk Department, and
  - Counterparty Credit Risk position.
- Credit Risk – Risk Policy, Modelling and Reporting, composed of:
  - Credit Risk Policy Department,
  - Credit Risk Systems Department,
  - Credit Risk Modelling Department,
  - Credit Risk Regulation Team, and
  - Credit Risk Reporting Team.

Each of the abovementioned areas exercises control and supervision over the respective area of the Bank's operations and risk management process.

For retail and corporate lending portfolios, the functions of credit risk policy, modelling and reporting are combined within relevant departments. In that way, consistent credit risk management actions are taken for both portfolios.

List of units engaged in the risk management process



Main tasks of Risk Division units reporting to Bank Executive Directors

All units and employees performing tasks within the Risk Division cooperate closely with one another to make the risk management process more effective and keep risk at the level set in the strategy, risk appetite and financial plans of the Bank.

Central Credit Risk Department:

- consults sales units of the Bank on credit risk,
- cooperates with sales units of the Bank to develop optimum transaction structures as well as ensure content and quality of lending packages,
- analyses risk, advises upon transactions and takes credit decisions,
- verifies and accepts client risk ratings, also in the appeal procedure,
- monitors credit risk exposures through verification of:
  - satisfaction of initial terms of lending,
  - instances of approved limit overrunning,
  - financial standing of clients,

  - repayment discipline,
  - satisfaction of contractual terms and collateral,
- is engaged in the Watch List portfolio handling process, identifies clients with worse risk profile, including irregular clients, and approaches them adequately,
- exercises functional control for the credit risk processes,
- ensures risk-related advisory services in the credit approval process,
- recommends and advises on changes to the lending process, product area and lending policy,
- accepts the credit risk and rating for the transactions with corporate and strategic clients,
- manages credit risk associated with client funding by: ensuring risk-related advisory services in the credit decision-taking process, enforcing implementation of credit decisions, recommending requisite changes to the lending process management,
- ensures relevant data for the lending policy rules, processes and procedures to approve the acceptable client risk level,
- raises awareness of credit risk and counterparty risk among Bank employees,
- recommends and advises on changes to the lending process management and definition of products and lending policy, and
- makes periodical analyses of the commercial real property market and develops periodical Polish real property market reports.

Regional Credit Risk Department:

- consults sales units of the Bank on credit risk,
- cooperates with sales units of the Bank to develop optimum transaction structures as well as ensure content and quality of lending packages,
- analyses credit risk, advises upon transactions and takes credit decisions,
- verifies and accepts client risk ratings, also in the appeal procedure,
- handles the logistics of the decision-making process at regional levels, engaging credit approvers from Risk in the said process,
- participates in monitoring of credit exposures, i.e.:
  - monitoring of client financial standing, repayment discipline and satisfaction of other credit conditions in the collateral monitoring,
  - and also in the identification of worse risk profile clients and approaching them in a competent manner.
- manages the quality of credit risk processes for the dedicated portfolio, inter alia:
  - has the role of the centre of excellence as regards credit analysis and risk assessment,
  - sees to quality of credit applications and runs adequate training courses,
  - monitors the quality of the credit decision-making process,
- is engaged in the Watch List portfolio handling process, identifies clients with worse risk profile, including in Stage 3 clients, and approaches them adequately,
- exercises functional control for the credit risk processes,
- recommends and advises on changes to the lending process management, definition of products and lending policy.

Counterparty Credit Risk position:

- oversees observance of counterparty limits and transactions by authorised Bank units and external units supervising the Bank,
- oversees FM transaction hedge management process,

- advises on and defines risks associated with the Bank's FM operations and transactions where the Bank serves financial institutions and banks,
- collaborates with dedicated Bank units as regards definition of the processes used to process transactions made by counterparties via the Bank,
- analyses risks, advises on transactions in the credit approval process and on documents for the transactions made by financial institutions and banks,
- verifies and accepts counterparty risk ratings.

Credit Risk Policy Department:

- formulates the credit risk management policy and oversees its implementation in order to ensure controlled, in terms of risks, development of the Bank's lending activity,
- develops and implements the policies and procedures on credit risk management, including credit risk assessment standards and principles for all Bank clients,
- develops guidelines for lending directions and sectorial guidelines based on the conclusions from the portfolio analyses and the analyses of the economic environment (both macroeconomic and sector ones), and
- promotes awareness of credit risk and its control options and methods among the Bank employees.

Credit Risk Systems Department:

- builds and develops the tools and systems supporting credit risk management,
- implements credit risk models, including models for establishing provisions for impairment losses and models for estimation of capital requirements for credit risk,
- raises awareness of credit risk, and particularly of its control and measurement methods, among the Bank employees.

Credit Risk Modelling Department:

- formulates the methodologies for building and monitoring regulatory credit risk models (including for stress testing purposes) which agree with the regulatory requirements and in-house standards of the Bank and ING Group,
- formulates the methodologies for building and monitoring decision-taking models for credit risk used to support risk assessment and boost the sale of bank products,
- regularly monitors regulatory and decision-taking models for credit risk,
- seeks new modelling methods and techniques to improve model performance and the capacity to make advanced analyses using large databases, among other sources,
- cooperates with the Model Validation Department, internal and external auditors and relevant organisational units of ING Group on regulatory and decision-taking models for credit risk and on maintenance of permanent compliance of their development and monitoring methodology and the model management rules with the regulatory regulations and ING standards.

Credit Risk Regulation Team:

- oversees and controls the credit risk management policy implementation at the Bank in order to ensure development of the Bank's lending in terms of risks,
- identifies the areas of the Bank's business operations, which impact the credit risk profile,
- identifies gaps within business processes, which may adversely impact the Bank's credit risk profile,
- initiates actions aimed at maintaining the assumed parameters concerning the quality of the lending portfolio,
- supervises effective implementation of the credit risk management policy,
- assesses and adjusts the solutions used in credit risk management, lending products and business practice to requirements resulting from:

  - the credit risk management policy,
  - laws,
  - regulatory regulations, recommendations and instructions of regulators,
  - the good practices and standards of the Bank and ING Group,
- co-operates with internal and external auditors, bank regulators, Polish Bank Association and relevant organisational units of ING Group as regards:
  - the credit risk management policy and
  - maintenance of permanent compliance of the Bank's regulations with the regulatory regulations and ING standards,
- prepares annual self-assessment of the Bank concerning compliance with the supervisory regulations for the AIRB Approach,
- mans the Credit Policy Committee secretary's office.

Credit Risk Reporting Team:

- develops credit risk reporting principles,
- performs tasks regarding credit risk measurement and reporting including calculation of impairment losses using a collective method and of capital requirements for credit risk,
- develops and maintains the tools and systems supporting credit risk management,
- performs Stress Tests complying with the regulatory requirements and Bank and ING Group internal standards as well as compiles reports on model management process (e.g. automatic monitoring),
- plans and forecasts the level of impairment losses using a collective method and as per the capital requirements for credit risk,
- makes relevant report-based assessments of the credit risk monitoring process,
- cooperates with the auditor, bank regulators, Polish Bank Association and relevant ING Group organisational units as regards credit risk reporting,
- cooperates with the Credit Information Bureau and other providers of external databases used for credit risk management.

Support position:

- provides support to the Risk Division and the Division's senior management in the implementation of the strategy, goals and priorities as well as related processes,
- coordinates communication in the Risk Division, including:
  - cooperating with the Bank's units responsible for internal communication,
  - acting as the editor of the main intranet Risk portal,
  - organising internal conferences and meetings of senior management and employees of the Risk Division,
  - preparing articles and educational materials and cooperating with other authors in the field of publications regarding the Risk Division,
  - organising or supporting organisers of educational activities, competitions and reward programs related to Risk,
  - organising Risk Division internal client satisfaction surveys,
  - coordinating WPC survey – acting a WPC Ambassador,
- promotes and supports the implementation of process management standards and tools in the Risk Division,
- supports projects and initiatives implemented in the Risk Division, and

- promotes and supports employee development programmes and manages training budgets at the Risk Division level.

5. Lending principles

The primary rule which the Bank abides in lending is to comply with the lending-related laws and external regulations like e.g.:

- Banking Law Act,
- Macroprudential Supervision Act,
- FX Law, or
- anti-money laundering regulations, etc.

The Bank neither enters into credit transactions nor engages in the activities whose ethical aspect is dubious and which could tarnish our reputation.

In lending, we follow the following rules:

- the Bank acquires and keeps in the lending portfolio the credit exposures which ensure safety of deposits and capital of the Bank,
- the Bank acts in the client's interest, factoring in both their needs and possibilities; the Bank avoids situations where the funding provided would entail a debt spiral for the client,
- the Bank acquires clients in line with the regulations and requirements concerning delivery of indispensable information and documents and procedural compliance,
- the Bank is efficient and professional in rendering credit services while respecting the interest of clients and expectations of Bank shareholders about the increase of the ING Bank Śląski S.A. goodwill,
- the Bank does not enter into transactions or loans without learning and understanding the economic background of the transaction,
- the Bank accepts credit risk when we can effectively control it and – in the event of default – conduct the debt recovery procedures,
- the Bank does not provide loans when we are exposed to reputational risk,
- the Bank takes decisions concerning new types or lines of credit exposures (e.g. new markets, market segments, client groups, products) upon the former analysis and assessment of new opportunities and related risks,
- in business relationships, the Bank applies the rule of "equal rights", i.e. the Bank requires the same documents and information from the clients identical in terms of credit risk outlook and we pay special attention to their equal treatment,
- the Bank communicates with clients as to disclosure requirements in the lending process.

In cooperation with business partners, the Bank abides by the following rules:

- verifies business partners with whom the Bank cooperates in the lending process,
- has document workflow procedures covering clients, business partners and the Bank,
- has quality assurance procedures for business partners,
- does not extend powers of attorney or grant rights to take credit decisions on behalf of and for the Bank in the credit approval (distribution) process,
- defines the acceptable risk level for individual sales channels,
- monitors the quality of the lending portfolio built up by individual business partners.

6. Credit risk management

The Bank manages credit risk per portfolio of credit exposures and per individual transaction.

Credit exposure portfolio risk management

The Bank portfolio credit risk management process serves to ensure portfolio building in line with the adopted strategy, while keeping the solvency ratio of the Bank at an acceptable level and within the predefined and approved risk parameters.

The Bank manages the credit risk of the credit exposure portfolio through:

- defining the credit risk management strategy,
- agreeing on the RAS with business,
- developing, implementing and monitoring the delivery of the lending policy,
- analysing the macroeconomic situation and the situation in individual sectors as well as formulating guidelines on the lending directions,
- developing and implementing lending products,
- setting competence levels for acceptance of waivers from the lending policy and product waivers,
- developing and implementing the tools to support risk assessment and measurement,
- analysing and assessing the performance of the lending process and the scope of functional control,
- managing the credit exposure portfolio,
- running training courses for employees in the lending process,
- designing and maintaining the incentive system for employees to ensure internal credit standards observance.

Managing the credit risk profile, the Bank:

- sets, monitors and reports internal concentration limits for sectors, collateral types, regions and mortgage-backed credit exposures,
- monitors and analyses the quality of accepted collateral,
- monitors and reports compliance with Banking Law Act-based prudential norms,
- sets, monitors and reports internal concentration limits considering individual sub-portfolios,
- defines modifications of the lending policy and product offer considering the cyclical nature of economy and changes in the real property market,
- acquires market data on the quality of lending portfolios and compares them with own lending portfolios.

Capital adequacy and credit risk provisioning

The Bank secures against the impairment of credit exposures by provisioning to cover the impairment under expected credit losses. The Bank also secures against loss fluctuations vis-à-vis the expected loss (that is the unexpected loss) by ensuring adequate regulatory capital and economic capital.

The Bank computes risk-weighted assets and capital requirement for:

- retail exposures – using the Standardised Approach,
- corporate credit exposures – using the AIRB Approach, save for the exposures to the governments, central banks, local government units and public sector entities wherefor we use the Standardised Approach.

The Bank computes credit risk provisions for all credit exposures in line with the International Financial Reporting Standards.

Stress tests

Stress tests are conducted to:

- assess and measure the impact of adverse (stress) internal and external conditions on the Bank's standing (lending portfolio and capital adequacy, for example),
- identify significant risk factors through determination of the Bank's sensitivity to changes of certain factors, and
- identify potential threats and possibility to work out hedging strategies.

At the Bank, we perform sensitivity tests and stress scenario tests for the economic and regulatory capitals, and for provisions. Analysis and reporting of results for both tests covers the impact of movements in macroeconomic ratios on the following credit risk parameters:

- probability of default (PD),
- loss given default (LGD),
- exposure at default (EAD),
- loan to value (LTV),
- debt to income (DTI) – the percentage of expenditures being payment of credit liabilities and financial liabilities (other than credit ones) to the client's net income.

Stress test results are used among others in the following processes:

- setting the RAS limits and internal limits mitigating credit risk,
- defining the principles of viability and creditworthiness calculation, to set the maximum DTI and LTV in particular.

Credit risk management for individual credit exposures

Credit risk management for individual credit exposures covers:

- defining the credit risk management process for the transactions bearing credit risk,
- managing documentation requirements applicable to the credit client of the Bank,
- defining the credit analysis standard,
- defining the maximum DTI, LTV and the minimum downpayment for certain products and transactions,
- formulating the rules of taking credit decisions and managing credit powers,
- managing the rules for:
  - defining the risk metrics using the risk models applied at the Bank,
  - verifying repayment discipline,
  - monitoring financial standing of clients,
  - monitoring satisfaction of contractual terms by clients,
  - monitoring other defined warning flags,
  - accepting and monitoring collaterals accepted by the Bank,
  - using and monitoring the limits available at the Bank.
- forming impairment losses for impaired exposures and provisions for off-balance sheet liabilities,
- managing credit risk of clients in Stage 3 portfolio.

In the process of award and management of individual credit exposures, the following activities are performed:

- client and transaction risk assessment,
- credit decision taking,

- monitoring,
- restructuring and debt recovery.

Client and transaction risk assessment

The most important elements of credit risk assessment for clients and transactions include:

- customer creditworthiness assessment

  The Bank assesses customer creditworthiness by:

  - verifying satisfaction of minimum criteria,
  - setting the client rating or scoring in the rating or scoring process, respectively.

  Client risk measurement in the rating or scoring process is based on the estimated probability of default (PD). Setting the client rating or scoring at a certain minimum level for a given client, lending process or product type preconditions client provision with funding.

  The Bank assesses creditworthiness of corporate clients in the rating process based on:

  - the rating assigned to the entities applying for credit exposure or providing collateral (surety or guarantee providers) and other entities if so required by the specific nature of collateral or transaction (e.g. debtors under the receivables assigned to the Bank),
  - the "four-eye" principle, i.e.:
    - commercial functions are separated from the rating approval functions performed by the Risk Division units or
    - the rules for automatic rating models which are approved by the Credit Policy Committee.

  The Bank assesses creditworthiness of retail clients based on:

  - credit risk scoring,
  - analysis of past repayment of liabilities with the Bank and with other financial institutions,
  - the borrowers' features of a significant impact on the assumed credit liability repayment (qualitative analysis), e.g.
    - personal data of the client: age, marital status, number of dependants, housing and property status, education, length of service, form of employment and profession practised, etc.
    - client history with the Bank: term of cooperation and account history.

  The Bank applies scoring models (application models, behavioural models and Credit Information Bureau scoring) which present the statistical level of client risk. The applied client creditworthiness assessment models undergo a cyclical monitoring and validation to ensure good quality of those tools.

- credit capacity assessment (quantitative assessment)

  Credit capacity is assessed by identifying the repayment source as well as its amount and stability throughout the tenor. It is the Bank's assessment of repayment options of the credit exposure of a certain amount, at certain dates and on certain terms and conditions by the client. In the client credit capacity assessment, the Bank uses the client creditworthiness score set in the rating or scoring process.

  In the client credit capacity assessment process:

  - we verify the source of repayment,
  - we assess its amount and stability,
  - we assess the prospective credit capacity based on forecasts and the assumption that the results will remain on the same level as in the current period,
  - we also factor in the FX risk and the IR risk borne by the debtor.

The credit capacity analysis for corporate clients and entrepreneurs may cover the following areas:

– client ownership structure,
– type of business,
– business and investment strategy,
– position on the market,
– sale market and vendors,
– financial analysis, financial forecast included,
– identification and assessment of repayment sources,
– financial standing vis-à-vis industry peers,
– global, macroeconomic, regional and industry factors impacting or possible to impact materially the financial standing of the company in the future.

Analysis of individual client credit capacity covers:

– setting the amount and stability of generated income (quantitative analysis),
– setting the amount of client financial liabilities (credit and non-credit ones),
– setting the amount of household expenses.

In the credit capacity assessment, the Bank uses the financial metrics based on mathematic formulas.

- collateral assessment

  At the Bank, the Bank uses collateral to mitigate the credit risk and the losses sustained in the event of client default on loan repayment. Before accepting the collateral, we assess the collateral object as well as its value and effectiveness. The Bank accepts all legally permitted forms of collateral. Collateral is selected considering various factors:

  – client's capacity to offer certain collateral,
  – exposure type and term,
  – client risk,
  – transaction risk,
  – collateral liquidity (quick sale options), and
  – collateral worth.

  Besides classic (tangible and personal) collateral forms, the Bank applies additional instruments to mitigate the risk of receivables loss being contractual conditions and covenants.

  To compute the capital requirement, the Bank uses the approved LGD models in which each collateral has a relevant recovery rate assigned. The Group follows the policy to grant loans in the amount and on the terms and conditions which enable regular repayment without the need to recover debt from collateral.

- transaction risk assessment

  In transaction assessment, the Bank factors in:

  – client creditworthiness and credit capacity assessment,
  – compliance with the lending policy,
  – credit facility purpose and transaction structure,
  – adequacy of the product requested,
  – LTV and LGD parameters, downpayment (if required),
  – covenants,
  – other risks like:

  - business – macroeconomic, market, industry and seasonality ones,
  - structural – structure of transactions, value of LTV and LGD parameters, downpayment (if required), strength of covenants, Bank's position vis-à-vis other lenders,
  - management staff – length of service, credit approver substitutability and succession risk,
  - financial – including FX and IR risks,
  - concentration – whether the requested exposure increase entails utilisation of the internal limit set by the Bank,
  - reputational – whether cooperation with the client may negatively impact the reputation of the Bank.
- pricing conditions, etc.

The impact of collateral for the models of expected credit loss estimation

In the case of corporate loans for which the Bank uses the AIRB approach, hedges are included in LGD models through the use of so-called Haircuts: the value of the collateral multiplied by (1-Haircut) assigned to a given type of collateral reduces the loss on the exposure in default when the exposure is not returned to the working portfolio:

LGD = (1-*Cure_Rate*) * [EAD - collateral_value * (1-*Haircut*) - Unsecured_Amount * *Unsecured_Recovery_Rate*] / EAD+*Costs*.

Main type of collaterals and recovery rates assigned to them (1-Haircut):

Group of collaterals	Recovery rate	
	LGD CORP model	SME LGD model
Financial resources (deposit in Bank or other banks)	100%	95%
Liquid securities	75%	50%
Properties	60%	42%
Means of transport	55%	-
Receivables	50%	20%
Machines and devices	45%	42%
Inventory	45%	15%
Intangible assets	10%	-
Other collaterals	10%	0%

Guarantees/ sureties	Recovery rate	
	LGD CORP model	SME LGD model
Export Credit Agencies (ECA): KUKE, Hermes	100%	99.59%
State - governmental	90%	90%
Banks: central banks, banks - investment rating 10 or better	90%	90%
Banks: central banks, banks - rating 11-15	80%	-
ING Bank internal	100%	0%
ING Group internal (entities from ING Group)	90%	0%
Non-banking financial institutions (NBFI), investment rating 10 or better	90%	60%
Non-banking financial institutions (NBFI), rating 11-15	80%	10%
Corporates, annual turnover above EUR 100 million, investment rating 10 or better	90%	30%
Mother company's or other related entitiy's in the meaning of one obligor principle, annual turnover above EUR 100 million, investment rating 10 or better	70%	10%
Corporates, annual turnover above EUR 100 million, rating 11-15	70%	30%
Mother company's or other related entitiy's in the meaning of one obligor principle, annual turnover above EUR 100 million, rating 11-15	50%	10%
Entities with annual turnover from EUR 1,200 thousand to EUR 100 million, rating 15 or better	40%	30%
Mother company's or other related entitiy's in the meaning of one obligor principle, annual turnover from EUR 1,200 thousand to EUR 100 million, rating 15 or better	20%	10%

Individuals	0%	0%

In case of retail segment the collateral has an impact on the expected credit loss estimation mainly for mortgages. The impact of LTV ratio for the LGD parameter for mortgages as at 31 December 2018 is presented below.

Mortgeges in Stage 3 – LTV impact on LGD:

LTV	Average LGD
0-50%	29%
50-100%	43%
above 100%	62%

The maximum recognizable amount of collateral or guarantee

2018

	The maximum recognizable amount of collateral or guarantee				
	loans secured by real estate		other secured loans		received financial guarantees
	residential	commercial	cash (issued debt instruments)	others	
Loans and receivables, including:	**32 816.1**	**19 373.3**	**148.9**	**7 024.6**	**16 239.1**
other institutions' sector	0.0	0.0	0.0	299.2	5 806.2
non-financial institution	153.5	17 029.4	144.5	6 216.8	10 093.0
households	32 661.7	2 310.9	4.4	485.8	287.9
including: loans for the purchase of residential real estate	30 241.8	437.9	1.6	0.3	0.4
other entities (banks, government)	0.9	33.0	0.0	22.8	52.0

Credit decision taking

The scope of credit powers as to acceptance of risk for individual credit exposures is determined by the Credit Policy Committee. Absence of data indispensable for risk assessment excludes its acceptance or decision taking action.

The decisions concerning lower-value exposures with shorter tenors and lower risk are taken at lower credit approval levels. As the credit risk increases – that is as a single or total credit exposure increases, the tenor is extended, non-standard elements in the application or waivers from the effective internal regulations appear – the decisions are taken by higher credit approval authorities.

Risk is assessed and accepted using the expert judgment which is based on the results of the risk measurement made with the assisting tools as defined in the lending policy and procedures. Automated decisions taken by the IT system or semi-automated decisions made in fast-track credit approval process are an exception here.

Credit decisions are taken following a comprehensive transaction risk analysis – in the proper credit approval track, determined by the transaction complexity and amount. For more automated tracks, transaction risk is analysed on the basis of clearly defined criteria, including behavioural ones, and on the basis of credit limit computed automatically using the algorithm approved by the Credit Policy Committee.

The credit decisions for Stage 1 and 2 portfolio are taken:

- collectively – by **the Bank Credit Committee** – for largest credit exposures,
- **on a four-eye basis** – by business units and transactional credit risk units,
- **on a two-eye basis** – by the Risk Manager for small credit exposures.

The decision-making mode does not exempt any of the decision-making process actors from personal responsibility for the decisions made.

Credit approvers in the four-eye approval procedure are provided with personal credit powers one by one, depending on their know-how and experience. The credit mandate correlates with the level of credit risk. When the credit risk is higher, decisions are taken by more experienced persons. The rules of assigning and cancelling credit powers are different for individual client segments.

When determining the relevant credit mandate for corporate clients, we take account of the total exposure of the Group to the group of related entities the client is the member of; for natural persons and natural persons running business, the approval authorities are correlated with the total exposure of the Bank to the said client. All transactions are accepted in line with the explicitly defined decision-taking rules and credit powers.

Credit decisions for Stage 3 portfolio are taken on a four-eye basis or by the Restructuring Committee.

Monitoring

All credit exposures involving credit risk, concentration risk included, and FM trades are monitored. Monitoring serves to identify early the warning flags and take measures to prevent occurrence of problem loans as well as to identify the criteria or objective evidence of impairment and take measures to limit losses for the Bank. Monitoring of granted credit exposure covers:

- repayment discipline,
- satisfaction of other contractual terms by the client,
- the financial and/or property-related situation of the client,
- way of cash utilisation in line with the funding purpose (if defined),
- investment project execution status (for capex loans),
- verification of warning flags for the client or transaction,
- occurrence of objective impairment evidence or impairment triggers,
- periodical assessment of collateral quality and amount.

Restructuring and debt recovery

The Bank supports our clients at each and every funding stage. The Bank offers bespoke products to them. In the event of their slight default on payment of liabilities, the Bank recommends flexible repayment schedules to them. Should clients encounter more difficulties in repayment, the Bank may suggest debt restructuring. Together with the client the Bank determines the best form of support or settlement.

The main objective of actions taken for the non-performing portfolio is to minimise the risk of loss for the Bank or the actual loss amount.

The Bank applies the following strategies for Stage 3 portfolio:

- debt restructuring – based on the cooperation with the client which can, in particular, consist in changing the covenants to bring the terms of debt repayment into line with the client's financial capacity e.g:
  - tenor extension,
  - sale of assets,
  - sale of some business activity of the borrower, or
  - write-off of some financial liabilities.

  The Bank takes a restructuring decision upon a detailed analysis and acceptance by a relevant decision-taking body of the Bank. The borrower is again subject to the standard credit risk monitoring process once the restructuring process has been completed successfully.

- debt recovery – i.e. claiming by the Bank the receivables from the established legal collateral or other property of the client or from the property of other obligors. The Bank may claim their receivables by instituting the enforcement proceedings or participating in the bankruptcy proceedings; further, for retail clients – via out-of-court debt collection, i.e. by enabling the clients to make payments at their discretion as part of the debt recovery procedure.

Forberance

Forbearance occurs when the Bank recognises that the client will not be able to satisfy their liabilities due to financial problems (declared or expected in the short run) and resolves to provide them with forbearance.

The Bank identifies forbearance when all the following conditions are met:

- the Bank identified difficulties in repayment of liabilities by the client or expect such difficulties in the short term,
- the Bank resolved to apply forbearance towards such a client so as to enable them to repay the contractual liabilities or to preclude such problems,
- there are no commercial grounds for forbearance and we award it on the terms and conditions differing from the market ones,
- the client accepted forbearance, i.e. the terms and conditions of the agreement binding so far have been changed or a refinancing agreement has been signed or an embedded forbearance clause has been introduced or the Bank has abandoned actions in the event of the client materially breaching the essential financial covenant

A forborne client may be kept in Stage 1 and 2 portfolio when there are no grounds for their downgrading to Stage 3 portfolio.

ING Bank Śląski S.A.
Annual financial statements for the period from 1 January 2018 to 31 December 2018 (PLN million)

Lending portfolio division into performing and non-performing exposure with forborne exposures indication

2018	performing exposure	including forbearance				non-performing exposure	including forbearance				
			Modification of terms and conditions	Refinancing	Under probation*			Modification of terms and conditions	Refinancing	Defaulted	Impaired
Gross lending portfolio, including:	**97 578.2**	**565.8**	**563.5**	**2.3**	**565.8**	**2 489.4**	**629.4**	**628.2**	**1.2**	**611.8**	**611.8**
Corporate banking including:	**53 992.2**	377.8	375.5	2.3	377.8	**1 700.8**	502.2	501.0	1.2	490.2	490.2
loans in the current account	**12 872.7**	129.3	127.4	1.9	129.3	**681.0**	75.7	75.7	0.0	72.4	72.4
term loans and advances	**38 309.7**	248.5	248.1	0.4	248.5	**1 019.8**	426.5	425.3	1.2	417.8	417.8
corporate and municipal securities	**2 809.8**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Retail banking, including:	**43 586.0**	188.0	188.0	0.0	188.0	**788.6**	127.2	127.2	0.0	121.6	121.6
mortgages	**33 159.2**	90.5	90.5	0.0	90.5	**212.5**	57.4	57.4	0.0	53.5	53.5
loans in the current account	**1 257.4**	2.7	2.7	0.0	2.7	**71.8**	2.3	2.3	0.0	2.2	2.2
other loans and advances	**9 169.4**	94.8	94.8	0.0	94.8	**504.3**	67.5	67.5	0.0	65.9	65.9
Expected credit loss allowance, including:	**-517.2**	**-16.4**	**-16.3**	**-0.1**	**-16.4**	**-1 593.6**	**-340.5**	**-339.9**	**-0.6**	**-338.4**	**-338.4**
Corporate banking including:	**-100.5**	-3.0	-2.9	-0.1	-3.0	**-1 005.7**	-255.5	-254.9	-0.6	-254.5	-254.5
loans in the current account	**-22.1**	-0.6	-0.6	0.0	-0.6	**-438.0**	-38.5	-38.5	0.0	-38.5	-38.5
term loans and advances	**-77.9**	-2.4	-2.3	-0.1	-2.4	**-567.7**	-217.0	-216.4	-0.6	-216.0	-216.0
corporate and municipal securities	**-0.5**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Retail banking, including:	**-416.7**	-13.4	-13.4	0.0	-13.4	**-587.9**	-85.0	-85.0	0.0	-83.9	-83.9
mortgages	**-101.4**	-4.3	-4.3	0.0	-4.3	**-123.5**	-32.0	-32.0	0.0	-31.1	-31.1
loans in the current account	**-49.6**	-0.1	-0.1	0.0	-0.1	**-56.2**	-1.3	-1.3	0.0	-1.3	-1.3
other loans and advances	**-265.7**	-9.0	-9.0	0.0	-9.0	**-408.2**	-51.7	-51.7	0.0	-51.5	-51.5
Net lending portfolio, including:	**97 061.0**	**549.4**	**547.2**	**2.2**	**549.4**	**895.8**	**288.9**	**288.3**	**0.6**	**273.4**	**273.4**
Corporate banking including:	**53 891.7**	374.8	372.6	2.2	374.8	**695.1**	246.7	246.1	0.6	235.7	235.7
loans in the current account	**12 850.6**	128.7	126.8	1.9	128.7	**243.0**	37.2	37.2	0.0	33.9	33.9
term loans and advances	**38 231.8**	246.1	245.8	0.3	246.1	**452.1**	209.5	208.9	0.6	201.8	201.8
corporate and municipal securities	**2 809.3**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Retail banking, including:	**43 169.3**	174.6	174.6	0.0	174.6	**200.7**	42.2	42.2	0.0	37.7	37.7
mortgages	**33 057.8**	86.2	86.2	0.0	86.2	**89.0**	25.4	25.4	0.0	22.4	22.4
loans in the current account	**1 207.8**	2.6	2.6	0.0	2.6	**15.6**	1.0	1.0	0.0	0.9	0.9
other loans and advances	**8 903.7**	85.8	85.8	0.0	85.8	**96.1**	15.8	15.8	0.0	14.4	14.4

*) The Bank classifies to "Under probation" class the exposures for which forbearance measures were granted in the past, and which are currently in a curing period

2017	performing exposure	including forbearance				non-performing exposure	including forbearance				
			Modification of terms and conditions	Refinancing	Under probation*			Modification of terms and conditions	Refinancing	Defaulted	Impaired
Gross lending portfolio, including:	83 050.7	350.8	348.8	2.0	350.8	2 110.4	582.8	582.3	0.4	579.1	579.1
Corporate banking including:	**46 916.0**	181.3	179.3	2.0	181.3	**1 430.7**	452.2	451.7	0.4	452.2	452.2
- loans and advances	**44 383.1**	181.3	179.3	2.0	181.3	**1 415.3**	452.2	451.7	0.4	452.2	452.2
- corporate and municipal debt securities	**2 532.9**	-	-	-	-	**15.4**	-	-	-	-	-
Retail banking, including:	**36 134.7**	169.5	169.5	0.0	169.5	**679.7**	130.6	130.6	0.0	126.9	126.9
- mortgages	**27 741.4**	92.3	92.3	-	92.3	**218.0**	59.8	59.8	-	56.9	56.9
- other loans and advances	**8 393.3**	77.2	77.2	-	77.2	**461.7**	70.8	70.8	-	70.0	70.0
Impairment losses, including:	-233.2	-8.8	-8.8	0.0	-8.8	-1 300.6	-270.9	-270.9	0.0	-270.6	-270.6
Corporate banking including:	**-70.7**	-4.8	-4.8	0.0	-4.8	**-837.3**	-205.5	-205.5	0.0	-205.5	-205.5
- loans and advances	**-70.0**	-4.8	-4.8	-	-4.8	**-821.9**	-205.5	-205.5	-	-205.5	-205.5
- corporate and municipal debt securities	**-0.7**	-	-	-	-	**-15.4**	-	-	-	-	-
Retail banking , including:	**-162.5**	-4.0	-4.0	0.0	-4.0	**-463.3**	-65.4	-65.4	0.0	-65.1	-65.1
- mortgages	**-53.6**	-1.5	-1.5	-	-1.5	**-129.9**	-27.8	-27.8	-	-27.6	-27.6
- other loans and advances	**-108.9**	-2.5	-2.5	-	-2.5	**-333.4**	-37.6	-37.6	-	-37.5	-37.5
Netlending portfolio, including:	82 817.5	342.0	340.0	2.0	342.0	809.8	311.9	311.4	0.4	308.5	308.5
Corporate banking including:	**46 845.3**	176.5	174.5	2.0	176.5	**593.4**	246.7	246.2	0.4	246.7	246.7
- loans and advances	**44 313.1**	176.5	174.5	2.0	176.5	**593.4**	246.7	246.2	0.4	246.7	246.7
- corporate and municipal debt securities	**2 532.2**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Retail banking, including::	**35 972.2**	165.5	165.5	0.0	165.5	**216.4**	65.2	65.2	0.0	61.8	61.8
- mortgages	**27 687.8**	90.8	90.8	0.0	90.8	**88.1**	32.0	32.0	0.0	29.3	29.3
- other loans and advances	**8 284.4**	74.7	74.7	0.0	74.7	**128.3**	33.2	33.2	0.0	32.5	32.5

Exposure with forborne exposures indication according risk rating

risk rating	gross exposure in PLN million 2018				gross exposure in PLN million 2017			
	performing		non-performing		performing		non-performing	
	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance
Corporate banking	**377.7**	**78.7**	**502.2**	**7.7**	**181.3**	**36.0**	**452.2**	**29.5**
middle and increased risk grades (rating 11-17)	288.7	74.7	1.9	-	119.7	29.4	-	-
problem loans (rating 18-22)	89.0	4.0	500.3	7.7	61.6	6.6	452.2	29.5
Retail banking	**188.1**	**0.0**	**127.2**	**0.0**	**169.5**	**0.0**	**130.6**	**0.0**
low risk grades (rating 1-10)	45.8	-	0.1	-	46.5	-	0.3	-
middle and increased risk grades (rating 11-17)	117.5	-	2.8	-	107.5	-	2.0	-
problem loans (rating 18-22)	24.8	-	124.3	-	15.5	-	128.3	-
Total	**565.8**	**78.7**	**629.4**	**7.7**	**350.8**	**36.0**	**582.8**	**29.5**

Exposure with forborne exposures indication according days past due

number of days past due	gross exposure in PLN million 2018				gross exposure in PLN million 2017			
	performing		non-performing		performing		non-performing	
	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance
Corporate banking	**377.7**	**78.7**	**502.2**	**7.7**	**181.3**	**36.0**	**452.2**	**29.5**
0	335.7	78.7	203.8	7.7	175.3	36.0	124.8	29.5
1-30	1.7	-	4.1	-	1.3	-	7.1	-
31-60	5.5	-	8.2	-	2.0	-	5.2	-
61-90	34.8	-	18.4	-	2.7	-	9.8	-
91-180	-	-	90.0	-	-	-	49.5	-
181-365	-	-	41.2	-	-	-	26.1	-
>365	-	-	136.5	-	-	-	229.7	-
Retail banking	**188.1**	**0.0**	**127.2**	**0.0**	**169.5**	**0.0**	**130.6**	**0.0**
0	156.0	-	52.6	-	149.6	-	61.6	-
1-30	27.0	-	25.3	-	16.5	-	22.6	-
31-60	4.1	-	10.8	-	2.4	-	11.7	-
61-90	1.0	-	4.1	-	1.0	-	6.2	-
91-120	-	-	2.3	-	-	-	2.5	-
121-150	-	-	1.2	-	-	-	1.4	-
151-180	-	-	2.7	-	-	-	1.4	-
>180	-	-	28.2	-	-	-	23.2	-
Total	**565.8**	**78.7**	**629.4**	**7.7**	**350.8**	**36.0**	**582.8**	**29.5**

Interest on loans and other receivables to customers in the 2018 income statement includes interest income on “forborne exposures” of PLN 38.6 million (as on 2017 PLN 36.6 million), where PLN 25.4 million derives from the performing exposures portfolio and PLN 13.2 million from non-performing exposures (as on 2017 PLN 15.6 million and PLN 21.0 million respectively).

7. Risk management system

The risk management system is an integrated collection of rules, tools and mechanisms, including but not limited to policies and procedures for risk processes. The role of the risk management system is to continuously identify, measure or estimate as well as monitor the Bank's risk and secure against potential losses through adequate controls, system of limits and adequate level of provisions as well as of capitals and liquidity buffers.

The Bank's credit risk management system is composed of:

- general principles of credit risk management and mitigation,
- RAS strategies and limits,
- credit risk management policies, manuals and procedures,
- credit risk systems, tools and models,
- management reporting system enabling credit risk monitoring,
- the organisational framework matching the amount and profile of credit risk borne by the Bank.

The risk management system activities may consist in:

- risk avoidance – liquidation or limitation of business which generates too high risk or the risk which cannot be effectively controlled,
- risk mitigation – taking actions to reduce the probability of adverse developments or limit their impact,
- risk transfer – transfer of the entire or some risk to another entity; e.g. under insurance or securitisation of the lending portfolio,
- risk acceptance – resignation from the above actions for economic or practical reasons, within the risk appetite of the Bank.

Under the risk management system at the Bank, we apply formal:

- risk tolerance determination rules and risk management rules,
- procedures intended to identify, measure or estimate and monitor risk, also accounting for anticipated future risk, and
- risk limits and rules of conduct in the event of limit overrun.

Additionally:

- we apply the approved management reporting system that allows risk level monitoring,
- we have the organisational framework matching the scale and profile of risk borne by the Bank,
- we have adequately defined credit risk assessment and measurement process, independent from the credit approval function; it encompasses:
  - efficient rating system,
  - efficient process of acquiring adequate information, including forecasts, used to value expected credit losses,
  - assessment policy which ensures that expected credit losses are valued case by case or collectively,
  - efficient process of model validation which ensures that models return accurate, consistent and objective forecasts and estimates on an ongoing basis,
  - plain formal communication and coordination of all activities of all employees involved in the risk assessment process and valuation of expected credit losses.

The credit risk management system used by the Bank – including the organisational structure, the lending process framework, the system of internal regulations and the applied tools and models – is verified on an ongoing basis and adapted as needed to ensure that the Bank's strategy, the risk appetite included, is accomplished. This is how we strive for the identification, assessment, measurement, monitoring and management actions taken for the business bearing credit risk to be adequate and, at the same time, consistent and compliant with the regulatory requirements.

The Bank manages its credit risk with the use of advanced credit risk assessment models. For the corporate credit portfolio, capital requirements are computed using the Advanced Internal Rating-Based Approach (AIRB). Also for the retail portfolio, the Bank aspires to obtain the Polish Financial Supervision Authority's approval of using this method for the mortgage and consumer portfolios. The risk management models applied by the Bank are systematically validated and developed.

Systems and models assisting viability and creditworthiness assessment for:

- corporate clients – are built and monitored in line with the requirements for use of the advanced method to compute capital requirements for credit risk and ING Group standards,
- retail clients – are scoring models (application models, behavioural models and Credit Information Bureau scoring) which present the statistical level of client risk as required by regulatory regulations,

To assess the credit risk of credit exposures, we use the following models:

- PD – probability of default measure,
- LGD – loss given default measure,
- EAD – exposure at default measure.

The models are built as required by the regulatory regulations and are used inter alia to quantify provisions and economic capital for credit risk for internal and external reporting requirements, perform reporting duties as required by the regulator and define the credit pricing and client profitability. We assess that the models applied by us are effective based on the validation and monitoring processes.

8. Structure of credit exposure portfolio

Credit exposure portfolio (PLN million)*

2018

	on-balance	off-balance
Gross credit exposure to corporate clients, including:	**55 693.0**	**26 151.1**
stage 1	50 361.4	25 785.7
stage 2	3 643.7	333.1
stage 3	1 687.9	32.3
Gross credit exposure to retail clients, including:	**44 374.6**	**4 263.1**
stage 1	37 821.8	3 903.7
stage 2	5 773.7	357.0
stage 3	779.1	2.4
Total gross credit exposure	**100 067.6**	**30 414.2**
expected credit loss allowance	-2 110.8	0.0
Total net credit exposure	**97 956.8**	**30 414.2**

*) The on-balance exposures taken for analysis include the outstanding principal, the interest accrued and adjustments under the effective interest rate method.

2017

	on-balance	off-balance
Gross credit exposure to corporate clients, including:	**47 787.1**	**23 821.1**
exposures with no impairment triggers	46 081.1	23 720.4
exposures with impairment triggers but with no actual impairment declared	275.7	68.6
impaired exposures, including:	1 430.3	32.1
- exposures measured individually	1 099.4	29.2
- exposures measured as per portfolio	330.9	2.9
Gross credit exposure to retail clients, including:	**36 814.4**	**3 936.6**
exposures with no impairment triggers	36 142.7	3 933.8
impaired exposures	671.7	2.8
Total gross credit exposure	**84 601.5**	**27 757.7**

Credit exposure by risk rating

2018

risk rating	Credit exposure to corporate clients in PLN million								Credit exposure to retail clients in PLN million							
	Stage 1		Stage 2		Stage 3		TOTAL		Stage 1		Stage 2		Stage 3		TOTAL	
	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance
low risk grades (rating 1-10)	27 550.1	13 970.7	104.6	0.6	0.0	0.0	**27 654.7**	**13 971.3**	30 245.2	3 199.7	2 277.5	192.1	0.4	0.1	**32 523.1**	**3 391.9**
middle and increased risk grades (rating 11-17)	22 811.2	11 703.2	3 287.0	330.1	2.7	0.0	**26 100.9**	**12 033.3**	7 576.4	704.0	2 989.8	160.9	4.1	1.8	**10 570.3**	**866.7**
problem loans (rating 18-22)	0.1	111.8	252.1	2.4	1 685.2	32.3	**1 937.4**	**146.5**	0.2	0.0	506.4	4.0	774.6	0.5	**1 281.2**	**4.5**
Total gross	**50 361.4**	**25 785.7**	**3 643.7**	**333.1**	**1 687.9**	**32.3**	**55 693.0**	**26 151.1**	**37 821.8**	**3 903.7**	**5 773.7**	**357.0**	**779.1**	**2.4**	**44 374.6**	**4 263.1**
expected credit loss allowance	-49.6		-51.9		-1 004.7		**-1 106.2**	**0.0**	-57.5		-361.3		-585.8		**-1 004.6**	**0.0**
Total net	**50 311.8**	**25 785.7**	**3 591.8**	**333.1**	**683.2**	**32.3**	**54 586.8**	**26 151.1**	**37 764.3**	**3 903.7**	**5 412.4**	**357.0**	**193.3**	**2.4**	**43 370.0**	**4 263.1**

2017

risk rating	Credit exposure to corporate clients in PLN million										Credit exposure to retail clients in PLN million					
	exposures with no impairment triggers		exposures with impairment triggers but with no actual impairment declared		impaired exposures, including:- measured individually		impaired exposures, including: - measured as per portfolio		TOTAL		exposures with no impairment triggers		impaired exposures - measured as per portfolio		TOTAL	
	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance
low risk grades (rating 1-10)	21 641.9	12 285.2	0.2	0.6	0.0	0.0	0.0	0.0	**21 642.1**	**12 285.8**	25 683.0	2 896.2	0.0	0.0	**25 683.0**	**2 896.2**
middle and increased risk grades (rating 11-17)	24 408.7	11 362.9	165.8	40.3	0.0	0.0	0.0	0.0	**24 574.5**	**11 403.2**	9 935.2	1 034.7	0.0	0.0	**9 935.2**	**1 034.7**
problem loans (rating 18-22)	30.5	72.3	109.7	27.7	1 099.4	29.2	330.9	2.9	**1 570.5**	**132.1**	524.5	2.9	671.7	2.8	**1 196.2**	**5.7**
Total gross	**46 081.1**	**23 720.4**	**275.7**	**68.6**	**1 099.4**	**29.2**	**330.9**	**2.9**	**47 787.1**	**23 821.1**	**36 142.7**	**3 933.8**	**671.7**	**2.8**	**36 814.4**	**3 936.6**

Credit exposures by days past due

2018

number of days past due	Credit exposure to corporate clients in PLN million								Credit exposure to retail clients in PLN million							
	Stage 1		Stage 2		Stage 3		TOTAL		Stage 1		Stage 2		Stage 3		TOTAL	
	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance
0	50 339.0	25 785.7	3 551.4	333.1	461.7	32.3	**54 352.1**	**26 151.1**	37 606.6	3 892.5	4 918.1	355.9	103.5	2.0	**42 628.2**	**4 250.4**
1-30	22.3	-	18.8	-	4.2	-	**45.3**	**0.0**	215.1	11.2	670.0	0.6	45.4	-	**930.5**	**11.8**
31-60	-	-	23.2	-	19.8	-	**43.0**	**0.0**	-	-	138.6	0.3	24.3	-	**162.9**	**0.3**
61-90	-	-	50.1	-	55.6	-	**105.7**	**0.0**	-	-	44.5	-	25.7	-	**70.2**	**0.0**
91-180	-	-	0.1	-	124.0	-	**124.1**	**0.0**	-	-	1.7	0.2	93.1	-	**94.8**	**0.2**
181-365	-	-	-	-	222.7	-	**222.7**	**0.0**	-	-	0.3	-	141.6	0.4	**141.9**	**0.4**
>365	0.1	-	0.1	-	799.9	-	**800.1**	**0.0**	0.1	-	0.5	-	345.5	-	**346.1**	**0.0**
Total gross	**50 361.4**	**25 785.7**	**3 643.7**	**333.1**	**1 687.9**	**32.3**	**55 693.0**	**26 151.1**	**37 821.8**	**3 903.7**	**5 773.7**	**357.0**	**779.1**	**2.4**	**44 374.6**	**4 263.1**

2017

number of days past due	Credit exposure to corporate clients in PLN million										Credit exposure to retail clients in PLN million					
	exposures with no impairment triggers		exposures with impairment triggers but with no actual impairment declared		exposures with no impairment triggers		exposures with impairment triggers but with no actual impairment declared		exposures with no impairment triggers		exposures with impairment triggers but with no actual impairment declared		exposures with no impairment triggers		exposures with impairment triggers but with no actual impairment declared	
	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance	on-balance	off-balance
0	45 540.3	23 710.9	267.4	68.6	237.9	29.2	57.0	2.8	**46 102.6**	**23 811.5**	35 221.4	3 907.9	98.7	2.1	**35 320.1**	**3 910.0**
1-30	523.1	0.5	3.2	-	65.1	-	6.6	0.1	**598.0**	**0.6**	773.9	24.6	42.4	0.1	**816.3**	**24.7**
31-60	13.9	0.1	2.3	-	12.9	-	21.7	-	**50.8**	**0.1**	104.6	1.0	28.2	0.1	**132.8**	**1.1**
61-90	3.3	-	2.8	-	25.9	-	21.6	-	**53.6**	**0.0**	39.7	0.2	23.2	-	**62.9**	**0.2**
91-180	0.4	5.0	0.0	-	161.3	-	29.5	-	**191.2**	**5.0**	1.9	0.1	74.6	0.5	**76.5**	**0.6**
181-365	-	-	-	-	47.1	-	59.1	-	**106.2**	**0.0**	0.4	-	106.7	-	**107.1**	**0.0**
>365	0.1	3.9	0.0	-	549.2	-	135.4	-	**684.7**	**3.9**	0.8	-	297.9	-	**298.7**	**0.0**
Total gross	**46 081.1**	**23 720.4**	**275.7**	**68.6**	**1 099.4**	**29.2**	**330.9**	**2.9**	**47 787.1**	**23 821.1**	**36 142.7**	**3 933.8**	**671.7**	**2.8**	**36 814.4**	**3 936.6**

Loans and receivables to other banks and debt securities

All debt securities from the portfolio of financial assets held for sale and portfolio of investment securities are in low risk grades with risk rating from 1 to 7. All debt securities from the investment securities portfolio are in Stage 1.

99% of loans and receivables to other banks are in low risk grades (risk rating 1-10), the rest are in middle and increased risk grades (risk rating 11-17). The exposures amounted to PLN 751.8 million are in Stage 1 while PLN 24.8 million in Stage 2 (total PLN 776,6 million).

III. Market risk

1. Introduction

The main goals of market risk management at ING Bank Śląski S.A. are to ensure that the Bank's exposure to market risk is understood and properly managed, and, if applicable, that the exposure is within approved limits.

The Bank defines market risk as the potential loss due to unfavourable changes in market prices (e.g. yield curves, FX rates, equity prices, etc.), market parameters (e.g. volatility of market prices and the correlation between moves in market prices) and customer behaviour (e.g. loan prepayments).

2. Market risk management process

The market risk management process within the Bank covers the identification, measurement, monitoring and reporting of risk. The Market Risk Management Department provides FM and Group Treasury Management, selected Management Board and ALCO Committee members with regular risk updates. Furthermore, the ALCO, the Bank Management Board and Supervisory Board receive periodic updates with the most important market risk metrics. The MRM Department is staffed with trained specialists and the independence of this department is ensured by its separation from the Bank units which generate market risk.

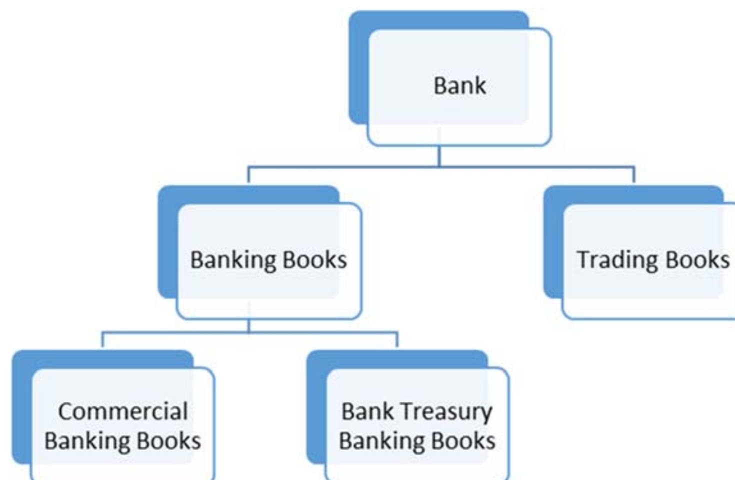
The market risk management process at the Bank also covers the Product Control function which assures correctness of Financial Markets and Group Treasury products valuation by monitoring the correctness of valuation models and controlling the quality of market data used for valuation and calculation of a financial result. Decisions about issues related to the valuation process e.g. sources of market data used for valuation, pricing model provisions calculation, etc. are taken by the Parameterisation Committee which is composed of representatives from the MRM Department, Financial Markets Division, Group Treasury and Finance Division.

3. Bank's book structure and risk measurement methods

The Bank maintains an intention-based book structure which drives many processes, including market risk management. The book structure reflects what kind of market risk is expected and acceptable in different parts of the Bank and where market risk should be internally transferred/hedged within the Bank. Books are categorized based on intention as:

- trading books (positions taken in expectation of short-term financial gains from market movements), and
- banking books (all other positions).

A high-level structure of the Bank's books is as follows:



Banking Books are further split into Commercial Banking Books and Group Treasury Banking Books. Commercial Banking Books are Retail and Wholesale Banking books containing commercial loans and deposits. The risk of those positions is transferred to:

- Group Treasury Banking Books (for interest rate risk, basis risk and liquidity risk) and
- trading books of the Financial Markets Division (for FX risk) via internal contracts.

The process ensures that the commercial banking books do not contain any material economic market risk. However, as described later in more detail, the short-term financial results of those books are sensitive to changes in market rates. The commercial activities of the subsidiaries belong to the commercial banking books.

The Group Treasury Banking Books serve to manage:

- the liquidity risk of the Bank as a whole, and
- the interest rate risk of the banking book.

Open positions are allowed within approved market risk limits:

- NIIaR (Net Interest Income at Risk) – the limit applies to the entire banking book.
- EVE (Economic Value of Equity) – the limit applies to the entire banking book.
- Slope – see the description in the section concerning trading books,
- CS01 – it is the change of a market value of a given security resulting from credit spread increase up by one basis point,
- CS RRaR (Credit Spread Revaluation Reserve at Risk) – the measure shows the potential impact of credit spread changes on the Revaluation Reserve level.
- IR RRaR (Interest Rate Revaluation Reserve at Risk) – the measure shows the potential impact of interest rate changes on the Revaluation Reserve level.
- BPV – see the description in the section concerning trading books.

Hedge accounting is used as a tool supporting the management of the interest rate risk in relation to the banking book. The assumptions of the hedging strategies are applied consistently in line with the market risk management approach as part of the market risk limits described above. Details of the assumptions of individual hedging strategies as part of hedge accounting have been described in the *Notes to the Consolidated Financial Statements, explanatory note no. 17: Hedge Accounting.*

Trading Books are books in the Financial Markets area: FX and interest rate trading books. These books include items held over a short period of time:

- for resale, or
- with the intent of benefiting from actual or expected short-term price movements, or
- items to lock in arbitrage profits.

The open positions in trading books are limited by the following risk measures:

- Value at Risk – VaR presents the potential loss, that should not be exceeded, assuming a certain confidence level (probability). The Bank calculates VaR figures for interest rate risk- and currency risk portfolios using historical simulation approach,
- Slope – Slope risk determines the risk of an adverse effect on the result due to non-parallel shifts of the yield curve – the assumption is to change the slope curve by one basis point every year. The slope risk is calculated per currency and total for the trading portfolio (taking into account netting between currencies).
- Basis Point Value (BPV) – BPV is defined as a net present value (NPV) change resulting from a parallel yield curve movement. This is a measure of portfolio sensitivity to changes in interest rates.

4. Measuring the interest rate risk in the banking book

In measuring the interest rate risk of the banking book, the Bank applies the measures required by the regulations of the European Banking Authority (EBA/GL/2015/08). The main measures are:

- Net Interest Income at Risk – measuring the sensitivity of the reported results of an item booked on an accrual basis based on a set of interest rate scenarios that assume different movements of the yield curve. We analyse the scenarios that assume gradual:
  - parallel movement of the curve,
  - steeping of the curve,
  - flattening of the curve.
- Net present value of discounted future cash flows exposed to risk (Economic Value of Equity – EVE) – measurement of the sensitivity of the economic value of interest rate positions to sudden changes in interest rates. In the EVE measurement, the Bank applies the scenarios described in the EBA regulation as a shock regulatory scenario. The idea of EVE calculation is based on subtracting from the appropriate NPV values for regulatory scenarios the NPV values from the baseline scenario.

As additional measures in the area of the banking book, the Bank measures:

- optionality risk – potential losses on those positions resulting from early withdrawal of deposits and/or prepayment of loans.
- residual risk – potential loss on those positions resulting from the application of non-standard pricing mechanisms which are not transferred to the Group Treasury that manages the interest rate risk.

The above risks have immaterial status (potential losses have a very small share in the historical and forecasted results).

Since the majority of the Group Treasury positions are measured at amortized cost, the Bank monitors the BPV measure which limits the interest rate economic risk of the position. In addition, the fluctuations of the revaluation reserve are limited by CS01, IR RRaR and CS RRaR.

Income-at-risk method (NIIaR)

The measurement of income at risk is used for all positions in banking books. Two approaches to measurements are used:

- the "base" approach is used for positions consisting of term transactions and small volumes of position on demand. This approach assumes that:
  - prices for variable interest rate positions are updated at the date of their revaluation as per the assigned interest rate index,
  - fixed interest rate positions are renewed as per the structure as at the analysis date,
  - the result on the Group Treasury positions is calculated assuming that the position structure will not change during the analysis;
- the "advanced" approach is applied to significant position volumes on demand. Currently, it is a deposit base on demand in PLN and EUR and their internal investments in the Group Treasury's banking books. The measurement determines changes in the Bank's results resulting from:
  - current (internal) investment of these funds and renewable investments because the investment projects launched expire and/or new volumes appear; future investments (re-investments) are projected provided that the current investment rules continue,
  - assessing the relationship between changes in market rates and rates that the Bank has to pay customers to maintain volumes.

Both approaches cover a one-year horizon and show possible changes of the result in the event of market developments resulting from the analysed scenarios.

Net present value of discounted future cash flows exposed to risk (EVE)

Measurement of the net present value of discounted future cash flows at risk (EVE) is a measurement of the sensitivity of the economic value of the interest rate position to sudden changes in interest rates. The measurement is made for:

- curve changes by +/- 2% (using the bottom floor level to 0%),
- risk-free curve is used for discounting,
- capital is excluded from the liability item,
- flows resulting from interest rates are discounted (interest accrued on loan margins is omitted).

This measurement is used for all items in banking books and is subject to regulatory limits of 20% of equity.

5. Market risk measurement in trading book

The Bank calculates VaR in line with the best market practice taking into account the following assumptions:

- one-day position holding period, 99% confidence level,
- 260-day observation period.

The adequacy of the VaR model is checked daily in a back-testing process (“VaR backtesting”). The financial result, both “daily” and “hypothetical” (change in the end-of-day market value of the positions in a trading portfolio over one day, so excluding all intra-day activities that occurred during that day) are compared to the VaR figure. Any model outliers are investigated and explained.

To tighten risk control, the Bank in the area of the FX risk book also implemented measurement of FX risk and monitoring of the approved intra-day limits.

The Bank is aware that VaR metrics does not give a full picture of market risk in individual portfolios as it does not account for potential losses in extreme market changes. Therefore "Stressed VaR" calculation has been introduced. Stressed VaR is a metrics that replicates calculation of historical simulation provided that in measurement we use the current portfolio and historical market data – they are taken from the cumulative yearly period and characterized by a significant deviation of the market parameters relevant for a given portfolio.

A bank-wide stress test is performed on a half-yearly basis covering, among other things, market risk, liquidity risk and credit risk under regulatory scenario and other scenarios developed by the Bank's economists and approved by ALCO. Moreover, on a quarterly basis a derivatives portfolio stress-test is performed to present the impact of shock scenarios on valuation of those instruments.

Value at Risk method (VaR)

The Financial Markets Division has actively taken open interest rate positions while minimalizing the FX trading risk. The average VaR limit utilization in 2018 settled at:

- 18% for the interest rate, and
- 6% for the FX position.

In November 2016, trading for the FX options portfolio was terminated through conclusion of trades opposite to the open ones. Since then, options have been traded on a back-to-back basis only (zero market risk).

Throughout the year there were no VaR limit breaches reported for trading. During the annual limit review, due to limited trading activity the VaR limit on FX risk has been reduced from EUR 500,000 to EUR 400,000.

The below tables present the VaR metrics* (PLN thousand) for 2018 and 2017:

Area	Limit	as at 31 Dec 2018	Average	Min	Max
Interest rate	4 300.0	1 750.0	770.7	208.7	2 286.9
FX	1 720.0	74.4	132.9	3.8	635.8

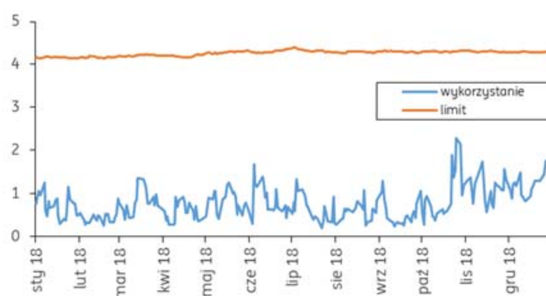
Area	Limit	as at 31 Dec 2017	Average	Min	Max
Interest rate	4 170,9	764,8	1 603,4	501,7	4 125,3
FX	2 085,5	441,0	162,2	2,9	765,0

*) At ING Bank Śląski S.A. all VaR limits and their utilisation are expressed in EUR. Limit levels and their utilisation in tables and graphs for the purpose of this document were converted into PLN using the daily NBP fixing rate, in column "Limit" numbers are presented using end of year fixing.

The below charts show the VaR limit for Financial Markets:

VaR limit for the interest rate risk and its utilisation

(PLN million)



VaR limit for the FX risk and its utilisation
(PLN million)

The table below presents the BPV measure (in EUR) in total and for main currencies as at 31 December 2018:

Area	TOTAL	PLN	EUR	USD
BPV of banking book	528 744	273 514	85 096	183 429
BPV of trading book	47 897	47 822	715	-901

6. Sensitivity of the result and capital to the interest rate risk

The tables below present an overview of the Bank's sensitivity to the interest rate risk:

- banking book – the changes observed in the measurement for both the NII and EVE measure result mainly from the two factors:
  - changes (increase) in product volumes, and
  - changes in model parameters used to determine the economic value of product portfolios without maturity
- market value of debt instruments classified as HtC&S in the Group Treasury portfolio:
  - slight changes in the sensitivity of the HtC&S portfolio were observed compared to the previous year. The BPV measure of the portfolio (BPV short position) went up from PLN 1.32 million to PLN 1.36 million.

The sensitivity of results to the interest rate movements resulting from the banking book:

(PLN million)	Change in the economic result for yield curve move		Change in the reported financial result for yield curve move	
	-2%	2%	-2% gradual	2% gradual
2018	-1 107.2	-154.8	-77.8	5.4
2017	-610.0	234.0	-30.9	61.6

The table below shows the sensitivity of the net interest income to changes in the interest rate scenarios:

	Change in net interest income	
	2018	2017
parallel +120bps*	2.4	28.3
parallel -120bps*	-31.9	7.0
an increase in short-term rates	-14.1	5.4
a decrease in short-term rates	-4.5	29.7
an increase in long-term rates	31.6	23.8
a decrease in long-term rates	-31.6	-23.8
a twist decrease in short-term rates	23.1	24.5
a twist increase in short-term rates	-26.7	-13.0

*) In 2017, the shock for the parallel scenarios was +/-90bps.

Sensitivity of own funds to interest rate changes due to HtC&S debt securities:

(PLN million)	Approximate change in regulatory capital base for yield curve move			
	-2%	-1%	+1%	+2%
2018	221.0	110.5	-110.5	-221.0
2017	159.5	80.1	-94.5	-190.0

7. Summary

In the reporting period, the market risk profile and the method of managing this risk did not change significantly.

IV. Funding and liquidity risk

1. Introduction

ING Bank Śląski S.A. recognizes the process of stable liquidity and funding risk management as one of the most important processes at the Bank.

Liquidity and funding risk is understood by the Bank as the risk of inability to meet, at a reasonable price, cash liabilities under balance sheet and off-balance sheet items. The Bank maintains liquidity so that its cash liabilities could be paid at all times from the available funds and inflows from maturing transactions, available funding sources at market prices and/or from sale of marketable assets.

2. Funding and Liquidity Risk Management

In order to optimize the liquidity and funding risk management process, the Bank has developed the ING Bank Śląski S.A. Liquidity and Funding Risk Management Policy which aims to describe the rules assuring adequate funding sources and minimization of risk and funding costs. The policy describes a general approach to liquidity and funding risk management process at the Bank. The primary objective of the funding and liquidity risk management process is to keep adequate liquidity to ensure safe and sound Bank's operations under normal and stress market conditions.

The policy results from the business risk management strategy (including strategy of liquidity and funding risk management) approved by the Supervisory Board. In particular, it reflects the risk appetite set in that strategy and approved by the Supervisory Board.

Additionally, the Bank compiles the ILAAP report. It presents key measures and figures on the Bank's liquidity profile in a comprehensive and coherent way. It takes account of the strategy, the funding plan and Bank's risk tolerance. The results of the report are approved by the Management and Supervisory Boards.

General approach to funding and liquidity risk management consists of the cycle of five repetitive actions: 1) risk identification, 2) risk assessment, 3) risk control, 4) risk monitoring and 5) reporting.

- Risk identification and assessment. Risk is identified annually through the risk identification workshops. Each identified risk is assessed in order to determine the importance of such risk for the Bank. Risks are controlled through actions that reduce probability of risk materialisation or actions that reduce the effects of risk materialisation. One of the elements of risk control is to define the acceptable risk level.
- Control. The important element of risk management is continuous verification whether an implemented risk control is being executed. Regular control allows to show whether actions in scope of risk control are effective. The key element of liquidity and funding risk management is adequate reporting which supplies management with information needed to manage risk.
- Monitoring and reporting. Pursuant to the requirements of PFSA Resolution 386/2008 and Recommendation S, the Bank prepares an in-depth analysis of the long-term liquidity focusing on mortgage loans in particular. This liquidity analysis shows the risk level connected with financing of long-term mortgage loans.

The Bank operates an active policy of liquidity management for major currencies. For these currencies, liquidity risk is measured and limited per currency and operational liquidity is managed separately for each currency to capture them in the risk transfer system.

Intraday liquidity is actively managed by the Group Treasury. In that process, the position and short-term liquidity risk are managed (one-day and intraday). It has been designed to meet payment and settlement obligations in a timely manner in normal times as well as in extraordinary/stress situations.

The Bank has the risk transfer system in which market risks, including liquidity risk, are transferred to the Group Treasury. Using proper tooling, it manages risks in a centralised manner through the system of limits adopted at the Bank.

3. Types of risk

The Bank splits the liquidity risk into two groups:

- liquidity risk arising from external factors and
- risk of internal factors associated with a given bank.

The Bank aims at having a conservative approach towards liquidity risk management which will enable it to safely survive the events specific to ING Bank Śląski S.A. and related to the whole banking sector.

In terms of the time horizon, the Bank splits the liquidity risk into:

- operational – focused on current financing of the Bank's position and intraday day liquidity management,
- strategic – focused on ensuring that structural liquidity positions of the Bank are at acceptable levels.

Taking account of the time and client behaviour (two aspects having impact on the Bank's liquidity), the Bank distinguishes three types of funding and liquidity risk:

- structural – understood as a potentially negative impact on the Bank's income due to a mismatch between expected maturities of the assets and liabilities of the Bank as well as the risk that refinancing will not be possible in the future,
- related to customer behaviour – understood as a potentially negative impact on the Bank's income due to liquidity options embedded into products offered by the Bank, and
- related to stress conditions – understood as the risk of the Bank's inability to meet its financial obligations when they are due and payable resulting from the inadequate level of available funds or the fact that they cannot be generated at any price which results in an immediate insolvency of the Bank.

4. Structure and organization of the risk management process

The structure of risk and control at the Bank is based on the Three Lines of Defence Model. The model is designed to ensure a stable and effective framework for risk management by defining and implementing three risk management "levels" with distinct roles, responsibilities and oversight responsibilities.

- **First line of defence** – business management at the Bank. The heads of particular business units bear the primary responsibility for the actions. operations. compliance with norms and effective risk control affecting the particular business unit, The business management participate in the process of liquidity and funding risk management at all levels of organization.
- **Second line of defence** – risk and finance management functions. The risk management functions and finance management functions, if applicable, are performed through:
  - development of policies, standards and guidance for their particular risk areas,
  - coordination, supervision and control of the actions taken by the first line of defence within the scope of assigned tasks and the management, control and reporting risks generated by the first line of defence,
  - escalating/vetoing of the business unit's activities that could possibly generate risks unacceptable for the Bank.
- **Third line of defence** – Internal Audit Department. The Internal Audit Department is responsible for ensuring independent assessment and opinion on:
  - the design and effectiveness of internal controls of the risks resulting from the Bank's activity,
  - the design and effectiveness of risk management performed by the first and second line of defence.

The particular role in the funding and liquidity risk management process is fulfilled by the Bank Management Board and Assets and Liabilities Committee (ALCO).

The Bank Management Board is responsible for:

- formulating the strategy for funding and liquidity risk, a target liquidity position, its funding methods and the liquidity risk profile,
- establishing the acceptable level of risk (risk appetite), liquidity risk tolerance and submitting it for the Supervisory Board approval,
- approving the liquidity and funding risk management policy and significant amendments thereto, in particular, the limits tailored to the overall acceptable level of risk approved by the Supervisory Board,
- ensuring allocation of adequate human and IT resources within the Bank to implement the policy.

Assets and Liabilities Committee (ALCO) is responsible for:

- implementing the Bank's liquidity and funding risk strategy,
- managing the liquidity buffer under the relevant policies and limits approved by the Bank Management Board. operational actions in this area are delegated to the Group Treasury,
- supervising and monitoring the level of liquidity risk as well as the structure of the financing in the Bank's balance sheet,
- monthly review of the short-term, medium-term, and long-term liquidity profile (strategic liquidity positions) presented in regulatory and internal reports,
- implementing the limits within the accepted risk appetite (approved by the Bank Management Board), approval of the assumptions for the reports and models,

- reviewing any proposed changes to this Policy and forwarding positively-advised changes to the Bank Management Board.

5. Risk management framework

Liquidity and funding risk management framework includes all relevant methods of daily, short-term, medium-term and long-term liquidity and funding risk management. It includes the following key elements:

- limits system and liquidity risk measurement,
- monitoring the funding sources and concentration risk,
- liquidity reserves management,
- intraday liquidity management,
- collateral positions management, and
- stress tests and contingency plans.

Limits system and liquidity risk measurement

Formal limits are defined by the banking sector regulator and/or the Bank as various liquidity metrics. The acceptable funding and liquidity risk level is determined by the twofold system: the general acceptable risk level which is approved by the Bank Supervisory Board, and the limit system which is approved by the Bank Management Board. The Supervisory Board is updated on compliance with the said metrics at least on a quarterly basis.

The limits are based on the Bank's strategic goals, identified types of liquidity risk, stress tests results and principles set by the regulatory bodies. The limits are taken into consideration in the planning processes (i.e. delivery on the adopted plans cannot lead to an overrun of limits). In the majority of cases, the limits have a warning level set above (or under) regulatory limits. The acceptable level of liquidity risk is determined and updated at least once a year.

The system of limits is more detailed than the level of risk approved by the Supervisory Board.

The acceptable level of risk is guaranteed by risk monitoring in different liquidity and funding reports related to normal/regular Bank's activity and also to extreme/stress situations. The Bank monitors, among others, funding concentration risk, an internal liquidity buffer and external funding stability.

M1-M4

Under Resolution No. 386/2008 of the Polish Financial Supervision Authority, the Bank is required to calculate liquidity risk metrics:

- M1 – Short-term liquidity gap (minimum value: 0.00),
- M2 – Short-term liquidity factor (minimum value: 1.00),
- M3 – Ratio of coverage of non-liquid assets with own funds (minimum value: 1.00), and
- M4 – Coverage ratio of non-liquid assets and limited liquidity assets with own funds and stable external funds (minimum value: 1.00).

Starting as of 31 January 2018, the Bank has been monitoring the four liquidity metrics. The Bank is required to monitor, on a daily basis, and observe the limits set out in PFSA resolution on M3 and M4 metrics. In 2018, the Bank kept all liquidity norms over the minimum values.

As at 31 December 2018, the regulatory liquidity measures for ING Bank Śląski S.A. were as follows:

	Liquidity metrics	Minimum value	2018	2017
M1	Short-term liquidity gap (PLN million)	n/a	7 255.3	11 381.3
M2	Short-term liquidity factor	n/a	1.23	1.40
M3	Ratio of coverage of non-liquid assets with own funds	1	11.38	13.73
M4	Coverage ratio of non-liquid assets and limited liquidity assets with own funds and stable external funds	1	1.15	1.19

Stability of the deposit base

One of the key elements of the regulatory liquidity norms calculation is to analyse the deposit base stability by calculating the stable part of the external funds. The analysis is performed based on the internal model. The model takes account of the following aspects:

- funding received from the major depositors,
- distribution of changes,
- estimation of volatility and time scaling,
- long- and short-term trends,
- impact of the exchange rate volatility on the stability of the deposit base.

The model is subject to the annual review which includes a detailed analysis of model performance, the analysis of the assumptions and historical verification (backtesting).

Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)

In keeping with the obligations and principles set out in the Regulation of the European Parliament and of the Council (EU) No. 575/2013, the Bank calculates regulatory liquidity measures:

- short-term liquidity metrics (LCR – Liquidity Covered Ratio) is to ensure that the Bank has the appropriate the level of high-quality liquid assets that will cover the liquidity needs within 30 calendar days of stress. Starting as of 1 January 2018, the target limit of 100% has been effective.
- long-term liquidity metrics (NSFR – Net Stable Funding Ratio) it is to ensure a minimum level of funding available in the mid- and long term.

The Bank is required to present the values of the liquidity metrics to the regulator on a monthly and quarterly basis.

As at 31 December 2018 and as at 31 December 2017, the regulatory liquidity measures for ING Bank Śląski S.A. were as follows:

	Liquidity metrics	Minimum value	2018	2017
LCR	Liquidity coverage ratio	100%	138%	151%
NSFR	Net stable funding ratio	n/a*	127%	122%

*) In keeping with the Regulation of the European Parliament and of the Council (EU) No. 575/2013, the target regulatory limit for NSFR has not been set yet, but the target level is expected to be at least 100%.

In line with the Guidelines on LCR disclosure to complement the disclosure of liquidity risk management issued by EBA, the Bank is required to present the elements of the LCR ratio in the form of the table below (liquidity coverage ratio). It includes information on:

- high-quality liquid assets – the weighted value after haircuts,
- outflows – the weighted and unweighted outflows,

- inflows – the weighted and unweighted inflows.

The "weighted" values for inflows and outflows are calculated as the value after the inflow and outflow rates are applied. Presented figures refer to each of the four calendar quarters in 2018. They represent average values of month-end observations over the twelve months preceding the end of each quarter.

Figures presented in the table include all items irrespective of the currency in which they are denominated and are disclosed in PLN. The liquidity coverage ratio comprises all essential elements of the Bank's liquidity profile.

Apart from the presented figures for the liquidity coverage ratio calculated for all currencies, the Bank is also monitoring the ratios calculated for all significant currencies, i.e. PLN and EUR.

In case of the ratio in EUR, the Bank identifies a currency mismatch in the liquidity coverage ratio which puts its value below the ratio calculated for all currencies.

This mismatch results from the long-term assets related to loans in EUR and how they are funded. In LCR inflows from those loans are limited to the nearest principal and interest instalment. The retail deposits characterised by a relatively low outflow ratio constitute only a part of deposits financing these positions. Remaining positions financing loans in EUR in terms of LCR are characterised by the higher outflow level. Outflows in EUR calculated this way are not completely covered by liquid assets in that currency causing lower level of the LCR ratio in EUR in relation to the LCR ratio calculated for all currencies.

ING Bank Śląski S.A.
Annual financial statements for the period from 1 January 2018 to 31 December 2018 (PLN million)

Liquidity Coverage Ratio

Scope of consolidation: solo Currency and units: TOTAL mln		TOTAL UNWEIGHTED VALUE (AVERAGE)				TOTAL WEIGHTED VALUE (AVERAGE)			
Quarter ending on (DD Month YYY)		31 Mar 2018	30 Jun 2018	30 Sep 2018	31 Dec 2018	31 Mar 2018	30 Jun 2018	30 Sep 2018	31 Dec 2018
Number of data points used in the calculation of averages		12	12	12	12	12	12	12	12
HIGH-QUALITY LIQUID ASSETS									
1	**Total high-quality liquid assets (HQLA)**					**27 601**	**27 981**	**28 058**	**28 408**
CASH-OUTFLOWS									
2	Retail deposits and deposits from small business customers, of which:	84 864	87 426	90 248	93 666	6 645	6 836	7 062	7 336
3	*Stable deposits*	54 215	55 966	57 796	59 940	2 711	2 798	2 890	2 997
4	*Less stable deposits*	30 649	31 460	32 452	33 726	3 935	4 038	4 173	4 339
5	Unsecured wholesale funding	14 815	15 204	15 352	15 313	8 637	8 944	9 050	9 098
6	*Operational deposits (all counterparties) and deposits in networks of cooperative banks*	0	0	0	0	0	0	0	0
7	*Non-operational deposits (all counterparties)*	14 815	15 204	15 352	15 313	8 637	8 944	9 050	9 098
8	*Unsecured debt*					0	0	0	0
9	Secured wholesale funding					0	0	0	0
10	Additional requirements	16 930	17 602	19 058	20 631	2 424	2 505	2 619	2 737
11	*Outflows related to derivative exposures and other collateral requirements*	994	988	963	937	994	988	963	937
12	*Outflows related to loss of funding on debt products*	0	0	0	0	0	0	0	0
13	*Credit and liquidity facilities*	15 936	16 614	18 095	19 694	1 430	1 517	1 656	1 800
14	Other contractual funding obligations	5 652	5 649	5 881	5 771	5 590	5 576	5 796	5 673
15	Other contingent funding obligations	11 977	12 217	11 725	11 196	0	0	0	0
16	**TOTAL CASH OUTFLOWS**					**23 296**	**23 861**	**24 527**	**24 844**
CASH-INFLOWS									
17	Secured lending (eg reverse repos)	90	74	67	60	0	0	0	0
18	Inflows from fully performing exposures	2 361	2 486	2 647	2 704	1 397	1 469	1 557	1 554
19	Other cash inflows	2 412	2 312	2 306	2 168	2 412	2 312	2 306	2 168
EU-19a	(Difference between total weighted inflows and total weighted outflows arising from transactions in third countries where there are transfer restrictions or which are denominated in non-convertible currencies)								
EU-19b	(Excess inflows from a related specialised credit institution)								
20	TOTAL CASH INFLOWS	4 863	4 872	5 020	4 932	3 809	3 781	3 863	3 722
EU-20a	***Fully exempt inflows***	0	0	0	0	0	0	0	0
EU-20b	***Inflows Subject to 90% Cap***	0	0	0	0	0	0	0	0
EU-20c	***Inflows Subject to 75% Cap***	4 863	4 872	5 020	4 932	3 809	3 782	3 863	3 722
						TOTAL ADJUSTED VALUE			
21	LIQUIDITY BUFFER					27 601	27 981	28 058	28 408
22	**TOTAL NET CASH OUTFLOWS**					**19 489**	**20 080**	**20 663**	**21 122**
23	**LIQUIDITY COVERAGE RATIO (%)**					**142**	**140**	**136**	**135**

Below table presents split of level 1 assets used by Bank in LCR calculation (according to definition of Commission Delegated Regulation (EU) 20015/61) for end of years 2017 and 2018. Level 1 assets means assets of extremely high liquidity and credit quality.

	2018	2017
Level 1 assets		
Cash	1 117.6	1 188.7
Amounts on nostro accounta in Central Bank decreased by required level of obligatory reserve	23.6	0.0
Other exposures to central bank (O/N deposit, central bank bills)	0.0	2 388.9
Unencumbered government debt securities	26 713.6	22 739.0
Unencumbered BGK debt securities	556.9	1 546.6
Unencumbered EIB debt securities	3 267.8	1 664.9
Total	**31 679.5**	**29 528.1**

Debt securities are presented in level 1 assets based on their market value. *Bank* liquidity position is decreased by encumbered debt securities (blocked, used as collateral) and increased by debt securities received as collateral in reverse-repo deals.

Additional liquidity monitoring metrics (ALMM)

In keeping with Commission Implementing Regulation (EU) No. 2016/313, the Bank reports a set of additional monitoring metrics for liquidity reporting purposes. The following is reported:

- maturity dates mismatch,
- concentration of funding by counterparty,
- concentration of funding by product type,
- prices for various lengths of funding,
- roll-over of funding, and
- concentration of counterbalancing capacity per issuer.

Internal liquidity reports

The next essential element of the Bank's liquidity risk management process are internally-defined reports which provide a detailed and diversified insight into the Bank's approach to risk measurement and management. The Bank models its liquidity profile of both assets and liabilities to reflect the expected/ actual customer behaviours. The approach is done based on the mixed approach. It means that the analysis of customer behaviour is based on the historical data and expert approach.

One of the internal liquidity reports is the structural liquidity report. It represents the gap between Bank's assets and liabilities in time bands on the properly functioning markets. The report is used to monitor and manage mid- and long-term liquidity positions. It supports the balance sheet planning and funding processes. It also presents all future material funding needs.

This report represents a scenario for the current balance sheet in normal market conditions. It does not cover any additional forecasts for balance sheet development. However, it accounts for typical client behaviours observed in previous periods. For instance – cash flows for mortgage loans account for prepayments, and cash flows for savings accounts and current accounts are allocated upon accounting for liquidity characteristics.

Structural liquidity report:

	1-6 months	7-12 months	1-5 years	6-10 years	11-15 years	over 15 years
2018 (PLN million)						
Liquidity gap	24 357.0	9 580.6	27 303.6	5 724.7	-57 139.0	-9 826.9
Cumulative liquidity gap	24 357.0	33 937.6	61 241.2	66 965.9	9 827.0	0.0
2017 (PLN million)						
Liquidity gap	24 233.1	7 147.9	13 658.3	-3 261.8	-30 754.5	-11 023.0
Cumulative liquidity gap	24 233.1	31 381.0	45 039.2	41 777.4	11 023.0	0.0

Monitoring the funding sources and concentration risk

The Bank determines, at least once a year, the overall business strategy and resulting medium-term (3-year) financial plan together with the overall risk strategy. An inherent element of the strategy is the funding plan which ensures effective diversification of funding sources and terms.

ALCO actively manages the funding base. It also monitors the funding sources to:

- verify compliance with the strategy and funding plan.
- identify potential funding-related risks.

The main source of funding at ING Bank Śląski S.A. are client deposits (retail and corporate). The Bank monitors the funding structure and the concentration risk through the analysis of its deposit base broken down by:

- funding type,
- client segment,
- product type,
- currencies,
- geographic region, and
- concentration of large deposits.

In cyclical analyses, risk generated by the linked customers (within the capital groups) is also monitored.

The current Bank's funding structure is well diversified. The funding structure with a split between direct and reciprocal funding as at the end of 2018 and 2017 is presented below: Direct funding is delivered first and foremost by retail and corporate clients. Reciprocal funding stems from the funds acquired from other banks first of all.

Direct funding:

	2018		2017	
Main client segments	**direct funding**	**% share**	**direct funding**	**% share**
Banks	899.0	0.7%	156.7	0.1%
Corporate clients	38 091.8	29.1%	35 168.9	30.4%
Retail clients	78 240.8	59.9%	67 941.8	58.8%
Own issued bonds	1 375.0	1.1%	925.6	0.8%
Principal	12 105.0	9.3%	11 351.7	9.8%

Reciprocal funding:

	2018		2017	
Main client segments	**reciprocal funding**	**% share**	**reciprocal funding**	**% share**
Banks	8 076.5	96.4%	12 741.9	97.8%
Corporate clients	299.0	3.6%	293.1	2.2%
Retail clients	0.0	0.0%	0.0	0.0%

Liquidity reserves management

An important element of the Bank's liquidity management is to maintain an adequate liquidity buffer. The liquidity buffer presents the available liquidity required to cover the gap between the cumulative outflows and inflows in a relatively short time. The buffer comprises "unencumbered" and easily available assets for liquidity purposes. Unencumbered assets are construed as free from any legal, regulatory, contractual limitations for the Bank to sell them. The liquidity buffer is crucial in the stress period when the Bank has to obtain liquidity in a short time and when standard funding sources are unavailable or insufficient.

The liquidity buffer is kept as collateral against the materialisation of various stress scenarios, while ensuring satisfaction of the additional liquidity requirement which may arise in a given time under stress conditions as well as in normal times.

The table below presents the structure of a buffer of liquid assets as at 31 December 2018.

Liquidity buffer structure	% share
bonds issued by the government or the central bank (PLN)	76.7%
bonds issued by the government or the central bank (EUR)	13.5%
bonds issued by BGK and EIB	9.7%

The Bank takes into account realistic reductions due to securities impairment, whose level is cyclically reviewed and accepted by ALCO. Those reductions are assessed, among other things, on the basis of market liquidity, volatility of market prices and central bank requirements.

The Bank also observes concentration of assets while ensuring their safe diversification in terms of the issuer, maturity and currency.

Intraday liquidity management

The Bank actively manages the short-term liquidity positions and risks (daily and intraday) in order to fulfil payment and settlement obligations in a timely manner in normal times as well as in extraordinary/ stress situations.

The intraday liquidity management process is critical from the perspective of correct functioning of the Bank as a whole and concerns the operations run under normal and extraordinary (stress)

conditions. It is part of operational current liquidity management. The Bank uses intraday metrics in intraday liquidity management. The intraday liquidity metrics are monitored on an ongoing basis and presented to the adequate liquidity risk management units as well as on the Assets and Liabilities Committee.

One of the elements of intraday liquidity management is to maintain an ability to meet Bank's obligations also in stress conditions. Therefore, it is necessary to maintain a proper liquidity buffer on the basis of information about the scope of potential deterioration of the Bank's access to intraday liquidity in case of market stress. In order to secure the proper liquidity buffer, the Bank runs the intraday liquidity stress test as part of the stress test programme.

Collateral positions management

Collateral management applies to items under CSA and GMRA agreements as well as to liquid assets used for operations with the central bank. Collaterals are managed at the level respective to the services provided, Bank's portfolio, funding profile and liquidity requirements.

Most of the counterparties, with which the Bank enters into derivative transactions, have signed collateral agreements (CSA – Credit Support Annex) which constitute an annex to an ISDA agreement. They govern the issues connected to the derivative transactions portfolio. They give a right to demand placing a security deposit for the party which has a positive valuation of the portfolio for a given day (in-the-money) and the right to demand release of that collateral in case the valuation changes. In line with the strategy of setting the collateral for each counterparty under the CSA agreement, the transaction portfolio is valued daily for the need of collateral.

Derivative instruments such as FRA and IRS are settled by the clearing houses (CCP – Central Clearing Party). It enables the Bank to effectively manage collaterals and mitigate the risk of counterparty's settlement. ING Bank Śląski S.A. has signed agreements with CCP CSD and London Clearing House (LCH).

Stress tests and contingency plans

In line with the requirements set by the regulators, the Bank introduced a stress testing program. It ensures that the stress tests are planned, designed, conducted and analysed to identify sources of potentially limited liquidity. It also determines how to prevent such situations so that the current exposure remain within the established limits. The Bank pays special attention to the stress testing process and on a semi-annual basis prepares scenario analysis and sensitivity analysis for liquidity risk.

The results of stress tests are taken into account in:

- formulation of the strategy,
- taking corrective actions or actions to limit the Bank's risk exposure,
- development of contingency plans should stress occur,
- daily risk management practice,
- defining the risk appetite and internal limits, and
- adapting and improving the internal regulations of the Bank.

The testing program consists of a scenario analysis, sensitivity analysis, and reverse tests. The scenario analysis combines elements of shock, for which there is a likelihood of materialising at the same time.

Three options are analysed in the tests:

- idiosyncratic – specific to the Bank, market conditions generally remain at a good level, the banking sector as a whole is not subject to extreme conditions,
- system-wide – external market crisis, the Bank is affected by extreme conditions as a result of the deterioration of market conditions,
- mixed – a combination of the two options mentioned above.

Within each option we study a number of risk factors and build a set of scenarios. As a rule, test scenarios are built assuming conservative assumptions.

The aim of the sensitivity analysis is to understand the Bank's sensitivity to individual risk factors.

An additional element are the reversed tests designed to analyse potential threats to the Bank. The tests are run across the Bank and cover various risks in order to obtain a complete and comprehensive picture of the risks existing at the Bank. Specific scenarios for liquidity risks during the day and the intraday liquidity norms and metrics are an important element in the liquidity testing process.

The results of the 2018 tests confirm a stable and safe position of the Bank. The Bank has liquidity reserves at an adequate level.

Development of the liquidity contingency plan, which is mutually linked to stress testing, is one of the essential processes of liquidity risk management. The Funding Contingency Plan developed by the Bank is designed to provide for guidelines on identification of a liquidity-related crisis and should such a crisis be identified to describe a set of actions to be taken to mitigate that crisis. The Funding Contingency Plan applies to the entire operations of the Bank. The Liquidity Crisis Team is a significant contributing factor if the Funding Contingency Plan needs to be implemented (started).

The Funding Contingency Plan is subject to periodic tests. The tests conducted in 2018 showed that the actions described in the Funding Contingency Plan are adequate for mitigating a liquidity crisis.

6. Maturity analysis of financial obligations and derivatives by contractual payment dates

The below table presents the financial liabilities by other contractual maturities – counting from the reporting date. The amounts include future interest payments. In the case of contingent liabilities extended, the earliest possible date for payment of the aforesaid liabilities by the Bank was taken into consideration when making the maturity analysis.

2018 (PLN million)	up to 1 month	1- 3 months	3 - 12 months	1-5 years	over 5 years
Liabilities to other banks	1 799.4	8.4	0.0	0.0	0.0
Financial liabilities measured at fair value through profit or loss	0.0	0.0	22.7	33.7	829.7
Liabilities to customers	114 946.0	1 022.7	1 244.4	87.8	1.3
Liabilities under issue of securities	0.0	0.0	300.3	0.0	0.0
Subordinated liabilities	1.0	3.1	12.4	66.4	1 123.2
Contingent liabilities granted	31 958.8	0.0	0.0	0.0	0.0

2017 (PLN million)	up to 1 month	1- 3 months	3 - 12 months	1-5 years	over 5 years
Liabilities to other banks	1 041.6	3.0	0.0	0.0	0.0
Financial liabilities measured at fair value through profit or loss	0.0	0.0	0.0	619.8	115.3
Liabilities to customers	100 734.0	1 928.5	1 237.1	82.7	101.9
Liabilities under issue of securities	0.0	0.0	0.0	300.3	0.0
Subordinated liabilities	0.0	3.1	9.1	48.8	665.3
Contingent liabilities granted	28 844.2	0.0	0.0	0.0	0.0

The below tables present maturity analysis of derivatives with negative valuation as at the reporting date. The analysis is based on other contractual maturities.

Derivatives settled in net amounts

Financial derivatives settled net by the Bank cover the IRS and FRA transactions as well as options and FX Forward NDF. For IRS transactions, the below data reflect the undiscounted interest future cash flows; for other transactions, their valuation as at 31 December 2018 and 31 December 2017 respectively was taken as the cash flow amount.

2018 (PLN million)	up to 1 month	1- 3 months	3 - 12 months	1-5 years	over 5 years
IRS transactions, including:	-157.7	-291.5	-222.5	-39.4	284.9
hedging transactions in hedge accounting	-46.2	-84.2	4.7	-44.2	81.1
other derivatives	-10.4	-11.6	-18.5	-7.9	-0.1

2017 (PLN million)	up to 1 month	1- 3 months	3 - 12 months	1-5 years	over 5 years
IRS transactions, including:	69.2	29.5	99.4	-136.2	-307.7
hedging transactions in hedge accounting	28.1	15.5	75.6	-36.8	-157.6
other derivatives	-17.0	-30.3	-57.5	-24.1	-0.2

Derivatives settled in gross amounts

Derivatives settled gross by the Bank cover the FX Swap, FX Forward and CIRS transactions. The below data reflect the undiscounted contractual cash outflows and inflows on notes and for CIRS transactions – on interest as at 31 December 2018 and 31 December 2017 respectively.

2018 (PLN million)	up to 1 month	1- 3 months	3 - 12 months	1-5 years	over 5 years
outflows	-2 472.1	-1 046.7	-1 326.2	-759.3	-313.9
inflows	2 461.0	1 016.4	1 307.4	769.5	311.0

2017 (PLN million)	up to 1 month	1- 3 months	3 - 12 months	1-5 years	over 5 years
outflows	-3 743.1	-1 776.8	-3 719.5	-736.3	-199.1
inflows	3 663.2	1 719.2	3 604.7	732.7	191.9

7. Risk management process centralisation

The liquidity risk management process is fully centralised at the Treasury and risk management functions level. The liquidity risk (along with the generated liquidity position) of individual business lines is transferred to the Group Treasury where it is managed.

The Bank recognises costs and benefits from various types of the liquidity risk in the internal transfer pricing system, in measuring the profitability and in the new product approval process in all significant areas of business (both balance sheet and off-balance sheet). The Group Treasury manages the positions transferred to its books by the risk transfer system; it also manages liquidity risk associated with the liquidity premium reset.

To ensure correct, independent and centralised performance of the tasks required in the liquidity risk management process (such as risk measurement and reporting; development, review and update of documents), the Bank established the Market Risk Management Department that reports to the Vice-President of the Management Board.

8. Reporting and liquidity risk measurement systems

Liquidity risk reporting and measurement is an automated process. The Bank possesses tools allowing to generate the set of liquidity reports in an automatic way on a daily or monthly basis. Information

on risk measures ensures ongoing monitoring of the liquidity profile and a control over the basic metrics.

Reports presenting the liquidity risk are presented to units involved in this risk management process.

9. Summary

In the reported period the liquidity and funding risk profile and the way of managing that risk did not change in a significant way. In terms of risk measurement, the changes resulted from regulators' guidelines including PFSA and EBA.

V. Non-financial risk

1. Introduction

The non-financial risk covers the operational- and compliance risk management functions based on the common framework which lays down clear rules and standards of risk identification, assessment, monitoring, mitigation and reporting. Non-financial risk management processes are supervised by the Non-Financial Risk Committee established by the Bank Management Board. The Bank Management Board accepts the joint Non-Financial Risk Appetite Statement which is approved by the Supervisory Board. Compliance with the declared risk appetite is monitored using the periodic Non-Financial Risk Dashboard.

The common non-financial risk management framework enables us to identify the main threats and gaps as well as related risks which may trigger undesirable events. We are supported by such processes as risk and control self-assessment, scenario analyses, monitoring of key risk indicators or key control testing. Results of internal and external event analyses are continuously used to improve the adequacy and effectiveness of the internal control system of the Bank.

We believe that an effective control environment is indispensable to build and maintain a sustainable business, and that it also helps to maintain and increase the trust of clients, employees and shareholders.

2. Operational risk

Introduction

We understand the operational risk as the risk of direct or indirect loss from inadequate or failed internal processes, people and systems, or from external events. We recognise the legal risk as an element of the operational risk.

The definition of operational risk is broad and covers the following areas:

- Control risk is the risk of loss caused by a failure to apply the controls established within management procedures or project management methods at our Bank.
- Unauthorised activity risk is the risk of loss caused by unauthorised activities of employees or overstepping of authority.
- Processing risk is the risk of loss resulting from human error or omission during data processing caused by occurrence of unexpected or unpredicted problems. It also includes the risk of loss caused by wrong processing or a mismanaged processing operation. Those errors are usually unintentional and occur when documenting or finalising current business transactions.
- HR and workplace security risk is the risk of loss caused by a failure to apply employment practices and rules, labour law, EHS regulations, agreements signed with employees or payments of claims for damages resulting from accidents at work and discrimination events.

- Staff and physical security risk – the risk that pertains to criminal-, civilisation- or environment threats which may affect security or have an adverse impact on personnel, customers, and Bank resources.
- IT risk is the risk of loss due to the loss of confidentiality, integrity or availability of information resulting from incorrect securing of information or information asset.
- Business continuity risk is the risk of an event posing a threat to continuity of the business activity or inability to restore operations after failure. It may be caused by such events as catastrophes, natural disasters, failures and lack of personnel.

Internal and external fraud risk is the risk of loss caused by an intentional abuse of procedures, systems, funds, products or services in order to obtain personal benefits in an unlawful or fraudulent manner or benefits for other persons.

Operational risk management process

Our operational risk management goal is a continuous improvement of the Bank's and clients' security as well as reduction in the Bank's operating costs and improvement of the operating effectiveness.

Having obtained the Supervisory Board's approval, the Bank Management Board outlined the strategy for managing the operational risk. It implemented a coherent set of internal prescriptive documents. The said documents define the scope, principles and duties of organisational units and employees aimed at limiting the impact and probability of financial and reputational losses in that area. The operational risk management strategy of our Bank takes account of legal- and regulatory requirements and uses ING Group good practices.

Furthermore, in liaison with the Supervisory Board, the Bank Management Board adopted the Risk Appetite Statement, wherein they specified the maximum acceptable limits of losses, capital limits and the risk that the Bank would be willing to undertake when achieving planned business goals in full compliance with the law and regulations. Limit utilisation is monitored and presented periodically to the Management Board, Risk Committee and Supervisory Board.

The operational risk management system applies to all spheres of our own- and our group operations, cooperation with clients, vendors and partners. It forms a consistent, permanent practice. It covers the following elements:

- risk identification and assessment,
- risk mitigation and issue tracking,
- control, and
- quality assurance and monitoring.

Our Bank manages operational risk using the following general principles:

- we maintain a complete, consistent and transparent structure of operational risk management and clearly stated scope of duties and responsibilities,
- we identify the nature of internal and external environments – including limitations and vulnerabilities – we draw conclusions from internal and external events to determine the root cause of an event and identify potential irregularities in the control environment or determine unidentified risk exposures,
- we identify root causes, types and levels of risk we are ready to accept. We set standards of control activities and mitigating measures,
- we operate effective and consistent risk identification and control for all products, activities, processes and systems functioning at the Bank,
- we monitor and report the amount of required capital, risk profile and risk exposure,

- we repeatedly highlight to need to raise awareness of employees and managers. We ensure that employees are properly qualified to perform non-financial risk management activities and equipped with proper tools.

Effectiveness of risk management processes and high quality of used data are the priority.

We find the following to be the key risk drivers are:

- employee knowledge and competence,
- working conditions,
- proper segregation of duties and supervision of their fulfilment,
- information (technology) security level,
- integrity of business processes and IT and technical systems,
- outsourcing,
- quality of internal and external documentation,
- external events associated with changes in the business environment,
- natural disasters, failures and catastrophes.

3. Compliance risk

Introduction

The mission of the Bank is to ensure compliance by building the corporate culture which is underpinned by knowledge of and compliance with laws, internal regulations, market standards and ING Values and Behaviours delineated in the Orange Code.

Compliance risk management process

The Bank Supervisory Board has oversight of compliance risk management at the Bank, and the Bank Management Board is responsible for the effective compliance risk management at the Bank, including responsibility for: implementing organisational solutions, regulations and procedures enabling effective compliance risk management and for ensuring adequate resources and funds as may be required to perform tasks in this area.

The Compliance Department is an organisational unit that performs the compliance risk management function; it is responsible for the organisation and operation of the compliance risk management process which is understood as the process of compliance risk identification, assessment, control and monitoring in terms of the Bank's compliance with laws, internal regulations and market standards; it also submits reports in that respect.

VI. Model risk

1. Introduction

Model risk is managed in line with the Risk Model Management Policy at ING Bank Śląski S.A. The Policy provides inter alia for the following:

- model lifecycle,
- principles of model materiality assessment,
- principles of model register functioning,
- capital computation principles for the model risk, and
- validation principles.

2. Model risk management process

The Capital Management Department keeps the model register, which is a repository of information about the risk models and valuation models effective in the Group. The model register and logs read model materiality, model monitoring and validation results and their risk levels, among others.

The Group regularly assesses the risks of individual models and estimates corresponding economic capital as per internal regulations. The capital calculation manner in the case of identification of material- or medium material models of high- or increased risk is set out in the methodology of economic capital requirement calculation for the model risk.

Model performance quality is verified via model monitoring and validation in the course of which the degree of model risk exposure is assessed as well. Models are validated in line with the Model Validation Policy at ING Bank Śląski S.A. and validation manuals.

Management reporting of the status of model management and validation actions to Committees, Management Board and Supervisory Board includes but is not limited to: model risk assessment and validation results, assessment of aggregated model risk in the context of adopted risk tolerance level, and also the actual model risk capital.

In 2018, the economic capital of PLN 28.9 million for risk models was allocated from January 2018 to September 2018 to newly developed models for provision calculation in line with IFRS 9 which have been applied since January 2018.

VII. Business risk

1. Introduction

The following material risks were identified by the Bank under the business risk:

- financial result risk,
- macroeconomic risk, and
- FX mortgage portfolio risk.

2. Financial result risk

Financial result risk, deemed permanently material, is defined at the Bank as the risk associated with taking adverse or erroneous business decisions, the lack of or faulty execution of taken assumptions/actions and changes in the external environment plus an inappropriate response to those changes which results in the financial result being below the requirements arising from the need to conduct ongoing operations and grow, mainly in order to supply the capital base.

In principle, financial result risk is recognised in the area of planned mergers and acquisitions on the market. For organic growth of the Bank, the risk is recognised as limited.

The main financial result risk triggers are: failure to earn the income planned or budget cost overrun. The said triggers are influenced by accomplishment of the planned client number, volume and market share, offer for clients and cost control. Additionally, innovativeness and attractiveness of the Bank as well as its perception by clients and the market are crucial.

3. Macroeconomic risk

Macroeconomic risk is the risk due to macroeconomic factors changes and their impact on the minimum capital requirements. The Bank manages that risk by conducting regular internal stress tests, whereby the sensitivity of minimum capital requirements to macroeconomic factors can be monitored on an ongoing basis. In 2018, the Bank ran full capital tests twice: for the data as at Q4 2017 and Q2 2018.

Based on internal stress test results for the mild recession scenario, the Bank estimates the additional capital requirement to secure against the impact of the said scenario materialisation. Stress-test results show that should the mild recession risk materialise it will not affect a decline in the capital adequacy below the required level.

4. FX mortgage portfolio risk

FX mortgage portfolio risk is the risk of financial losses connected with FX mortgage loans conversion into PLN mortgage loans.

To manage the risk, the Bank uses current legislation proposals for conversion of FX mortgage loans.

One should highlight at that point that the Bank did not receive a capital add-on for that risk (imposed by the Polish Financial Supervision Authority on the banks having significant FX mortgage portfolios). Still, bearing in mind the risk of legislative uncertainty in that area, the Bank resolved to secure itself by computing the economic capital add-on.

As at 2018 yearend, the value of the FX mortgage portfolio of the Bank was PLN 1.0 billion.

SIGNATURES OF THE MANAGEMENT BOARD MEMBERS OF ING BANK ŚLĄSKI S.A.

2019-02-26	**Brunon Bartkiewicz** *President*	The original Polish document is signed with a qualified electronic signature
2019-02-26	**Michał Bolesławski** *Vice-President*	The original Polish document is signed with a qualified electronic signature
2019-02-26	**Joanna Erdman** *Vice-President*	The original Polish document is signed with a qualified electronic signature
2019-02-26	**Marcin Giżycki** *Vice-President*	The original Polish document is signed with a qualified electronic signature
2019-02-26	**Bożena Graczyk** *Vice-President*	The original Polish document is signed with a qualified electronic signature
2019-02-26	**Patrick Roesink** *Vice-President*	The original Polish document is signed with a qualified electronic signature
2019-02-26	**Lorenzo Tassan-Bassut** *Vice-President*	The original Polish document is signed with a qualified electronic signature

SIGNATURE OF THE PERSON RESPONSIBLE FOR ACCOUNTS

2019-02-26	**Jolanta Alvarado Rodriguez**	Director of Accounting Department Chief Accountant	The original documents is signed with a qualified electronic signature