

Consolidated Financial Statements of Bank Pekao S.A. Group for the year ended on 31 December 2017



Warsaw, February 2018

This document is a free translation of the Polish original. Terminology current in Anglo-Saxon countries has been used where practicable for the purposes of this translation in order to aid understanding. The binding Polish original should be referred to in matters of interpretation.

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Consolidated income statement

(In PLN thousand)

	NOTE	2017	2016 RESTATED
Interest income	10	5 640 714	5 448 490
Interest expense	10	(1 047 218)	(1 066 485)
Net interest income		4 593 496	4 382 005
Fee and commission income	11	2 663 565	2 683 111
Fee and commission expense	11	(310 520)	(293 121)
Net fee and commission income		2 353 045	2 389 990
Dividend income	12	19 772	16 798
Result on financial assets and liabilities held for trading	13	42 992	54 383
Result on fair value hedge accounting	30	4 616	1 313
Gains (losses) on disposal of:	14	187 161	435 903
loans and other financial receivables		145 981	159 493
available for sale financial assets and held to maturity investments		41 452	276 493
financial liabilities		(272)	(83)
Operating income		7 201 082	7 280 392
Net impairment losses on financial assets and off-balance sheet commitments:	18	(521 350)	(500 629)
loans and other financial receivables		(503 720)	(401 409)
available for sale financial assets and held to maturity investments		(99)	-
off-balance sheet commitments		(17 531)	(99 220)
Net result on financial activity		6 679 732	6 779 763
Administrative expenses	15	(3 709 824)	(3 602 324)
personnel expenses		(1 950 302)	(1 896 836)
other administrative expenses		(1 759 522)	(1 705 488)
Depreciation and amortization	16	(347 338)	(340 866)
Net result on other provisions		(36 023)	(14 475)
Net other operating income and expenses	17	112 448	30 528
Operating costs		(3 980 737)	(3 927 137)
Gains (losses) on subsidiaries and associates	19	453 414	38 561
Gains (losses) on disposal of property, plant and equipment and intangible assets	20	622	5 359
Profit before income tax		3 153 031	2 896 546
Income tax expense	21	(677 323)	(616 782)
Net profit for the period		2 475 708	2 279 764
1. Attributable to equity holders of the Bank		2 475 129	2 279 275
2. Attributable to non-controlling interests	51	579	489
Earnings per share (in PLN per share)			
basic for the period	22	9.43	8.68
diluted for the period	22	9.43	8.68

Notes to the financial statements presented on pages 10 - 164 constitute an integral part of the consolidated financial statements.

Consolidated statement of comprehensive income

(In PLN thousand)

	NOTE	2017	2016
Net profit for the period		2 475 708	2 279 764
1. Attributable to equity holders of the Bank		2 475 129	2 279 275
2. Attributable to non-controlling interests	51	579	489
Other comprehensive income			
Item that are or may be reclassified subsequently to profit or loss:			
Change in fair value of available-for-sale financial assets		230 592	(608 819)
Change in fair value of cash flow hedges	30	(33 143)	(5 557)
Tax on items that are or may be reclassified subsequently to profit or loss	21	(37 515)	116 731
Items that will never be reclassified to profit or loss:			
Remeasurements of the defined benefit liabilities	45	8 557	(11 560)
Share in remeasurements of the defined benefit liabilities of associates		-	18
Tax on items that will never be reclassified to profit or loss	21	(1 625)	2 196
Other comprehensive income (net of tax)		166 866	(506 991)
Total comprehensive income		2 642 574	1 772 773
1. Attributable to equity holders of the Bank		2 641 995	1 772 284
2. Attributable to non-controlling interests	51	579	489

Notes to the financial statements presented on pages 10 – 164 constitute an integral part of the consolidated financial statements.

Consolidated statement of financial position

(In PLN thousand)

	NOTE	31.12.2017	31.12.2016
ASSETS			
Cash and due from Central Bank	24	5 236 318	5 872 911
Loans and advances to banks	25	2 627 327	3 257 829
Financial assets held for trading	26	1 730 416	732 469
Derivative financial instruments (held for trading)	27	1 349 047	1 913 429
Loans and advances to customers	28	127 949 307	118 689 267
Receivables from finance leases	29	4 351 352	3 974 643
Hedging instruments	30	259 396	289 752
Investments (placement) securities	31	36 905 822	35 120 619
1. Available for sale		33 424 031	32 101 634
2. Held to maturity		3 481 791	3 018 985
Assets held for sale	33	65 565	48 277
Investments in associates	34	-	136 221
Intangible assets	35	1 525 645	596 181
Property, plant and equipment	36	1 425 469	1 422 930
Investment properties	37	22 167	24 874
Income tax assets		960 754	1 104 343
1. Current tax assets		9 959	100 992
2. Deferred tax assets	21	950 795	1 003 351
Other assets	38	1 056 985	1 031 198
TOTAL ASSETS		185 465 570	174 214 943
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to Central Bank	24	6 079	6 091
Amounts due to other banks	40	4 981 291	4 823 440
Financial liabilities held for trading	26	469 448	673 165
Derivative financial instruments (held for trading)	27	2 030 103	1 952 674
Amounts due to customers	41	146 186 268	137 815 926
Hedging instruments	30	862 331	1 638 718
Debt securities issued	42	2 771 399	1 522 963
Subordinated liabilities	43	1 257 188	-
Income tax liabilities		237 885	11 579
1. Current tax liabilities		200 201	6 694
2. Deferred tax liabilities	21	37 684	4 885
Provisions	44	602 622	560 392
Other liabilities	45	2 793 142	2 298 052
TOTAL LIABILITIES		162 197 756	151 303 000
Equity			
Share capital	50	262 470	262 470
Other capital and reserves	51	20 561 177	20 375 527
Retained earnings and profit for the period	51	2 444 167	2 259 022
Total equity attributable to equity holders of the Bank		23 267 814	22 897 019
Non - controlling interests	52	-	14 924
TOTAL EQUITY		23 267 814	22 911 943
TOTAL LIABILITIES AND EQUITY		185 465 570	174 214 943

Notes to the financial statements presented on pages 10 - 164 constitute an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

(In PLN thousand)

For the period from 1 January 2017 to 31 December 2017

	EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK								NON - CONTROLLING INTERESTS	TOTAL EQUITY	
	SHARE CAPITAL	OTHER CAPITAL AND RESERVES					RETAINED EARNINGS AND NET PROFIT FOR THE PERIOD	TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Note	50	51	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	OTHER	51	52		
Equity as at 1.01.2017	262 470	20 375 527	9 137 221	1 982 324	9 092 735	(223 394)	386 641	2 259 022	22 897 019	14 924	22 911 943
Management options	-	-	-	-	-	-	-	-	-	-	-
Options exercised (share issue)	-	-	-	-	-	-	-	-	-	-	-
Revaluation of management share options	-	-	-	-	-	-	-	-	-	-	-
Comprehensive income	-	166 866	-	-	-	166 866	-	2 475 129	2 641 995	579	2 642 574
Remeasurements of the defined benefit liabilities (net of tax)	-	6 932	-	-	-	6 932	-	-	6 932	-	6 932
Revaluation of available-for-sale investments (net of tax)	-	186 780	-	-	-	186 780	-	-	186 780	-	186 780
Revaluation of hedging financial instruments (net of tax)	-	(26 846)	-	-	-	(26 846)	-	-	(26 846)	-	(26 846)
Net profit for the period	-	-	-	-	-	-	-	2 475 129	2 475 129	579	2 475 708
Appropriation of retained earnings	-	11 744	-	135	-	-	11 609	(2 289 984)	(2 278 240)	-	(2 278 240)
Dividend paid	-	-	-	-	-	-	-	(2 278 240)	(2 278 240)	-	(2 278 240)
Profit appropriation to other reserves including consolidation adjustments	-	11 744	-	135	-	-	11 609	(11 744)	-	-	-
Other	-	7 040	-	-	7 040	-	-	-	7 040	(15 503)	(8 463)
Acquisition of non - controlling interests	-	7 040	-	-	7 040	-	-	-	7 040	(15 503)	(8 463)
Equity as at 31.12.2017	262 470	20 561 177	9 137 221	1 982 459	9 099 775	(56 528)	398 250	2 444 167	23 267 814	-	23 267 814

Notes to the financial statements presented on pages 10 - 164 constitute an integral part of the consolidated financial statements.

Consolidated statement of changes in equity (cont.)

(In PLN thousand)

For the period from 1 January 2016 to 31 December 2016

	EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK										TOTAL EQUITY
	SHARE CAPITAL	OTHER CAPITAL AND RESERVES						RETAINED EARNINGS AND NET PROFIT FOR THE PERIOD	TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK	NON-CONTROLLING INTERESTS	
		TOTAL OTHER CAPITAL AND RESERVES	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	OTHER				
Note	50	51						51		52	
Equity as at 1.01.2016	262 470	20 869 976	9 137 221	1 975 415	9 092 740	283 597	381 003	2 275 783	23 408 229	15 964	23 424 193
Management options	-	-	-	-	-	-	-	-	-	-	-
Options exercised (share issue)	-	-	-	-	-	-	-	-	-	-	-
Revaluation of management share options	-	-	-	-	-	-	-	-	-	-	-
Comprehensive income	-	(506 991)	-	-	-	(506 991)	-	2 279 275	1 772 284	489	1 772 773
Remeasurements of the defined benefit liabilities (net of tax)	-	(9 346)	-	-	-	(9 346)	-	-	(9 346)	-	(9 346)
Revaluation of available-for-sale investments (net of tax)	-	(493 144)	-	-	-	(493 144)	-	-	(493 144)	-	(493 144)
Revaluation of hedging financial instruments (net of tax)	-	(4 501)	-	-	-	(4 501)	-	-	(4 501)	-	(4 501)
Net profit for the period	-	-	-	-	-	-	-	2 279 275	2 279 275	489	2 279 764
Appropriation of retained earnings	-	12 547	-	6 909	-	-	5 638	(2 296 036)	(2 283 489)	(1 529)	(2 285 018)
Dividend paid	-	-	-	-	-	-	-	(2 283 489)	(2 283 489)	(1 529)	(2 285 018)
Profit appropriation to other reserves including consolidation adjustments	-	12 547	-	6 909	-	-	5 638	(12 547)	-	-	-
Other	-	(5)	-	-	(5)	-	-	-	(5)	-	(5)
Other	-	(5)	-	-	(5)	-	-	-	(5)	-	(5)
Equity as at 31.12.2016	262 470	20 375 527	9 137 221	1 982 324	9 092 735	(223 394)	386 641	2 259 022	22 897 019	14 924	22 911 943

Notes to the financial statements presented on pages 10 – 164 constitute an integral part of the consolidated financial statements.

Consolidated cash flow statement

(In PLN thousand)

	NOTE	2017	2016
Cash flow from operating activities – indirect method			
Net profit for the period		2 475 129	2 279 275
Adjustments for:		(1 605 241)	9 190 668
Depreciation and amortization	16	347 338	340 866
Share of profit (loss) of associates		(453 414)	(38 561)
(Gains) losses on investing activities		(41 507)	(280 761)
Net interest income	10	(4 593 496)	(4 382 005)
Dividend income	12	(19 772)	(16 798)
Interests received		5 599 928	5 347 032
Interests paid		(1 060 824)	(1 104 545)
Income tax		677 323	800 763
Income tax paid		(387 535)	(613 243)
Change in loans and advances to banks		(56 810)	214 246
Change in financial assets held for trading		(997 239)	393 623
Change in derivative financial instruments (assets)		564 382	1 293 018
Change in loans and advances to customers and bill of exchange eligible for rediscounting at Central Bank		(9 187 272)	(42 858)
Change in receivables from finance leases		(376 709)	(470 664)
Change in investment (placement) securities		(214 640)	(928 421)
Change in other assets		(27 143)	1 228 207
Change in amounts due to banks		297 042	(989 982)
Change in financial liabilities held for trading		(203 717)	61 723
Change in derivative financial instruments (liabilities)		77 429	(1 251 654)
Change in amounts due to customers		8 398 516	8 969 426
Change in debt securities issued		(28 350)	11 832
Change in subordinated liabilities		7 188	-
Change in provisions		42 230	135 018
Change in other liabilities		31 811	514 406
Net cash flows from operating activities		869 888	11 469 943
Cash flow from investing activities			
Investing activity inflows		63 888 703	83 089 908
Sale of investment securities		63 187 207	82 248 380
Sale of intangible assets and property, plant and equipment		1 332	14 190
Dividend received	12	19 772	16 798
Other investing inflows		680 392	810 540
Investing activity outflows		(66 174 231)	(96 608 585)
Acquisition of shares in subsidiary, net of cash acquired		(599 362)	-
Acquisition of non - controlling interests		(8 463)	-
Acquisition of investment securities		(65 195 768)	(96 335 321)
Acquisition of intangible assets and property, plant and equipment	35, 36	(370 638)	(273 264)
Net cash flows from investing activities		(2 285 528)	(13 518 677)

Notes to the financial statements presented on pages 10 - 164 constitute an integral part of the consolidated financial statements.

Consolidated cash flow statement (cont.)

(In PLN thousand)

	NOTE	2017	2016
Cash flows from financing activities			
Financing activity inflows		2 819 944	1 146 805
Due to loans and advances received from banks	53	-	17 072
Issue of debt securities	53	1 569 944	1 129 733
Issue of subordinated liabilities	53	1 250 000	-
Financing activity outflows		(2 725 354)	(4 945 376)
Repayment of loans and advances received from banks	53	(139 462)	(155 835)
Redemption of debt securities	53	(307 652)	(2 506 052)
Dividends and other payments to shareholders		(2 278 240)	(2 283 489)
Net cash flows from financing activities		94 590	(3 798 571)
Total net cash flows		(1 321 050)	(5 847 305)
including: effect of exchange rate fluctuations on cash and cash equivalents held		(157 249)	96 157
Net change in cash and cash equivalents		(1 321 050)	(5 847 305)
Cash and cash equivalents at the beginning of the period		8 666 090	14 513 395
Cash and cash equivalents at the end of the period	53	7 345 040	8 666 090

Notes to the financial statements presented on pages 10 - 164 constitute an integral part of the consolidated financial statements.

Notes to the financial statements (cont.)

(In PLN thousand)

The accompanying notes to the financial statements constitute an integral part of the consolidated financial statements.

1. General information

The parent company of the Bank Pekao S.A. Group (the 'Group') is Bank Pekao S.A. (hereinafter referred to the 'the Parent Company', 'the Bank'), with Head Office in Warsaw, at 53/57 Grzybowska Street, 00-950 Warsaw. Bank Pekao S.A. was incorporated on 29 October 1929 in the Commercial Register of the District Court in Warsaw and has been continuously in operation since its incorporation.

Bank Pekao S.A. is registered in the National Court Registry – Enterprise Registry of the Warsaw District Court XII Commercial Division of the National Court Registry in Warsaw under the reference number KRS 0000014843.

The Bank's statistical REGON number is 000010205.

Both the Parent Company and the consolidating entities constituting the Capital Group has been established for an indefinite period of time.

According to IFRS 10 'Consolidated financial statements', the parent entity of Bank Pekao S.A. is Powszechny Zakład Ubezpieczeń S.A. (hereinafter 'PZU S.A.') with its registered office in Warsaw at Al. Jana Pawła II 24.

The Bank's shares are quoted on the Warsaw Stock Exchange (WSE). The Bank's securities, traded on regulated markets, are classified in the banking sector.

Bank Pekao S.A. is a universal commercial bank, offering a broad range of banking services on domestic and foreign financial markets, provided to retail and corporate clients, in compliance with the scope of services, set forth in the Bank's Articles of Association. The Bank runs both PLN and forex operations, and it actively participates in both domestic and foreign financial markets. Moreover, acting through its subsidiaries, the Group provides stockbroking, leasing, factoring operations and offering other financial services.

Changes in share ownership structure of the Bank

In the current report no. 33/2017, the Management Board of Bank Pekao S.A. informed that on 7 June 2017 the Bank has received a notice from PZU S.A. and the Polski Fundusz Rozwoju S.A. (hereinafter 'PFR S.A. '), pursuant to which as a result of settlement on 7 June 2017 of the purchase transaction from UniCredit S.p.A. by PZU S.A. and PFR S.A. of 86 090 172 shares of the Bank, constituting 32.8% of the Bank's share capital and carrying 86 090 172 votes accounting for 32.8% of the total number of votes, PZU S.A. and PFR S.A. jointly exceeded the threshold of 25% of the total number of votes at the Bank.

Since the acquisition of the Bank's shares, PZU S.A. and PFR S.A. hold together 86 090 173 shares of the Bank, accounting for approximately 32.8% of the Bank's share capital and entitling them to 86 090 173 votes representing approximately 32.8% of the total number of votes, with the following votes as at 31 December 2017:

- PZU S.A. holds directly 52 494 007 shares of the Bank, representing approximately 20% of the Bank's share capital and entitling to 52 494 007 votes representing approximately 20% of total number of votes, while
- PFR S.A. holds directly 33 596 166 shares of the Bank, constituting approximately 12.8% of the Bank's share capital and entitling to 33 596 166 votes representing approximately 12.8% of the total number of votes.

Changes in the composition of the Management Board and the Supervisory Board of the Bank

The changes in the composition of the Management Board and the Supervisory Board of the Bank are presented in the Note 4.2 'Changes in the Statutory Bodies of the Bank' of the Report on the activities of Bank Pekao S.A. Group for the year of 2017.

Notes to the financial statements (cont.)

(In PLN thousand)

2. Group structure

The Group consists of Bank Pekao S.A. as the parent entity and the following subsidiaries

NAME OF ENTITY	LOCATION	CORE ACTIVITY	PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING	
			31.12.2017	31.12.2016
Pekao Bank Hipoteczny S.A.	Warsaw	Banking	100.00	100.00
Centralny Dom Maklerski Pekao S.A.	Warsaw	Brokerage	100.00	100.00
Pekao Leasing Sp. z o.o.	Warsaw	Leasing services	100.00	100.00
Pekao Investment Banking S.A.	Warsaw	Brokerage	100.00	100.00
Pekao Faktoring Sp. z o.o.	Lublin	Factoring services	100.00	100.00
Pekao Powszechne Towarzystwo Emerytalne S.A. (ex. Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A.)	Warsaw	Pension fund management	100.00	65.00
Centrum Kart S.A.	Warsaw	Financial support	100.00	100.00
Pekao Financial Services Sp. z o.o.	Warsaw	Transferable agent	100.00	100.00
Centrum Bankowości Bezpośredniej Sp. z o.o.	Cracow	Call-center services	100.00	100.00
Pekao Property S.A., including:	Warsaw	Real estate development	100.00	100.00
<i>FPB - Media Sp. z o.o.</i>	<i>Warsaw</i>	<i>Real estate development</i>	<i>100.00</i>	<i>100.00</i>
Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation)	Warsaw	Business consulting	100.00	100.00
Dom Inwestycyjny Xelion Sp. z o.o.	Warsaw	Financial intermediary	100.00	-
Pekao Investment Management S.A. (ex. Pioneer Pekao Investment Management S.A.)	Warsaw	Holding	100.00	-
<i>Pekao TFI S.A. (ex. Pioneer Pekao TFI S.A.)</i>	<i>Warsaw</i>	<i>Asset management</i>	<i>100.00</i>	<i>-</i>

As at 31 December 2017, all of the subsidiaries have been consolidated.

Associates

Bank Pekao S.A. Capital Group has an interest in the following associates

NAME OF ENTITY	LOCATION	CORE ACTIVITY	PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING	
			31.12.2017	31.12.2016
Dom Inwestycyjny Xelion Sp. z o.o.	Warsaw	Financial intermediary	-	50.00
Pekao Investment Management S.A.	Warsaw	Holding	-	49.00
<i>Pekao TFI S.A.</i>	<i>Warsaw</i>	<i>Asset management</i>	<i>-</i>	<i>49.00</i>
CPF Management	Tortola, British Virgin Islands	Financial brokerage – not operating	40.00	40.00

As at 31 December 2017, the Group held no shares in entities under joint control.

Notes to financial statements (cont.)

(In PLN thousand)

Changes in the Group structure

Acquisition of shares in Pekao PTE S.A.

On 17 October 2017, the Bank acquired the remaining 35% of the issued shares of Pekao PTE S.A. for a purchase consideration of PLN 8 463 thousand. The Group now holds 100% share in the equity of Pekao PTE S.A. The carrying amount of the non-controlling interests in Pekao PTE S.A. on the date of acquisition was PLN 15 503 thousand. The Group derecognized non-controlling interests amounting to PLN 15 503 thousand and recorded an increase in equity attributable to equity holders of the Bank amounting to PLN 7 040 thousand.

The effect of changes in the ownership interest of Pekao PTE S.A. on the equity attributable to equity holders of the Bank during the reporting period is presented in the table below.

	2017	2016
Carrying amount of non-controlling interests acquired	15 503	-
Consideration paid to non-controlling interests	(8 463)	-
Increase in equity attributable to equity holders of the Bank	7 040	-

Acquisition of shares in Pekao Investment Management S.A.

On 11 December 2017, the Bank acquired the remaining 51% of the issued shares of Pekao Investment Management S.A. and took control over the entity. In consequence, the Group currently holds 100% of the issued shares of Pekao Investment Management S.A. and indirectly 100% of the issued shares of Pekao TFI S.A. The acquired entities deal with management of investment funds assets and are of strategic importance for the Group that distributes and serving such products. The acquisition transaction results from the arrangements made when UniCredit S.p.A. sold the Bank's shares, which assumed full control over these entities by Bank Pekao S.A. The purchase consideration was PLN 590 799 thousand and consisted of cash in total.

The recognized fair values of identifiable assets acquired and liabilities assumed are presented in the table below.

ITEM	
Loans and advances to banks	317 834
Financial assets held for trading	4 746
Intangible assets	175 773
Property, plant and equipment	1 631
Deferred tax assets	2 242
Other assets	29 380
TOTAL ASSETS	531 606
Current tax liabilities	1 779
Deferred tax liabilities	33 262
Provisions	7 184
Other liabilities	23 079
TOTAL LIABILITIES	65 304
TOTAL NET ASSETS	466 302

The item 'Intangible assets' includes additional assets in the amount of PLN 175 064 thousand that meet the conditions for being recognized as intangible assets. These assets result from acquired relationships with customers of Pekao TFI S.A.

As at 31 December 2017 the Group made a final settlement of taking control over Pekao Investment Management S.A. and indirectly over Pekao TFI S.A., and recognized goodwill in amount of PLN 692 128 thousand.

Notes to financial statements (cont.)

(In PLN thousand)

Consideration paid	590 799
Balance sheet value of previously held shares	160 375
Revaluation of shares held	407 256
Less: fair value of identifiable net assets	(466 302)
Goodwill	692 128

The recognized goodwill represents a control premium, and arises from the possibility to generate additional benefits from the expected synergies, increase in revenues. The goodwill is not subject to the tax deductions.

As at the acquisition date the fair value of previously held shares amounting to PLN 567 631 thousand. The gain on remeasurement to fair value of previously held shares amounts to PLN 407 256 thousand and is recognized in the item 'Gains (losses) on subsidiaries and associates' of the consolidated income statement.

The Group incurred acquisition-related costs of PLN 1 186 thousand. These costs have been included in the item 'Administrative expenses' of the consolidated income statement.

The interest income and commission income included in the consolidated income statement since the acquisition date contributed by the acquired entities was PLN 29 047 thousand. The acquired entities also contributed net profit of PLN 5 811 thousand for the same period.

If the acquisition had occurred on 1 January 2017, it is estimated that interest income and commission income of the Group would have been PLN 8 432 493 thousand, and the net profit for the year attributable to equity holders of the Bank would have been PLN 2 106 404 thousand (excluding the gain on remeasurement to fair value of previously held shares).

Acquisition of shares in Dom Inwestycyjny Xelion Sp. z o.o.

On 11 December 2017, the Bank acquired the remaining 50% of the issued shares of Dom Inwestycyjny Xelion Sp. z o.o. and took control over the entity. Dom Inwestycyjny Xelion Sp. z o.o. provides its customers with comprehensive brokerage services and professional investment management. The acquisition transaction results from the arrangements made when UniCredit S.p.A. sold the Bank's shares, which assumed full control over Dom Inwestycyjny Xelion Sp. z o.o. by Bank Pekao S.A. The purchase consideration was PLN 8 562 thousand and consisted of cash in total. The Group currently holds 100% of the issued shares of Dom Inwestycyjny Xelion Sp. z o.o.

The recognized fair values of identifiable assets acquired and liabilities assumed are presented in the table below.

ITEM	
Loans and advances to banks	35 069
Loans and advances to customers	1 119
Debt securities held to maturity	19 134
Intangible assets	800
Property, plant and equipment	566
Other assets	11 643
TOTAL ASSETS	68 331
Amounts due to customers	22 539
Current tax liabilities	192
Provisions	1 187
Other liabilities	13 847
TOTAL LIABILITIES	37 765
TOTAL NET ASSETS	30 566

Notes to financial statements (cont.)

(In PLN thousand)

As at 31 December 2017 the Group made a final settlement of taking control over Dom Inwestycyjny Xelion Sp. z o.o. and recognized a gain from a bargain purchase in the amount of PLN 13 442 thousand, that is included in the item 'Gains (losses) on subsidiaries and associates' of the consolidated income statement. The gain from a bargain purchase arose as a result of negotiating a favorable transaction price.

Consideration paid	8 562
Balance sheet value of previously held shares	15 283
Revaluation of shares held	(6 721)
Less: fair value of identifiable net assets	(30 566)
Gain from a bargain purchase	13 442

As at the acquisition date the fair value of previously held shares amounting to PLN 8 562 thousand. The loss on remeasurement to fair value of previously held shares amounts to PLN 6 721 thousand and is recognized in the item 'Gains (losses) on subsidiaries and associates' of the consolidated income statement.

The Group incurred acquisition-related costs of PLN 17 thousand. These costs have been included in the item 'Administrative expenses' of the consolidated income statement.

The interest income and commission income included in the consolidated income statement since the acquisition date contributed by Dom Inwestycyjny Xelion Sp. z o.o. was PLN 5 073 thousand. The acquired entity also contributed net profit of PLN 316 thousand for the same period.

If the acquisition had occurred on 1 January 2017, it is estimated that interest income and commission income of the Group would have been PLN 8 362 551 thousand, and the net profit for the year attributable to equity holders of the Bank would have been PLN 2 470 969 thousand (excluding the gain from a bargain purchase and the loss on remeasurement to fair value of previously held shares).

3. Business combination

In 2017 the Bank acquired 51% of the share capital of Pekao Investment Management S.A. and 50% of the share capital of Dom Inwestycyjny Xelion Sp. z o.o. The transactions were detailed in Note 2.

4. Statement of compliance

The annual consolidated financial statements ('financial statements') of the Bank Pekao S.A. Group have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union, and in respect to matters that are not regulated by the above standards, in accordance with the requirements of the Accounting Act dated 29 September 1994 (Official Journal from 2017, item 2342) and respective operating regulations, and in accordance with the requirements for issuers of securities admitted or sought to be admitted to trading on an official stock exchange listing market.

These consolidated financial statements were approved for publication by the Bank's Management Board on 26 February 2018.

Notes to financial statements (cont.)

(In PLN thousand)

5. Significant accounting policies

5.1 Basis of preparation of consolidated financial statements

General information

These Consolidated Financial Statements of the Group, which have been prepared for the period from 1 January to 31 December 2017, contain the financial results of the Bank and of its subsidiaries, comprising the 'Group', as well as the results of associated entities, measured using the equity method.

The financial statements have been prepared in Polish zloty, and all data in the financial statements are presented in PLN thousand (PLN '000), unless indicated otherwise.

The financial statements have been prepared on a going concern basis on the assumption that the Group will continue its business operations substantially unchanged in scope for a period of at least one year from the balance sheet date.

The accounting principles as described below have been consistently applied for all the reporting periods. The principles have been applied consistently by all the Group entities.

Consolidated Financial Statements of the Group have been prepared based on the following valuation methods:

- at fair value for: derivatives, financial assets and liabilities held for trading, financial assets recognized initially at fair value through profit or loss and available-for-sale financial assets, except for those for which the fair value cannot be reliably measured,
- at amortized cost for other financial assets, including loans and advances and other financial liabilities,
- at historical cost for non-financial assets and liabilities or financial assets available for sale whose fair value cannot be reliably measured,
- non-current assets (or disposal groups) classified as held for sale are measured at the lower of the carrying amount or the fair value less costs to sell.

Changes in presentation of financial data

The Bank provides customers with the services of buying and selling foreign currencies, for which it receives remuneration in the form of exchange rate margins included in the exchange rates offered to the Bank's customers. So far such margins have been presented under the item 'Result on financial assets and liabilities held for trading' ('Foreign exchange result').

According to the Bank, the exchange rate margin is of similar nature to other fees and commissions charged by the Bank for the services rendered and therefore should be presented in the Bank's fee and commission income.

As a result, for year of 2017 the Group introduced changes in presentation in the income statement of the margins on foreign exchange transactions with the Group's clients and currently the margins are presented under the item 'Fee and commission income'.

Due to the change the comparative data presented in these financial statements were restated.

Notes to financial statements (cont.)

(In PLN thousand)

The impact of the change in accounting policy on comparative data in income statement is presented in the below table.

	2016 (BEFORE RESTATEMENT)	RESTATEMENT	2016 (AFTER RESTATEMENT)
Interest income	5 448 490	-	5 448 490
Interest expense	(1 066 485)	-	(1 066 485)
Net interest income	4 382 005	-	4 382 005
Fee and commission income	2 252 085	431 026	2 683 111
Fee and commission expense	(293 121)	-	(293 121)
Net fee and commission income	1 958 964	431 026	2 389 990
Dividend income	16 798	-	16 798
Result on financial assets and liabilities held for trading	485 409	(431 026)	54 383
Result on fair value hedge accounting	1 313	-	1 313
Gains (losses) on disposal of:	435 903	-	435 903
loans and other financial receivables	159 493	-	159 493
available for sale financial assets and held to maturity investments	276 493	-	276 493
financial liabilities	(83)	-	(83)
Operating income	7 280 392	-	7 280 392
Net impairment losses on financial assets and off-balance sheet commitments	(500 629)	-	(500 629)
loans and other financial receivables	(401 409)	-	(401 409)
off-balance sheet commitments	(99 220)	-	(99 220)
Net result on financial activity	6 779 763	-	6 779 763
Administrative expenses	(3 602 324)	-	(3 602 324)
personnel expenses	(1 896 836)	-	(1 896 836)
other administrative expenses	(1 705 488)	-	(1 705 488)
Depreciation and amortization	(340 866)	-	(340 866)
Net result on other provisions	(14 475)	-	(14 475)
Net other operating income and expenses	30 528	-	30 528
Operating costs	(3 927 137)	-	(3 927 137)
Gains (losses) on subsidiaries and associates	38 561	-	38 561
Gains (losses) on disposal of property, plant and equipment and intangible assets	5 359	-	5 359
Profit before income tax	2 896 546	-	2 896 546
Income tax expense	(616 782)	-	(616 782)
Net profit	2 279 764	-	2 279 764
1. Attributable to equity holders of the Bank	2 279 275	-	2 279 275
2. Attributable to non-controlling interests	489	-	489
Earnings per share (in PLN per share)			
basic for the period	8.68		8.68
diluted for the period	8.68		8.68

Notes to financial statements (cont.)

(In PLN thousand)

The consolidated financial statements include the requirements of all the International Financial Reporting Standards and International Accounting Standards approved by the European Union and related interpretations. Changes in published standards and interpretations, which became effective on or after 1 January 2017, had no material impact on the Group's financial statements (Note 5.10).

The financial statements does not take into consideration interpretations and amendments to Standards, pending approval by the European Union or approved by the European Union but came into force or shall come into force after the balance sheet date (Note 5.11 and Note 5.12).

In the Group's opinion, amendments to Standards and interpretations will not have a significant influence on the consolidated financial statements of the Group, with the exception of IFRS 9 'Financial Instruments'.

IFRS 9 'Financial Instruments'

The Bank has adopted International Financial Reporting Standard 9 'Financial Instruments' with a date of transition of 1 January 2018.

The adoption of IFRS 9 has resulted in changes in the accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. Set out below is the summary of recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets applied from 1 January 2018.

Classification and measurement

According to IFRS 9, classification of financial assets at initial recognition is based upon:

- the entity's business model for managing the financial assets,
- the contractual cash flow characteristics of the financial asset (i.e. whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding, hereinafter 'SPPI').

Depending on the entity's business model, financial assets may be classified as:

- 'held to collect' contractual cash flows (measured at amortized cost, if SPPI criteria are met, and subject to the expected loss impairment),
- 'held to collect or sale' (measured at fair value through other comprehensive income, if SPPI criteria are met, and subject to the expected loss impairment), or
- 'held for trading' or other (measured at fair value through profit or loss).

Financial assets may be reclassified when, and only when, the Bank changes its business model for managing financial assets. In such a case the Bank shall reclassify all financial assets affected by the change of business model.

IFRS 9 introduces a definition of gross carrying amount of a financial asset. The change results in a difference in the calculation of the gross value of financial assets classified in Stage 3 in relation to the previously applicable rules. From 1 January 2018, interest accrued (including penalty interest) is on the balance sheet recorded in value calculated based on a gross value of an exposure. For the purpose of the profit and loss, interest income on financial assets classified in Stage 3 is calculated based on the net value of an exposure.

IFRS 9 allows an entity at initial recognition to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading. Dividends from such an investment shall be recognized in profit or loss. IFRS 9 eliminates the possibility of measuring unquoted capital investments at cost and requires determining fair value for these investments.

The implementation of the new standard has no impact on the accounting treatment of financial liabilities, as IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities.

Impairment of financial assets

IFRS 9 has replaced the 'incurred loss' model in IAS 39 binding until 31 December 2017 with a forward-looking 'expected credit loss' (ECL) model. Because of the aforementioned change the Bank is obliged to calculate loss allowances based on the expected credit loss over the life of a financial instrument, taking into consideration forecasts of future economic conditions with regard to the measurement of the credit risk of an exposure.

Notes to financial statements (cont.)

(In PLN thousand)

The new impairment model applies to financial instruments measured, in accordance with IFRS 9, at amortized cost or at fair value through other comprehensive income, except for equity instruments.

Replacing the concept of 'incurred loss' with the concept of 'expected credit loss' has significantly impacting the way of modelling credit risk parameters and the estimated value of loss allowances. The loss identification period and IBNR (incurred but not reported) category of loss allowance are not used anymore. In accordance with IFRS 9, the loss allowances are calculated in the following categories (instead of the IBNR loss allowances and the loss allowances for non-performing exposures):

1. Stage 1 – 12-month expected credit losses – the expected credit losses on a financial instrument that are possible within the 12 months after the reporting date,
2. Stage 2 – lifetime expected credit losses – the expected credit losses over the life of a financial instrument,
3. Stage 3 – lifetime expected credit losses – the expected credit losses over the life of a financial instrument in default.

The measurement of lifetime expected credit losses applies to all exposures for which during the period between the initial recognition and the reporting date the Bank has identified a significant increase in credit risk (Stage 2) or has identified impairment (Stage 3). The measurement of 12-month expected credit losses (Stage 1) applies to all exposures for which the Bank has not identified a significant increase in credit risk or impairment during the period between the initial recognition and the reporting date.

The new approach to calculating the impairment of the financial assets also has an impact on the interest income recognition. In particular, interest income on financial assets allocated to Stages 1 and 2 is calculated based on the gross carrying amount of the exposure, whereas interest income on financial assets allocated to Stage 3 is calculated based on the net carrying amount of the exposure (similarly to impaired financial assets under the requirements of IAS 39).

Within the scope of the IFRS 9 implementation project, the Bank has implemented a new methodology of loss allowances calculation as well as appropriate modifications in IT systems and processes used by the Bank, in particular on acquiring appropriate data, designing the processes and tools for calculation of loss allowances in accordance with IFRS 9.

Modelling of the future exposure on the date of default leverage on available payment schedules, whereas for the exposures without defined payment schedules the Bank applies the methodology aimed at modelling limit utilization at the date of default. In respect of transfer criteria between Stage 1 and Stage 2 the Bank develops statistical transfer logic models of identification of significant increase in credit risk since the recognition of assets in the balance sheet.

The implementation of the new Standard has required the application of more complex credit risk models of greater predictive abilities which require a significantly broader set of source data than the models applied so far.

Hedge accounting

The Bank decided to take advantage of the choice which gives IFRS 9 and continues to apply the hedge accounting requirements of IAS 39. This decision will apply to all hedging relationships, for which the Bank applies and will apply hedge accounting in the future.

Therefore, in the case of hedge accounting, the entry into force of IFRS 9 did not have any impact on the financial position of the Bank.

Disclosures and comparatives

New requirements of IFRS 9 significantly change the presentation and extent of the disclosures on financial instruments, particularly in the year of the adoption of the new standard.

The Bank decided to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally have been recognized in retained earnings as at 1 January 2018.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Bank as at 1 January 2018.

Notes to financial statements (cont.)

(In PLN thousand)

The table below discloses at the time of the first application of IFRS 9 comparison of categories for the measurement of financial assets and their carrying amounts in accordance with IAS 39 and new categories of measurement of financial assets and their carrying amounts in accordance with IFRS 9.

	IAS 39 MEASUREMENT CATEGORY	IFRS 9 MEASUREMENT CATEGORY	IAS 39 CARRYING AMOUNT	IFRS 9 CARRYING AMOUNT
Cash and due from Central Bank	Loans and advances (Amortised cost)	Amortised cost	5 236 318	5 236 107
Loans and advances to banks	Loans and advances (Amortised cost)	Amortised cost	2 627 327	2 627 117
Financial assets held for trading	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	1 730 416	1 730 416
Derivative financial instruments	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	1 349 047	1 349 047
Hedging derivatives	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	259 396	259 396
Loans and advances to customers	Loans and advances (Amortised cost)	Amortised cost	113 330 806	112 284 080
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through profit or loss (mandatory)	363 079	365 137
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through other comprehensive income	1 597 449	1 555 964
Receivables from finance leases	Loans and advances (Amortised cost)	Amortised cost	4 351 352	4 347 855
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Amortised cost	7 550 390	7 543 879
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Fair value through other comprehensive income	5 107 583	5 096 743
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Amortised cost	1 620 367	1 620 237
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Fair value through other comprehensive income	1 861 424	1 887 731
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Amortised cost	2 229 193	2 336 021
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	31 047 397	31 047 397
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through profit or loss (mandatory)	52 376	52 376
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	95 065	264 444
Other assets	Loans and advances (Amortised cost)	Amortised cost	948 231	941 722
FINANCIAL ASSETS			181 357 216	180 545 669

The application of IFRS 9 for the first time by the Bank had no impact on the classification and measurement of financial liabilities.

Notes to financial statements (cont.)

(In PLN thousand)

The table below presents the reconciliation of the carrying amounts of financial assets by category of measurement under IAS 39 with the carrying amounts of these items according to the category of their valuation under IFRS 9, on the date of the first application of IFRS 9.

	CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
FINANCIAL ASSETS				
AMORTISED COST				
Cash and due from Central Bank				
Opening balance	5 236 318			
Remeasurement			(211)	
Closing balance				5 236 107
Loans and advances to banks				
Opening balance	2 627 327			
Remeasurement			(210)	
Closing balance				2 627 117
Loans and advances to customers				
Opening balance	127 949 307			
Remeasurement			(1 046 726)	
A	Reclassification to fair value through other comprehensive income	(1 597 449)		
B	Reclassification to fair value through profit or loss	(363 079)		
C	Reclassification to investments (placement) securities at fair value through other comprehensive income	(5 107 583)		
D	Reclassification to investments (placement) securities at amortised cost	(7 550 390)		
Closing balance				112 284 080
Receivables from finance leases				
Opening balance	4 351 352			
Remeasurement			(3 497)	
Closing balance				4 347 855
Investments (placement) securities				
Opening balance	3 481 791			
Remeasurement			100 187	
	Reclassification from loans and advances to customers	7 550 390		
	Reclassification from available for sale	2 229 193		
	Reclassification to fair value through other comprehensive income	(1 861 424)		
Closing balance				11 500 137
Other assets				
Opening balance	948 231			
Remeasurement			(6 509)	
Closing balance				941 722
MEASURED AT AMORTISED COST TOTAL				136 937 018

Notes to financial statements (cont.)

(In PLN thousand)

	CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
AVAILABLE FOR SALE				
Investments (placement) securities				
	Opening balance	33 424 031		
E	Reclassification to amortised cost		(2 229 193)	
G	Reclassification to fair value through other comprehensive income – debt securities		(31 047 397)	
H	Reclassification to fair value through other comprehensive income – equity instruments		(95 065)	
I	Reclassification to fair value through profit or loss – equity instruments		(52 376)	
	Closing balance			-
FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME				
Investments (placement) securities (debt securities)				
	Opening balance	-		
	Remeasurement		15 467	
G	Reclassification from available for sale	31 047 397		
C,F	Reclassification from amortised cost	6 969 007		
	Closing balance			38 031 871
Investments (placement) securities (equity instruments)				
	Opening balance	-		
	Remeasurement		169 379	
H	Reclassification from available for sale	95 065		
	Closing balance			264 444
Loans and advances to customers				
	Opening balance	-		
	Remeasurement		(41 485)	
A	Reclassification from amortised cost	1 597 449		
	Closing balance			1 555 964
	MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME TOTAL			39 852 279

Notes to financial statements (cont.)

(In PLN thousand)

	CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
	FAIR VALUE THROUGH PROFIT OR LOSS			
Financial assets held for trading	1 730 416			1 730 416
Derivative financial instruments (held for trading)	1 349 047			1 349 047
Hedging instruments	259 396			259 396
Loans and advances to customers				
Opening balance	-			
Remeasurement			2 058	
B) Reclassification from amortised cost		363 079		
Closing balance				365 137
Investments (placement) securities – equity instruments				
Opening balance	-			
I) Reclassification from available for sale		52 376		
Closing balance				52 376
FAIR VALUE THROUGH PROFIT OR LOSS TOTAL				3 756 372

The following explains how the application of the new requirements for the classification of IFRS 9 led to the changes in the classification of certain financial assets held by the Bank as shown in the table above.

Loans and advances to customers

- A)** Certain loans and advances to customers are measured at fair value through other comprehensive income because they are classified into a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Before applying the requirements of IFRS 9, these loans were measured at amortized cost, in accordance with IAS 39.
- B)** Some of the loans and advances to customers are classified as measured at fair value through profit or loss, as their contractual cash flows failed to meet the 'solely payments of principal and interest' (SPPI) requirement, due to the leverage that increases the volatility of the contractual cash flows. This applies mainly to student loans, loans with subsidies of the Agency for Restructuring and Modernization of Agriculture and several corporate exposures. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39.

The remaining loans and advances to customers held to collect contractual cash flows and meeting the SPPI criteria are still measured at amortized cost.

Corporate and municipal debt securities

- C)** The Bank assessed the business model for corporate and municipal securities and identified that part of the portfolio of these securities meets the criteria of the business model, whose objective is achieved by both collecting contractual cash flows and selling financial assets. Therefore, certain securities from this portfolio were classified as measured at fair value through other comprehensive income. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39 and presented as loans and advances to customers.
- D)** The remaining part of the portfolio, which is held to collect contractual cash flows, has been reclassified to the item Securities and is measured at amortized cost. Before applying the requirements of IFRS 9, these items were presented as Loans and advances to customers, as they were classified in the loans and receivables category in accordance with IAS 39.

Notes to financial statements (cont.)

(In PLN thousand)

Investments (placement) securities

- E)** The Bank assessed the business model for investment securities, which are mostly held to collect cash flows and sell, and identified that in relation to certain of these securities its past practice has been to hold to collect the contractual cash flows and the intention of the Bank remains unchanged. Therefore, the Bank assessed that the appropriate business model for these securities is a model whose objective is to hold to collect contractual cash flows and reclassified them to the amortized cost measurement. Previously, these securities were classified as available for sale and measured at fair value through other comprehensive.
- F)** The Bank assessed the business model for held-to-maturity securities and, due to the intention to sell certain securities in this portfolio, reclassified securities to be measured at fair value through other comprehensive income, because it assessed that the appropriate business model for these securities is the model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39. Other securities previously classified as held to maturity were classified as amortized cost.
- G)** Other securities previously classified as available for sale were classified as at fair value through other comprehensive income, without the change in the measurement method.

Equity instruments

- H)** Certain long-term equity instruments in the Bank's portfolio have been irrevocably designated in accordance with IFRS 9 to measure at fair value through other comprehensive income. Prior to the application of IFRS 9, these instruments were measured at fair value through other comprehensive income or at cost, as the Bank stated that it was not possible to reliably measure their fair value. IFRS 9 abolished the possibility of measuring them at cost. Changes in the fair value of such securities will no longer be reclassified to profit or loss when they are disposed of.
- I)** Other equity instruments that, in accordance with IAS 39, were classified as available for sale and were measured at fair value through other comprehensive income, and were not irrevocably designated for measurement at fair value through other comprehensive income, were reclassified to fair value through profit or loss.

Notes to financial statements (cont.)

(In PLN thousand)

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 and provisions for off-balance sheet liabilities calculated in accordance with IAS 37 as at 31 December 2017 to the opening balance of expected credit losses in accordance with IFRS 9 as at 1 January 2018

	IAS 39 MEASUREMENT CATEGORY	IFRS 9 MEASUREMENT CATEGORY	IMPAIRMENT ALLOWANCE IAS 39/IAS 37 31.12.2017	RECLASSIFICATIONS(*)	REMEASUREMENTS	IMPAIRMENT ALLOWANCE IFRS 9 01.01.2018
Cash and due from Central Bank	Loans and advances (Amortised cost)	Amortised cost	-	-	211	211
Loans and advances to banks	Loans and advances (Amortised cost)	Amortised cost	16 637	4 494	210	21 341
Loans and advances to customers	Loans and advances (Amortised cost)	Amortised cost	5 247 726	3 222 963	1 046 726	9 517 415
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through profit or loss (mandatory)	4 057	3 869	(7 926)	-
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through other comprehensive income	8 901	0	9 258	18 159
Receivables from finance leases	Loans and advances (Amortised cost)	Amortised cost	173 715	0	3 497	177 212
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Amortised cost	84 535	(31 680)	4 517	57 372
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Fair value through other comprehensive income	12 979	-	9 209	22 188
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Amortised cost	-	-	130	130
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Fair value through other comprehensive income	-	-	179	179
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Amortised cost	-	-	196	196
Investments (placement) securities – debt instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	-	-	1 944	1 944

Notes to financial statements (cont.)

(In PLN thousand)

	IAS 39 MEASUREMENT CATEGORY	IFRS 9 MEASUREMENT CATEGORY	IMPAIRMENT ALLOWANCE IAS 39/IAS 37 31.12.2017	RECLASSIFICATIONS(*)	REMEASUREMENTS	IMPAIRMENT ALLOWANCE IFRS 9 01.01.2018
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through profit or loss (mandatory)	-	-	-	-
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	1 119	(1 119)	-	-
Other assets	Loans and advances (Amortised cost)	Amortised cost	95 992	5 926	6 509	108 427
Provisions for undrawn credit facilities and guarantees issued	Provisions	Provisions	236 909	-	60 860	297 769
		IMPAIRMENT ALLOWANCES TOTAL	5 882 570	3 204 453	1 135 520	10 222 543

*) The item 'Reclassifications' includes changes in the level of impairment allowance that occurred in correspondence with the corresponding change in the gross carrying amount, including: (1) increase in impairment allowances as a result of adjusting the gross carrying amount to IFRS 9 (presentation change resulting in increase in the gross carrying amount by recognition of contractual interest accrued in full against receivables in Stage 3 and, as a consequence, an analogous increase in the level of impairment allowance) and (2) a decrease in impairment allowance for loans and advances classified as POCI, which as at the initial recognition are recognized at fair value and do not show impairment allowance. As a result, the changes described above did not affect the level of the Bank's retained earnings.

Notes to financial statements (cont.)

(In PLN thousand)

The table below presents the net impact (gross impact less tax effect) of the first application of IFRS 9 on the equity

	IMPACT OF FIRST TIME ADOPTION OF IFRS 9 AT 01.01.2018		
	BEFORE TAX	DEFERRED TAX	NET
REVALUATION RESERVES			
Revaluation reserves at 31.12.2017 under IAS 39	(69 787)	13 260	(56 527)
Remeasurement of debt securities / loans and advances to customers reclassified from Amortised cost to Fair value through other comprehensive income	(47 898)	9 101	(38 797)
Remeasurement of debt securities reclassified from available for sale to amortised cost	105 030	(19 956)	85 074
Reclassification of equity instruments from available for sale to fair value through profit or loss	(3 232)	614	(2 618)
Remeasurement of equity instruments reclassified from available for sale to fair value through other comprehensive income	169 379	(32 182)	137 197
Recognition of ECL for debt securities / loans and advances to customers at fair value through other comprehensive income	42 470	(8 069)	34 401
Revaluation reserves at 01.01.2018 under IFRS 9	195 962	(37 232)	158 730
RETAINED EARNINGS			
Retained earnings at 31.12.2017 under IAS 39	(38 225)	7 263	(30 962)
Reclassification of equity instruments from available for sale to fair value through profit or loss	3 232	(614)	2 618
Remeasurement of loans and advances to customers mandatory at fair value through profit or loss	(5 868)	1 115	(4 753)
Recognition of ECL for financial assets and off-balance sheet commitments	(1 135 520)	201 965	(933 555)
Retained earnings at 01.01.2018 under IFRS 9	(1 176 381)	209 729	(966 652)
TOTAL IMPACT OF FIRST TIME ADOPTION OF IFRS 9 ON EQUITY	(872 407)	151 974	(720 433)

The provisions of IFRS 9 are not unambiguous and are subject to interpretation by both entities implementing the standard as well as by the regulator or audit firms, and the position of all interested parties is not uniform in all aspects.

The market practice of applying the standard's provisions is still changing and may be subject to change.

Impact of IFRS 9 on capital adequacy

The Bank has decided to apply transitional arrangements specified in art. 473a of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 as amended Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 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.

The following table presents the impact of the adoption of IFRS 9 for the first time on capital adequacy with and without transitional arrangements:

	IMPACT OF IFRS 9 WITH TRANSITIONAL ARRANGEMENTS	IMPACT OF IFRS 9 WITHOUT TRANSITIONAL ARRANGEMENTS
Total capital requirement	9 591 856	9 540 398
Total own funds (Tier 1 and Tier 2)	20 455 480	19 795 360
Total Capital Ratio (%)	17.1%	16.6%

Notes to financial statements (cont.)

(In PLN thousand)

IFRS 15 'Revenue from Contracts with Customers'

IFRS 15 'Revenue from Contracts with Customers' has been approved for application in the European Union by the Regulation of the European Commission No. 2016/1905 of 22 September 2016 and applies to financial statements issued for financial periods beginning on 1 January 2018 or later.

IFRS 15 shall be applied to all contracts with customers, except lease contracts within the scope of IAS 17 'Leases', financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments, IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IAS 27 'Separate Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures', insurance contracts within the scope of IFRS 4 'Insurance Contracts'.

The core principle of this Standard is that the Group shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Group expects to be entitled in exchange for those goods or services.

In accordance with IFRS 15, the transfer of goods and services is based on the concept of transferring control to the customer, which may occur at a point in time (delivery of goods, service) or over time (for example during the service or during the creation of the ordered goods).

IFRS 15 defines a five-step revenue recognition model:

Step 1: Identifying the contract with a client

This step consists in making sure that contracts concluded with clients (in writing, orally or in accordance with other customary business practices) are valid and constitute actual transactions. According to IFRS 15, a contract with a client is a contract if it creates enforceable rights and obligations and the following criteria are met:

- the parties to the contract have approved the contract and are committed to perform their respective obligations,
- each party's rights regarding the goods or services to be transferred can be identified,
- the payment terms for the goods or services to be transferred can be identified
- the contract has commercial substance,
- it is probable that the Group will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, the Group shall consider the customer's ability and intention to pay that amount of consideration when it is due.

In some cases the Group shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

- the contracts are negotiated as a package with a single commercial objective,
- the amount of consideration to be paid in one contract depends on the price or performance of the other contract,
- the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

Step 2: Identifying performance obligations

The performance obligation corresponds to the promised goods or services (or their package), which may be perceived as 'distinct' from other goods or services promised in the contract.

A good or service that is promised to a customer is distinct if both of the following criteria are met:

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (the determinant of this criterion is regular sale by the Group of goods or services separately),
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Notes to financial statements (cont.)

(In PLN thousand)

Step 3: Determining the transaction price

The transaction price is the amount of consideration which the Group expects to receive in exchange for the transfer of goods or services. Determining the transaction price can be complicated if the contract provides for variable consideration (eg bonuses, penalties, refunds, clauses assuming price change, etc.), significant share of financing costs, non-cash consideration or amounts due to the buyer.

Variable consideration is included in the transaction price only when there is a high probability that its inclusion will not result in a 'significant reversal of revenue' in the future as a result of revaluation. A significant reversal of the revenue approach takes place when the subsequent change in the estimated amount of variable consideration results in a significant decrease in the accumulated value of recognized revenues from a given customer. The variable remuneration includes each variable contractual amount, including for example performance bonuses, penalties, discounts, rebates.

Step 4: Allocating the transaction price to distinct performance obligations

If the contract contains more than one distinct performance obligation, the Group allocates the transaction price to individual obligation based on their stand-alone selling prices.

If the transaction price includes a variable consideration, it should be analyzed whether this amount applies to all or only certain performance obligations contained in the contract. If the criteria included in the standard do not meet the variable consideration as referring only to certain obligations, it should be allocated to all performance obligations included in the contract.

Step 5: Revenue recognition

Revenue is recognised revenue when (or as) the Group satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. Therefore revenues are recognized either at a point in time or over time.

Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset (ie good or service).

The Group transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- the customer simultaneously receives and consumes the benefits provided by the Group's performance as the Group performs,
- the Group's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced,
- the Group's performance does not create an asset with an alternative use to the Group and the Group has an enforceable right to payment for performance completed to date.

If a performance obligation is not satisfied over time the following indicators of the transfer of control should be considered to determine the point in time at which a customer obtains control of a promised asset:

- The Group has transferred physical possession of the asset,
- The Group has a present right to payment for the asset,
- The customer has accepted the asset,
- The customer has the significant risks and rewards of ownership of the asset,
- The customer has legal title to the asset.

The Group applies IFRS 15 from 1 January 2018. In 2017, the Group analyzed the impact of implementing IFRS 15.

The analysis covered the following types of contracts with clients:

1. Agreements with card organizations regarding marketing and promotional activities and related to the development of card activities,
2. Lease agreements in which the Bank is the lessor and, in addition to the rental rent, agree with the client (tenant) how to settle the maintenance fees for maintenance of the property. In such contracts, the Bank buys and resells, for example, municipal services and electricity,
3. Contracts for cash transport services for clients,

Notes to financial statements (cont.)

(In PLN thousand)

4. Bank accounts contracts, in relation to fees and commissions that are not included in effective interest rate,
5. Credit and loan agreements, in relation to fees and commissions that are not included in effective interest rate,
6. Agreements regarding the intermediation in the sale of insurance products,
7. Agreements regarding the investment funds management.

The Group did not identify agreements with a variable uncertain consideration components or contracts for which the implementation of IFRS 15 could have a significant impact on the financial statements.

5.2 Consolidation

Consolidation principles

The consolidated financial statements of Bank Pekao S.A. Group include the financial data of Bank Pekao S.A. and its subsidiaries as at 31 December 2017. The financial statements of the subsidiaries are prepared at the same reporting date as those of the parent entity, using consistent accounting policies within the Group in all important aspects.

All intra-group balances and transactions, including unrealized gains, have been eliminated. Unrealized losses are also eliminated, unless there is an objective evidence of impairment, which should be recognized in the consolidated financial statements.

Investments in subsidiaries

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group has power over an entity, is exposed to or has rights to variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity. The subsidiaries are consolidated from the date of obtaining control by the Group until the date when the control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. Identifiable assets acquired and liabilities assumed are measured at their fair values at the acquisition date. The Group measures any non-controlling interests in the acquiree at fair value or at the present ownership instruments' proportionate share in the recognized amounts of the acquiree's identifiable net assets. Acquisition-related costs are expenses as incurred (in the income statement under 'Administrative expenses').

If the business combination is achieved in stages, the acquirer remeasures its previously held equity interests in the acquiree at fair value at the acquisition date (date of obtaining control) and recognizes the resulting gain or loss in the income statement.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If the total of consideration transferred, non-controlling interest recognized and previously held interest measured is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly in the income statement.

The above policy does not apply to the business combinations under common control.

The changes in a parent entity's ownership interest in a subsidiary that do not result in the parent entity losing control of the subsidiary are accounted for as equity transactions (i.e. transactions with owners of parent entity). The Group recognizes directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attributes it to the owners of the parent entity.

When the Group ceases to have control over the subsidiary, any retained interest in that subsidiary is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognized in the income statement.

Notes to the financial statements (cont.)

(In PLN thousand)

Recognition of business combinations under common control at book value

Business combinations under common control are excluded from the scope of IFRS. As a consequence, following the recommendation included in IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', in the absence of any specific guidance within IFRS, Bank Pekao S.A. has adopted the accounting policy consistently applied in all business combinations under common and recognizes those transactions using book value.

The acquirer recognizes the assets and liabilities of the acquired entity at their current book value adjusted exclusively for the purpose of aligning the accounting principles. Neither goodwill, nor badwill is recognized.

Any difference between the book value of the net assets acquired and the fair value of the consideration paid is recognized in the Group's equity. In applying this book value method, the comparative periods are not restated.

If the transaction results in the acquisition of non-controlling interests, the acquisition of any non-controlling interest is accounted for separately.

There is no guidance in IFRS how to determine the percentage of non-controlling interests acquired from the perspective of a subsidiary. Accordingly Bank Pekao S.A. uses the same principles as the ultimate parent for estimating the value of non-controlling interests acquired.

Investments in Associates

An associate is an entity over which the Group has significant influence, and that is neither a subsidiary nor a joint venture. The Group usually holds from 20% to 50% of the voting rights in an associate. The equity method is calculated using the financial statements of the associates. The balance sheet dates of the Group and its associates are the same.

On acquisition of the investment, any difference between the cost of the investment and the Group's share in the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

- goodwill relating to an associate is included in the carrying amount of the investment,
- any excess of the Group's share in the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the Group's share in the associate's profit or loss in the period in which the investment is acquired.

The Group recognizes the investments in associates applying the equity method. The investment in associates is initially recognized at cost and the carrying amount is increased or decreased to recognize the Group's share in net assets of the associate after the date of acquisition, net of any impairment allowances. The Group's share of post-acquisition profit or loss is recognized in the income statement, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. Distributions received from an associate reduce the carrying amount of the investment.

If the Group's share in the losses of an associate equals or exceeds the Group's share in the associate, the Group ceases to recognize further losses, unless it assumed obligations or made a payment on behalf of the associate.

Unrealized profits or losses from transactions between the Group and associates are eliminated pro rata to the Group's share in the associates.

5.3 Accounting estimates

Preparation of financial statements in accordance with IFRS requires the Group to make certain estimates and to adopt certain assumptions, which affect the amounts of assets and liabilities presented in the financial statements.

Estimates and assumptions are reviewed on an ongoing basis and rely on historic data and other factors including expectation of the future events which seems justified in given circumstances. Although the estimates are based on the best knowledge of current conditions and activities which the Group will undertake, the actual results may differ from such estimates.

Estimates and underlying assumptions are subject to a regular review. Revisions to accounting estimates are recognised prospectively starting from the period in which the estimates are revised.

Notes to the financial statements (cont.)

(In PLN thousand)

Information on the applied estimates and the underlying uncertainty related to significant risk of the material adjustments in the financial statements are presented below.

Impairment of loans and advances to customers

At each balance sheet date the Group assesses whether there is any objective evidence ('trigger') that loan exposures are impaired. Impairment losses are incurred if, and only if at least one impairment trigger is identified and the event implicating the impairment trigger has a negative impact on the estimated future cash flows of the loan exposure. Whilst the identification of loan exposures impairment the Group does not consider future events, irrespective of probability of its occurrence.

In the process of impairment assessment the Group considers all loan exposures, irrespective of the level of risk of particular loan exposures or a group of loan exposures.

The Group splits the loan exposures into individually significant exposures and individually insignificant exposures. The individually significant exposures are in particular all loan exposures of the borrower, for whom total Group's exposure exceeds the threshold value as at balance sheet date and the restructuring loan exposures of debtors being the entrepreneurs within the meaning of the Article 43 of the Civil Code. The individually insignificant exposures are all loan exposures, which are not classified as individually significant exposures.

For all loans exposures, which are impaired, the Group measures the amount of impairment allowance as the difference between the loan exposure's carrying amount and the present value of estimated future cash flows, discounted at the loan exposure's original effective interest rate.

For all individually significant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of individual assessment. The individual assessment is carrying out by the Group's employees and consists of individual verification of the impairment occurrence and projection of future cash flows from foreclosure less costs for obtaining and selling the collateral or other resources. The Group compares the estimated future cash flows applied for measurement of individual impairment allowances with the actual cash flows on a regular basis.

For all individually insignificant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of collective assessment. Each exposure assessed collectively is grouped based on similar credit risk characteristics (on the basis of the borrower's type, the product's type, past-due status or other relevant factors impacting on the debtor's ability to pay all amounts due according to the contractual terms). The future cash flows are estimated on the basis of historical data of cash flows and historical loss experience for exposures with credit risk characteristics similar to those in the group. Historical data, when necessary, are adjusted on the basis of current data to remove the effects of conditions in the historical period that do not exist currently.

The recovery rates and the methodology and assumptions used for estimating future cash flows for particular groups of loan exposures are reviewed regularly.

For all loan exposures, for which no impairment triggers have been identified, the Group measures the allowance for losses incurred, but not reported ('IBNR').

The following table presents the impact on the net impairment losses as part of collective assessment and IBNR of a change in the estimated recovery rates (RR) and estimated probability of default (PD) by 10%.

31.12.2017	NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS AND OFF-BALANCE SHEET COMMITMENTS	
	10% INCREASE	10% DECREASE
Recovery rates (RR)	100 879	(101 719)
Probability of default (PD)	(36 268)	36 514

31.12.2016	NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS AND OFF-BALANCE SHEET COMMITMENTS	
	10% INCREASE	10% DECREASE
Recovery rates (RR)	98 821	(99 182)
Probability of default (PD)	(32 689)	32 956

Notes to the financial statements (cont.)

(In PLN thousand)

Impairment of non-current assets

At each balance sheet date the Group reviews its assets for indications of impairment. Where such indications exist, the Group makes a formal estimation of the recoverable value. If the carrying amount of a given asset is in excess of its recoverable value, impairment is defined and a write-down is recorded to adjust the carrying amount to the level of its recoverable value. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value-in-use.

Estimation of the value-in-use of an assets (or cash generating unit) requires assumptions to be made regarding, among other, future cash flows which the Group may obtain from the given asset (or cash generating unit), any changes in amount or timing of occurrence of these cash flows and other factors such as the lack of liquidity. The adoption of different measurement assumptions may affect the carrying amount of some of the Group's non-current assets.

Measurement of derivatives and unquoted debt securities available for sale

The fair value of non-option derivatives and debt securities available for sale that do not have a quoted market price on an active market is measured using valuation models based on discounted cash flows. Options are valued using option valuation models. Variables used for valuation purposes include, where possible, the data from observable markets. However, the Group also adopts assumptions concerning counterparty's credit risks which affect the valuation of instruments. The adoption of other measurement assumptions may affect the valuation of these financial instruments. The assumptions used for fair value measurement are described in detail in Note 6.7 'Fair value of financial assets and liabilities'.

Provisions for defined benefit plans

The principal actuarial assumptions applied to estimation of provisions for defined benefit plans, as well as the sensitivity analysis were presented in Note 46.

Goodwill

The Group performs an impairment test of goodwill on a yearly basis or more often if impairment triggers occur. The assessment of goodwill impairment requires an estimate of value in use of all cash-generating units to which the goodwill relates. The principal assumptions applied to an impairment test of goodwill were presented in Note 35.

5.4 Foreign currencies

- Transactions and balances
Foreign currency transactions are calculated into the functional currency using the spot exchange rate from the date of the transaction. Gains and losses from foreign currency translation differences resulting from settlements of such transactions and from the statement of financial position valuation of monetary assets and liabilities expressed in foreign currencies are recognized in the income statement.
- Foreign currency translation differences arising from non-monetary items, such as equity instruments classified as financial assets measured at fair value through the profit or loss are recognized together with the changes in the fair value of that item in the income statement.
Foreign currency translation differences arising from non-monetary items such as equity instruments classified as available for sale financial assets are recognized in the revaluation reserves.

The foreign exchange rate differences from the valuation of foreign entities are accounted for as a separate component of equity.

Goodwill arising on acquisition of the entity operating abroad as well as any adjustments of the balance sheet value of assets and liabilities to fair value arising on the acquisition of the entity are treated as assets and liabilities of a foreign entity i.e. they are expressed in the functional currency of the overseas entity and translated at the closing exchange rate as described above.

Notes to the financial statements (cont.)

(In PLN thousand)

5.5 Income statement

Interest income and expense

The Group recognizes in the income statement all interest income and expense related to financial instruments valued at amortized cost using the effective interest rate method, financial assets available for sale and financial assets at fair value through profit or loss.

The effective interest rate is the discount rate of estimated future cash inflows and payments made during the expected period until the expiry of the financial instruments, and in justified cases in a shorter time, to the net carrying amount of such financial assets or liabilities. The calculation of the effective interest rate includes all commissions paid and received by parties to the agreement, transaction costs and all other premiums and discounts, comprising an integral part of the effective interest rate.

Interest income includes interest and commission fees received or due from credits, interbank deposits and held to maturity securities, recognized in the calculation of effective interest rate, as well as from securities available for sale and measured at fair value through the income statement and hedging derivatives.

At the recognition of impairment of financial instruments measured at amortized cost and of available for sale financial assets, the interest income is accrued based on the carrying amount of the receivable (this is the new, lower value reduced by the impairment charge) using the interest rate used when discounting the future cash flows for impairment calculation. Interest expense of the reporting period related to interest liabilities associated with client accounts and liabilities from the issue of treasury stock are recognized in the income statement using the effective interest rate.

Fee and commission income and expense

Fee and commission income is generated from financial services provided by the Group. Fee and commission income and expense is recognized in the profit or loss using the following methods:

- fees and commissions directly attributable to financial asset or liability origination (both income and expense) are recognized in the income statement using the effective interest rate method and are described above,
- fees and commissions relating to the loans and advances without a defined repayment schedule and without a defined interest rate schedule e.g. overdraft facilities and credit cards are amortized over the life of the product using the straight line method,
- other fees and commissions arising from the Group's financial services offering (customer account transaction charges, credit card servicing transactions, bonuses from card providers in order to cover the marketing card cost, brokerage activity and canvassing) as well as the trade margins on foreign exchange transactions with the Bank's clients are recognized in the income statement up-front when the corresponding service is provided.

Income and expense from bancassurance

The Bank splits the remuneration for sale of insurance products linked to loans into separate components, i.e. dividing the remuneration into proportion of fair value of financial instrument and fair value of intermediary service to the sum of those values. The fair values of particular components of the remuneration are determined based on market data to a highest degree.

The particular components of the Bank's remuneration for sale of insurance products linked to loans are recognized in the income statement according to the following principles:

- remuneration from financial instrument – as part of effective interest rate calculation, included in interest income,
- remuneration for intermediary service – upfront at the time when the insurance product is sold, included in fee and commission income.

Additionally the Bank estimates the part of the remuneration which will be refunded in the future (eg. due to early termination of insurance contract, early repayment of loan). The estimate of the provision for future refunds is based on the analysis of historical data and expectations in respect to refunds trend in the future.

In 2017 the Bank recognized upfront 10% of bancassurance revenue associated with cash loans and 17% of bancassurance revenue associated with mortgage loans. The remaining portion of bancassurance revenue is amortized over the life of the associated loans as part of effective interest rate.

Notes to the financial statements (cont.)

(In PLN thousand)

Result on financial assets and liabilities held for trading

Result on financial assets and liabilities held for trading include:

- **Foreign exchange result**
The foreign exchange gains (losses) are calculated taking into account the positive and negative foreign currency translation differences, whether realized or unrealized from the daily valuation of assets and liabilities denominated in foreign currencies. The revaluation is performed using the average exchange announced by the NBP on the balance sheet date.
The foreign exchange result includes swap points from derivative transactions, entered into by the Group for the purpose of managing the Group's liquidity in foreign currencies.
Income from foreign exchange positions includes also foreign currency translation differences from valuation of investments in foreign operations arising on disposal thereof. Until the disposal, foreign currency translation differences from valuation of assets in foreign operations are recognized in 'Other capital and reserves'.
- **Income from derivatives and securities held for trading**
The income referred to above includes gains and losses realized on a sale or a change in the fair value of assets and liabilities held for trading.
The accrued interest and unwinding of a discount or a premium on securities held for trading is presented in the net interest income.

Gains (losses) on financial assets/liabilities at fair value through profit or loss

This includes gains and losses realized on a sale or a change in the fair value of assets and liabilities, designated at fair value through profit or loss.

The accrued interest and unwinding of a discount or a premium on financial assets/ liabilities designated at fair value through profit or loss are recognized in the interest result.

Other operating income/expense

Other operating income includes mainly amounts received for compensation, revenues from operating leases, recovery of debt collection costs, excess payments, miscellaneous income and releases of provision for legal cases. Other operating expenses include mainly the costs of client claims, compensation paid, sundry expenses and costs of provision for litigations.

5.6 Valuation of financial assets and liabilities, derivative financial instruments

Financial assets

Financial assets are classified into the following categories:

- **Financial assets measured at fair value through profit or loss**
This category comprises two sub-categories: financial assets held for trading and financial assets designated at initial recognition as financial assets measured at fair value through profit or loss.
Financial assets held for trading include: debt and equity securities, loans and receivables purchased or classified into this category for the purpose of disposal thereof on a short-term basis. The classification also includes derivative instruments (not used as hedging instruments).
Financial assets classified at the moment of original recognition as financial assets measured at fair value through profit or loss include debt securities acquired by the Group for the purpose of elimination or considerable reduction of inconsistencies in the valuation between these securities and the derivatives, which are economically hedging the interest rate risk of such securities. Otherwise, such securities would have been classified into the available for sale portfolio, with the effect of valuation recognized in revaluation reserves, and valuation of derivatives economically hedging such securities reported in the income statement.

Notes to the financial statements (cont.)

(In PLN thousand)

- **Held to maturity**
These are non-derivative financial assets with fixed or determinable payments and fixed maturity, for which the entity has an intent and ability to hold to maturity, other than:
 - a) those that the entity upon initial recognition designates as at fair value through profit or loss,
 - b) those that the entity designates as available for sale, and
 - c) those that meet the definition of loans and receivables.Financial assets classified into this category are measured at amortized cost using the effective interest rate method. The recognition of amortized cost with the use of effective interest rate is recognized in interest income.
- **Loans and receivables**
Loans and receivables are non-derivative financial assets, with fixed or determinable payments, not quoted on active markets, other than:
 - a) 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 designates as at fair value through profit or loss upon initial recognition,
 - b) those that the Group upon initial recognition designates as available for sale, or
 - c) 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.This category also contains debt securities, purchased from the issuer, for which there is no active market, as well as credits, loans, receivables from reverse repo transactions and other receivables acquired and granted. Loans and receivables are measured at amortized cost using the effective interest rate method and with consideration of impairment.
- **Available for sale**
This includes financial assets with an undefined holding period. The portfolio includes: debt and equity securities, as well as loans and receivables not classified into other categories. Interest on assets available for sale is calculated using the effective interest rate method, and recognized in the income statement. Available for sale financial assets are measured at fair value, whereas gains and losses resulting from changes in fair value against amortized cost are recognized in the revaluation reserves. Amounts in the revaluation reserves are recognized in the income statement either on the sale of an asset, or its impairment. In case of impairment of an asset, previous increases from revaluation to fair value will decrease the 'Revaluation reserves'. Should the amount of previously recognized increases be insufficient to cover the impairment, the difference will be recorded in the income statement as 'Net impairment losses on financial assets and off-balance sheet commitments'.

Dividends from equity instruments are recognized in the profit or loss at the moment the rights to receive such payments are established.

Standardized purchase and sale transactions of financial assets designated at fair value through profit or loss, designated as held for trading (except for derivatives), held to maturity, and available for sale, are recognized and derecognized by the Group on the settlement date of such transaction, i.e. as at the date of receipt or delivery of such assets.

Changes in the fair value of assets, which occur during the period from transaction date to transaction settlement date, shall be recognized similarly as in the case of the asset held.

Credits and loans are recognized on the date of cash disbursement to the debtor.

Derivative instruments are recognized or derecognized on transaction dates.

Reclassification of financial assets

The Group may reclassify the financial assets classified as available for sale, which meet the definition of loans and receivables, from the category of available for sale financial assets to the category of loans and receivables, if the Group has the intent and the ability to hold such financial assets in foreseeable future or until their maturity.

If the financial asset with a given maturity is reclassified, prior gains and losses associated with such asset, recognized in other comprehensive income, are amortized in the profit or loss throughout the remaining period until maturity, using the effective interest rate method. Any differences between such new amortized cost and embedded amount is amortized throughout the period remaining until the maturity of such asset using the effective interest rate method, similar to premium or discount amortization.

Notes to the financial statements (cont.)

(In PLN thousand)

The Group allows the reclassification of financial assets classified as financial assets measured at fair value through profit or loss, if extraordinary circumstances occur, i.e. events that are unusual and highly unlikely to recur in the near term.

Such financial assets are reclassified at fair value as at reclassification date. The gains or losses recognized in the profit or loss before such reclassification cannot be reversed. The fair value of financial assets, as at reclassification date, is recognized as its new cost or its new amortized cost.

Impairment of financial assets

Assets measured at amortized cost – loans and advances

At each balance sheet date the Group assesses whether there is any objective evidence ('triggers') that loans and advances or financial assets held-to-maturity measured at amortized cost ('loan exposures') are impaired. In the process of impairment assessment the Group considers all loan exposures, irrespective of the level of risk of particular loan exposures or a group of loan exposures.

The Group splits the loan exposures into individually significant exposures and individually insignificant exposures.

In respect to exposures assessed individually the Group applies the following list of impairment triggers:

- overdue in repayment of principal, interest or credit fees more than 90 days and more than 2 working days in case of exposure towards banks including credit transactions and reverse repo/sell-buy-backs,
- significant financial difficulties of borrower (including loss of job or other events that could impact on ability to repayment in case of individuals). Significant financial difficulties of economic entity mean financial standing that could threaten timely repayment of liabilities towards the Group, especially when incurred losses have consumed equity in 50%, excluding projects where losses have been assumed or where external financial support exists (in form of injections to the equity, granting a loan, warranty/guarantee by related company or other third party, conversion of loan into equity, issuance of shares/bonds),
- restructuring, if it is related with granting an advantage, due to economic or legal reasons resulted from financial difficulties of the borrower, that in other circumstances the Group would not give. The advantage leads to reduction of the Group's loan exposure, and may include: reduction of the interest rate, temporary interest accruing holidays, cancelling a part or total of the exposures, in this interest or principal,
- lowering by the well-known and accepted rating agency a borrower's rating or country's rating – country of domicile or rating of debt securities issued by the borrower by at least 4 notches including modifiers within one year. Decrease in credit rating alone is not an evidence of impairment trigger but could be confirmation of impairment if it is analyzed together with other available information,
- significant worsening of rating or scoring analysis results. It means the decrease in rating by 4 notches in the scale and at the same time move to non-performing category based only on rating criterion, excluding situations of rating deterioration resulted from seasonality of activity and excluding impact of classification in RMT ('Risk Management Tool') on rating. Decrease in rating alone is not an evidence of impairment trigger but could be confirmation of impairment if it is analyzed together with other available information,
- the Group has started an execution process or has been informed about execution towards borrower,
- the debt/loan is questioned by the borrower including commencement of legal proceedings,
- the debt/loan has been due as the credit agreement has been terminated,
- the motion for borrower's bankruptcy has been filed in the court or legal proceedings has been instituted,
- disappearance of active market for given credit exposure resulted from financial difficulties of debtor. This impairment trigger could refer to financial instruments listed on stock exchanges, when due to significant deterioration in financial standing of issuer (eventually bankruptcy), the liquidity of assets trading is so low that reliable price fixing is not possible,
- receivership has been established or debtor has stopped/suspended its activity,
- unknown place of stay and not disclosed assets of the borrower.

In respect to exposures assessed collectively the Group applies the following list of impairment triggers:

- overdue in repayment of principal, interest or credit fees greater or equal to 90 days,
- significant financial difficulties of debtor, including loss of job or other events that could impact on ability to repayment,
- unknown place of stay and not disclosed assets of the retail debtor or sole trader.

Notes to the financial statements (cont.)

(In PLN thousand)

The Group classifies the exposure as past due in case the borrower has failed to make payment on the principal and/or interest in the contractual maturity date. The Group presents the whole amount of exposure as past due, regardless of whether the delay of payment affects the whole exposure, or only part of it (installment).

The number of days past due for receivables paid by installments is assumed as the period from the date of maturity of the earliest installment, when the repayment is delayed.

In case of identification of impairment triggers for at least one of loan exposures of the borrower, all loan exposures of such borrower are assessed for impairment.

For all loans exposures, which are impaired, the Group measures the amount of impairment allowance as the difference between the loan exposure's carrying amount and the present value of estimated future cash flows, discounted at the loan exposure's original effective interest rate. The carrying amount of the loan exposure is reduced through use of an allowance account. The amount of the impairment loss is recognized in profit or loss. If, in a subsequent period, the amount of impairment loss decreases, then the previously recognized impairment loss is reversed by adjusting an allowance account. The amount of the reversal is recognized in profit or loss.

For all individually significant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of individual assessment. The individual assessment is carried out by the Group's employees and consists of individual verification of the impairment occurrence and projection of future cash flows from foreclosure less costs for obtaining and selling the collateral or other resources. The Group compares the estimated future cash flows applied for measurement of individual impairment allowances with the actual cash flows on a regular basis.

For all individually insignificant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of collective assessment. Each exposure assessed collectively is grouped based on similar credit risk characteristics on the basis of the borrower's type, the product's type, past-due status or other relevant factors impacting on the debtor's ability to pay all amounts due according to the contractual terms. The future cash flows are estimated on the basis of historical data of cash flows and historical loss experience for exposures with credit risk characteristics similar to those in the group (for example, the value of the real estate taken as the collateral for the mortgage). Historical data, when necessary, are adjusted on the basis of current data to remove the effects of conditions in the historical period that do not exist currently. The recovery rates ('RR') and the methodology and assumptions used for estimating future cash flows for particular groups of loan exposures are reviewed regularly.

For all loan exposures, for which no impairment triggers have been identified, the Group measures the allowance for losses incurred, but not reported ('IBNR'). As part of IBNR assessment the Group estimates the loss resulting from events not reported as at balance sheet date and for which no impairment triggers have been identified, but the events occurred prior to balance sheet date and the loss was incurred. While estimating the IBNR, it is assumed that there is a several-months period from the date of emergence of objective impairment trigger to the date of its reporting, i.e. loss identification period ('LIP'). The value of LIP parameter is estimated on the basis of statistical analysis using the historical data. The Group applies different loss identification periods for different groups of loan exposures, taking into account the client's segment, the product's type and the collateral. The update of LIP parameter is carried out at least once a year.

The IBNR is measured based on the likelihood that the debtor will be unable to meet its obligations during loss identification period ('PD_LIP') multiplied by impairment loss estimated analogously like collective allowance for value of exposure at default ('EAD'). The value of EAD parameter is estimated on the basis of historical data.

The Group estimates the value of PD_LIP parameter using the PD measured by Basel models with relevant transformation taking into account the shortening of loss identification period for applied length of LIP and Point-in-Time adjustment. Within the transformation the Group calibrates the values of PD parameter to the most up to date realized PD_LIP values once a month. The values of PD_LIP as estimated reflect the current economic conditions the best. The model applied to measurement of PD_LIP is of 'Point-In-Time' type.

The values of LIP, PD_LIP, EAD and RR applied for IBNR measurement as well as the methodology and assumptions used for estimating such parameters for particular groups of loan exposures are reviewed regularly.

Notes to the financial statements (cont.)

(In PLN thousand)

Financial assets available for sale

When a decline in the fair value of an available for sale financial asset has been recognized directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that has been recognized directly in equity is removed from equity and recognized in the income statement. The amount of the cumulative loss transferred to the income statement is the difference between the acquisition cost (net of any principal repayment and amortization) and the current fair value. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in the income statement.

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Off-balance sheet commitments

The provisions for off-balance sheet commitments is measured as the difference between the expected value of balance sheet exposure arising from granted off-balance sheet commitment and the present value of estimated future cash flows from that balance sheet exposure at the date of impairment identification. The expected value of balance sheet exposure arising from granted off-balance sheet commitment is measured using the credit conversion factor ('CCF'), estimated on the basis of historical data.

The values of CCF applied for measurement of provisions for off-balance sheet commitments as well as the methodology and assumptions used for estimating such parameters for particular groups of loan exposures are reviewed regularly.

The Group estimates the future cash flows as part of individual assessment or collective assessment depending on classification of particular off-balance sheet commitments as individually significant exposures or individually insignificant exposures.

Repo and reverse-repo agreements

Repo and reverse-repo transactions, as well as sell-buy back and buy-sell back transactions are classified as sales or purchase transactions of securities with the obligation of repurchase or resale at an agreed date and price.

Sales transactions of securities with the repurchase obligation granted (repo and sell-buy back) are recognized as at transaction date in amounts due to other banks or amounts due to customers from deposits depending upon the counterparty to the transaction. Securities purchased in reverse-repo and buy-sell back transactions are recognized as loans and receivables from banks or as loans and receivables from customers, depending upon the counterparty to the transaction.

The difference between the sale and repurchase price is recognized as interest income or expense, and amortized over the contractual life of the contract using the effective interest rate method.

Derivative financial instruments and hedge accounting

The Group acquires the derivative financial instruments: currency transactions (spot, forward, currency swap and currency options, CIRS), exchange rate transactions (FRA, IRS, CAP), derivative transactions based on security prices, indices of stocks and commodities. Derivative financial instruments are initially recorded at fair value as at the transaction date and subsequently re-measured at fair value at each balance sheet date. The fair value is established on the basis of market quotations for an instrument traded in an active market, as well as on the basis of valuation techniques, including models using discounted cash flows and options valuation models, depending on which valuation method is appropriate.

Positive valuation of derivative financial instruments is presented in the statement of financial position in the line 'Derivative financial instruments (held for trading)' or 'Hedging instruments' on an asset side, whereas the negative valuation - 'Derivative financial instruments (held for trading)' or 'Hedging instruments' on a liabilities side. For financial instruments with an embedded derivative component, if the whole or part of the cash flows related to such a financial instrument changes in a way similar to what would be the case with the embedded derivative instrument on its own, then the embedded derivative instrument is reported separately from the basic contract.

Notes to the financial statements (cont.)

(In PLN thousand)

This occurs under the following conditions:

- the financial instrument is not included in assets held for trading or in assets designated at fair value through the profit or loss the revaluation results of which are reflected in the financial income or expense of the reporting period,
- the nature of the embedded instrument and the related risks are not closely tied to the nature of the basic contract and to the risks resulting from it,
- a separate instrument characteristics of which correspond to the features of the embedded derivative instrument would meet the definition of the derivative instrument,
- it is possible to reliably establish the fair value of the embedded derivative instrument.

In case of contracts that are not financial instruments with a component of an instrument meeting the above conditions the built-in derivative instrument is classified in accordance with assets or liabilities of derivatives financial instruments with respect to the income statement in accordance with derivative financial instruments valuation principles.

The method of recognition of the changes in the fair value of an instrument depends on whether a derivative instrument is classified as held for trading or is designated as a hedging item under hedge accounting.

The changes in fair value of the derivative financial instruments held for trading are recognized in the income statement.

The Group designates some of its derivative instruments as hedging items in applying hedge accounting. The Group implemented fair value hedge accounting as well as cash flow hedge accounting, under the condition of meeting the criteria of IAS 39 'Financial Instruments: Recognition and Measurement'.

Fair value hedge accounting principles

Changes in the measurement to fair value of financial instruments indicated as hedged positions are recognized - in the part ensuing from hedged risk - in the income statement. In the remaining part, changes in the carrying amount are recognized in accordance with the principles applicable for the given class of financial instruments.

Changes in the fair market valuation of derivative financial instruments, indicated as hedging positions in fair value hedge accounting, are recognized in the profit or loss in the same caption, in which the gains/losses from change in the value of hedged positions are recognized.

Interest income on derivative instruments hedging interest positions hedged is presented as interest margin.

The Group ceases to apply hedge accounting, when the hedging instrument expires, is sold, dissolved or released (the replacement of one hedging instrument with another or extension of validity of given hedging instrument is not considered an expiration or release, providing such replacement or extension of validity is a part of a documented hedging strategy adopted by given unit), or does not meet the criteria of hedge accounting or the Group ceases the hedging relation.

An adjustment for the hedged risk on hedged interest position is amortized in the income statement at the point of ceasing to apply hedge accounting.

Cash flow hedge accounting principles

Changes in the fair value of the derivative financial instruments indicated as cash flow hedging instruments are recognized:

- directly in the caption 'Revaluation reserves' in the part constituting the effective hedge,
- in the income statement in the line 'Result on financial assets and liabilities held for trading' in the part representing ineffective hedge.

The amounts accumulated in the 'Revaluation reserves' are transferred to the income statement in the period, in which the hedge is reflected in the income statement and are presented in the same lines as individual components of the hedged position measurement, i.e. the interest income from hedging derivatives in cash flow hedge accounting is recognized in the interest result, whereas gains/losses from foreign exchange revaluation are presented in the foreign exchange gains (losses).

The Group ceases to apply hedge accounting when the hedging instrument expires or is sold, or if the Group revokes the designation. In such cases, the accumulated gains or losses related to such hedging item, initially recognized in 'Revaluation reserves', if the hedge was effective, are still presented in equity until the planned transaction was closed and recognized in the income statement.

Notes to the financial statements (cont.)

(In PLN thousand)

If the planned transaction is no longer probable, the cumulative gains or losses recognized in 'Revaluation reserves' are transferred to the income statement for the given period.

Financial liabilities

The Group's financial liabilities are classified to the following categories:

- financial liabilities held for trading, valued at fair value,
- financial liabilities not held for trading, valued at amounts payable, measured at amortized cost using the effective interest rate method.

Financial liabilities not held for trading consist of amounts due to banks and customers, loans from other banks, and own debt securities issued.

Subordinated liabilities

Subordinated liabilities are measured at amortized cost using the effective interest rate method.

De-recognition of financial instruments from the statement of financial position

Financial assets are derecognized when the contractual rights to the cash flows from the financial assets expire or when the Group transfers the contractual rights to receive the cash flows in a transaction in which substantially all risk and rewards of ownership of the financial asset are transferred.

The Group derecognizes a credit or a loan receivable, or its part, when it is sold. Additionally, the Group writes-off a receivable against the corresponding impairment provision when the debt redemption process is completed and when no further cash flows from the given receivable are expected. Such cases are documented in compliance with the current tax regulations.

The Group derecognizes a financial liability, or its part, when the liability expires. The liability expires when the obligation stated in the agreement is settled, redeemed or the period for its collection expires.

5.7 Valuation of other items in the Group's consolidated statement of financial position

Intangible assets

Goodwill

Goodwill is defined as a surplus of the purchasing price over the fair value of the assets, liabilities and contingent liabilities of the acquired subsidiary, associate or a unit under joint control. Goodwill at initial recognition is carried at purchase price reduced by any accumulated impairment losses. Impairment is determined by estimating the recoverable value of the cash generating unit, to which given goodwill pertains.

If the recoverable value of the cash generating unit is lower than the carrying amount an impairment charge is made. Impairment identified in the course of such tests is not subject to subsequent adjustments.

Goodwill on acquisition of subsidiaries is presented in intangible assets and goodwill on acquisition of associates is presented under the caption 'Investments in associates'.

Other intangible assets

Intangible assets are assets controlled by the Group which do not have a physical form which are identifiable and represent future economic benefits for the Group directly attributable to such assets.

These assets include:

- computer software licenses,
- copyrights,
- costs of completed development works.

Intangible assets are initially carried at purchase price. Subsequently intangible assets are stated at cost less accumulated amortization and accumulated impairment losses.

Intangible assets with a definite useful life are amortized over their estimated useful life. Intangible assets with indefinite useful life are not amortized.

Notes to the financial statements (cont.)

(In PLN thousand)

All intangible assets are reviewed on a periodical basis to verify if any significant impairment triggers occurred, which would require performing a test for impairment and a potential impairment charge.

As far as intangible assets with indefinite useful life and those still not put into service are concerned, impairment test is performed on a yearly basis and additionally when impairment triggers are identified.

Property, plant and equipment

Property, plant and equipment are defined as controlled non-current assets and assets under construction. Non-current assets include certain tangible assets with an expected useful life longer than one year, which are maintained for the purpose of own use or to be leased to other entities.

Property, plant and equipment are recognized at historical cost less accumulated depreciation and accumulated impairment write downs. Historical cost consists of purchase price or development cost and costs directly related to the purchase of a given asset.

Each component of property, plant and equipment, the purchase price or production cost of which is significant compared to the purchase price or production cost of the entire item is a subject to separate depreciation. The Group separates the initial value of property, plant and equipment into its significant parts.

Subsequent expenditures relating to property plant and equipment are capitalized only when it is probable that such expenditures will result in future economic benefits to the Group, and the cost of such expenses can be reliably measured.

Service and maintenance costs of property, plant and equipment are expensed in the reporting period in which they have been incurred.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense.

Depreciation and amortization

Depreciation expense for property, plant and equipment and investment properties and the amortization expense for intangible assets are calculated using straight line method over the expected useful life of an asset. Depreciated value is defined as the purchase price or cost to develop a given asset, less residual value of the asset. Depreciation rates and residual values of assets, determined for balance-sheet purposes, are subject to regular reviews, with results of such reviews recognized in the same period.

The statement of financial position depreciation and amortization rates applied to property, plant and equipment, investment properties and intangible assets are as follows:

a) depreciation rates applied for non-current assets

Buildings and structures and cooperative ownership rights to residential premises and cooperative ownership rights to commercial premises	1.5% – 10.0%
Technical equipment and machines	4.5% – 30.0%
Vehicles	7% – 20.0%

b) amortization rates for intangible assets

Software licenses, copyrights	12.5% – 50.0%
Costs of completed development projects	33.3%
Other intangibles	20% – 33.3%

c) depreciation rates for investment properties

Buildings and structures	1.5% – 10.0%
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Land, non-current assets under construction and intangible assets under development are not subject to depreciation and amortization.

Depreciation and impairment deductions are charged to the income statement in the item 'Depreciation and amortization'.

Notes to the financial statements (cont.)

(In PLN thousand)

Investment properties

Investment properties assets are recognized initially at purchase cost, taking the transaction costs into consideration. Upon initial recognition, investment property assets are measured using the purchasing price model.

Investment property assets are derecognized from the statement of financial position when disposed of, or when such investment property is permanently decommissioned and no future benefits are expected from its sale. Any gains or losses resulting from de-recognition of an investment property are recognized in the income statement in the period when such de-recognition occurred.

Non-current assets held for sale and discontinued operations

Non-current assets held for sale include assets, the carrying amount of which is to be recovered by way of resale and not from their continued use. The only assets classified as held for sale are those available for immediate sale in their present condition, and the sale of which is highly probable, i.e. when the decision has been made to sell a given asset, an active program to identify a buyer has been launched and the divestment plan is completed. Moreover, such assets are offered for sale at a price which approximates its present fair value, and it is expected that the sale will be recognized as completed within one year from the date of such asset is reclassified into this category.

Non-current assets held for sale are recognized at the carrying amount or at fair value reduced by the cost of such assets, whichever is lower. Assets classified in this category are not subject to depreciation.

A discontinued operation is a component of the Group's business which constitutes a separate line of business or a geographical area of operations, which was sold, made available for sale or to be disposed, or is a subsidiary acquired exclusively with a view to re-sale. Classification as a discontinued operation occurs on disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as held for sale, the comparative figures in the income statement are represented as if the operation had been discontinued from the beginning of the comparative period.

Leases

The Group is a party to leasing contracts on the basis of which it grants a right to use a non-current asset or an intangible asset for an agreed period of time in return for payment.

The Group is also a party to leasing contracts under which it receives a right to use a non-asset or an intangible asset for an agreed period of time from another party in return for a payment.

Operating leases

In the case of leasing contracts entered into by the Group acting as lessor, the leased asset is presented in the Group's statement of financial position, since there is no transfer to the lessee of essentially all risks and benefits resulting from the asset.

In the case of lease agreements, entered into by the Group as lessee, the leased asset is not recognized in the Group's statement of financial position.

The entire amount of charges from operating leases is recognized in the profit or loss on a straight line basis, throughout the leasing period.

Finance leases

The Group as lessor

In the lease agreements, where essentially all risks and benefits relating to the ownership of an asset are transferred, the leased asset is no longer recognized in the statement of financial position of the Group. However, receivables are recognized in the amount equal to the present value of the minimum lease payments. Lease payments are split into the financial income and the reduction of receivables balance in order to maintain a fixed interest rate on the outstanding liability.

Lease payments from agreements, which do not meet the conditions of finance lease agreements are recognized as revenues in the income statement using the straight-line method over the life of the lease.

Notes to the financial statements (cont.)

(In PLN thousand)

The Group as lessee

For lease agreements in which in principle all risks and benefits relating to ownership of the leased assets are transferred to the Group, the leased asset is recognized as a non-current asset and simultaneously 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 split into costs of lease charges and a reduction of liabilities in order to maintain a fixed interest rate on the outstanding liability. Financial costs are recognized directly in the income statement.

Non-current assets subject to finance lease agreements are depreciated in the same way as other non-current assets. However, if it is uncertain whether the ownership of the asset subject of the contract will be transferred then the asset is depreciated over the shorter of the expected useful life or the initial period of lease.

Lease charges from agreements that do not fulfill the criteria for finance lease agreements are recognized as costs in the income statement on a straight line basis over the lease period.

Provisions

The provisions are recognized when the Group has a present obligation (legal or constructive) resulting from the past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, the amount of a provision is established by discounting forecasted future cash flows to the present value, using the discount rate reflecting current market estimates of the time value of money and the possible risk associated with the obligation.

The provisions include the provisions relating to long-term employee benefits, in this those measured by an actuary and provisions for restructuring costs. The provision for restructuring costs is recognized when the general recognition criteria for provisions and detailed criteria for recognition of provisions for restructuring cost under IAS 37 'Provisions, contingent liabilities and contingent assets' are met. The amount of employment restructuring provision is calculated by the Group on the basis of the best available estimates of direct outlays resulting from restructuring activities, which are not connected with the Group's current activities.

The provisions are charged to the income statement, except for actuarial gains and losses from the measurement of the defined benefit plans obligations, which are recognized in other comprehensive income.

Deferred income and accrued expenses (liabilities)

This caption includes primarily commission income settled using the straight line method and other income charged in advance, that will be recognized in the income statement in the future periods.

Accrued expenses include accrued costs resulting from services provided for the Group by counterparties which will be settled in future periods, accrued payroll and other employee benefits (including annual and Christmas bonuses, other bonuses and awards and accrued holiday pay).

Deferred income and accrued expenses are presented in the statement of financial position under the caption 'Other liabilities'.

Government grants

The Group recognizes government grants when there is reasonable assurance that it will comply with any conditions attached to the grant and the grant will be received. Government grants are recognized in profit or loss in the periods in which the related expenses are recognized which the grants are intended to compensate. For the settlement of the grant, the Group uses the income method. Government grants related to assets are presented in the statement of financial position of the Group as a reduction in the carrying value of the asset.

Equity of the Group

Equity is comprised of the capital and funds created by the companies of the Group in accordance with the binding legal regulations and the appropriate laws and Articles of Association. Equity also includes retained earnings. Subsidiaries' equity line items, other than share capital, are added to the relevant equity line items of the parent company, in the proportion of the Group's interest.

The equity of the Group includes only those parts of the subsidiaries' equity which were created after the date of purchase of shares or stocks by the parent entity.

Notes to the financial statements (cont.)

(In PLN thousand)

The Group equity consists of the following:

- a) share capital - applies only to the capital of the Bank as the parent entity and is presented at nominal value specified in the Articles of Association and in the entry in the Enterprises Registry,
- b) 'issue premium' - surplus generated during share issues over the nominal value of such issues, remaining after the issue costs are covered. Moreover, this item also includes a change in the value of minority shares, ensuing from an increase of the share of the Parent entity in Bank's share capital. This accounting principle is in accordance with the accounting principles applied by UniCredit Group,
- c) the general banking risk fund is established at Bank Pekao S.A. in keeping with the Banking Act dated 29 August 1997 from profit after tax,
- d) other reserve capital utilized for the purposes defined in the Statute is created from appropriations of profits,
- e) revaluation reserve includes the impact of valuation of financial instruments available for sale, effects of valuation of derivative instruments hedging cash flows, remeasurements of the defined benefit liabilities and the value of deferred tax for items classified as temporary differences, recognized as valuation allowance. In the statement of financial position, the valuation allowance is presented as net value,
- f) other capital:
 - other supplementary capital, established in keeping with provisions under the Articles of Association of companies from profit appropriations,
 - capital components:
 - bonds convertible to shares - includes the fair value of financial instruments issued as part of transactions settled in equity instruments,
 - provision for purchase of parent entity stocks,
 - brokerage activity fund for stock broking operations, carried out by Bank Pekao S.A.,
 - retained earnings from prior periods includes undistributed profit and uncovered losses generated/incurred in prior periods by subsidiaries consolidated full method,
 - net profit/loss which constitutes profit/loss presented in the income statement for the relevant period. Net profit is after accounting for income tax.

Non - controlling interests

Non - controlling interests are defined as the equity in a subsidiary not attributable, directly or indirectly, to the Bank.

Bank's Pekao S.A. phantom shares-settled share-based payment transaction

The cost of transactions settled with employees in phantom shares is measured by reference to the fair value of the liability as of the balance sheet date.

The fair value of the liability is estimated based upon the Bank's shares price on the (WSE) as of the balance sheet date and expected number of phantom shares to which full rights will be acquired.

The cost of phantom share-based payments is recognized in personnel expenses together with the accompanying increase in the value of liabilities towards employees presented in 'Provisions'.

The accumulated cost recognized for transactions settled in phantom shares for each balance sheet date until the vesting date reflects the extent of elapse of the vesting period and the number of rights to shares the rights to which – in the opinion of the Bank's Management Board for that date based on best available estimates of the number of phantom shares – will be eventually vested.

5.8 Income tax

Income tax expense comprises current and deferred tax. The income tax expense is recognized in the income statement excluding the situations when it is recognized directly in equity. The current tax is the tax payable of the Group entities on their taxable income for the period, calculated based on binding tax rates, and any adjustment to tax payable in respect of previous years. The receivables resulting from taxes are disclosed if the Group's companies has sufficient certainty that they exist and that they will be recovered.

Notes to the financial statements (cont.)

(In PLN thousand)

Deferred income tax assets and liabilities are calculated, using the balance sheet method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax is determined using tax rates based on legislation enacted or substantively enacted at the balance sheet date and expected to apply when the deferred tax asset or the deferred tax liability is realized.

A deferred tax asset is recognized for negative temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.

A deferred tax liability is calculated using the balance sheet method based on identification of positive temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

5.9 Other

Contingent liabilities and commitments

The Group enters into transactions which are not recognized in the statement of financial position as assets or liabilities, but which result in contingent liabilities and commitments. Contingent liabilities are characterized as:

- a potential obligation the existence of which will be confirmed upon occurrence or non-occurrence of uncertain future events that are beyond the control of the Group (e.g. litigations),
- a current obligation which arises as a result of past events but is not recognized in the statement of financial position as it is improbable that it will result in an outflow of benefits to settle the obligation or the amount of the obligation cannot be reliably measured (mainly: unused credit lines and guarantees and letters of credit issued).

The issuer of the financial guarantee contract recognizes it at the higher of:

- the amount determined in accordance with IAS 37 'Provisions, contingent liabilities and contingent assets', or
- the amount initially recognized less, when appropriate, cumulative amortization charges recognized in accordance with IAS 18 'Revenue'.

Cash and cash equivalents

Cash and cash equivalents in the consolidated cash flow statement include 'Cash and due from Central Bank' and loans and receivables from banks with maturities up to three months.

5.10 New standards, interpretations and amendments to published standards that have been approved and published by the European Union and are effective on or after 1 January 2017

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IAS 7 (amendment) 'Statement of Cash Flows' - Disclosure Initiative	The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. Date of application: annual periods beginning on or after 1 January 2017. The amendment has been adopted by EU on 6 November 2017.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 12 (amendment) 'Income Taxes'	The amendments to IAS 12 clarify how to account for deferred tax assets related to debt instruments measured at fair value. Date of application: annual periods beginning on or after 1 January 2017. The amendment has been adopted by EU on 6 November 2017.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
Improvements to IFRS 2014-2016	Amendments result from the annual improvement project of IFRS. Amendments relate to IFRS 1, IFRS 12 and IAS 28 and were introduced primarily with a view to removing inconsistencies and clarifying wording. Date of application: amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017.	The Group claims that the improvements will not have a material impact on its financial statements in the period of its first application.

Notes to the financial statements (cont.)

(In PLN thousand)

5.11 New standards, interpretations and amendments to published standards that have been published by the International Accounting Standards Board (IASB) and approved by the European Union but are not yet effective

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 9 'Financial Instruments'	<p>New regulations constitute a part of changes designed to replace IAS 39 'Financial Instruments: Recognition and Measurement'. The main changes, introduced by the new standard, are as follows:</p> <ul style="list-style-type: none"> • new categorisation of financial assets, • new criteria of assets classification to the group of financial assets measured at amortized cost, • new impairment model – expected credit losses model, • new principles for recognition of changes in fair value measurement of capital investment in financial instruments, • elimination of the necessity to separate embedded derivatives from financial assets. <p>The major part of IAS 39 requirements relating to financial liabilities classification and valuation were transferred to IFRS 9 unchanged. Date of application: the first financial year beginning after 1 January 2018.</p>	<p>The impact assessment of the new standard implementation on Group's financial statements is described in note 5.1 Basis of preparation of consolidated financial statements.</p>
IFRS 15 'Revenue from Contracts with Customers'	<p>The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally. The core principle of the new Standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. In accordance with new IFRS 15, the revenue is recognized when the control over the goods or services is transferred to the customer. Date of application: the first financial year beginning after 1 January 2018.</p>	<p>The impact assessment of the new standard implementation on Group's financial statements is described in note 5.1 Basis of preparation of consolidated financial statements.</p>
IFRS 15 (amendment) 'Revenue from Contracts with Customers'	<p>Clarifications to IFRS 15 Revenue from Contracts with Customers. Date of application: annual periods beginning on or after 1 January 2018.</p>	<p>The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.</p>
IFRS 16 'Leases'	<p>Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. IFRS 16 defines a lease term as the noncancellable period for which the lessee has the right to use an underlying asset including optional periods when an entity is reasonably certain to exercise an option to extend (or not to terminate) a lease. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis. Date of application: annual periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of this Standard.</p>	<p>The Group did not use the option of early application of IFRS 16 and will apply the standard from 1 January 2019. As part of the implementation of the new standard, the Group commenced the assessment of contracts to identify whether the contract meets the definition of leasing and estimate of the leasing period. The new requirements eliminate nearly all off balance sheet accounting for lessees. The new standard requires lessees to recognise nearly all leases on the balance sheet which will reflect their right to use an asset for a period of time and the associated liability for payments. This will redefine many commonly used financial metrics. The Group plans to elect not to apply the new requirements to short-term leases and leases for which the underlying asset is of low value. The value of leasing payments according to maturity dates as at 31 December 2017 is presented in the Note 48. In relation to the Group as a lessor - the accounting largely remains unchanged. However the Group might see an impact to its business model and lease products due to changes in needs and behaviours.</p>

Notes to the financial statements (cont.)

(In PLN thousand)

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 4 (amendment) 'Insurance Contracts'	The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing the replacement standard that the Board is developing for IFRS 4. Date of application: annual periods beginning on or after 1 January 2018 or when IFRS 9 'Financial Instruments' is applied first time.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
Improvements to IFRS 2014-2016	Amendments result from the annual improvement project of IFRS. Amendments relate to IFRS 1, IFRS 12 and IAS 28 and were introduced primarily with a view to removing inconsistencies and clarifying wording. Date of application: amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.

5.12 New standards, interpretations and amendments to published standards that have been published by the International Accounting Standards Board (IASB) and not yet approved by the European Union

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 14 'Regulatory deferral accounts'	The aim of this standard is to enhance the comparability of financial reporting by entities that are engaged in rate-regulated activities. Date of application: the first financial year beginning on or after 1 January 2016. The European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard.	The Group claims that the new standard will not have a material impact on its financial statements in the period of its first application.
IFRS 17 'Insurance Contracts'	The new standard requires insurance liabilities to be measured at a current fulfillment value and provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of a consistent, principle-based accounting for insurance contracts. IFRS 17 supersedes IFRS 4 'Insurance Contracts' and related interpretations while applied. Date of application: annual periods beginning on or after 1 January 2021.	The Group claims that the new standard will not have a material impact on its financial statements in the period of its first application.
IFRS 10 (amendment) 'Consolidated Financial Statements' and IAS 28 (amendment) 'Investments in Associates and Joint Ventures'	The amendments concern the sale or contribution of assets between the investor and the associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. Effective date has been deferred indefinitely until the research project on the equity method has been concluded.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IFRS 2 (amendment) 'Share-based Payment'	The amendments provide requirements on the accounting for (a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, (b) share-based payment transactions with a net settlement feature for withholding tax obligations, and (c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. Date of application: annual periods beginning on or after 1 January 2018. At the date of authorisation of these financial statements the amendment has not been endorsed by EU.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.

Notes to the financial statements (cont.)

(In PLN thousand)

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 9 (amendment) 'Financial Instruments'	Amendments to IFRS 9 - Prepayment Features with Negative Compensation – modify the existing requirements regarding termination rights in order to allow measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments. Under the amendments, the sign of the prepayment amount is not relevant, i. e. depending on the interest rate prevailing at the time of termination, a payment may also be made in favour of the contracting party effecting the early repayment. The calculation of this compensation payment must be the same for both the case of an early repayment penalty and the case of an early repayment gain. Date of application: annual periods beginning on or after 1 January 2019.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 19 (amendment) 'Employee Benefits'	Amendments to IAS 19 'Employee Benefits' - Plan Amendment, Curtailment or Settlement – require to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. Date of application: annual periods beginning on or after 1 January 2019.	The Group is currently analyzing the impact of those changes on the financial statements.
IAS 28 (amendment) 'Investments in Associates and Joint Ventures'	Amendments to IAS 28 - Long-term Interests in Associates and Joint Ventures - were introduced to clarify that an entity applies IFRS 9 including its impairment requirements, to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. Amendments also delete paragraph 41 because the Board felt that it merely reiterated requirements in IFRS 9 and had created confusion about the accounting for long-term interests. Date of application: annual periods beginning on or after 1 January 2019.	The Group is currently analyzing the impact of those changes on the financial statements.
IAS 40 (amendment) 'Investment Property'	Amendments to IAS 40 'Investment Property' - Transfers of Investment Property state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. Amendments also state that the list of evidence in paragraph 57 was designated as non-exhaustive list of examples instead of the previous exhaustive list. Date of application: annual periods beginning on or after 1 January 2018. At the date of authorisation of these financial statements the amendment has not been endorsed by EU.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IFRIC 22 'Foreign Currency Transactions and Advance Consideration'	Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. Date of application: annual periods beginning on or after 1 January 2018. At the date of authorisation of these financial statements the amendment has not been endorsed by EU.	The Group is currently analyzing the impact of those changes on the financial statements.
IFRIC 23 'Uncertainty over Income Tax Treatments'	It may be unclear how tax law applies to a particular transaction or circumstance, or whether a taxation authority will accept a company's tax treatment. IAS 12 Income Taxes specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. IFRIC 23 provides requirements that add to the requirements in IAS 12 by specifying how to reflect the effects of uncertainty in accounting for income taxes. Date of application: annual periods beginning on or after 1 January 2019.	The Group is currently analyzing the impact of those changes on the financial statements.

Notes to the financial statements (cont.)

(In PLN thousand)

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
Improvements to IFRS 2015-2017	<p>Amendments to various standards resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording. The amendments clarify that: a company remeasures its previously held interest in a joint operation when it obtains control of the business (IFRS 3); a company does not remeasure its previously held interest in a joint operation when it obtains joint control of the business (IFRS 11); a company accounts for all income tax consequences of dividend payments in the same way (IAS 12); and a company treats as part of general borrowings any borrowing originally made to develop an asset when the asset is ready for its intended use or sale (IAS 23).</p> <p>Date of application: annual periods beginning on or after 1 January 2019.</p>	The Group is currently analyzing the impact of those changes on the financial statements.

6. Risk management

The risk management policy of the Group aims at optimizing the structure of the balance sheet and off-balance sheet items taking into consideration the assumed risks-income relation and overall impact of various risks that the Group undertakes in conducting its business activities. Risks are monitored and controlled with reference to profitability and capital coverage and are regularly reported in accordance with rules presented below.

All significant risks incurred in the course of the Group's operations are described in the further part of the Note.

6.1 Organizational structure of risk management

Supervisory Board

The Supervisory Board provides supervision over the risk management system, assessing its adequacy and effectiveness. Moreover, the Supervisory Board also provides supervision of the compliance of the Group's policy with respect to risk taking with the Group's strategy and financial plan.

Management Board

The Management Board is responsible for the development, implementation and functioning of risk management processes by, among others, introduction of relevant, internal regulations, taking into consideration the results of internal audit inspections.

The Management Board is responsible for the effectiveness of the risk management system, internal control system, internal capital computation process and the effectiveness of the review of the process of computing and monitoring of internal capital. Moreover, the Management Board also introduces the essential adjustments or improvements to those processes and systems whenever necessary. This need may be a consequence of changes to risk levels of the Group's operations, business environment factors or irregularities in the functioning of processes or systems.

Periodically, the Management Board submits to the Supervisory Board concise information on the types, scale and significance of risks the Group is exposed to, as well as on methods used in the management of such risks.

The Management Board is responsible for assessing, whether activities such as identification, measurement, monitoring, reporting and control or mitigation are carried out appropriately within the scope of the risk management process. Moreover, the Management Board examines whether the management at all levels is effectively managing the risks within the scope of their competence.

Notes to the financial statements (cont.)

(In PLN thousand)

Committees

In performing these tasks, in terms of risk management, the Management Board is supported by the relevant committees:

- Assets, Liabilities and Risk Management Committee - in market risk management, liquidity and capital adequacy,
- Liquidity and Market Risk Committee, acting as support for the Assets, Liabilities and Risk Management Committee – in terms of liquidity and market risk management,
- Operational Risk Committee – in operational risk management,
- Credit Committee - in making credit decisions within the powers and in the case of issuing recommendations on the largest transactions presented to the Management Board for decision,
- Change Management Committee - in the implementation of new or modification of existing products and business and non-business processes,
- Safety Committee - in the field of security and business continuity management,
- Model Risk Committee – in model risk management.

6.2 Credit risk

Credit risk is one of the basic risks associated with activities of the Group. The percentage share of credits and loans in the Group's statement of financial position makes the maintenance of this risk at safe level essential to the Group's performance. The process of credit risk management is centralized and managed mainly by Risk Management Division units, situated at the Bank Head Office or in local units.

The integration of various risks in the Risk Management Division, where apart from credit risk, market and operational risk are dealt with, facilitates effective management of all credit-related risks.

This process covers all credit functions – credit analysis, making credit decisions, monitoring and loan administration, as well as restructuring and collection.

These functions are conducted in compliance with the Bank's credit policy, adopted by the Bank's Management Board and the Bank's Supervisory Board for a given year and its related guidelines. The effectiveness and efficiency of credit functions are achieved using diverse credit methods and methodologies, supported by advanced IT tools, integrated into the Bank's general IT system. The Bank's procedures facilitate credit risk mitigation. In particular those related to transaction risk evaluation, establishing collateral, setting authorization limits for granting loans and limiting of exposure to some areas of business activity in line with current client's segmentation scheme in the Bank.

The Bank's lending activity is limited by the restrictions of the Banking Act as well as internal limits in order to increase safety. These restrictions refer in particular to concentration limits for specific sectors of the economy, share of large exposures in the loan portfolio of the Bank and exposure limits for particular foreign countries, foreign banks and domestic financial institutions.

Credit granting limits, concentration limits for specific business activities as well as internal and external prudential standards include not only credits, loans and guarantees, but also derivatives transactions and debt securities.

The Bank established the following portfolio limits:

- share of large exposures in the loan portfolio of the Bank – approved by the Management Board and the Supervisory Board of the Bank,
- customer segment limits – established in the Bank's credit policy,
- product limits (mortgage loans given to private individuals, financing commercial real estate) - established in the Bank's credit policy,
- concentration limits for specific sectors of the economy - approved by the Credit Committee of the Bank.

Since key limits are determined by decision-making bodies which simultaneously receive and analyze reports on credit risk (presenting also the Basel parameters of credit risk), limit-related decisions take into consideration the credit risk assessments supported by internal rating systems. Moreover, the Bank limits higher risk credit transactions, marked by excess risk by restricting the decision-making powers in such cases to higher-level decision-making bodies.

The management of the Bank's credit portfolio quality is further supported by regular reviews and continuous monitoring of timely loan repayments and the financial condition of the borrowers.

Notes to the financial statements (cont.)

(In PLN thousand)

Rating models utilized in the credit risk management process

For credit risk management purposes, the Bank uses the internal rating models depending on the client's segment and/or exposure type.

The rating process is a significant element of credit risk assessment in relation to clients and transactions, and constitutes a preliminary stage of the credit decision-making process of granting a new credit or changing the terms and conditions of an existing credit and of the credit portfolio quality monitoring process.

In the credit risk measurement the following three parameters are used: PD, LGD and EAD. PD is the probability of a Client's failure to meet its obligations and hence the violation of contract terms and conditions by the borrower within one year horizon, such default may be subject-matter or product-related. LGD indicates the estimated value of the loss to be incurred for any credit transaction from the date of occurrence of such default. EAD reflects the estimated value of credit exposure as at such date.

The risk parameters used in the rating models are designed for calculation of the expected losses resulted from credit risk.

The value of expected loss is one of the significant assessment criteria taken into consideration by the decision-making bodies in the course of the crediting process. In particular, this value is compared to the requested margin level.

The level of minimum margins for given products or client segments is determined based upon risk analysis, taking into consideration the value of risk parameters assessed and comprising an element of internal rating systems.

The client and transaction rating, as well as other credit risk parameters hold a significant role in the Credit Risk Management Information System. For each rating model, the credit risk reports provide information on the comparison between the realized parameters and the theoretical values for each rating class.

Credit risk reports are generated on a monthly basis, with their scope varying depending upon the recipient of the report (the higher the management level, the more aggregated the information presented). Hence, the reports are being effectively used in the credit risk management process.

For internal purposes, within the Bank the following rating models are used, developed in accordance with provisions of Regulation (EU) no 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms:

- 1) For the private individuals, the Bank uses two separate models applicable for:
 - mortgage loans,
 - consumer loans.
- 2) For the corporate clients, the Bank uses rating models dividing clients for:
 - non-financial corporate clients,
 - specialized lending (commercial real estate financing).

The following exposure types are not covered by internal rating models:

- 1) retail exposures immaterial in terms of size and perceived risk profile:
 - Eurokonto limits,
 - overdrafts,
 - forced debits,
 - exposures related to credit cards,
 - exposures related to the Building Society (Kasa Mieszkaniowa) unit,
 - other loans.

Notes to the financial statements (cont.)

(In PLN thousand)

- 2) corporate clients immaterial in terms of size and perceived risk profile:
 - exposures to stock exchanges and other financial intermediators,
 - exposures to insurance companies,
 - project financing,
 - purchased receivables,
 - exposures to investment funds,
 - exposures to leasing companies and financial holding companies,
 - other loans.
- 3) exposures to regional governments and local authorities which are not treated as exposures to central governments, for which the number of significant counterparties is limited.

Rating scale

The rating scale is determined by the client segment and the exposure type.

The proceeds of assigning a client or an exposure to a given rating class depends on its probability of default (PD parameter).

The tables below present the loan portfolio quality for exposures encompassed by internal rating models.

The distribution of rated portfolio for individual client segment (excluding impaired loans) – mortgage loans

RATING CLASS	RANGE OF PD	31.12.2017		31.12.2016	
		CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.06%	10 308 122	21.1%	11 544 215	26.2%
2	0.06% <= PD < 0.19%	5 220 016	10.7%	6 794 533	15.4%
3	0.19% <= PD < 0.35%	21 828 654	44.8%	17 482 613	39.7%
4	0.35% <= PD < 0.73%	8 464 383	17.4%	5 463 689	12.4%
5	0.73% <= PD < 3.50%	1 553 153	3.2%	1 435 604	3.3%
6	3.50% <= PD < 14.00%	627 941	1.3%	638 891	1.5%
7	14.00% <= PD < 100.00%	722 811	1.5%	671 745	1.5%
Total		48 725 080	100.0%	44 031 290	100.0%

The distribution of rated portfolio for individual client segment (excluding impaired loans) – consumer loans

RATING CLASS	RANGE OF PD	31.12.2017		31.12.2016	
		CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.09%	763 055	7.4%	658 213	7.5%
2	0.09% <= PD < 0.18%	1 597 102	15.5%	1 329 744	15.2%
3	0.18% <= PD < 0.39%	2 555 301	24.7%	2 118 809	24.2%
4	0.39% <= PD < 0.90%	2 423 887	23.5%	1 931 549	22.1%
5	0.90% <= PD < 2.60%	1 603 023	15.5%	1 513 316	17.3%
6	2.60% <= PD < 9.00%	854 202	8.3%	757 861	8.6%
7	9.00% <= PD < 30.00%	335 767	3.2%	272 166	3.1%
8	30.00% <= PD < 100.00%	194 236	1.9%	175 362	2.0%
Total		10 326 573	100.0%	8 757 020	100.0%

Notes to financial statements (cont.)

(In PLN thousand)

The distribution of rated portfolio for non-financial corporate client segment (excluding impaired loans)

RATING CLASS	RANGE OF PD	31.12.2017		31.12.2016	
		CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.15%	618 103	3.0%	1 374 175	6.8%
2	0.15% <= PD < 0.27%	1 400 964	6.9%	3 038 750	15.1%
3	0.27% <= PD < 0.45%	2 802 868	13.7%	2 368 185	11.8%
4	0.45% <= PD < 0.75%	6 073 391	29.7%	4 214 933	21.0%
5	0.75% <= PD < 1.27%	3 468 286	17.0%	2 131 155	10.6%
6	1.27% <= PD < 2.25%	2 494 294	12.2%	3 449 183	17.1%
7	2.25% <= PD < 4.00%	1 244 813	6.1%	1 266 801	6.3%
8	4.00% <= PD < 8.50%	2 246 694	11.0%	1 948 060	9.7%
9	8.50% <= PD < 100.00%	84 549	0.4%	319 268	1.6%
Total		20 433 962	100.0%	20 110 510	100.0%

For specialized lending, the Bank adopts slotting criteria approach within internal rating method which uses supervisory categories in the process of assigning risk weigh category.

Distribution of the portfolio exposure to specialized lending (excluding impaired loans)

SUPERVISORY CATEGHORY	31.12.2017		31.12.2016	
	CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
High	1 105 911	15.3%	3 470 755	42.6%
Good	4 863 113	67.1%	3 623 153	44.5%
Satisfactory	1 271 661	17.5%	1 010 603	12.4%
Low	7 080	0.1%	44 728	0.5%
Total	7 247 765	100.0%	8 149 239	100.0%

Division of loans and advances to customers for covered and not covered by internal rating models

	31.12.2017	31.12.2016
Loans with no impairment:	129 764 165	120 112 554
Loans to individuals:	62 073 320	55 863 932
Covered by internal rating model:	59 051 653	52 788 310
Mortgage loans	48 725 080	44 031 290
Consumer loans	10 326 573	8 757 020
Other, not covered by internal rating model	3 021 667	3 075 622
Loans to corporates:	67 690 845	64 248 622
Covered by internal rating model	20 433 962	20 110 510
Specialized lending exposures	7 247 765	8 149 239
Debt securities, not covered by internal rating model	12 657 973	12 352 160
Repo transactions, not covered by internal rating model	-	-
Other, not covered by internal rating model	27 351 145	23 636 713
Impaired loans	2 536 250	2 550 658
Total loans and advances to customers (*)	132 300 415	122 663 212

(*) Loans and advances to customers include receivables from financial leases.

Notes to the financial statements (cont.)

(In PLN thousand)

Client/transaction rating and credit risk decision-making level

Decision-making level connected with transaction approval is directly dependent upon the client's rating.

Decision-making entitlement limits are associated with the position held, determined in accordance with the Bank's organizational structure. The limits are determined taking the following matters into consideration:

- the Bank's total exposure to a client, including the amount of the requested transaction,
- type of a client,
- commitments of persons and entities associated with the client.

Validation of rating models

The internal validation of models and risk parameter assessments is focused on the quality assessment of risk models and the accuracy and stability of parameter assessments, applied by the Bank. Validation is carried out at the level of each risk model, although the Bank may apply several models for each class of exposures.

Moreover, the internal audit unit is obligated to review the Bank's rating systems and their functionality at least once a year. In particular, the internal audit unit reviews the scope of operations of credit division and estimations of risk parameters. It also verifies compliance of rating systems and their functionality with all requirements of advanced methods.

Group's exposure to credit risk

The maximum credit risk exposure

The table below presents the maximum credit risk exposure for statement of financial position and off-balance sheet positions as at the reporting date

	31.12.2017	31.12.2016
Due from Central Bank	2 549 735	3 233 379
Loans and advances from banks and from customers	130 576 634	121 947 096
Receivables from finance leases	4 351 352	3 974 643
Financial assets held for trading	1 730 416	732 469
Derivative financial instruments (held for trading)	1 349 047	1 913 429
Hedging instruments	259 396	289 752
Investment securities	36 905 822	35 120 619
Other assets (*)	948 232	1 020 482
Balance sheet exposure (**)	178 670 634	168 231 869
Obligations to grant loans	33 959 339	32 126 475
Other contingent liabilities	12 020 062	11 473 757
Off-balance sheet exposure	45 979 401	43 600 232
Total	224 650 035	211 832 101

(*) Includes the following items of the statement of financial position: 'Investments in associates' and part of 'Other assets' (Accrued income, Interbank and interbranch settlements, Other debtors and Card settlements).

(**) Balance sheet exposure is equal to the carrying amount presented in the statement of financial position.

Credit risk mitigation methods

Bank Pekao S.A. Group has established specific policies with regard to collateral accepted to secure loans and guarantees. This policy is reflected under internal rules and regulations, which are based on supervision rules, specified in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

Notes to the financial statements (cont.)

(In PLN thousand)

The most frequently used types of collateral for credits and loans, accepted in compliance with the relevant policy of Pekao Group, are as follows

COLLATERAL	COLLATERAL VALUATION PRINCIPLES
MORTGAGES	
- commercial	Collateral value is defined as the fair market value endorsed by a real estate expert. Other evidenced sources of valuation are acceptable, e.g. binding purchase offer, value dependent on the stage of tendering procedure, etc.
- residential	
REGISTERED PLEDGE/ ASSIGNMENT	
- inventories	The value is defined basing on well evidenced sources e.g. amount derived from pledge agreement, amount disclosed in last financial statement, insurance policy, stock exchange quotations, the value disclosed through foreclosure procedure supported with evidence e.g. prepared by bailiff/receiver.
- machines and appliances	The value is defined as expert appraisal or present value determined based on other, sound sources, such as current purchase offer, register of debtor's non-current assets, value evidenced by bailiff or court receiver, etc.
- vehicles	The value is defined based on available tables (e.g. from insurance companies) proving the car value depending on its producer, age, initial price, or other reliable sources e.g. value stated in the insurance policy.
- other	The value is defined upon individually. The valuation should result from reliable sources.
- securities and cash	The value is defined upon individually estimated fair market value. Recovery rate shall be assessed prudently reflecting the securities price volatility.
TRANSFER OF RECEIVABLES	
- from clients with investment rating assigned by independent rating agency or by internal rating system of the Bank	The value is defined upon individually assessed claims' amount.
- from other counterparties	The value is defined upon individually assessed claim's amount.
GUARANTIES/SURETIES (INCL. RAFTS) / ACCESSION TO DEBT	
- from banks and the State Treasury	Up to the guaranteed amount.
- from other counterparties enjoying good financial standing, particularly when confirmed by investment rating, assigned by an independent rating agency or by the internal rating system of the Bank	The value is defined upon individually assessed claim's amount.
- from other counterparties	Individually assessed fair market value.

The financial effect of pledged collaterals for exposure portfolio with recognized impairment defined individually amounts to PLN 1 254 271 thousand as at the 31 December 2017 (1 496 661 thousand as of the 31 December 2016). The level of required impairment allowances for the portfolio would increase by this amount, if the discounted cash flows from collateral were not taken into account during estimation.

Offsetting financial assets and financial liabilities

The disclosures set out in the tables below include financial assets and financial liabilities that are subject to an enforceable master netting agreements or similar agreements, irrespective of whether they are offset in the statement of financial position.

The netting agreements concluded by the Group are:

- ISDA agreements and similar master netting agreements on derivatives,
- GMRA agreements on repo and reverse-repo transactions.

Notes to the financial statements (cont.)

(In PLN thousand)

The netting agreements do not meet the criteria for offsetting in the statement of financial position. This is because they create for the parties to the agreement a right of set-off of recognized amounts that is enforceable only following an event of default, insolvency or bankruptcy of the one of the counterparty. In addition, the Group and its counterparties do not intend to settle on a net basis or to realize the assets and settle the liabilities simultaneously.

The Group receives and gives collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives,
- repo and reverse-repo transactions.

Such collateral is subject to standard industry terms. The collateral in the form of cash stems from an ISDA Credit Support Annex (CSA).

The securities received/given as collateral on repo and reverse-repo transaction can be pledged or sold during the term of the transaction but have to be returned on maturity of the transaction. The terms also give each party the right to terminate the related transactions on the counterparty's failure to post collateral.

Financial assets and financial liabilities subject to enforceable master netting agreements and similar agreements and which may be potentially offset in the statement of financial position.

31.12.2017	CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL RECEIVED	
FINANCIAL ASSETS				
Derivatives	1 328 535	(902 102)	(265 808)	160 625
TOTAL	1 328 535	(902 102)	(265 808)	160 625

31.12.2017	CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL PLEDGED	
FINANCIAL LIABILITIES				
Derivatives	2 575 961	(1 476 984)	(954 537)	144 440
TOTAL	2 575 961	(1 476 984)	(954 537)	144 440

31.12.2016	CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL RECEIVED	
FINANCIAL ASSETS				
Derivatives	1 848 236	(1 434 265)	(182 765)	231 206
TOTAL	1 848 236	(1 434 265)	(182 765)	231 206

Notes to the financial statements (cont.)

(In PLN thousand)

31.12.2016	CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL PLEDGED	
FINANCIAL LIABILITIES				
Derivatives	3 254 372	(1 434 265)	(1 651 984)	168 123
TOTAL	3 254 372	(1 434 265)	(1 651 984)	168 123

The carrying amount of financial assets and financial liabilities disclosed in the above tables have been measured in the statement of financial position on the following bases:

- derivatives – fair value,
- assets and liabilities resulting from repo and reverse-repo transactions – amortized cost.

Reconciliation of the carrying amount of financial assets and financial liabilities subject to enforceable master netting agreements and similar agreements to the amounts presented in the statement of financial position.

31.12.2017	NET CARRYING AMOUNT	ITEM IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES	NOTE
FINANCIAL ASSETS					
Derivatives	1 251 739	Derivative financial instruments (held for trading)	1 349 047	97 308	27
	76 796	Hedging instruments	259 396	182 600	30
FINANCIAL LIABILITIES					
Derivatives	1 717 556	Derivative financial instruments (held for trading)	2 030 103	312 547	27
	858 405	Hedging instruments	862 331	3 926	30

31.12.2016	NET CARRYING AMOUNT	ITEM IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES	NOTE
FINANCIAL ASSETS					
Derivatives	1 791 677	Derivative financial instruments (held for trading)	1 913 429	121 752	27
	56 559	Hedging instruments	289 752	233 193	30
FINANCIAL LIABILITIES					
Derivatives	1 618 110	Derivative financial instruments (held for trading)	1 952 674	334 564	27
	1 636 262	Hedging instruments	1 638 718	2 456	30

Notes to the financial statements (cont.)

(In PLN thousand)

Overall characteristics of monitoring process

The monitoring process is oriented at the identification of symptoms and threats, affecting the client, undertaking actions preventing the deterioration of credit portfolio quality for the purpose of maximizing the probability of recovery of assets made available to the client.

In particular, the monitoring of credit risk includes the control of timely debt service, analysis of client's financial standing, verification of meeting the terms of credit agreement and reviewing the collaterals.

Loans for large corporate clients are monitored using the rating system and data from both internal and external sources of information. In case of small and medium-size clients, the monitoring process is carried out using an internal tool, embedded into the statistical behavioral model. Process efficiency is further enhanced by regular reviews of the credit portfolio, carried out by representatives of the Risk Management Division and other Business Divisions for the purpose of determining the actual quality of individual exposures and of the entire credit portfolio.

The monitoring of individual clients is carried by IT systems and is based on the results of behavioral scoring.

Overall characteristics of provisioning model

The Group establishes loan loss provisions ('LLP') in line with International Financial Reporting Standards ('IFRS'). LLP reflects the loan impairment and whether the Group recognizes objective impairment triggers. Impairment of loans is recognized under an individual and collective approach.

The process of identifying impaired exposures covered by individual valuation is carried out with the use of an internal tool and consists of the following stages:

- identification, whether the impairment trigger for given a credit exposure has been recognized and, upon such identification, determination of the type of such trigger and assignment of default status to the exposure,
- assessment of future cash flows, discounted using the effective interest rate, generated both from collateral and client operations,
- calculation and registration of loan loss provision in the IT system.

Exposures covered by the collective approach valuation are classified into the default class for overdue amounts exceeding 90 days. For such exposures, the loan loss provision is calculated using a statistical model.

If an impairment trigger is not recognized, the Group establishes provisions for incurred but not reported losses (IBNR) applying a statistical model of expected loss.

The applied statistical models are based on historical data for homogenous groups of exposure.

Both the models and parameters applied in the establishment of loan loss provision are subject to regular validation.

Notes to the financial statements (cont.)

(In PLN thousand)

The quality analysis of the Group's financial assets

The Group exposures to credit risk with impairment recognized, broken down by delays in repayment

	LOANS AND ADVANCES TO BANKS (*)		LOANS AND ADVANCES TO CUSTOMERS (*)	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
GROSS CARRYING AMOUNT OF EXPOSURE INDIVIDUALLY IMPAIRED				
- not past due	-	-	1 011 252	642 927
- up to 1 month	-	-	42 669	106 904
- between 1 month and 3 months	-	-	111 966	31 323
- between 3 months and 1 year	-	-	120 121	228 925
- between 1 year and 5 years	6 833	8 192	1 635 866	2 565 907
- above 5 years	-	-	2 143 548	1 498 788
Total gross carrying amount	6 833	8 192	5 065 422	5 074 774
ALLOWANCE FOR IMPAIRMENT				
- not past due	-	-	(255 996)	(292 907)
- up to 1 month	-	-	(23 018)	(30 285)
- between 1 month and 3 months	-	-	(86 208)	(7 077)
- between 3 months and 1 year	-	-	(37 509)	(121 057)
- between 1 year and 5 years	(6 833)	(8 192)	(1 116 165)	(1 563 402)
- above 5 years	-	-	(1 643 846)	(1 170 559)
Total allowance for impairment	(6 833)	(8 192)	(3 162 742)	(3 185 287)
Net carrying amount of exposure individually impaired	-	-	1 902 680	1 889 487
GROSS CARRYING AMOUNT OF EXPOSURE COLLECTIVELY IMPAIRED				
- not past due	-	-	218 892	166 121
- up to 1 month	-	-	58 963	69 664
- between 1 month and 3 months	-	-	68 834	56 545
- between 3 months and 1 year	-	-	305 690	286 856
- between 1 year and 5 years	-	-	1 156 425	1 297 813
- above 5 years	9 800	9 800	760 823	914 748
Total gross carrying amount	9 800	9 800	2 569 627	2 791 747
ALLOWANCE FOR IMPAIRMENT				
- not past due	-	-	(80 194)	(54 371)
- up to 1 month	-	-	(19 811)	(21 678)
- between 1 month and 3 months	-	-	(25 824)	(20 975)
- between 3 months and 1 year	-	-	(164 187)	(152 797)
- between 1 year and 5 years	-	-	(975 542)	(1 038 042)
- above 5 years	(9 800)	(9 800)	(670 499)	(842 713)
Total allowance for impairment	(9 800)	(9 800)	(1 936 057)	(2 130 576)
Net carrying amount of exposure collectively impaired	-	-	633 570	661 171

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases.

Notes to the financial statements (cont.)

(In PLN thousand)

The Group exposures to credit risk with no impairment recognized, broken down by delays in repayment

	LOANS AND ADVANCES TO BANKS (*)		LOANS AND ADVANCES TO CUSTOMERS (*)			
	31.12.2017	31.12.2016	CORPORATE		RETAIL	
			31.12.2017	31.12.2016	31.12.2017	31.12.2016
GROSS CARRYING AMOUNT OF EXPOSURE WITH NO IMPAIRMENT						
- not past due	2 627 580	3 258 534	67 653 963	64 156 501	60 829 671	54 316 545
- up to 30 days	-	-	208 260	240 713	1 012 401	1 314 340
- between 30 days and 60 days	-	-	33 921	27 468	184 759	177 909
- above 60 days	-	-	90 322	88 700	183 978	184 075
Total gross carrying amount	2 627 580	3 258 534	67 986 466	64 513 382	62 210 809	55 992 869
IBNR PROVISION						
- not past due	(8)	(8)	(289 184)	(256 869)	(93 753)	(80 772)
- up to 30 days	-	-	(2 714)	(5 106)	(25 030)	(30 818)
- between 30 days and 60 days	-	-	(2 652)	(1 425)	(11 455)	(9 873)
- above 60 days	-	-	(1 071)	(1 360)	(7 251)	(7 474)
Total IBNR provision	(8)	(8)	(295 621)	(264 760)	(137 489)	(128 937)
Net carrying amount of exposure with no impairment	2 627 572	3 258 526	67 690 845	64 248 622	62 073 320	55 863 932

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases.

The Group exposures to credit risk, broken down by impairment triggers criteria

	LOANS AND ADVANCES TO BANKS (*)		LOANS AND ADVANCES TO CUSTOMERS (*)	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
IMPAIRED EXPOSURE				
Gross carrying amount	16 633	17 992	7 635 049	7 866 521
Allowance for impairment	(16 633)	(17 992)	(5 098 799)	(5 315 863)
Total net carrying amount	-	-	2 536 250	2 550 658
EXPOSURES WITH IMPAIRMENT TRIGGERS FOR WHICH NO IMPAIRMENT HAS BEEN IDENTIFIED				
Gross carrying amount, in this:	-	-	173 476	100 560
<i>Exposure with collateral value included in expected discounted cash flow, in this</i>	-	-	173 476	100 560
<i>Past due exposures</i>	-	-	35 246	35 382
IBNR provision	-	-	(7 790)	(2 610)
Total net carrying amount	-	-	165 686	97 950
EXPOSURES WITH NO IMPAIRMENT TRIGGERS				
Gross carrying amount	2 627 580	3 258 534	130 023 799	120 405 691
IBNR provision	(8)	(8)	(425 320)	(391 087)
Total net carrying amount	2 627 572	3 258 526	129 598 479	120 014 604

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases.

Notes to the financial statements (cont.)

(In PLN thousand)

Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2017

RATING	DEBT SECURITIES				TOTAL
	HELD FOR TRADING	AVAILABLE FOR SALE	HELD TO MATURITY	REPO TRANSACTIONS (***)	
AA+ to AA-	-	722 151	-	-	722 151
A+ to A-	1 646 758	20 835 674	3 450 338	492 419	26 425 189
no rating	79 100	11 718 765 (*)	31 453 (**)	-	11 829 318
Total	1 725 858	33 276 590	3 481 791	492 419	38 976 658

(*) Including NBP bills in an amount of PLN 11 066 168 thousand.

(**) Including NBP bills in an amount of PLN 31 453 thousand.

(***) Fair value of debt securities purchased in the reverse repo transactions.

Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2016

RATING	DEBT SECURITIES				TOTAL
	HELD FOR TRADING	AVAILABLE FOR SALE	HELD TO MATURITY	REPO TRANSACTIONS (***)	
AA+ to AA-	-	327 613	-	-	327 613
A+ to A-	654 918	24 719 097	2 998 379	700 960	29 073 354
BBB+ to BBB-	9 719	-	-	-	9 719
no rating	66 113	6 903 060 (*)	20 606 (**)	-	6 989 779
Total	730 750	31 949 770	3 018 985	700 960	36 400 465

(*) Including NBP bills in an amount of PLN 5 978 629 thousand.

(**) Including NBP bills in an amount of PLN 20 606 thousand.

(***) Fair value of debt securities purchased in the reverse repo transactions.

Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2017

RATING	DERIVATIVES						TOTAL
	TRADING DERIVATIVES			DERIVATIVE HEDGING INSTRUMENTS			
	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	
AAA	129	-	-	-	-	-	129
AA+ to AA-	59 784	-	-	-	-	-	59 784
A+ to A-	588 677	102 882	-	40 143	-	-	731 702
BBB+ to BBB-	40 019	-	-	-	-	-	40 019
no rating	224 868	66 941	265 747	36 653	182 600	-	776 809
Total	913 477	169 823	265 747	76 796	182 600	-	1 608 443

Notes to the financial statements (cont.)

(In PLN thousand)

Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2016

RATING	DERIVATIVES						TOTAL
	TRADING DERIVATIVES			DERIVATIVE HEDGING INSTRUMENTS			
	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	
AAA	143	-	-	-	-	-	143
AA+ to AA-	75 047	-	-	1 044	-	-	76 091
A+ to A-	581 997	179 546	-	22 224	-	-	783 767
BBB+ to BBB-	379 748	-	-	4 414	-	-	384 162
no rating	303 021	69 325	324 602	26 868	235 202	-	959 018
Total	1 339 956	248 871	324 602	54 550	235 202	-	2 203 181

Forbearance measures

With reference to European Securities and Markets Authority (ESMA) document 2012/853 and instructions issued by European Banking Authority in terms of disclosure as far as forbore exposures, the Group in cooperation with its mother company has implemented a process of classification of this type of exposures.

Forborne exposures are debt contracts in respect of which forbearance measures have been extended. Forbearance measures occur in situations in which the borrower is considered to be unable to meet the terms and conditions of the contract due to financial difficulties. Based on these difficulties, the Group decides to modify the terms and conditions of the contract to allow the borrower sufficient ability to service the debt or refinance the contract, either totally or partially. Modification of the terms and conditions of the contract may include i.e. the reduction of the interest rate, principal, accrued interest or the rescheduling of the dates of payment of principal and/or interests.

In particular, the Group assumes that the forbearance has taken place when:

- the modified contract was classified as impaired and the modifications were made within restructuring activities,
- the modified contract was totally or partially past-due by more than 30 days (without being impaired) at least once during the three months prior to its modification or would be more than 30 days past-due, totally or partially, without modification,
- simultaneously with or close in time to the concession of additional debt by the Group, the debtor made payments of principal or interest on another contract with the Group that was totally or partially 30 days past due at least once during the three months prior to its refinancing.

The classification as forbore exposure shall be discontinued when all the following conditions are met:

- the contract is considered as exposure without impairment triggers,
- a minimum 2 year probation period has passed from the date the forbore exposure was considered as exposure without impairment triggers,
- regular payments of more than an insignificant amount of principal or interest have been made,
- none of the exposures to the debtor is more than 30 days past-due at the end of the probation period of forbore exposure.

If a decision is made to extend a concession, modify the contractual terms or refinance, which is not related to the financial difficulties of the borrower, then forbearance has not occurred.

The forbearance agreements are monitored for fulfillment of contractual provisions. Dedicated units of the Bank manage the agreements with identified forbearance measures and monitor such agreements on a current basis.

Notes to the financial statements (cont.)

(In PLN thousand)

When the exposure is classified as forborne and at each balance sheet date the Group assesses whether there is any objective evidence that the exposure is impaired. The accounting policies in respect to the evaluation and the provisioning of the forborne exposures generally follow the principles in line with the provisions of IAS 39, i.e. whether there are objective evidences that it has incurred a loss for impairment of loans valued at amortized cost, the amount of the loss is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet incurred) discounted at the original effective interest rate of the loan.

When the forbearance measures lead to derecognition of the original loan, the Group recognizes the new loan at its fair value. The difference between the carrying amount of the original loan and the fair value of the new loan is recognised in income statement.

The Group also performs an in-depth analysis of the credit risk characteristics of assets for which forbearance measures have been applied, when assessing for specific as well as collective impairment.

Share of forborne exposures in the Group's loan portfolio

	31.12.2017	31.12.2016
LOANS AND ADVANCES TO CUSTOMERS		
Exposures with no impairment, of which:	129 764 165	120 112 554
forborne exposures	726 571	574 117
Impaired exposures, of which:	2 536 250	2 550 658
forborne exposures	1 515 066	1 476 521
Total net carrying amount, of which:	132 300 415	122 663 212
forborne exposures	2 241 637	2 050 638

The quality analysis of forborne exposures

	31.12.2017	31.12.2016
Exposures with no impairment		
Gross carrying amount	739 470	587 347
IBNR provisions	(12 899)	(13 230)
Net carrying amount	726 571	574 117
Impaired exposures		
Gross carrying amount, of which:	3 297 371	3 152 110
exposures individually impaired	2 903 187	2 816 470
exposures collectively impaired	394 184	335 640
Allowances for impairment, of which:	(1 782 305)	(1 675 589)
exposures individually impaired	(1 599 248)	(1 524 510)
exposures collectively impaired	(183 057)	(151 079)
Net carrying amount	1 515 066	1 476 521
Total net carrying amount	2 241 637	2 050 638

The Group holds the collaterals for forborne exposures amounting to PLN 1 065 815 thousand as at 31 December 2017 (PLN 1 023 631 thousand at 31 December 2016).

Notes to the financial statements (cont.)

(In PLN thousand)

The quality analysis of forborne exposures broken down by delays in repayment

	31.12.2017	31.12.2016
Gross carrying amount of exposures with no impairment, of which:	739 470	587 347
- not past due	666 166	483 434
- up to 30 days	41 180	73 519
- between 30 days and 60 days	17 936	19 513
- above 60 days	14 188	10 881
IBNR provisions for exposures with no impairment, of which:	(12 899)	(13 230)
- not past due	(9 675)	(8 476)
- up to 30 days	(1 347)	(3 051)
- between 30 days and 60 days	(1 197)	(1 037)
- above 60 days	(680)	(666)
Gross carrying amount of impaired exposures, of which:	3 297 371	3 152 110
- not past due	1 024 413	627 945
- up to 1 month	56 348	150 815
- between 1 month and 3 months	51 205	46 077
- between 3 months and 1 year	127 593	214 022
- between 1 year and 5 years	1 383 279	2 026 748
- above 5 years	654 533	86 503
Allowances for impairment, of which:	(1 782 305)	(1 675 589)
- not past due	(316 331)	(270 904)
- up to 1 month	(17 183)	(44 380)
- between 1 month and 3 months	(16 987)	(13 893)
- between 3 months and 1 year	(45 622)	(116 608)
- between 1 year and 5 years	(959 942)	(1 168 335)
- above 5 years	(426 240)	(61 469)
Total net carrying amount	2 241 637	2 050 638

Changes in net carrying amount of forborne exposures

	2017	2016
Net carrying amount at the beginning	2 050 638	1 960 384
Amount of exposures recognized in the period	776 948	569 808
Amount of exposures derecognized in the period	(171 301)	(218 057)
Changes in impairment allowances	(114 270)	(118 306)
Other changes	(300 378)	(143 191)
Net carrying amount at the end	2 241 637	2 050 638
Interest income	138 936	139 522

Notes to the financial statements (cont.)

(In PLN thousand)

Forborne exposures by type of forbearance activity

	31.12.2017	31.12.2016
Modification of terms and conditions	3 864 442	3 546 182
Refinancing	172 399	193 275
Total gross carrying amount	4 036 841	3 739 457
Impairment allowances	(1 795 204)	(1 688 819)
Total net carrying amount	2 241 637	2 050 638

Forborne exposures by product type

	31.12.2017	31.12.2016
Mortgage loans	1 675 196	1 293 194
Current accounts	275 530	264 371
Operating loans	947 710	966 079
Investment loans	761 581	844 813
Cash loans	196 501	221 506
Other loans and advances	180 323	149 494
Total gross carrying amount	4 036 841	3 739 457
Impairment allowances	(1 795 204)	(1 688 819)
Total net carrying amount	2 241 637	2 050 638

Forborne exposures by industrial sectors

	31.12.2017	31.12.2016
Corporations:	3 436 645	3 122 618
Real estate activities	893 476	481 286
Construction	830 660	770 424
Manufacturing	683 820	770 470
Professional, scientific and technical activities	510 494	554 119
Accommodation and food service activities	210 504	230 080
Wholesale and retail trade	134 140	155 655
Transportation and storage	65 706	60 215
Mining and quarrying	58 120	58 100
Agriculture, forestry and fishing	23 120	14 495
Other sectors	26 605	27 774
Individuals	600 196	616 839
Total gross carrying amount	4 036 841	3 739 457
Impairment allowances	(1 795 204)	(1 688 819)
Total net carrying amount	2 241 637	2 050 638

Notes to the financial statements (cont.)

(In PLN thousand)

Forborne exposures by geographical structure

	31.12.2017	31.12.2016
Poland	3 734 933	3 391 584
Ukraine	271 325	319 396
Cyprus	28 747	26 874
Other countries	1 836	1 603
Total gross carrying amount	4 036 841	3 739 457
Impairment allowances	(1 795 204)	(1 688 819)
Total net carrying amount	2 241 637	2 050 638

Credit risk concentration

According to valid regulations the total exposure of the Group to single borrower or a group of borrowers related by capital or management may not exceed 25% of the Group's own funds. In 2017 the maximum exposure limits set in the valid regulations were not exceeded.

a) Breakdown by individual entities:
As at 31 December 2017

EXPOSURE TO 10 LARGEST CLIENTS OF THE GROUP	% SHARE OF PORTFOLIO
Client 1	1.3%
Client 2	1.2%
Client 3	0.8%
Client 4	0.8%
Client 5	0.7%
Client 6	0.7%
Client 7	0.6%
Client 8	0.6%
Client 9	0.5%
Client 10	0.5%
Total	7.7%

b) Concentration by capital groups:
As at 31 December 2017

EXPOSURE TO 5 LARGEST CAPITAL GROUPS SERVICED BY THE GROUP	% SHARE OF PORTFOLIO
Group 1	1.5%
Group 2	1.5%
Group 3	1.1%
Group 4	1.0%
Group 5	0.9%
Total	6.0%

Notes to the financial statements (cont.)

(In PLN thousand)

c) Breakdown by industrial sectors:

In order to mitigate credit risk associated with excessive sector concentration a system for shaping the sector credit exposure structure has been dedicated. The system involves setting concentration ratios for particular sectors, monitoring the loan portfolio and procedures for exchanging information. The system refers to credit exposure in particular types of business activity according to the classification applied by the Polish Classification of Economic Activities (Polska Klasyfikacja Działalności – PKD).

Concentration ratios are determined on the basis of current credit exposure to the particular sector and risk assessment of each sector. Periodic comparison of exposure to particular sectors with the current concentration ratio allows timely identification of the sectors in which the concentration of sector risk may become excessive. If such situation arises an analysis of the economic situation of the sector is performed considering the current and predicted trends and the quality of the current exposure to that sector. These measures enable the Group to develop policies that reduce sector risk and allow for a timely reaction to a changing environment.

The table below presents the structure of exposures by industrial sectors

SECTOR DESCRIPTION	31.12.2017	31.12.2016
Wholesale and retail trade; repair of motor vehicles	15.4%	15.4%
Real estate activities	13.7%	12.4%
Public administration and defence	9.3%	10.3%
Construction	6.6%	6.8%
Electricity, gas, steam	6.6%	7.3%
Transportation and storage	6.3%	6.4%
Manufacture of metals, metal products and machinery	5.3%	5.0%
Manufacture of coke, refined petroleum products, chemicals and pharmaceutical products	5.1%	4.5%
Manufacture of beverages and food products	4.7%	4.4%
Financial and insurance activities	3.8%	4.1%
Other manufacturing	7.3%	7.6%
Other sectors	15.9%	15.8%
Total	100.0%	100.0%

CHF loans to individuals

Since 2003 Bank Pekao S.A. has not granted CHF loans for individuals. Almost the entire portfolio of CHF loans for individuals was granted before August 2006 by Bank BPH S.A. and then taken over by Bank Pekao S.A. as a result of the merger.

A few concepts of restructuring of CHF mortgage loans for individuals have been proposed recently. The proposed solutions are under discussion and may change significantly. Therefore, at the moment, the Group is not able to reliably estimate the impact of the proposed solutions on the financial statements. However, taking into account the relatively minor share of these loans in the total assets and limited market share, the Group assesses that potentially taken solutions should not materially affect the financial standing of the Group.

Notes to the financial statements (cont.)

(In PLN thousand)

The tables below present the structure and quality of CHF loans for individuals.

Gross and net amount of CHF loans to individuals

	31.12.2017	31.12.2016
Gross carrying amount, of which:	3 467 081	4 492 086
- denominated in CHF	3 447 189	4 461 077
- indexed to CHF	19 892	31 009
Impairment allowances, of which:	(77 018)	(91 931)
- denominated in CHF	(76 732)	(91 604)
- indexed to CHF	(286)	(327)
Net carrying amount, of which:	3 390 063	4 400 155
- denominated in CHF	3 370 457	4 369 473
- indexed to CHF	19 606	30 682

Quality of CHF loans to individuals

	31.12.2017	31.12.2016
Gross carrying amount of exposures with no impairment, of which:	3 304 616	4 302 638
- not past due	3 122 380	3 956 983
- up to 30 days	132 677	280 365
- between 30 days and 60 days	33 708	47 308
- above 60 days	15 851	17 982
IBNR provisions for exposures with no impairment, of which:	(7 642)	(11 261)
- not past due	(3 507)	(4 183)
- up to 30 days	(2 302)	(4 464)
- between 30 days and 60 days	(1 294)	(1 755)
- above 60 days	(539)	(859)
Gross carrying amount of impaired exposures, of which:	162 465	189 448
- not past due	40 032	31 997
- up to 1 month	10 829	18 589
- between 1 month and 3 months	11 175	12 590
- between 3 months and 1 year	19 686	32 948
- between 1 year and 5 years	43 159	55 254
- above 5 years	37 584	38 070
Allowances for impairment, of which:	(69 376)	(80 670)
- not past due	(7 500)	(6 020)
- up to 1 month	(1 966)	(2 867)
- between 1 month and 3 months	(1 807)	(2 720)
- between 3 months and 1 year	(5 156)	(9 379)
- between 1 year and 5 years	(25 130)	(31 609)
- above 5 years	(27 817)	(28 075)
Total net carrying amount	3 390 063	4 400 155

As of 31 December 2017 the average LTV for CHF loans to individuals granted by the Group amounted to 46.3% (56.3% as at 31 December 2016), with an average LTV for the whole portfolio of 64.3% (66.0% as at 31 December 2016).

Notes to the financial statements (cont.)

(In PLN thousand)

Credit exposures towards Ukraine

As at 31 December 2017, the net balance sheet value of remaining exposures towards Ukraine amounted to PLN 29 million (which constitutes 0.02% of total Group exposures), less by PLN 82 million in comparison to the end of December 2016.

The below table presents the Group's exposure towards the Ukrainian entities

	31.12.2017	31.12.2016
Balance sheet exposure		
Loans and advances to banks	-	-
Loans and advances to customers	275 049	321 048
Total gross carrying amount	275 049	321 048
IBNR / Impairment allowances	(246 012)	(209 687)
Total net carrying amount	29 037	111 361
Off-balance sheet exposure		
Credit lines granted	263	428
Total gross carrying amount	263	428
IBNR	-	-
Total net carrying amount	263	428

6.3 Market risk

The Group is exposed in its operations to market risk and other types of risk caused by changing market risk parameters. Market risk is the risk of deteriorating financial result or capital of the Group resulting from market changes. The main factors of market risk are as follows:

- interest rates,
- foreign exchange rates,
- stock prices,
- commodity prices.

The Group established a market risk management system, providing structural, organizational and methodological frames for the purpose of shaping the structure of balance and off-balance items to assure the achievement of strategic goals.

The main objective of market risk management is to optimize financial results so as to assure the implementation of financial goals of the Group while keeping the exposure to market risk within the risk appetite defined through risk limits approved by the Management Board and the Supervisory Board.

The organization of the market risk management process is based on a three-tier control system, established in compliance with the best international banking practices and recommendations from banking supervision. The process of market risk management and procedures regulating it have been developed taking into consideration the split into trading and banking books.

Notes to the financial statements (cont.)

(In PLN thousand)

Market risk of the trading book

The Group's management of market risk of the trading book aims at optimizing the financial results and assuring the highest possible quality of customer service in reference to the market accessibility (market making) while staying within the limits of risk approved by the Management Board and the Supervisory Board.

The main tool for market risk of the trading book measurement is Value at Risk model (VaR). This value corresponds to the level of a one-day loss, which will be exceeded with the probability not greater than 1%. VaR value is calculated with historical simulation method based on 2 years of historical observations of market risk factors' dynamics. The set of factors used when calculating VaR consists of all significant market factors that are taken into account for valuation of financial instruments, excluding specific credit risk of an issuer and counterparty. Estimating the impact of changes in market factors on the present value of a given portfolio is performed under the full revaluation (which is a difference between the value of the portfolio after the adjustments in market parameters' levels by historically observed changes of the parameters and the present value of the portfolio). For such a set of probable changes in the portfolio value (distribution), VaR is defined to be equal to 1% quantile.

The model is subject to continuous, statistical verification by comparing the VaR values to actual and revaluated performance figures. Results of analyses carried out in 2017 and 2016 confirmed the adequacy of the model applied.

The tables below presents the market risk exposure of the trading portfolio of the Group measured by Value at Risk in 2017 and 2016

	31.12.2017	MINIMUM VALUE	AVERAGE VALUE	MAXIMUM VALUE
foreign exchange risk	739	13	364	1 918
interest rate risk	791	496	1 013	1 925
Trading portfolio	975	614	1 152	3 046

	31.12.2016	MINIMUM VALUE	AVERAGE VALUE	MAXIMUM VALUE
foreign exchange risk	60	14	275	1 958
interest rate risk	819	804	1 106	1 677
Trading portfolio	791	791	1 187	2 174

Interest rate risk of the banking book

In managing the interest rate risk of the banking book the Group aims at hedging the economic value of capital and achieving the planned interest result within the accepted limits. The financial position of the Group in relation to changing interest rates is monitored through the interest rate gap (repricing gap), duration analysis, sensitivity analysis, stress testing and VaR. The interest rate risk of the banking book measurement is generally carried out on a monthly basis.

The table below presents the sensitivity levels of the contractual interest income (NII) to the interest rate change by 100 b.p. and of economic value of the Group's equity (EVE) to the interest rate change by 200 b.p. for the end of December 2017 and December 2016. Both analyses assume instant change of market rates. Interest rates of banking products change according to contractual notations, nevertheless in case of contractual NII, for retail deposits the drop of interest rates is limited by 0. In case of EVE sensitivity for current deposits in PLN, the deposit model is applied, which adjusts deposits revaluation profile.

SENSITIVITY IN %	31.12.2017	31.12.2016
NII	(8.14)	(8.03)
EVE	0.79	(0.76)

Notes to the financial statements (cont.)

(In PLN thousand)

Currency risk

Currency risk management is performed simultaneously for the trading and the banking book. The objective of currency risk management is to maintain the currency profile of statement of financial position and off-balance items within the internal limits.

The table below presents the Group's foreign currency risk profile measured at Value at Risk

CURRENCY	31.12.2017	31.12.2016
Currencies total (*)	727	208

(*) VaR presented in 'Currencies total' is VaR for the whole portfolio, and includes correlations among currencies.

Foreign currency position of the Group

31.12.2017	BALANCE SHEET OPERATIONS		OFF-BALANCE SHEET OPERATIONS- DERIVATIVES		NET POSITION
	ASSETS	LIABILITIES	LONG POSITION	SHORT POSITION	
EUR	19 567 142	20 121 199	12 724 337	12 223 771	(53 491)
USD	4 773 014	8 156 208	9 025 991	5 582 828	59 969
CHF	3 646 120	931 055	3 212 318	5 928 833	(1 450)
GBP	267 038	945 805	786 010	104 930	2 313
CZK	188 269	336 573	158 242	9 956	(18)
Other currencies	326 179	229 077	147 429	243 119	1 412
TOTAL	28 767 762	30 719 917	26 054 327	24 093 437	8 735

31.12.2016	BALANCE SHEET OPERATIONS		OFF-BALANCE SHEET OPERATIONS- DERIVATIVES		NET POSITION
	ASSETS	LIABILITIES	LONG POSITION	SHORT POSITION	
EUR	21 197 815	17 067 038	12 655 773	16 763 013	23 537
USD	5 210 025	7 710 838	6 409 305	3 980 769	(72 277)
CHF	4 722 131	1 049 133	3 606 673	7 285 284	(5 613)
GBP	212 581	869 553	687 217	29 324	921
CZK	34 786	529 413	602 343	107 358	358
Other currencies	262 357	164 008	208 033	304 055	2 327
TOTAL	31 639 695	27 389 983	24 169 344	28 469 803	(50 747)

6.4 Liquidity risk

The objective of liquidity risk management is to:

- ensure and maintain the Group's solvency with respect to current and future payables taking into account the cost of acquiring liquidity and return on the Group's equity,
- prevent the occurrence of crisis situations, and
- provide solutions necessary to survive a crisis situation when such circumstances occur.

The Group has centralized liquidity risk management system covering current liquidity management and first level control performed by the responsible functions, the second level control carried out by a dedicated unit responsible for risk management and independent audit.

Managing the Group's liquidity is carried out in intraday, short-term and long-term horizon. Analysing of Intraday liquidity concerns flows realized during the day, through a short-term liquidity analysis is understood liquidity measurement system which refers to the time horizon shorter than one year, long-term analysis covers period above one year. Due to the specific tools and techniques used for liquidity risk management, the Group manages current and medium-term liquidity together with short-term liquidity.

Notes to the financial statements (cont.)

(In PLN thousand)

The liquidity control is performing as a continuous process of determining and analysing the levels of various indicators and measures related to intraday, short-term and long-term liquidity. Monitoring frequency is matched to the specific liquidity aspect – e.g. daily for short-term liquidity, monthly for long-term liquidity. Liquidity ratios and measures are subject to a formal limiting process. The limits' utilisation is regularly monitored and presented to the Management of the Bank and subsidiaries. In case of exceeding, escalation process is running as to inform decision-makers and ultimately to restore the liquidity risk exposures to acceptable levels.

Scenario-based stress analyses, conducted on a monthly basis, constitute an integral part of the Group's liquidity monitoring process. Within the scope of these analyses the Group's liquidity is assessed under the conditions of crisis which is caused by financial markets or is caused by internal factors, specific to the Group.

Managing the liquidity, the Group pays special attention to the liquidity in foreign currencies through monitoring, limiting and controlling the liquidity individually for each currency, as well as monitoring demand for the current and future currency liquidity and in case of identification of such need the Group hedges using currency swaps. It is also monitored the potential influence on the liquidity of placing required collateral deposits for derivative transaction.

In order to define the principles of contingency liquidity management, Bank introduced, approved by the Management Board, 'Contingency Liquidity Policy', which defines the contingency procedures in the event of crisis situations. This policy involves daily monitoring of the system and specific early-warning indicators for the Bank and the Group as well as three levels of liquidity risk states depending on the level of early-warning indicators, the Bank's, the Group's and market situation. It also defines the sources for covering the expected outflows from the Group. This document sets the procedures for monitoring the liquidity states, emergency action procedures, task forces dedicated for restoring the Group's liquidity and the Management's responsibilities for taking necessary decisions to restore the required liquidity level.

Below are presented basic quantitative information concerning the Group's liquidity at the end of 2017 year in comparison to the end of 2016. They cover the structure of financial liabilities by contractual maturity, adjusted liquidity gap and financial flows from derivative transactions.

Structure of financial liabilities by contractual maturities (*)

31.12.2017	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
BALANCE SHEET LIABILITIES						
Amounts due to banks (**)	1 864 915	17 813	172 101	1 950 047	984 629	4 989 505
Amounts due to customers	112 901 631	14 836 699	18 398 928	398 424	41 901	146 577 583
Debt securities issued	162 660	363 837	1 056 673	1 140 615	159 958	2 883 743
Subordinated liabilities	-	-	35 606	180 573	1 526 158	1 742 337
Financial liabilities held for trading	-	-	-	309 328	160 120	469 448
Total	114 929 206	15 218 349	19 663 308	3 978 987	2 872 766	156 662 616
OFF-BALANCE SHEET COMMITMENTS						
Financial liabilities granted	33 879 984	-	-	-	-	33 879 984
Guarantees issued	11 498 681	-	-	-	-	11 498 681
Total	45 378 665	-	-	-	-	45 378 665

(*) Exposure amounts from balance liabilities, financing-related off-balance sheet commitments granted and guarantee liabilities granted have been allocated to earliest tenors, for which an outflow of assets from the Group is possible based on contracts entered into by the Group. However, outflows expected by the Group are actually significantly lower than those indicated by the specification presented above. The above is a consequence of considerable diversification of amounts due to customers and stages of life of individual contracts. Risk monitoring and management in relation to the outflow of assets are provided by the Group on continuous basis. The Group estimates also more probable flows that are reflected in Tables 'Adjusted liquidity gap'

(**) Including Central Bank.

Notes to the financial statements (cont.)

(In PLN thousand)

Structure of financial liabilities by contractual maturities (*)

31.12.2016	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
BALANCE SHEET LIABILITIES)						
Amounts due to banks (**)	1 568 626	7 866	62 274	1 490 498	1 775 910	4 905 174
Amounts due to customers	107 386 695	11 705 237	18 590 217	529 562	81 291	138 293 002
Debt securities issued	28 936	194 369	171 915	1 056 438	206 332	1 657 990
Financial liabilities held for trading	102 076	-	131 194	263 435	176 460	673 165
Total	109 086 333	11 907 472	18 955 600	3 339 933	2 239 993	145 529 331
OFF-BALANCE SHEET COMMITMENTS						
Financial liabilities granted	32 304 313	-	-	-	-	32 304 313
Guarantees issued	11 259 832	-	-	-	-	11 259 832
Total	43 564 145	-	-	-	-	43 564 145

(*) Exposure amounts from balance liabilities, financing-related off-balance sheet commitments granted and guarantee liabilities granted have been allocated to earliest tenors, for which an outflow of assets from the Group is possible based on contracts entered into by the Group. However, outflows expected by the Group are actually significantly lower than those indicated by the specification presented above. The above is a consequence of considerable diversification of amounts due to customers and stages of life of individual contracts. Risk monitoring and management in relation to the outflow of assets are provided by the Group on continuous basis. The Group estimates also more probable flows that are reflected in Tables 'Adjusted liquidity gap'

(**) Including Central Bank.

Adjusted liquidity gap

The adjusted liquidity gaps presented below include, inter alia, the adjustments concerning the stability of core deposits and their maturities, adjustments of flows from granted off-balance sheet commitments arising from financing, guarantees and from assets without contractual repayment schedules. On top of that, included are also the adjusted flows stemming from the security portfolio and flows resulting from earlier repayment of mortgage loans portfolio. These are the main elements differentiating the adjusted gaps from unadjusted ones. Moreover, the gaps are of static nature, i.e. they do not take into consideration the impact of changes of balance sheet and off-balance sheet items volume (i.e. new deposits) as well as the effect of non-equity related cash flows upon the liquidity profile of the Group.

Adjusted liquidity gap

31.12.2017	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Balance sheet assets	44 331 276	5 616 950	24 338 476	55 530 078	55 648 790	185 465 570
Balance sheet liabilities	19 514 831	10 388 117	23 351 313	22 738 502	109 472 807	185 465 570
Off-balance sheet assets/liabilities (net)	(5 931 269)	97 029	(410 093)	2 359 200	3 209 552	(675 581)
Periodic gap	18 885 176	(4 674 138)	577 070	35 150 776	(50 614 465)	(675 581)
Cumulated gap	-	14 211 038	14 788 108	49 938 884	(675 581)	-

31.12.2016	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Balance sheet assets	42 255 570	4 225 036	24 539 554	50 597 089	52 597 694	174 214 943
Balance sheet liabilities	19 300 857	6 459 100	18 513 533	20 417 900	109 523 553	174 214 943
Off-balance sheet assets/liabilities (net)	(4 956 771)	(16 411)	862 106	1 309 640	1 496 475	(1 304 961)
Periodic gap	17 997 942	(2 250 475)	6 888 127	31 488 829	(55 429 384)	(1 304 961)
Cumulated gap	-	15 747 467	22 635 594	54 124 423	(1 304 961)	-

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance derivative transactions

The tables below show the financial flows relating to derivative off balance transactions.

According to Group's policy, off-balance derivative transactions settled in net amounts include:

- Interest Rate Swaps (IRS),
- Forward Rate Agreements (FRA),
- Foreign currency options and for gold,
- Interest rate options (Cap/Floor),
- Transactions based on equity securities and stock indexes,
- Transactions based on commodities and precious metals.

Off-balance derivative transactions settled by the Group in gross amounts include:

- Cross-Currency Interest Rate Swaps (CIRS),
- Foreign currency forward contracts,
- Foreign currency swaps (FX-Swap),
- Forward contracts based on securities.

Liabilities from off-balance transactions on derivatives recognized in net amounts

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2017	32 892	27 031	649 423	834 010	285 318	1 828 674
31.12.2016	26 757	51 903	131 715	1 219 802	449 921	1 880 098

Cash flows related to off-balance derivative transactions settled in gross amounts

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2017						
Inflows	20 996 756	8 816 296	6 701 443	5 583 512	2 601 848	44 699 855
Outflows	21 001 290	8 855 192	6 812 448	5 992 032	2 657 321	45 318 283
31.12.2016						
inflows	20 805 957	6 032 490	7 701 296	8 030 511	2 915 201	45 485 455
outflows	20 827 342	6 055 624	7 823 747	8 745 485	3 322 026	46 774 224

Notes to the financial statements (cont.)

(In PLN thousand)

6.5 Operational risk

Operational risk is defined as the risk of losses resulting from inadequacy or failure of internal processes, people, systems or external events. It includes law risk, whereas strategic risk, business risk and reputation risk are separate risk categories.

Operational risk management is based on internal procedures that are consistent with the law requirements, resolutions, recommendations and guidelines of the supervisor. Operational risk management includes identification, assessment, monitoring, preventing and reporting. Identification and assessment of operational risk is based on an analysis of internal factors and external factors that may have a significant impact on the achievement of the objectives of the Group. The main tools used in identifying and assessing operational risk are: internal operational events, external operational events, key risk indicators, scenario analysis and self-assessment of operational risk. Monitoring activities are conducted on three levels of control: operational control (all employees), risk management control (Financial and Operational Risk Management Department) and internal audit (Internal Audit Department). Preventing operational risk includes definition of operational risk limits and the obligation to initiate mitigation actions in case they are exceeded, the system of internal control, business continuity plans and insurance coverage. Operational risk reporting system enables the assessment of the Group's exposure to operational risk and the effective management of this risk, and also plays a fundamental role in the process of informing the Supervisory Board, the Management Board and executives of the Group's exposure to operational risk. It is based in particular on the quarterly reports on operational risk control that include, among others: profile of operational risk, loss limit utilization, analysis of trends in the relevant categories of operational risk, potential losses, information on key indicators of operational risk and operational risk capital requirement.

The Supervisory Board, the Management Board and the Operational Risk Committee are involved in operational risk management. The Financial and Operational Risk Management Department coordinates the process of operational risk management. All employees of the Group and selected specialized units are responsible in their areas for operational risk management, due to diversified character of this risk which requires professional knowledge.

In order to ensure compliance of the operational risk management system with regulatory requirements, at least once a year verification of the operational risk management system is carried out.

The table below presents operational events by categories as defined by the Article 324 of Regulation (EU) No 575/2013 of the European Parliament and of the Council:

- internal frauds – losses resulting from acts of intended fraud, misappropriation of property, circumvention of regulations, the laws and internal policies of a company, excluding losses resulting from diversity or discrimination of employees, which concern at least one internal party,
- external frauds – losses being a consequence of acts of defraud, misappropriation of property or circumvention of regulations performed by a third party,
- employment practices and workplace safety – losses due to acts inconsistent with regulations or employment agreements, workplace health and safety agreements, payments from personal injuries claims or losses from discrimination and unequal employee treatment,
- clients, products and business practices – losses arising from failures of meeting professional obligations towards clients due to unintended or negligent acts (including custody requirements and appropriate behavior) or concerning specific features or a design of a product,
- damages to physical assets – losses due to damage or loss of tangible assets resulting from natural disasters or other events,
- business disruption and system failures – losses stemming from business or system failures,
- execution, delivery and process management – losses resulting from failed transaction settlements or process management and losses from relations with cooperating parties and vendors.

Notes to the financial statements (cont.)

(In PLN thousand)

OPERATING EVENTS BY CATEGORIES	2017	2016
Internal frauds	46.08%	10.62%
External frauds	24.37%	18.08%
Employment practices and workplace safety	1.76%	14.26%
Clients, products and business practices	3.91%	7.35%
Damages to physical assets	8.08%	32.00%
Business disruption and system failures	0.46%	0.40%
Execution, delivery and process management	15.34%	17.29%
Total	100.00%	100.00%

6.6 Capital management

The capital management process applied by the Group has been adopted for the following purposes:

- ensuring the safe and secure functioning by maintaining the balance between the capacity to undertake risk (limited by own funds), and the risk levels generated,
- maintenance of capital for covering risk above the minimum stated levels in order to assure further business operations, taking into consideration the possible, future changes in capital requirements and to safeguard the interests of shareholders,
- maintenance of the optimal capital structure in order to maintain the desired quality of risk coverage capital,
- creation of value to shareholders by the best possible utilization of the Group funds.

The Group has put in place a formalized process of capital management and monitoring, established within the scope of Internal Capital Adequacy Assessment Process - ICAAP process. The Finance Division under the Chief Financial Officer is responsible for functioning of the capital management process in the Bank. The ultimate responsibility for capital management is allocated to the Management Board of the Bank, supported by the Assets, Liabilities and Risk Management Committee, which approves the capital management process. The Supervisory Board supervises the capital management system, in particular approves the capital management strategy. The Capital Management Strategy defines the objectives and general rules of the management and monitoring of the Group's capital adequacy, such as the guidelines concerning risk coverage sources, preferred structure of capital for risk coverage, long-term capital targets, capital limits system and sources of additional capital under contingency.

The Group has also implemented the Capital Contingency Policy which establishes rules and obligations in the event of crisis appearance or further development that would significantly reduce capitalization level of the Bank or Group. The policy defines the principles of supervision including split of responsibilities for the purpose of early and consistent management in case of crisis situation development.

The capital adequacy of the Group is controlled by the Assets, Liabilities and Risk Management Committee and Management Board of Bank. Periodic reports on the scale and direction of changes of the capital ratios together with indication of potential threats are prepared for the Supervisory Board, Management Board and for the Assets, Liabilities and Risk Management Committee. The level of basic types of risks is monitored according to the external limits of the banking supervision and the internal limits of the Group. Analyses and evaluations of directions of business activities development are performed assessing the compliance with capital requirements. Forecasting and monitoring of risk weighted assets, own funds and capital ratios constitute an integral part of the planning and budgeting process, including stress tests.

The Group also has a capital allocation process in place, with an aim of guaranteeing the shareholders a safe and effective return on invested capital. On one hand, the process requires capital allocations to products/clients/business lines, which guarantee profits adequate to the risks taken, while on the other hand taking into consideration the cost of capital associated with the business decisions taken. Risk-related efficiency ratios are used in the analyses of income generated compared against the risk taken as well as for the optimization of capital usage for different types of operations.

Notes to the financial statements (cont.)

(In PLN thousand)

Regulatory capital requirements

Calculations of the regulatory capital requirements were performed based on Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, with further amendments as well as Commission Implementing and Delegated Regulations (EU) (hereinafter: 'Regulation 575/2013').

Capital ratios are the basic measures applied for the measurement of capital adequacy. Minimum capital ratios required by law equal 9.75% for TCR and 7.75% for Tier 1 which are the sum of minimum value defined in Regulation 575/2013 (8.0% for TCR and 6.0% for Tier 1) and the combined buffer requirement defined in Act of 5 August 2015 on macro-prudential supervision over financial system and crisis management in financial system (a conservation buffer of 1.25% and other systemically important institution buffer of 0.50%, according to the Polish Financial Supervision Authority (KNF) decision on December 19, 2017 - (total of 1.75%). According to the recommendation of the (KNF) total capital ratio of the Group, must be not lower than 13.75% and Tier 1 capital ratio not lower than 10.75%. Both levels are increased by additional capital Supervisory Review and Evaluation Process (SREP) requirement imposed by KNF (in case of Bank Pekao S.A. Group, additional capital SREP requirement imposed by KNF on total capital ratio is equal to 0.01 p.p. and for Tier 1 capital 0.0075 p.p.).

As at 31 December 2017 total capital ratio of the Group amounted at 17.1% (as at 31 December 2016 – 17.6%).

	31.12.2017	31.12.2016
CAPITAL REQUIREMENTS		
Credit and counterparty risk including CVA	8 973 363	8 511 165
Market risk	48 154	44 022
Operational risk	560 851	493 557
Total capital requirement	9 582 368	9 048 744
OWN FUNDS		
Common Equity Tier 1 capital	19 252 010	19 954 579
Tier 2 capital	1 250 000	-
Own funds for total capital ratio	20 502 010	19 954 579
OWN FUNDS REQUIREMENTS		
Common Equity Tier 1 capital ratio (%)	16.1%	17.6%
Total capital ratio (%)	17.1%	17.6%

Total capital ratio at the end of 2017 compared with the end of 2016 decreased by 0.5 p.p.

Total capital requirement increased by 5.9%, mainly due to higher credit risk capital requirement resulting from, among others, increase in loan volumes and KNF recommendation on application of credit conversion factor (CCF) 0%.

Common Equity Tier 1 Capital was lower by 3.5% as compared to December 2016 due to acquisition by the Bank of stocks of Pekao Investment Management S.A. Increase in own funds for total capital ratio calculation by 2.7% resulted from including in Tier 2 capital, after obtaining KNF approval, the amount of PLN 1.25 billion from the issue of subordinated bonds.

Notes to the financial statements (cont.)

(In PLN thousand)

For the purpose of capital requirement calculation the Group uses:

- Standardised Approach for credit risk capital requirement calculation,
- Financial Collateral Comprehensive Method for credit risk mitigation,
- Mark-to-Market Method for counterparty credit risk capital requirement calculation,
- Standardised Approach for capital requirement calculation of specific risk and duration-based calculation for general risk of debt instruments,
- Standardised Approach for capital requirement calculation of general and specific risk of equity instruments,
- Standardised Approach for capital requirement calculation for pre-funded contributions to the default fund of a qualifying central counterparty,
- Standardised Approach for foreign-exchange risk capital requirement calculation,
- Simplified approach for commodities risk capital requirement calculation,
- Standardised Approach for capital requirements for credit risk valuation adjustment risk,
- Advanced Measurement Approach for operational risk measurement in case of Bank (however, at a level not lower than 50% of the capital requirement calculated using the Standardised Approach and Standardised Approach for Bank's subsidiaries.

Own funds

The Group defines components of own funds in line with the binding law, particularly with Regulation No 575/2013 and The Banking Act of 29 August 1997 with further amendments.

The Group's own funds consist of Common Equity Tier 1 capital and Tier 2 capital. Additional Tier 2 capital are not identified in the Group.

	31.12.2017	31.12.2016
OWN FUNDS		
Capital	23 267 815	22 911 943
Different scope of consolidation	16 586	16 361
Component of the capital not included into own funds, in which:	(2 475 129)	(2 279 275)
Current year net profit	(2 475 129)	(2 279 275)
Regulatory adjustments, in which:	(1 557 262)	(694 450)
Intangible assets	(1 458 263)	(531 041)
Capital from revaluation	(5 331)	(32 177)
Unrealised loss from debt and capital instruments available for sale	-	-
Unrealised gain from debt and capital instruments available for sale	(28 584)	(51 593)
Deferred tax assets that rely on future profitability	(19 911)	(18 876)
Additional value adjustments due to prudent calculation	(45 173)	(45 839)
Minority interests	-	(14 924)
Common Equity Tier 1 capital	19 252 010	19 954 579
Tier 2 capital	1 250 000	-
Own funds for total capital ratio	20 502 010	19 954 579

Components of capital not included into own funds:

- Current year net profit – net profit of current reporting period, verified by statutory auditor responsible for auditing of the Group's accounts reduced by all foreseeable charge and dividend, can be included into Common Equity Tier 1 capital only with the permission of KNF. As at 31 of December 2017, current profit of the Group was not included into Common Equity Tier 1 capital.

Notes to the financial statements (cont.)

(In PLN thousand)

Regulatory adjustments:

- intangible assets (after deduction of related deferred tax liabilities) decrease Common Equity Tier 1 capital, according to Article 36 of Regulation No 575/2013,
- capital from revaluation reflecting fair value of cash flow hedges is not included in any element of own funds, according to Article 33 of Regulation No 575/2013,
- unrealised losses from debt and capital instruments classified as available for sale according to Article 467 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act, decrease Common Equity Tier 1 capital in 100%,
- unrealised gains from debt and capital instruments classified as available for sale according to Article 468 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act are included in 80% to Common Equity Tier 1 capital,
- deferred tax assets based on future profitability decrease Common Equity Tier 1 capital according to Article 36 of Regulation No 575/2013 only in 80% (Article 469 of Regulation No 575/2013 using national options defined in Article 171a Banking Act),
- additional value adjustments due to prudent valuation are created for every asset measured at fair value, according to Article 34 of Regulation No 575/2013,
- minority interests are deducted from Group's capital because requirements laid down in Regulation No 575/2013 are not meet.

Internal capital adequacy assessment

To assess the internal capital adequacy of the Group, the Bank applies methods designed internally.

The Group takes the following risks into consideration:

- credit risk,
- operational risk,
- market risk,
- liquidity risk,
- real estate risk,
- macroeconomic risk,
- business risk (including strategic risk),
- compliance risk,
- reputational risk,
- model risk,
- excessive leverage risk,
- bancassurance risk,
- financial investment risk.

For each risk deemed material, the Group develops and applies adequate risk assessment and measurement methods. The Group applies the following risk assessment methods:

- qualitative assessment – applied in case of risks which are difficult to measure (compliance, reputational and bancassurance risks) with potential capital coverage in other risks areas,
- assessment by estimation of capital buffer, for risks that are not easily quantifiable however some aggregate assessment of their impact is possible (model risk and macroeconomic risk),
- quantitative assessment – applied for risks which can be measured with the use of economic capital (other risk types apart from liquidity risk and excessive leverage risk) or based on other risk-specific measures (liquidity risk and excessive leverage risk).

Notes to the financial statements (cont.)

(In PLN thousand)

Generally, preferred methods of measuring risks and determining the resulting capital requirements are Value at Risk models, based on assumptions derived from the Group's risk appetite. The models are developed in compliance with the best market practices and regulatory requirements and supplemented with stress tests and/or scenario analyses. In case of risk types for which such methodologies have not been finally developed or implemented, the Group uses regulatory models supplemented with stress tests or simplified measurement methods.

Also, a consistent methodology for estimating the buffer for macroeconomic changes and model risks has been developed. The macroeconomic changes risk capital buffer is determined on the basis of the impact of the economic slowdown scenario on economic capital in the forecast horizon.

Model risk is assessed with scenario analyses making it possible to evaluate the impact of potential model inconsistencies on its output. Based on the aggregated output, the model risk capital buffer is determined.

The procedure of estimating capital needs starts with the calculation of economic capital, separately for each material quantifiable risk identified by the Group. Next, economic capital figures for individual risks are aggregated inclusive of diversification effect. The amount is then increased by the capital buffer for model and macroeconomic changes risks. The sum of economic capital (inclusive of diversification effect) and the capital buffer constitutes the internal capital of the Group.

6.7 Fair value of financial assets and liabilities

Financial instruments that are measured at fair value in the consolidated statement of financial position of the Group

The measurement of fair value of financial instruments, for which market values from active markets are available, is based on market quotations of a given instrument (mark-to-market).

The measurement of fair value of Over-the-counter ('OTC') derivatives and instruments with limited liquidity (i.e. for which no market quotations are available), is made on the basis of other instruments quotations on active markets by replication thereof using a number of valuation techniques, including the estimation of present value of future cash flows (mark-to-model).

As of 31 December 2017 and 31 December 2016, the Group classified the financial assets and liabilities measured at fair value into the following hierarchy of three categories based on the valuation method:

- Level 1: mark-to-market, applies to securities quoted on active markets,
- Level 2: mark-to-model valuation with model parameterization, based on quotations from active markets for given type of instrument, applies to illiquid government, municipal, corporate and central bank debt securities, linear and non-linear derivative instruments of interest rate markets (including forward transactions on debt securities), equity, commodity and foreign currency exchange markets, except for those cases that meet the criteria of Level 3,
- Level 3: mark-to-model valuation with partial model parameterization, based on estimated risk factors, applicable to corporate and municipal debt securities and for linear and non-linear derivative instruments of interest rate, equity, commodity and foreign currency exchange markets for which unobservable parameters (e.g. credit risk factors) are recognized as significant.

The measurement at fair value is performed directly by a unit within Risk Management Division, independent of front-office units. The methodology of fair value measurement, including the changes of its parameterization, is subject to approval of Assets and Liabilities Committee (ALCO). The adequacy of measurement methods is subject to on-going analysis and periodical reviews in the framework of model risk management. The same Risk Management Division unit performs the assessment of adequacy and significance of risk factors for the assignment of valuation models to appropriate method class, according to established hierarchy of classification.

Notes to the financial statements (cont.)

(In PLN thousand)

Assets and liabilities measured at fair value in breakdown by fair value hierarchy levels

31.12.2017	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:	19 838 234	16 173 785	750 871	36 762 890
Financial assets held for trading	1 629 449	86 756	14 211	1 730 416
Derivative financial instruments, including:	19	1 347 810	1 218	1 349 047
- Banks	-	912 259	1 218	913 477
- Customers	19	435 551	-	435 570
Hedging instruments, including:	-	259 396	-	259 396
- Banks	-	76 796	-	76 796
- Customers	-	182 600	-	182 600
Securities available for sale	18 208 766	14 479 823	735 442	33 424 031
Liabilities:	456 512	2 905 370	-	3 361 882
Financial liabilities held for trading	456 510	12 938	-	469 448
Derivative financial instruments, including:	2	2 030 101	-	2 030 103
- Banks	-	815 493	-	815 493
- Customers	2	1 214 608	-	1 214 610
Hedging instruments, including:	-	862 331	-	862 331
- Banks	-	858 274	-	858 274
- Customers	-	4 057	-	4 057

31.12.2016	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:	20 944 182	13 685 790	407 312	35 037 284
Financial assets held for trading	636 385	29 971	66 113	732 469
Derivative financial instruments, including:	1	1 913 428	-	1 913 429
- Banks	-	1 339 956	-	1 339 956
- Customers	1	573 472	-	573 473
Hedging instruments, including:	-	289 752	-	289 752
- Banks	-	54 550	-	54 550
- Customers	-	235 202	-	235 202
Securities available for sale	20 307 796	11 452 639	341 199	32 101 634
Liabilities:	527 840	3 736 717	-	4 264 557
Financial liabilities held for trading	527 836	145 329	-	673 165
Derivative financial instruments, including:	4	1 952 670	-	1 952 674
- Banks	-	1 349 082	-	1 349 082
- Customers	4	603 588	-	603 592
Hedging instruments, including:	-	1 638 718	-	1 638 718
- Banks	-	1 636 262	-	1 636 262
- Customers	-	2 456	-	2 456

Notes to the financial statements (cont.)

(In PLN thousand)

Change in fair value of financial instruments measured at fair value according to Level 3 by the Group

2017	FINANCIAL ASSETS HELD FOR TRADING	DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS)	SECURITIES AVAILABLE FOR SALE
Opening balance	66 113	-	341 199
Increases, including:	1 388 818	2 353	717 283
Reclassification	-	-	674 519
Acquisition	1 387 394	-	-
Settlement	-	-	-
Derivatives transactions made in 2017	-	2 353	-
Gains on financial instruments	1 424	-	42 764
recognized in the income statement	1 424	-	41 152
recognized in revaluation reserves	-	-	1 612
Decreases, including:	(1 440 720)	(1 135)	(323 040)
Reclassification	-	-	-
Settlement / Redemption	(1 020)	-	(290 030)
Sale	(1 439 693)	-	-
Loss on financial instruments	(7)	(1 135)	(33 010)
recognized in the income statement	(7)	(1 135)	(10 054)
recognized in revaluation reserves	-	-	(22 956)
Closing balance	14 211	1 218	735 442
Unrealized income from financial instruments held in portfolio until end of period, recognized in:	400	(1 135)	2 853
Income statement:	400	(1 135)	23 456
net interest income	178	-	23 456
result on financial assets and liabilities held for trading	222	(1 135)	-
Other components income	-	-	(20 603)

Notes to the financial statements (cont.)

(In PLN thousand)

Change in fair value of financial instruments measured at fair value according to Level 3 by the Group

2016	FINANCIAL ASSETS HELD FOR TRADING	DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS)	SECURITIES AVAILABLE FOR SALE
Opening balance	47 389	943	456 169
Increases, including:	188 786	-	68 170
Reclassification	-	-	-
Acquisition	187 298	-	58 952
Settlement	-	-	-
Gains on financial instruments	1 488	-	9 218
recognized in the income statement	1 488	-	7 598
recognized in revaluation reserves	-	-	1 620
Decreases, including:	(170 062)	(943)	(183 140)
Reclassification	-	(943)	-
Settlement / Redemption	(23 454)	-	(181 678)
Sale	(146 585)	-	-
Loss on financial instruments	(23)	-	(1 462)
recognized in the income statement	(23)	-	(4)
recognized in revaluation reserves	-	-	(1 458)
Closing balance	66 113	-	341 199
Unrealized income from financial instruments held in portfolio until end of period, recognized in:	25	-	(1 187)
Income statement:	25	-	271
net interest income	41	-	271
result on financial assets and liabilities held for trading	(16)	-	-
Other components income	-	-	(1 458)

Transfers of instruments between fair value hierarchy levels are based on changes in availability of active market quotations as at the end of the reporting periods.

In the period from 1 January to 31 December 2017, the following transfers between fair value hierarchy levels were performed:

- government bonds in PLN, for which prices from active market were available, were transferred from Level 2 to Level 1,
- municipal bonds with significant impact of estimated credit parameters on their valuation were transferred from Level 2 to Level 3,
- government bonds in PLN, for which impact on their valuation of the estimated spread to a selected benchmark bond was significant, were transferred from Level 2 to Level 3,
- corporate bonds, which were valued based on market prices of comparable instruments, were transferred from Level 3 to Level 2.

Notes to the financial statements (cont.)

(In PLN thousand)

The impact of estimated parameters on measurement of financial instruments for which the Group applies fair value valuation according to Level 3 as at 31 December 2017 and 31 December 2016 is as follows

FINANCIAL ASSET/LIABILITY	FAIR VALUE AS AT 31.12.2017	VALUATION TECHNIQUE	UNOBSERVABLE FACTOR	ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE)	IMPACT ON FAIR VALUE AS AT 31.12.2017	
					POSITIVE SCENARIO	NEGATIVE SCENARIO
Municipal debt securities	652 597	Discounted cash flow	Credit spread	0.45%-0.87%	3 856	(3 856)
Government debt securities	14 211	Discounted cash flow	Benchmark bond spread	0.09%-0.46%	448	(448)
Derivatives	1 218	Black Scholes Model	Correlation	0-1	966	(578)

FINANCIAL ASSET/LIABILITY	FAIR VALUE AS AT 31.12.2016	VALUATION TECHNIQUE	UNOBSERVABLE FACTOR	ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE)	IMPACT ON FAIR VALUE AS AT 31.12.2016	
					POSITIVE SCENARIO	NEGATIVE SCENARIO
Corporate debt securities	316 025	Discounted cash flow	Credit spread	0.32%-1.13%	613	(627)

Financial instruments that are not measured at fair value in the consolidated statement of financial position of the Group

The Group also holds financial instruments which are not presented at fair value in the financial statements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

As of 31 December 2017 and on 31 December 2016, the Group classified the financial assets and liabilities not measured at fair value in the consolidated statement of financial position into the following three categories based on the valuation level:

- Level 1: mark-to-market, applies to government securities quoted on the liquid market and cash,
- Level 2: mark-to-model valuation with model parameterization, based on quotations from active markets for given type of instrument, applies to interbank deposits, own issues, illiquid government, municipal, corporate and central bank debt securities,
- Level 3: mark-to-model valuation with partial model parameterization, based on estimated risk factors is applicable to corporate and municipal debt securities and loans and deposits for which the applied credit risk factor (an unobservable parameter) is recognized significant.

In case of certain groups of financial assets, recognized at the amount to be received with impairment considered, the fair value was assumed to be equal to carrying amount. The above applies in particular to cash and other financial assets and liabilities.

In the case of loans for which no quoted market values are available, the fair values presented are generally estimated using valuation techniques taking into consideration the assumption, that at the moment when the loan is granted its fair value is equal to its carrying amount. Fair value of non-impaired loans is equal to the sum of future expected cash flows, discounted at the balance sheet date minus the expected credit loss. The discount rate is defined as the appropriate market risk-free rate plus the liquidity margin and current sales margin for the given loan products group. The margin is computed by product groups and maturity. For the purpose of the fair value of foreign currency loans estimation, the liquidity margin on PLN loans adjusted by the fx swap and cross-currency basis swap quotes is used. The fair value of impaired loans is defined as equal to the sum of expected recoveries, discounted with the use of effective interest rate, since the average expected recovery values take the element of credit risk fully into consideration. In case of loans without repayment schedule (loans in current account, overdrafts and credit cards), the fair value was assumed as equal to the carrying amount.

For the Group's capital exposure, for which no active market prices are available and market values are unattainable, the Group does not measure their fair value. Such exposures include companies from financial sector, associated with the use of the financial and banking infrastructure and payment card services and companies taken-over as a result of debt restructuring.

Notes to the financial statements (cont.)

(In PLN thousand)

Since no quoted market prices are available for deposits, their fair values have been generally estimated using valuation techniques with the assumption that the fair value of a deposit at the moment of its receipt is equal to its carrying amount. The fair value of term deposits is equal to the sum of future expected cash flows, discounted at the relevant balance sheet date. The cash flow discount rate is defined as the relevant market risk-free rate, increased by the sales margin. The margin is computed on deposits acquired during last three months broken down by deposit product groups and maturity. In case of short term deposits (current deposits, overnights, saving accounts), the fair value was assumed as equal to the carrying amount.

The fair value of deposits and loans, apart from cash loans and mortgage loans denominated in PLN and CHF for which prepayment model is used, is calculated based on contractual cash flows.

The mark-to-model valuation of own issue debt instruments is based on the method of discounting the future cash flows. Variable cash flows are estimated based upon rates adopted for specific markets (depending upon issue specifications). Both the fixed and implied cash flows are discounted using interbank money market rates.

Assets and liabilities not measured at fair value in the financial statement in breakdown by fair value hierarchy levels

31.12.2017	CARRYING AMOUNT	FAIR VALUE	OF WHICH:		
			LEVEL 1	LEVEL 2	LEVEL 3
Assets					
Cash and due from Central Bank	5 236 317	5 236 317	2 686 582	2 549 735	-
Loans and advance to banks	2 627 327	2 627 266	-	1 101 422	1 525 844
Loans and advances to customers	127 949 307	127 027 425	-	8 153 945	118 873 480
Receivables from financial leases	4 351 352	4 416 054	-	-	4 416 054
Debt securities held to maturity	3 481 791	3 516 116	3 484 665	31 451	-
Total assets	143 646 094	142 823 178	6 171 247	11 836 553	124 815 378
Liabilities					
Amounts due to Central Bank	6 079	6 080	-	-	6 080
Amounts due to other banks	4 981 291	4 909 701	-	671 642	4 238 059
Amounts due to customers	146 186 268	146 367 007	-	788 437	145 578 570
Debt securities issued	4 028 587	4 043 526	-	4 043 526	-
Total liabilities	155 202 225	155 326 314	-	5 503 605	149 822 709

31.12.2016	CARRYING AMOUNT	FAIR VALUE	OF WHICH:		
			LEVEL 1	LEVEL 2	LEVEL 3
Assets					
Cash and due from Central Bank	5 872 911	5 872 802	2 639 531	3 233 271	-
Loans and advance to banks	3 257 829	3 257 936	-	1 089 488	2 168 448
Loans and advances to customers	118 689 267	117 912 278	-	5 789 241	112 123 037
Receivables from financial leases	3 974 643	4 038 178	-	-	4 038 178
Debt securities held to maturity	3 018 985	3 033 397	3 012 791	20 606	-
Total assets	134 813 635	134 114 591	5 652 322	10 132 606	118 329 663
Liabilities					
Amounts due to Central Bank	6 091	6 185	-	-	6 185
Amounts due to other banks	4 823 440	4 870 778	-	482 375	4 388 403
Amounts due to customers	137 815 926	137 494 049	-	1 436 240	136 057 809
Debt securities issued	1 522 963	1 565 925	-	1 565 925	-
Total liabilities	144 168 420	143 936 937	-	3 484 540	140 452 397

Notes to the financial statements (cont.)

(In PLN thousand)

7. Custody activity

Custody activities are performed by virtue of a permit, issued by the Polish Financial Supervision Authority. The Bank's clients include a number of domestic and foreign financial institutions, banks offering custody and investment services, insurance companies, investment and pension funds, as well as non-financial institutions. The Bank provides custody services, including, inter alia, the settlement of transactions effected on domestic and international markets, custody of clients' assets, running of securities accounts, valuation of assets and services related to dividend and interest payments. The Bank also performs the activities of investment and pension funds depository.

As at 31 December 2017 the Bank maintained 12 517 securities accounts and omnibus accounts (in comparison to 12 333 accounts as at 31 December 2016).

8. Brokerage activity

The Group offers a wide range of capital market products and services via specialized Bank's organizational unit – Dom Maklerski Pekao and by the agency of Centralny Dom Maklerski Pekao S.A., Pekao Investment Banking S.A. and Dom Inwestycyjny Xelion Sp. z o.o. a subsidiaries of the Bank Pekao S.A.

Dom Maklerski Pekao and Centralny Dom Maklerski Pekao S.A.

The objective of Dom Maklerski Pekao is to provide the highest quality brokerage services within the Bank's offer. The comprehensive offer enables investors, in particular the individual clients of the Bank, to invest in financial instruments with diverse characteristics, which are listed on the regulated market and on the alternative trading system organized by the Warsaw Stock Exchange (GPW S.A.) and by the BondSpot S.A. (i.e. shares, treasury and corporate bonds, derivatives – futures and options, ETF, certificates, warrants) as well as the instruments traded on the specific foreign markets offered via any customer service channel (i.e. website, mobile service, telephone, and in the form of direct service provided by Customer Advisors through the branches). As part of the cooperation within the entities of the Capital Group, the entity provides intermediary services of Closed-end Investment Funds offered by TFI PZU, acts as the Offeror and accepts subscriptions for mortgage bonds issued by Pekao Bank Hipoteczny S.A. and also acts as an intermediary in sales of the Structured Certificates of Deposit issued by Bank Pekao S.A. As part of retail consortia, Dom Maklerski Pekao offers investors to acquire instruments in the IPOs serviced by the entity as well as to make transactions on the non-public market. The direct service is provided in nearly 390 Brokerage Services Spots located in the Bank Pekao S.A.'s branches throughout Poland and via remote channels of Pekao24Makler (website, telephone, mobile application) fully integrated with the Bank's electronic banking platform Pekao24.

Centralny Dom Maklerski Pekao S.A. (CDM) is one of the largest and the oldest operating brokerage firm on the Polish capital market. The aim of CDM is to provide comprehensive service of investment accounts. The product portfolio enables Clients to invest in a wide variety of financial products inter alia shares, Treasury bonds, corporate bonds, certificates, funds' units, ETF, structured products, insurance and pension programs. CDM also offers for its clients such services as investments on derivatives, foreign markets and OTC markets. Clients are served in 43 Consumer Service Spots located in Bank branches located in Poland and additionally in 12 places dedicated to service for strategic clients and through remote service channels of CDM24 (CDMInternet, TeleCDM, CDM Mobile) enabling access to electronic banking platform Pekao24.

The close cooperation of Dom Maklerski Pekao and CDM on the realization of the projects conducted on the primary market and through other business areas guarantees professional and comprehensive brokerage services.

Both CDM and Dom Maklerski Pekao are members of the Warsaw Stock Exchange (GPW S.A.) and a direct participants in the National Depository of Securities (KDPW).

Both entities conform to the Good Practices Code of Brokerage Firms guaranteeing comprehensive services in accordance with highest ethics standards. Both Dom Maklerski Pekao and CDM actively participate in capital market development in Poland.

Notes to the financial statements (cont.)

(In PLN thousand)

Pekao Investment Banking S.A.

Pekao Investment Banking S.A. operates as a brokerage house supervised by the Financial Supervision Commission, focusing on the service of institutional and corporate clients. Pekao Investment Banking S.A. is also supervised to a limited extent by the supervisory authorities in the EU-countries in which the operations of Pekao Investment Banking S.A. have been passported. The scope of services provided by comprises in particular the acceptance and transfer of orders for the purchase or sale of financial instruments, the execution of these orders on the account of the person or entity placing the order, the offering of financial instruments, advisory services for enterprises on capital structure, corporate strategy or other matters related to such structure or strategy as well as advisory services and other services relating to mergers, spin-offs and acquisitions of companies, underwriting and similar services and research activity.

Pekao Investment Banking S.A. also performs the function of market maker both on the capital market and on the derivatives market, and in this role is one of the most active market makers.

Pekao Investment Banking S.A. is a member of the Warsaw Stock Exchange (GPW S.A.), a member of BondSpot S.A and a direct participant in the National Depository of Securities (KDPW).

Dom Inwestycyjny Xelion Sp. z o.o.

Dom Inwestycyjny Xelion Sp. z o.o. operates as a brokerage house supervised by the Financial Supervision Commission, focusing on the service of retail clients. The range of services rendered by Dom Inwestycyjny Xelion covers acceptance and transfer of orders for purchase or sale of financial instruments, execution of orders for purchase or sale of financial instruments on account of the person placing the order, investment advisory, custody and registration of securities including keeping securities accounts and cash accounts and also preparing of investment analysis, financial analysis and general recommendations on transactions in financial instruments.

Dom Inwestycyjny Xelion is a member of the Warsaw Stock Exchange (GPW S.A.) and a direct participant in the National Depository of Securities (KDPW).

Information about the financial instruments of the clients held on securities accounts or stored in a form of document

	31.12.2017		31.12.2016	
	QUANTITY (pcs)	VALUE	QUANTITY (pcs)	VALUE
CLIENTS' FINANCIAL INSTRUMENTS				
Held on securities accounts	3 531 159 615	25 297 335	3 556 221 597	24 707 398
Equity securities and rights to such financial assets	3 434 929 439	23 203 078	3 550 120 296	23 236 537
Debt instruments and rights to such financial assets	96 230 176	2 094 257	6 101 301	1 470 861
Stored in a form of document	2 598 381 120	6 264 610	2 623 762 193	6 291 869
Equity securities and rights to such financial assets	2 598 381 120	6 264 610	2 623 762 193	6 291 869
Debt instruments and rights to such financial assets	-	-	-	-

Customers' cash on brokerage accounts

	31.12.2017	31.12.2016
Deposited on cash accounts in brokerage house and paid for securities bought in IPO or on the primary market	1 097 702	1 100 623
Other customers' cash	10 458	40 955
Total	1 108 160	1 141 578

Notes to the financial statements (cont.)

(In PLN thousand)

Settlements due to unsettled transactions

	31.12.2017	31.12.2016
Receivables from executed transactions	23 283	32 061
Liabilities from executed transactions	751	-

Settlements with National Depository of Securities (KDPW), KDPW_CCP and other stock exchange clearing houses

	31.12.2017	31.12.2016
Receivables from clearing fund	23 471	24 817
Receivables from margin deposits	35 630	32 391
Other receivables	1 432	1 252
Total receivables	60 533	58 460
Amounts due on margin deposits	-	921
Other liabilities	288	317
Total liabilities	288	1 238

Items concerning the participation in the compensation fund managed by the National Depository of Securities (KDPW)

	31.12.2017	31.12.2016
Receivables from compensation fund	12 049	11 432
Prepaid expenses - system maintenance fees	2 221	1 764
Deferred income – benefits from system	(14 252)	(13 411)
Total net balance sheet items concerning participation in the compensation fund	18	(215)

Settlement with entities running regulated securities markets and commodity exchanges

	31.12.2017	31.12.2016
Amounts due to Warsaw Stock Exchange	814	527
Total liabilities	814	527

9. Operating segments

Data reported in the section stem from the application of the management model ('Model') in which the main criterion for segmentation is the classification of customers based on their profile and service model.

Reporting and monitoring of results, for managerial purposes, includes all components of the income statement up to the gross profit level. Therefore, the income from the segment's activities as well as operating costs related to those activities (including direct and allocated costs in line with the allocation model applied) and other components of income statement are attached to each segment.

The Group settles transactions between segments on an arm's length basis by applying current market prices. Fund transfers between retail, private, corporate and investment banking segments, and the assets and liabilities management and other area are based on market prices applicable to the funds' currency and maturity, including liquidity margins.

Notes to the financial statements (cont.)

(In PLN thousand)

Operating segments

The operating segments of the Group are as follows:

- Retail banking – all banking activities related to retail customers (excluding private banking customers), small and micro companies with annual turnover not exceeding PLN 20 million, as well as results of the subsidiaries, and shares in net profit of associates accounted for using the equity method, that are assigned to the retail banking activity,
- Private banking – all banking activities related to the most affluent individual customers,
- Corporate and Investment banking – all banking activities related to the medium and large companies, interbank market, debt securities and other instruments, and results of the subsidiaries that are assigned to the Corporate and Investment banking activity,
- assets and liabilities management and other – supervision and monitoring of fund transfers, other activities centrally managed as well as the results of subsidiaries and share in net profit of associated accounted for using equity method that are not assigned to other reported segments.

Operating segments reporting for the period from 1 January to 31 December 2017

	RETAIL BANKING	PRIVATE BANKING	CORPORATE AND INVESTMENT BANKING	ASSETS AND LIABILITIES MANAGEMENT AND OTHER	TOTAL
Total net interest income	2 650 376	59 287	1 616 024	327 018	4 652 705
Non-interest income	1 510 463	28 593	933 621	225 039	2 697 716
Operating income	4 160 839	87 880	2 549 645	552 057	7 350 421
Personnel expenses	(1 138 329)	(25 426)	(266 258)	(520 289)	(1 950 302)
Other administrative expenses	(1 279 702)	(26 856)	(340 688)	681 536	(965 710)
Depreciation and amortisation	(167 544)	(1 441)	(22 900)	(155 453)	(347 338)
Operating costs	(2 585 575)	(53 723)	(629 846)	5 794	(3 263 350)
Gross operating profit	1 575 264	34 157	1 919 799	557 851	4 087 071
Net impairment losses on loans and off-balance sheet commitments	(230 734)	(453)	(298 432)	8 368	(521 251)
Net operating profit	1 344 530	33 704	1 621 367	566 219	3 565 820
Net result on other provisions	(12 504)	(230)	191	(23 480)	(36 023)
Guarantee funds charges	(109 214)	(622)	(138 712)	(20 437)	(268 985)
Tax on certain financial institutions	-	-	-	(522 281)	(522 281)
Net result on investment activities	(274)	-	705	414 069	414 500
Profit before tax	1 222 538	32 852	1 483 551	414 090	3 153 031
Income tax expense					(677 323)
Net profit for the period					2 475 708
Attributable to equity holders of the Bank					2 475 129
Attributable to non-controlling interests					579
Allocated assets	70 451 423	333 353	109 395 487	(4 033 634)	176 146 629
Unallocated assets					9 318 941
Total assets					185 465 570
Allocated liabilities	85 439 917	8 563 104	67 835 783	(4 774 575)	157 064 229
Unallocated liabilities					28 401 341
Total liabilities					185 465 570

Notes to the financial statements (cont.)

(In PLN thousand)

Operating segments reporting for the period from 1 January to 31 December 2016

	RETAIL BANKING	PRIVATE BANKING	CORPORATE AND INVESTMENT BANKING	ASSETS AND LIABILITIES MANAGEMENT AND OTHER	TOTAL
Total net interest income	2 452 273	49 904	1 638 137	297 069	4 437 383
Non-interest income	1 520 531	30 824	927 658	430 822	2 909 835
Operating income	3 972 804	80 728	2 565 795	727 891	7 347 218
Personnel expenses	(1 111 686)	(25 335)	(261 344)	(498 471)	(1 896 836)
Other administrative expenses	(1 245 544)	(25 180)	(333 404)	629 923	(974 205)
Depreciation and amortisation	(177 566)	(1 714)	(22 642)	(138 944)	(340 866)
Operating costs	(2 534 796)	(52 229)	(617 390)	(7 492)	(3 211 907)
Gross operating profit	1 438 008	28 499	1 948 405	720 399	4 135 311
Net impairment losses on loans and off-balance sheet commitments	(250 177)	1	(252 807)	2 354	(500 629)
Net operating profit	1 187 831	28 500	1 695 598	722 753	3 634 682
Net result on other provisions	(651)	(514)	1 259	(14 569)	(14 475)
Guarantee funds charges	(102 114)	(650)	(136 073)	(40 631)	(279 468)
Tax on certain financial institutions	-	-	-	(449 533)	(449 533)
Net result on investment activities	(170)	-	498	5 012	5 340
Profit before tax	1 084 896	27 336	1 561 282	223 032	2 896 546
Income tax expense					(616 782)
Net profit for the period					2 279 764
Attributable to equity holders of the Bank					2 279 275
Attributable to non-controlling interests					489
Allocated assets	63 535 068	264 940	105 201 817	(3 930 069)	165 071 756
Unallocated assets					9 143 187
Total assets					174 214 943
Allocated liabilities	78 948 120	8 409 354	63 467 075	(5 142 416)	145 682 133
Unallocated liabilities					28 532 810
Total liabilities					174 214 943

Reconciliation of operating income for reportable segments

	2017	2016
Total operating income for reportable segments	7 350 421	7 347 218
Share in gains (losses) from associates	(39 437)	(38 580)
Net other operating income and expenses	(112 448)	(30 528)
Refunding of administrative expenses	2 546	2 282
Operating income	7 201 082	7 280 392

Geographical segment

The operating activity of Bank Pekao S.A. Group is concentrated in Poland through the network of branches and the subsidiaries.

Notes to the financial statements (cont.)

(In PLN thousand)

10. Interest income and expense

Interest income

	2017	2016
Loans and other receivables from customers	4 721 533	4 431 535
Interbank placements	80 805	79 776
Reverse repo transactions	30 427	50 078
Investment securities	671 936	736 789
Hedging derivatives	123 610	138 866
Financial assets held for trading	12 403	11 446
Total	5 640 714	5 448 490

Interest income for 2017 includes income from impaired financial assets in the amount of PLN 226 065 thousand (in 2016 PLN 243 131 thousand).

Total amount of interest income for 2017 measured at amortized cost using the effective interest rate method, which applies to financial assets not measured at fair value through profit or loss, amounted to PLN 4 049 781 thousand (in 2016 PLN 3 797 006 thousand).

Interest expense

	2017	2016
Deposits from customers	(917 433)	(941 996)
Interbank deposits	(16 356)	(24 257)
Repo transactions	(55 234)	(44 045)
Loans and advances received	(8 968)	(10 817)
Debt securities issued	(49 227)	(45 370)
Total	(1 047 218)	(1 066 485)

Total amount of interest expense for 2017, measured at amortized cost using the effective interest rate method with reference to financial liabilities, which are not valued at fair value through profit or loss amounted to PLN 804 576 thousand (in 2016 PLN 868 315 thousand).

Notes to the financial statements (cont.)

(In PLN thousand)

11. Fee and commission income and expense

Fee and commission income

	2017	2016
Accounts maintenance, payment orders and cash transactions	603 643	630 068
Payment cards	586 824	598 246
Loans and advances	438 640	460 543
Margin on foreign exchange transactions with clients	439 623	431 026
Investment products sales intermediation	286 744	248 716
Securities operations	92 827	91 198
Custody activity	66 481	62 842
Pension and investment funds service fees	49 786	48 920
Guarantees, letters of credit and similar transactions	54 451	54 774
Other	44 546	56 778
Total	2 663 565	2 683 111

Fee and commission expense

	2017	2016
Payment cards	(229 717)	(218 109)
Money orders and transfers	(20 757)	(20 077)
Securities and derivatives operations	(28 931)	(28 578)
Accounts maintenance	(5 056)	(5 236)
Custody activity	(14 781)	(14 378)
Pension and investment funds management charges	(1 003)	(856)
Acquisition services	(4 890)	(3 968)
Other	(5 385)	(1 919)
Total	(310 520)	(293 121)

12. Dividend income

	2017	2016
Issuers of securities held for trading	65	89
Issuers of securities available for sale	19 707	16 709
Total	19 772	16 798

Notes to the financial statements (cont.)

(In PLN thousand)

13. Result on financial assets and liabilities held for trading

	2017	2016
Foreign currency exchange result	(27 863)	(14 995)
Gains (losses) on derivatives	50 317	45 994
Gains (losses) on securities	20 538	23 384
Total	42 992	54 383

In 2017, the total change in the fair value of financial instruments valued at fair value through profit or loss, determined with the use of valuation techniques (when no published quotations from active markets are available) amounted to PLN 58 346 thousand (in 2016 PLN 53 902 thousand).

14. Gains (losses) on disposal

Realized gains

	2017	2016
Loans and other financial receivables (*)	146 046	159 495
Available for sale financial assets – debt instruments	34 663	14 531
Available for sale financial assets – equity instruments (**)	6 153	262 826
Held to maturity investments	638	-
Debt securities issued	-	1
Total	187 500	436 853

(*) In 2017 the Bank sold loans with a total debt of PLN 1 188 million. The realized gross result on the transaction was PLN 142.7 million. In 2016 the Bank sold loans with a total debt of PLN 1 863 million. The realized gross result on the transaction was PLN 149.9 million.

(**) In 2016 the Bank has received information about the closing of the acquisition of Visa Europe Limited by Visa Inc.

Realized losses

	2017	2016
Loans and other financial receivables	(65)	(2)
Available for sale financial assets – debt instruments	-	(864)
Held to maturity investments	(2)	-
Debt securities issued	(272)	(84)
Total	(339)	(950)

Net realized profit	187 161	435 903
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The change in fair value of financial assets available for sale transferred in 2017 directly to equity amounted to PLN 271 408 thousand (increase), in 2016 PLN 332 328 thousand (decrease).

The change in fair value of financial assets, transferred in 2017 from equity to financial income amounted to PLN 40 816 thousand (profit), in 2016 PLN 276 493 thousand (profit).

Notes to the financial statements (cont.)

(In PLN thousand)

15. Administrative expenses

Personnel expenses

	2017	2016
Wages and salaries	(1 642 738)	(1 600 420)
Insurance and other charges related to employees	(287 865)	(286 844)
Share-based payments expenses	(19 699)	(9 572)
Total	(1 950 302)	(1 896 836)

Other administrative expenses

	2017	2016
General expenses	(915 567)	(924 479)
Taxes and charges	(41 308)	(40 874)
Bank Guarantee Fund fee	(267 918)	(278 929)
Financial supervision authority fee (KNF)	(12 448)	(11 673)
Tax on certain financial institutions	(522 281)	(449 533)
Total	(1 759 522)	(1 705 488)

Total administrative expenses	(3 709 824)	(3 602 324)
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From 1 January 2017 new rules for making contributions to Bank Guarantee Fund (hereinafter 'BGF'), defined in the Act of 10 June 2016 on Bank Guarantee Fund, deposit guarantee schemes and resolution of banks (hereinafter 'BGF Act'), have to be applied.

In accordance with BGF Act, the banks are committed to make quarterly contributions to deposit guarantee fund of banks and annual contribution to resolution fund of banks. Such contributions are expenses not deductible for tax purposes. The obligation to make quarterly contribution to deposit guarantee fund of banks arises at the first day of each quarter, whereas the obligation to make annual contribution to resolution fund of banks arises at 1 January of the year concerned.

As a result of application of the Interpretation IFRIC 21 *Levies* for recognition of the above obligations, the costs of quarterly contributions to deposit guarantee fund of banks in the amount of PLN 89 529 thousand and the costs of annual contribution to resolution fund of banks in the amount of PLN 178 389 thousand are charged to the income statement of Bank Pekao Group for the year of 2017.

In 2016 other legal provisions in respect of determining and payment of contributions (obligatory and prudential) to BGF were binding. Those legal provisions allowed recognizing the costs of contributions to BGF in the income statements on a quarterly basis. Moreover the obligatory contributions were expenses deductible for tax purposes.

16. Depreciation and amortization

	2017	2016
Property, plant and equipment	(175 841)	(168 077)
Investment property	(926)	(1 183)
Intangible assets	(170 571)	(171 606)
Total	(347 338)	(340 866)

Notes to the financial statements (cont.)

(In PLN thousand)

17. Net other operating income and expenses

Other operating income

	2017	2016
Rental income	20 827	21 259
Miscellaneous income	12 957	17 608
Recovery of debt collection costs	14 089	13 539
Revenues from sale of products, goods and services	95 596	16 442
Excess payments, repayments	2 309	9 692
Compensation, recoveries, penalty fees and fines received	83 957	5 885
Revenues from leasing activity	3 685	2 615
Refunding of administrative expenses	2 546	2 282
Income from written off liabilities	474	3 512
Releases of impairment allowances for litigation and other assets	10 154	1 021
Gains on sale of leasing assets for third person and other assets	746	883
Other	6 368	4 967
Total	253 708	99 705

Other operating expenses

	2017	2016
Costs related to leasing activity	(1 828)	(2 262)
Credit insurance expenses	(7 870)	(11 163)
Sundry expenses	(9 892)	(15 501)
Reimbursement and deficiencies	(3 117)	(2 877)
Costs from sale of products, goods and services	(90 048)	(13 119)
Customers complaints expenses	(1 555)	(1 734)
Impairment allowance for litigations and other assets	(9 444)	(4 418)
Costs of litigation and claims	(1 898)	(1 394)
Compensation, penalty fees and fines paid	(824)	(1 682)
Losses on disposal of leasing assets for third person and other assets	(854)	(466)
Other	(13 930)	(14 561)
Total	(141 260)	(69 177)

Net other operating income and expenses	112 448	30 528
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Notes to the financial statements (cont.)

(In PLN thousand)

18. Net impairment losses on financial assets and off-balance sheet commitments

2017	OPENING BALANCE	INCREASES		DECREASES			CLOSING BALANCE	IMPACT ON INCOME STATEMENT
		IMPARMENT CHARGES	OTHER (*)	WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET	RELEASE OF IMPARMENT CHARGES	OTHER (*)		
Impairment of financial assets and off-balance sheet commitments								
Loans and advances to banks valued at amortized cost	17 993	313	217	-	(460)	(1 426)	16 637	147
Loans and advances to customers valued at amortized cost	5 542 619	1 126 254	94 356	(359 168)	(629 191)	(416 672)	5 358 198	(497 063)
Receivables from financial leases	166 947	18 234	8	(18)	(11 430)	(26)	173 715	(6 804)
Financial assets available for sale	1 257	99	-	-	-	(237)	1 119	(99)
Off-balance sheet commitments	220 983	71 221	-	-	(53 690)	(1 605)	236 909	(17 531)
Total financial assets and off-balance sheet commitments	5 949 799	1 216 121	94 581	(359 186)	(694 771)	(419 966)	5 786 578	(521 350)
Impairment of other assets								
Investments in associates	-	-	-	-	-	-	-	-
Intangible assets	-	-	-	-	-	-	-	-
Property, plant and equipment	7 758	1 386	-	-	-	(1 116)	8 028	(1 386)
Investment properties	7 031	-	-	-	-	(860)	6 171	-
Other	80 266	9 444	32 471	(2 233)	(10 154)	(13 802)	95 992	710
Total impairment of other assets	95 055	10 830	32 471	(2 233)	(10 154)	(15 778)	110 191	(676)
Total	6 044 854	1 226 951	127 052	(361 419)	(704 925)	(435 744)	5 896 769	(522 026)

(*) Including foreign exchange differences and transfers between positions.

Notes to the financial statements (cont.)

(In PLN thousand)

2016	OPENING BALANCE	INCREASES		DECREASES			CLOSING BALANCE	IMPACT ON INCOME STATEMENT(**)
		IMPARIATION CHARGES	OTHER (*)	WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET	RELEASE OF IMPARIATION CHARGES	OTHER (*)		
Impairment of financial assets and off-balance sheet commitments								
Loans and advances to banks valued at amortized cost	19 774	590	1 451	-	(2 933)	(889)	17 993	2 343
Loans and advances to customers valued at amortized cost	5 678 633	1 021 762	167 086	(583 975)	(602 645)	(138 242)	5 542 619	(419 117)
Receivables from financial leases	163 704	17 112	3	(86)	(13 244)	(542)	166 947	(3 868)
Financial assets available for sale	122	-	1 135	-	-	-	1 257	-
Off-balance sheet commitments	120 771	160 561	992	-	(61 341)	-	220 983	(99 220)
Total financial assets and off-balance sheet commitments	5 983 004	1 200 025	170 667	(584 061)	(680 163)	(139 673)	5 949 799	(519 862)
Impairment of other assets								
Investments in associates	60	-	-	-	-	(60)	-	-
Intangible assets	10 961	-	-	(10 961)	-	-	-	-
Property, plant and equipment	8 451	-	-	(693)	-	-	7 758	-
Investment properties	8 682	-	-	(926)	-	(725)	7 031	-
Other	77 736	4 418	1 369	(2 230)	(1 021)	(6)	80 266	(3 397)
Total impairment of other assets	105 890	4 418	1 369	(14 810)	(1 021)	(791)	95 055	(3 397)
Total	6 088 894	1 204 443	172 036	(598 871)	(681 184)	(140 464)	6 044 854	(523 259)

(*) Including foreign exchange differences and transfers between positions.

(**) 'Impairment of financial assets and off-balance sheet commitments' includes net impairment in the amount of PLN minus 519 862 thousand and proceeds from recovered bad debt in the amount of PLN 19 233 thousand, the total is PLN minus 500 629 thousand.

Notes to the financial statements (cont.)

(In PLN thousand)

19. Gains (losses) on subsidiaries and associates

Share of profit (losses) from associates

	2017	2016
Share in gains (losses) from associates		
Dom Inwestycyjny Xelion Sp. z o.o.	2 562	2 179
Pekao Investment Management S.A.	36 875	36 401
Total share in gains (losses) from associates (*)	39 437	38 580
Loss on liquidation of subsidiaries	-	(19)
Gain on revaluation of shares held in Pekao Investment Management S.A. and Dom Inwestycyjny Xelion Sp. z o.o.	413 977	-
Total gains (losses) from subsidiaries and associates	453 414	38 561

(*) The Group's interest in the net profit (loss) for the period till the date when the Group has taken control over the entities (discontinuation of the equity method valuation)

20. Gains (losses) on disposal of property, plant and equipment, and intangible assets

	2017	2016
Gains (losses) on disposal of property, plant and equipment classified as assets held for sale	1 491	1 029
Gains (losses) on de-recognition of property, plant and equipment and intangible assets other than classified as assets held for sale	(869)	4 330
Total gains (losses) on disposal of property, plant and equipment and intangible assets	622	5 359

21. Income tax

The below additional information notes present the Group gross profit's.

Reconciliation between tax calculated by applying the current tax rate to accounting profit and the actual tax charge presented in the consolidated income statement.

	2017	2016
Profit before income tax	3 153 031	2 896 546
Tax charge according to applicable tax rate	599 076	550 344
Permanent differences:	78 247	66 438
Non taxable income	(94 177)	(35 001)
Non tax deductible costs	175 598	105 720
Impact of other tax rates applied in accordance with art.19.1.2 of CIT Act	925	-
Impact of utilized tax losses	-	-
Tax relieves not included in the income statement	109	80
Other	(4 208)	(4 361)
Effective income tax charge on gross profit	677 323	616 782

The applied tax rate of 19% is the corporate income tax rate binding in Poland.

Notes to the financial statements (cont.)

(In PLN thousand)

The basic components of income tax charge presented in the income statement and equity

	2017	2016
INCOME STATEMENT		
Current tax	(662 129)	(586 052)
Current tax charge in the income statement	(674 600)	(585 499)
Adjustments related to the current tax from previous years	12 795	207
Other taxes (e.g. withholding tax)	(324)	(760)
Deferred tax	(15 194)	(30 730)
Occurrence and reversal of temporary differences	(15 194)	(30 730)
Tax charge in the consolidated income statement	(677 323)	(616 782)
EQUITY		
Deferred tax	(39 140)	118 927
Income and costs disclosed in other comprehensive income:		
revaluation of financial instruments - cash flows hedges	6 297	1 056
revaluation of available for sale financial assets – debt securities	(41 763)	77 187
revaluation of available for sale financial assets – equity securities	(2 049)	38 488
Tax on items that are or may be reclassified subsequently to profit or loss	(37 515)	116 731
Tax charge on items that will never be reclassified to profit or loss	(1 625)	2 196
revaluation of the defined benefit liabilities	(1 625)	2 196
Total charge	(716 463)	(497 855)

Notes to the financial statements (cont.)

(In PLN thousand)

	CHANGES IN TEMPORARY DIFFERENCES IN 2017										
	OPENING BALANCE			CHANGES RECOGNIZED IN			CHANGES RESULTING FROM CHANGES IN THE SCOPE OF CONSOLIDATION AND OTHER		OPENING BALANCE		
	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	EQUITY	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY	
DEFERRED TAX LIABILITY											
Accrued income – securities	46 320	46 320	-	(34 027)	-	-	-	12 293	12 293	-	
Accrued income – loans	144 132	144 132	-	2 340	-	-	-	146 472	146 472	-	
Change in revaluation of financial assets	12 568	4 706	7 862	133 649	(3 949)	68	-	142 336	138 423	3 913	
Accelerated depreciation	115 904	115 904	-	470	-	-	-	116 374	116 374	-	
Investment relief	5 317	5 317	-	(357)	-	-	-	4 960	4 960	-	
Other	104 337	104 337	-	13 107	-	33 335	-	150 779	150 779	-	
Gross deferred tax liability	428 578	420 716	7 862	115 182	(3 949)	33 403	-	573 214	569 301	3 913	
DEFERRED TAX ASSET											
Accrued expenses - securities	1 513	1 513	-	9	-	-	-	1 522	1 522	-	
Accrued expenses - deposits and loans	37 951	37 951	-	(2 199)	-	-	-	35 752	35 752	-	
Downward revaluation of financial assets	302 537	261 072	41 465	106 173	(41 465)	-	-	367 245	367 245	-	
Income received to be amortized over time from loans and current accounts	177 410	177 410	-	20 706	-	-	-	198 116	198 116	-	
Loan provisions charges	540 707	540 707	-	(21 119)	-	-	-	519 588	519 588	-	
Personnel related provisions	118 288	99 609	18 679	1 319	(1 624)	1 635	-	119 618	102 563	17 055	
Accruals	17 670	17 670	-	4 963	-	747	-	23 380	23 380	-	
Previous year losses	31 460	31 460	-	(6 571)	-	-	-	24 889	24 889	-	
Other	199 508	199 508	-	(3 293)	-	-	-	196 215	196 215	-	
Gross deferred tax asset	1 427 044	1 366 900	60 144	99 988	(43 089)	2 382	-	1 486 325	1 469 270	17 055	
Deferred tax charge	x	x	x	(15 194)	(39 140)	(31 021)	-	x	x	x	
Net deferred tax assets	1 003 351	951 069	52 282	x	x	x	-	950 795	937 653	13 142	
Net deferred tax provision	4 885	4 885	-	x	x	X	-	37 684	37 684	-	

Notes to the financial statements (cont.)

(In PLN thousand)

	CHANGES IN TEMPORARY DIFFERENCES IN 2016							
	OPENING BALANCE			CHANGES RECOGNIZED IN			CLOSING BALANCE	
	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	EQUITY	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY
DEFERRED TAX LIABILITY								
Accrued income – securities	-	-	-	46 320	-	46 320	46 320	-
Accrued income – loans	128 540	128 540	-	15 592	-	144 132	144 132	-
Change in revaluation of financial assets	102 790	19 661	83 129	(14 955)	(75 267)	12 568	4 706	7 862
Accelerated depreciation	123 326	123 326	-	(7 422)	-	115 904	115 904	-
Investment relief	5 724	5 724	-	(407)	-	5 317	5 317	-
Other	90 118	90 118	-	14 219	-	104 337	104 337	-
Gross deferred tax liability	450 498	367 369	83 129	53 347	(75 267)	428 578	420 716	7 862
DEFERRED TAX ASSET								
Accrued expenses - securities	23 366	23 366	-	(21 853)	-	1 513	1 513	-
Accrued expenses - deposits and loans	45 339	45 339	-	(7 388)	-	37 951	37 951	-
Downward revaluation of financial assets	256 958	256 958	-	4 114	41 465	302 537	261 072	41 465
Income received to be amortized over time from loans and current accounts	174 097	174 097	-	3 313	-	177 410	177 410	-
Loan provisions charges	493 328	493 328	-	47 379	-	540 707	540 707	-
Personnel related provisions	114 657	98 174	16 483	1 435	2 196	118 288	99 609	18 679
Accruals	19 517	19 517	-	(1 847)	-	17 670	17 670	-
Previous year losses	10 033	10 033	-	21 427	-	31 460	31 460	-
Other	223 471	223 471	-	(23 963)	-	199 508	199 508	-
Gross deferred tax asset	1 360 766	1 344 283	16 483	22 617	43 661	1 427 044	1 366 900	60 144
Deferred tax charge	x	x	x	(30 730)	118 928	x	x	x
Net deferred tax assets	915 204	981 850	(66 646)	x	x	1 003 351	951 069	52 282
Net deferred tax provision	4 936	4 936	-	x	x	4 885	4 885	-

Notes to the financial statements (cont.)

(In PLN thousand)

In the opinion of the Group the deferred tax asset in the amount of PLN 950 795 thousand reported as at 31 December 2017 is sustainable in total amount. The analysis was performed based on the past results of the Group's companies and assumed results in the future periods. The analysis assumed the five years' time horizon.

As at 31 December 2017 and 31 December 2016, there were temporary differences related to investments in subsidiaries and associates, for which deferred tax liability was not created as a result of meeting the conditions of controlling the terms of temporary differences' reversing and being probable that these differences will not reverse in foreseeable future.

The table below presents the amount of negative temporary differences, unrecognized tax losses, unutilized tax reliefs, in relation to which deferred tax asset was not recognized in the statement of financial position as well as the expiration date of temporary differences.

EXPIRATION YEAR OF TEMPORARY DIFFERENCES	AMOUNT OF DIFFERENCES AS AT 31.12.2017	AMOUNT OF DIFFERENCES AS AT 31.12.2016
2018	26 526	14 165
2019	20 787	7 730
2020	313	313
2021	187	-
No time limits	2 062	32 043
Total	49 875	54 251

22. Earnings per share

Basic earnings per share

Basic earnings per share are calculated by dividing net profit attributable to equity holders of the Group by the weighted average number of the ordinary shares outstanding during the period.

	2017	2016
Net profit	2 475 129	2 279 275
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Earnings per share (in PLN per share)	9.43	8.68

Diluted earnings per share

Diluted earnings per share are calculated by dividing net profit attributable to equity holders of the Group by the weighted average number of the ordinary shares outstanding during the given period adjusted for all potential dilution of ordinary shares.

As at 31 December 2017 there no diluting instruments in the form of convertible bonds in the Group.

	2017	2016
Net profit	2 475 129	2 279 275
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Weighted average number of ordinary shares for the purpose of calculation of diluted earnings per share	262 470 034	262 470 034
Diluted earnings per share (in PLN per share)	9.43	8.68

Notes to the financial statements (cont.)

(In PLN thousand)

23. Dividend proposal

As at the date of approval of these financial statements for publication, the Management Board of Bank Pekao S.A. has not made a decision about the recommendation regarding the payment of the dividend for 2017.

24. Cash and balances with Central Bank

CASH AND DUE FROM CENTRAL BANK	31.12.2017	31.12.2016
Cash	2 686 570	2 639 532
Current account at Central Bank	2 264 688	1 718 775
Other	285 059	1 514 604
Total	5 236 317	5 872 911

AMOUNTS DUE TO CENTRAL BANK	31.12.2017	31.12.2016
Term deposits	6 079	6 091
Total	6 079	6 091

Cash and balances with Central Bank by currencies

31.12.2017	ASSETS	LIABILITIES
PLN	4 352 578	6 079
EUR	463 160	-
USD	168 562	-
CHF	58 882	-
Other currencies	193 135	-
Total	5 236 317	6 079

31.12.2016	ASSETS	LIABILITIES
PLN	4 944 326	6 091
EUR	443 480	-
USD	260 015	-
CHF	59 727	-
Other currencies	165 363	-
Total	5 872 911	6 091

During the day, the Bank may use funds from the mandatory reserve account for ongoing payments pursuant to an instruction, submitted to the National Bank of Poland. It must, however, ensure that the average monthly balance on such accounts comply with the requirements described in the mandatory reserve declaration.

As at 31 December 2017 the interest rate of funds held on the mandatory reserve account is at 1.35% (0.9 of NBP reference rate). As at 31 December 2016 the interest rate was at 1.35% (0.9 of NBP reference rate).

Notes to the financial statements (cont.)

(In PLN thousand)

25. Loans and advances to banks

Loans and advances to banks by product type

	31.12.2017	31.12.2016
Current accounts	335 016	118 142
Interbank placements	271 823	267 828
Loans and advances	29 528	34 517
Cash collateral	1 006 332	1 771 842
Reverse repo transactions	494 706	703 635
Cash in transit	506 559	379 858
Total gross amount	2 643 964	3 275 822
Impairment allowances	(16 637)	(17 993)
Total net amount	2 627 327	3 257 829

Loans and advances to banks by quality

	31.12.2017	31.12.2016
Loans and advances to banks, including:		
non impaired (gross)	2 627 331	3 257 830
impaired (gross)	16 633	17 992
individual impairment allowances	(6 833)	(8 192)
collective impairment allowances (*)	(9 804)	(9 801)
Total	2 627 327	3 257 829

(*) Including estimated impairment allowances for losses incurred but not reported (IBNR).

Loans and advances to banks by contractual maturity

	31.12.2017	31.12.2016
Loans and advances to banks, including:		
up to 1 month	2 588 346	3 178 259
between 1 and 3 months	31 579	345
between 3 months and 1 year	7	69 684
between 1 and 5 years	29	47
over 5 years	50	2
past due	23 953	27 485
Total gross amount	2 643 964	3 275 822
Impairment allowances	(16 637)	(17 993)
Total net amount	2 627 327	3 257 829

Notes to the financial statements (cont.)

(In PLN thousand)

Loans and advances to banks by currencies

	31.12.2017	31.12.2016
PLN	702 126	1 012 264
CHF	23 342	19 462
EUR	1 346 256	2 010 070
USD	209 142	68 792
Other currencies	346 461	147 241
Total	2 627 327	3 257 829

Changes in impairment allowances in 2017 and 2016 are presented in the Note 18.

26. Financial assets and liabilities held for trading

Financial assets and liabilities held for trading by product type

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
Debt securities	1 725 858	730 750
Equity securities	4 558	1 719
Total financial assets	1 730 416	732 469
FINANCIAL LIABILITIES		
Debt securities	469 448	673 165
Total financial liabilities	469 448	673 165

Debt securities held for trading

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
Debt securities issued by State Treasury	1 646 758	654 918
T- bills	-	-
T- bonds	1 646 758	654 918
Debt securities issued by banks	50 258	9 719
Debt securities issued by business entities	28 842	66 113
Debt securities issued by local governments	-	-
Total financial assets	1 725 858	730 750
FINANCIAL LIABILITIES		
Debt securities issued by State Treasury	469 448	673 165
T- bonds	469 448	673 165
Total financial liabilities	469 448	673 165

Equity securities held for trading

	31.12.2017	31.12.2016
Shares	208	1 719
Participation units	4 350	-
Total	4 558	1 719

Notes to the financial statements (cont.)

(In PLN thousand)

Debt securities held for trading by maturity

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
Debt securities, including:		
up to 1 month	123 505	-
between 1 and 3 months	-	239
between 3 months and 1 year	12 605	117 804
between 1 and 5 years	1 461 523	324 868
over 5 years	128 225	278 120
unspecified term	-	9 719
Total financial assets	1 725 858	730 750
FINANCIAL LIABILITIES		
Debt securities, including:		
up to 1 month	-	102 076
between 1 and 3 months	-	-
between 3 months and 1 year	-	131 194
between 1 and 5 years	309 328	263 435
over 5 years	160 120	176 460
Total financial liabilities	469 448	673 165

Debt securities held for trading by currency

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
PLN	1 718 202	710 575
EUR	4 542	5 629
USD	3 114	14 546
Total financial assets	1 725 858	730 750
FINANCIAL LIABILITIES		
PLN	469 448	673 165
Total financial liabilities	469 448	673 165

27. Derivative financial instruments (held for trading)

Derivative financial instruments at the Group

In its operations the Group uses different financial derivatives that are offered to the clients and are used for managing risks involved in the Group's business. The majority of derivatives at the Group include over-the-counter contracts. Regulated stock exchange contracts (mainly futures) represent a small part of those derivatives.

Derivative foreign exchange transactions include the obligation to buy or sell foreign and domestic currency assets. Forward foreign exchange transactions are based on the foreign exchange rates, specified on the transaction date for a predefined future date. These transactions are valued using the discounted cash flow model. Cash flows are discounted according to zero-coupon yield curves, relevant for a given market.

Foreign exchange swaps are a combination of a swap of specific currencies as at spot date and of reverse a transaction as at forward date with foreign exchange rates specified in advance on transaction date. Transactions of such type are settled by an exchange of assets. These transactions are valued using the discounted cash flow model. Cash flows are discounted according to zero-coupon yield curves relevant for a given market.

Notes to the financial statements (cont.)

(In PLN thousand)

Foreign exchange options with delivery are defined as contracts, where one of the parties, i.e. the option buyer, purchases from the other party, referred to as the option writer, at a so-called premium price the right without the obligation to buy (call option) or to sell (put option), at a specified point of time in the future or during a specified time range a foreign currency amount specified in the contract at the exchange rate set during the conclusion of the option agreement.

In case of options settled in net amounts, upon acquisition of the rights, the buyer receives an amount of money equal to the product of notional and difference between spot and strike price.

Barrier option with one barrier is a type of option where exercise of the option depends on the underlying crossing or reaching a given barrier level. A barrier may be reached starting from lower ('UP') or from higher ('DOWN') level of the underlying instrument. 'IN' options start their lives worthless and only become active when a predetermined knock-in barrier price is breached. 'OUT' options start their lives active and become null and void when a certain knock-out barrier price is breached.

Foreign exchange options are priced using the Garman-Kohlhagen valuation model (and in case of barrier and Asian options using the so-called expanded Garman-Kohlhagen model). Parameters of the model based on market quotations of plain-vanilla at-the-money options and market spreads for out-of-the-money and in-the-money options (volatility smile) for standard maturities.

Derivatives related to interest rates enable the Group and its customers to transfer, modify or limit interest rate risk.

In the case of Interest Rate Swaps (IRS), counterparties exchange between each other the flows of interest payments, accrued on the nominal amount identified in the contract. These transactions are valued using the discounted cash flow model. Floating (implied) cash flows are estimated on base of respective IRS rates. Floating and fixed cash flows are discounted by relevant zero-coupon yield curves.

Forward Rate Agreements (FRA) involve both parties undertaking to pay interest on a predefined nominal amount for a specified period starting in the future and charged according to the interest rate determined on the day of the agreement. The parties settle the transaction on value date using the reference rate as a discount rate in the process of discounting the difference between the FRA rate (forward rate as at transaction date) and the reference rate. These transactions are valued using the discounted cash flow model.

Cross currency IRS involves both parties swapping capital and interest flows in different currencies in a specified period. These transactions are valued using the discounted cash flow model. Valuation of Basis Swap transactions (cross currency IRS with floating coupon) takes into account market quotations of basis spread (Basis swap spread).

In the case of forward transactions on securities, counterparties agree to buy or sell specified securities on a forward date for a payment fixed on the date of transaction. Such transactions are measured based upon the valuation of the security (mark-to-market or mark-to-model) and valuation of the related payment (method of discounting cash flows by money market rate).

Interest rate options (cap/floor) are contracts where one of the parties, the option buyer, purchases from the other party, the option writer, at a so-called premium price, the right without the obligation to borrow (cap) or lend (floor) at specified points of time in the future (independently) amounts specified in the contract at the interest rate set during the conclusion of the option. Contracts are net-settled (without fund location) at agreed time. Transactions of this type are valued using the Normal model. The model is parameterized based upon market quotations of at-the-money options as at standard quoted maturities.

Interest rate futures transactions refer to standardized forward contracts purchased on the stock market. Futures contracts are measured based upon quotations available directly from stock exchanges.

Commodity swap contracts are obligations to net settlement equivalent to the execution of a commodity buy or sell transaction at the settlement price according to determination rules set at the trade inception. Commodity instruments are valued with the discounted cash flows method, which includes commodity prices term structure.

Asian commodity options are contracts with the right to buy or sell a certain amount of commodity on a expiry date at the specified price, where settlement price is based on an average level established on the basis of a series of commodity price observations in the period preceding the maturity date of the option. Commodity options are valued with the Black-Scholes model that includes moment matching of commodity price distribution for the arithmetic average.

Notes to the financial statements (cont.)

(In PLN thousand)

Derivative financial instruments embedded in other instruments

The Group uses derivatives financial instruments embedded in complex financial instruments, i.e. such as including both a derivative and base agreement, which results in part of the cash flows of the combined instrument changing similarly to cash flows of an independent derivative. Derivatives embedded in other instruments cause part or all cash flows resulting from the base agreement to be modified as per a specific interest rate, price of a security, foreign exchange rate, price index or interest rate index.

Call options in some of the corporate, municipal bonds and own equity placements are derivatives embedded in balance sheet financial instruments. In this case, embedded financial instruments are closely related to the base contract and thus the embedded derivative does not need to be isolated or recognized and valued separately.

The Group has deposits and certificates of deposits on offer which include embedded derivatives. As the nature of such instrument is not strictly associated with the nature of the deposit agreement, the embedded instrument is separated and classified into the portfolio held-for-trading. The valuation of such instrument is recognized in the income statement. Embedded instruments include simple options (plain vanilla) and exotic options for single stocks, commodities, indices and other market indices, including interest rate indices, foreign exchange rates and their related baskets.

All embedded options are immediately closed back-to-back on the interbank market.

Currency options embedded in deposits are valued as other currency options.

Exotic options embedded in deposits as well as their close positions are valued using the Monte-Carlo simulation technique assuming Geometric Brownian Motion model of risk factors. Model parameters are determined first of all on the basis of quoted options and futures contracts and in their absence based on statistical measures of the underlying instrument dynamic.

The Group carried out an analysis of the portfolio of credit agreements and of regular agreements in order to isolate embedded derivatives and decided that the agreements in question do not require isolation and separate treatment of embedded instruments.

Risk involved in financial derivatives

Market risk and credit risk are the basic types of risk, associated with derivatives.

At the beginning, financial derivatives usually have a small market value or no market value at all. It is a consequence of the fact that derivatives require no initial net investments, or require a very small net investment compared to other types of contracts, which display a similar reaction to changing market conditions.

Derivatives gain positive or negative value as a result of change in specific interest rates, prices of securities, prices of commodities, currency exchange rates, price index, credit standing or credit index or another market parameter. In case of such changes, the derivatives held become more or less advantageous than instruments with the same residual maturities, available at that moment on the market.

Credit risk related to derivative contracts is a potential cost of concluding a new contract on the original terms and conditions if the other party to the original contract fails to meet its obligations. In order to assess the potential cost of replacement the Group uses the same method as for credit risk assessment. In order to control its credit risk levels the Group performs assessments of other contract parties using the same methods as for credit decisions.

The following tables present nominal amounts of financial derivatives and fair values of such derivatives. Nominal amounts of certain financial instruments are used for comparison with balance sheet instruments but need not necessarily indicate what the future cash flow amounts will be or what the current fair value of such instruments is and therefore do not reflect the Group's credit or price risk level.

Notes to the financial statements (cont.)

(In PLN thousand)

Fair value of trading derivatives

31.12.2017	ASSETS	LIABILITIES
Interest rate transactions		
Interest Rate Swaps (IRS)	967 627	1 530 119
Forward Rate Agreements (FRA)	176	-
Options	6 161	2 252
Other	461	416
Foreign currency and gold transactions		
Cross-Currency Interest Rate Swaps (CIRS)	54 451	29 255
Currency Forward Agreements	120 428	185 924
Currency Swaps (FX-Swap)	87 603	173 636
Options for currency and for gold	27 932	24 955
Transactions based on equity securities and stock indexes		
Options	10 225	10 219
Other	19	2
Transactions based on commodities and precious metals		
Options	14 739	14 366
Other	59 225	58 959
Total	1 349 047	2 030 103

31.12.2016	ASSETS	LIABILITIES
Interest rate transactions		
Interest Rate Swaps (IRS)	1 517 526	1 503 394
Forward Rate Agreements (FRA)	347	155
Options	1 837	1 710
Other	426	618
Foreign currency and gold transactions		
Cross-Currency Interest Rate Swaps (CIRS)	49 978	161 421
Currency Forward Agreements	183 636	84 759
Currency Swaps (FX-Swap)	62 207	93 089
Options for currency and gold	52 971	53 605
Transactions based on equity securities and stock indexes		
Options	5 403	5 422
Other	1	9 723
Transactions based on commodities and precious metals		
Options	2 113	1 971
Other	36 984	36 807
Total	1 913 429	1 952 674

Notes to the financial statements (cont.)

(In PLN thousand)

Nominal value of trading derivatives

31.12.2017	CONTRACTUAL MATURITY					TOTAL
	UP TO 1MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	
Interest rate transactions						
Interest Rate Swaps (IRS)	1 781 188	1 815 069	18 501 960	49 820 422	11 372 737	83 291 376
Forward Rate Agreements (FRA)	-	500 000	450 000	-	-	950 000
Options	-	270 951	1 349 236	3 860 482	11 248	5 491 917
Other	785 253	-	-	-	-	785 253
Foreign currency and gold transactions						
Cross-Currency Interest Rate Swaps (CIRS) - currency bought	129 765	277 103	911 633	1 118 680	929 237	3 366 418
Cross-Currency Interest Rate Swaps (CIRS) - currency sold	127 707	271 275	910 417	1 138 688	898 692	3 346 779
Currency Forward Agreements - currency bought	7 088 255	3 030 242	3 239 251	735 665	-	14 093 413
Currency Forward Agreements - currency sold	7 076 423	3 075 685	3 287 164	740 000	-	14 179 272
Currency Swaps (FX-Swap) – currency bought	13 046 653	5 315 571	1 263 965	-	-	19 626 189
Currency Swaps (FX-Swap) – currency sold	13 141 143	5 320 541	1 241 015	-	-	19 702 699
Options bought	428 084	807 930	2 414 151	502 929	-	4 153 094
Options sold	429 477	799 227	2 418 390	502 929	-	4 150 023
Transactions based on equity securities and stock indexes						
Options	73 865	-	-	68 404	-	142 269
Other	-	-	257	245	-	502
Transactions based on commodities and precious metals						
Options	4 526	44 052	418 842	135 353	-	602 773
Other	104 966	147 378	233 076	189 527	-	674 947
Total	44 217 305	21 675 024	36 639 357	58 813 324	13 211 914	174 556 924

Notes to the financial statements (cont.)

(In PLN thousand)

Nominal value of trading derivatives

31.12.2016	CONTRACTUAL MATURITY					TOTAL
	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	
Interest rate transactions						
Interest Rate Swaps (IRS)	2 064 679	2 846 675	11 640 203	51 529 159	12 317 504	80 398 220
Forward Rate Agreements (FRA)	275 000	750 000	300 000	-	-	1 325 000
Options	700 000	604 917	857 351	3 907 471	165 096	6 234 835
Other	458 475	-	-	-	-	458 475
Foreign currency and gold transactions						
Cross-Currency Interest Rate Swaps (CIRS) - currency bought	-	413 339	652 407	1 959 424	1 071 214	4 096 384
Cross-Currency Interest Rate Swaps (CIRS) - currency sold	-	427 850	665 328	2 022 765	1 086 332	4 202 275
Currency Forward Agreements - currency bought	6 765 791	2 525 196	3 177 714	1 337 691	-	13 806 392
Currency Forward Agreements - currency sold	6 791 531	2 541 317	3 101 465	1 346 657	-	13 780 970
Currency Swaps (FX-Swap) – currency bought	13 380 696	2 643 905	2 799 405	115 108	-	18 939 114
Currency Swaps (FX-Swap) – currency sold	13 369 780	2 644 057	2 797 880	110 600	-	18 922 317
Options bought	463 120	540 425	2 526 286	186 400	-	3 716 231
Options sold	465 995	545 333	2 538 592	186 400	-	3 736 320
Transactions based on equity securities and stock indexes						
Options	-	-	-	73 865	-	73 865
Other	-	863	1 037	-	21 000	22 900
Transactions based on commodities and precious metals						
Options	8 693	13 039	80 418	-	-	102 150
Other	61 558	78 176	218 647	272 791	-	631 172
Total	44 805 318	16 575 092	31 356 733	63 048 331	14 661 146	170 446 620

Notes to the financial statements (cont.)

(In PLN thousand)

28. Loans and advances to customers

Loans and advances to customers by product type

	31.12.2017	31.12.2016
Mortgage loans	59 729 689	54 713 809
Current accounts	11 028 956	10 599 898
Operating loans	12 916 798	13 897 871
Investment loans	18 665 906	16 810 632
Cash loans	12 190 872	10 211 931
Payment cards receivables	1 081 499	970 673
Factoring	3 478 545	2 890 930
Other loans and advances	1 386 808	1 595 088
Debt securities	12 749 288	12 451 372
Reverse repo transactions	-	-
Cash in transit	79 144	89 682
Total gross amount	133 307 505	124 231 886
Impairment allowances	(5 358 198)	(5 542 619)
Total net amount	127 949 307	118 689 267

Loans and advances to customers by customer type

	31.12.2017	31.12.2016
Corporate	58 841 495	55 257 059
Individuals	64 377 510	58 379 647
Budget entities	10 088 500	10 595 180
Total gross amount	133 307 505	124 231 886
Impairment allowances	(5 358 198)	(5 542 619)
Total net amount	127 949 307	118 689 267

Loans and advances to customers by quality

	31.12.2017	31.12.2016
Loans and advances to customers, including:		
non impaired (gross)	125 898 087	116 571 271
impaired (gross)	7 409 418	7 660 615
individual impairment allowances	(3 380 415)	(3 189 149)
collective impairment allowances (*)	(1 977 783)	(2 353 470)
Total	127 949 307	118 689 267

(*) Including estimated impairment allowances for losses incurred but not reported (IBNR).

Notes to the financial statements (cont.)

(In PLN thousand)

Loans and advances to customers by contractual maturity

	31.12.2017	31.12.2016
Loans and advances to customers, including:		
up to 1 month	14 966 833	15 184 650
between 1 and 3 months	4 657 178	3 050 503
between 3 months and 1 year	10 286 555	12 393 167
between 1 and 5 years	41 942 265	37 323 318
over 5 years	55 962 982	50 359 575
past due	5 491 692	5 920 673
Total gross amount	133 307 505	124 231 886
Impairment allowances	(5 358 198)	(5 542 619)
Total net amount	127 949 307	118 689 267

Loans and advances to customers by currencies

	31.12.2017	31.12.2016
PLN	107 990 654	96 647 980
CHF	3 561 945	4 640 419
EUR	13 688 524	13 934 872
USD	2 477 434	3 289 584
Other currencies	230 750	176 412
Total	127 949 307	118 689 267

Changes in impairment allowances in 2017 and 2016 are presented in the Note 18.

29. Receivables from finance leases

The Group conducts leasing operations through its subsidiary Pekao Leasing Sp. z o.o.

The value of gross lease investments and minimum lease payments are follows as

31.12.2017	GROSS LEASING INVESTMENT	PRESENT VALUE OF MINIMUM LEASING PAYMENTS
Up to 1 year	1 711 448	1 576 487
Between 1 and 5 years	2 775 224	2 626 222
Over 5 years	335 744	322 358
Total	4 822 416	4 525 067
Unrealized financial income	(297 349)	
Net leasing investment	4 525 067	
Unguaranteed residual values accruing to the benefit of the lessor	-	
Present value of minimum lease payments	4 525 067	
Impairment allowances	(173 715)	
Balance sheet value	4 351 352	

Notes to the financial statements (cont.)

(In PLN thousand)

The value of gross lease investments and minimum lease payments are follows as

31.12.2016	GROSS LEASING INVESTMENT	PRESENT VALUE OF MINIMUM LEASING PAYMENTS
Up to 1 year	1 632 601	1 492 018
Between 1 and 5 years	2 520 358	2 353 845
Over 5 years	322 590	295 727
Total	4 475 549	4 141 590
Unrealized financial income	(333 959)	
Net leasing investment	4 141 590	
Unguaranteed residual values accruing to the benefit of the lessor	-	
Present value of minimum lease payments	4 141 590	
Impairment allowances	(166 947)	
Balance sheet value	3 974 643	

The Group is acting as a lessor in finance leases mainly for transport vehicles, machines and equipment.

Moreover, when the Group is a lessee in a finance lease contract among the Group entities, the inter-company transactions relating to the finance lease are eliminated in the consolidated financial statements.

Lease financing receivables from banks by quality

	31.12.2017	31.12.2016
Receivables from financial leases from banks, including:		
non impaired (gross)	248	704
impaired (gross)	-	-
individual impairment allowances	-	-
collective impairment allowances (*)	(4)	(6)
Total	244	698

(*) Including estimated impairment allowances for losses, incurred but not reported (IBNR).

Lease financing receivables from customers by quality

	31.12.2017	31.12.2016
Receivables from financial leases from customers, including:		
non impaired (gross)	4 299 188	3 934 980
impaired (gross)	225 631	205 906
individual impairment allowances	(29 164)	(30 047)
collective impairment allowances (*)	(144 547)	(136 894)
Total	4 351 108	3 973 945

(*) Including estimated impairment allowances for losses, incurred but not reported (IBNR).

Receivables from finance leases by currencies

	31.12.2017	31.12.2016
PLN	2 747 448	2 450 665
CHF	467	1 416
EUR	1 588 474	1 522 242
USD	14 963	320
Total	4 351 352	3 974 643

Changes in impairment allowances in 2017 and 2016 are presented in the Note 18.

Notes to the financial statements (cont.)

(In PLN thousand)

30. Hedge accounting

As at 31 December 2017 the Group applies fair value hedge accounting and cash flow hedge accounting.

In the period from 1 January to 31 December 2017 the Group continued to apply the following hedge accounting:

- fair value hedge accounting for fixed coupon debt securities classified as available-for-sale (AFS) hedged with interest rate swap (IRS) transactions – described in point 1 of the table with details of hedging relationships,
- cash flow hedge accounting for floating-rate financial assets and liabilities hedged with cross-currency interest rate swap (CIRS) transactions – described in point 2 of the table with details of hedging relationships,
- cash flow hedge accounting for floating-rate financial assets hedged with interest rate swap (IRS) transactions – described in point 3 of the table with details of hedging relationships,
- cash flow hedge accounting for variable portfolio of loans in EUR and USD hedged with FX-Swap instruments – described in point 4 of the table with details of hedging relationships,
- fair value hedge accounting for fixed coupon debt securities classified as loans and receivables hedged with interest rate swaps (IRS) – described in point 5 of the table with details of hedging relationships.

In the period from 1 January to 31 December 2017 the Group:

- designated to the hedge accounting the hedging relationship and terminated the relationship – cash flow hedge accounting for highly probable cash flow denominated in EUR (short position in EUR for the Group) hedged with foreign exchange forward transactions (a series of FX-Spot and FX-Swap transactions) – described in point 6 of the table with details of hedging relationships. Termination of the relationship resulted from settlement of transactions included in the hedging relationship. Last cash flows from hedged items occurred on 11 December 2017.
- designated to the hedge accounting the hedging relationship – cash flow hedge accounting for deposits portfolio in PLN and EUR, which economically reflect long-term variable-rate liability, hedged with interest rate swap (IRS) transactions – described in point 7 of the table with details of hedging relationships.

The tables below presents the fair values of hedging derivatives

31.12.2017	ASSETS	LIABILITIES
Fair value hedge accounting		
Interest rate swaps (IRS)	16 496	186 102
Cross-currency interest rate swaps (CIRS)	-	-
Cash flow hedge accounting		
Interest rate swaps (IRS)	200 672	1 700
Cross-currency interest rate swaps (CIRS)	-	674 529
Currency Swaps (FX-Swap)	42 228	-
Total	259 396	862 331

31.12.2016	ASSETS	LIABILITIES
Fair value hedge accounting		
Interest rate swaps (IRS)	14 683	267 311
Cross-currency interest rate swaps (CIRS)	-	-
Cash flow hedge accounting		
Interest rate swaps (IRS)	263 752	-
Cross-currency interest rate swaps (CIRS)	-	1 370 905
Currency Swaps (FX-Swap)	11 317	502
Total	289 752	1 638 718

Notes to the financial statements (cont.)

(In PLN thousand)

The tables below presents nominal values of hedging derivatives

31.12.2017	CONTRACTS ACCORDING TO MATURITIES					TOTAL
	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	
Fair value hedge accounting						
Interest rate swaps (IRS)	-	115 000	-	1 744 024	1 696 087	3 555 111
Cross-currency interest rate swaps (CIRS)	-	-	-	-	-	-
Cash flow hedge accounting						
Interest rate swaps (IRS)	-	-	15 000	3 963 702	197 000	4 175 702
Cross-currency interest rate swaps (CIRS)	-	-	1 635 139	7 842 510	3 431 241	12 908 890
Currency Swaps (FX-Swap)	602 846	381 072	1 025 307	-	-	2 009 225
Total	602 846	496 072	2 675 446	13 550 236	5 324 328	22 648 928

31.12.2016	CONTRACTS ACCORDING TO MATURITIES					TOTAL
	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	
Fair value hedge accounting						
Interest rate swaps (IRS)	-	553 000	-	1 627 612	2 113 964	4 294 576
Cross-currency interest rate swaps (CIRS)	-	-	-	-	-	-
Cash flow hedge accounting						
Interest rate swaps (IRS)	-	25 000	150 000	3 600 000	-	3 775 000
Cross-currency interest rate swaps (CIRS)	867 025	-	1 033 820	9 883 752	4 079 680	15 864 277
Currency Swaps (FX-Swap)	-	892 450	1 297 025	-	-	2 189 475
Total	867 025	1 470 450	2 480 845	15 111 364	6 193 644	26 123 328

The table below presents the amounts recognized in the income statement and in the revaluation reserves due to cash flow hedge accounting

	2017	2016
Revaluation reserves (deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge - gross value)	6 581	39 724
Net interest income on hedging derivatives	190 802	212 587
Ineffective portion in changes in fair value of hedging transactions recognized in income statement	(224)	(756)

The table below presents changes in the revaluation reserves during the period due to cash flow hedge accounting

	2017	2016
Opening balance	39 724	45 280
Deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge	(33 087)	(5 451)
Amount of the deferral of fair value changes of hedging instruments of the effective hedge removed from revaluation reserves and presented in net profit or loss	(56)	(105)
Closing balance	6 581	39 724

Notes to the financial statements (cont.)

(In PLN thousand)

The table below presents the amounts recognized in the income statement due to the fair value hedge accounting

TYPE OF GAINS/LOSSES	2017	2016
Gains/losses from revaluation of hedging instruments to fair value	67 231	26 502
Gains/losses from revaluation of hedged item associated with hedged risk to fair value	(62 615)	(25 189)
Result on fair value hedge accounting	4 616	1 313
Net interest income of hedging derivatives	(67 192)	(73 721)

Detailed description of hedging relationships applied by the Group during the period from 1 January to 31 December 2017

DESCRIPTION OF THE HEDGING RELATIONSHIP	HEDGED ITEM	HEDGING DERIVATIVES	FINANCIAL STATEMENTS PRESENTATION	PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR
1. Fair value hedge of fixed-coupon debt securities				
The Group hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions.	The hedged items are fixed coupon debt securities classified as AFS, denominated in PLN, EUR and USD.	The hedging derivatives consist of IRS transactions in PLN, EUR and USD (short position in fixed-rate) for which the Group receives floating-rate payments, and pays fixed-rate.	The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. The remaining portion of the change in the hedged items' fair value (resulting from spread between swap yield curve and bond yield curve) is recognized in accordance with the accounting principles applicable to AFS (i.e. in the revaluation reserve in equity). Interest accrued on AFS bonds is presented in the net interest income. Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 18 January 2036.
2. Cash flow hedge of floating-rate loans and floating-rate deposits				
The Group hedges a portion of the interest rate risk and the foreign currency risk resulting from the volatility of cash flows from floating-rate assets and liabilities with the designated CIRS transactions (basis swap).	Hedged item consists of two separate components, which are cash flows arising from floating-rate assets portfolio and floating-rate liabilities portfolio.	Hedging derivatives consist of a portfolio of CIRS transactions (basis swap), where the Group pays floating-rate currency cash flows, and receives floating-rate PLN/currency cash-flows. CIRS transactions are decomposed into the part hedging the assets portfolio and the part hedging the liabilities portfolio.	The effective portion of the change in fair value of hedging derivatives' is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on CIRS transactions and hedged items is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 15 May 2029.
3. Cash flow hedge of floating-rate loans				
The Group hedges a portion of the interest rate risk related to the volatility of cash flows on floating-rate assets with the designated IRS transactions.	The hedged items consist of the cash flows from floating-rate assets.	The hedging derivatives consist of portfolio of IRS transactions (short position in floating rate – the Group receives fixed payments and pays floating-rate).	The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of change in fair value hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on IRS transactions and hedged items is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 29 April 2020.
4. Cash flow hedge of floating-rate currency assets hedged with FX-Swap transactions against the exchange and interest rate risk				
The Group hedges volatility of cash flows constituting floating-rate financial assets (loans in EUR and USD) with FX-Swap transactions. The currency and interest rate risk is hedged.	Loans with variable interest rate risk, denominated in EUR and USD constitute hedged items.	FX-Swap transaction portfolio constitutes the hedging position.	The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. Settled part of the swap points on the hedging instrument is transferred from the revaluation reserve in equity and recognized in interest income. Currency revaluation regarding the first capital exchange on the hedging instrument is transferred from the revaluation reserve in equity and recognized in the foreign currency exchange result.	It is expected that the cash flows related to the hedged items will occur until 12 October 2018.

Notes to the financial statements (cont.)

(In PLN thousand)

DESCRIPTION OF THE HEDGING RELATIONSHIP	HEDGED ITEM	HEDGING DERIVATIVES	FINANCIAL STATEMENTS PRESENTATION	PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR
5. Fair value hedge of fixed-coupon debt securities				
The Group hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions.	The hedged items are fixed coupon debt securities classified as loans and receivables, denominated in PLN.	The hedging derivatives consist of IRS transactions in PLN (short position in fixed-rate) for which the Group receives floating-rate payments, and pays fixed-rate.	The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on bonds is presented in the net interest income. Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 22 December 2026.
6. Cash flow hedge of expected future outflows in foreign currency – relationship completed				
The Group hedged the volatility of cash flows denominated in EUR constituting the projected outflows from expected purchases with the designated FX-Forward transactions. The currency risk was hedged. Discontinuation of the hedge accounting resulted from settlement of transactions included in the hedging relationship.	Projected outflows dependent on EUR and Polish zloty exchange rates were the hedged item.	The hedging derivatives consisted of a portfolio of FX-Forward transactions (FX-Spot and series of FX-Swap), in which the Group bought EUR currency in exchange for PLN currency at an agreed exchange rate.	The amount of the settlement of hedging transactions adjusted the settlement of the hedged item.	-
7. Cash flow hedge of floating-rate deposits in PLN				
The Group hedges a portion of the interest rate risk related to the volatility of cash flows on floating-rate deposits with the designated IRS transactions.	The hedged items consist of the cash flows from floating-rate deposits.	The hedging derivatives consist of portfolio of IRS transactions (short position in fixed rate – the Group receives floating-rate payments and pays fixed-rate).	The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of change in fair value hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on IRS transactions and hedged items is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 22 June 2032.

31. Investment (placement) securities

	31.12.2017	31.12.2016
Debt securities available for sale (AFS)	33 276 590	31 949 770
Equity securities available for sale (AFS)	147 441	151 864
Debt securities held to maturity (HTM)	3 481 791	3 018 985
Total	36 905 822	35 120 619

Debt securities available for sale (AFS)

	31.12.2017	31.12.2016
Securities issued by State Treasury	21 557 825	25 046 710
T-bills	-	-
T-bonds	21 557 825	25 046 710
Securities issued by Central Banks	11 066 168	5 978 629
Securities issued by business entities	-	249 912
Securities issued by local governments	652 597	674 519
Total	33 276 590	31 949 770
including impairment of assets	-	-

Notes to the financial statements (cont.)

(In PLN thousand)

Equity securities available for sale (AFS)

	31.12.2017	31.12.2016
Shares	147 404	151 864
Investment certificates	37	-
Total	147 441	151 864
including impairment of assets	(1 119)	(1 257)

Debt securities held to maturity (HTM)

	31.12.2017	31.12.2016
Securities issued by State Treasury	3 450 338	2 998 379
T- bills	-	-
T- bonds	3 450 338	2 998 379
Securities issued by Central Banks	31 453	20 606
Total	3 481 791	3 018 985
including impairment of assets	-	-

Investment debt securities according to contractual maturities

	31.12.2017	31.12.2016
Debt securities, including:		
up to 1 month	11 112 757	7 424 354
between 1 and 3 months	121 753	573 661
between 3 months and 1 year	6 054 947	6 072 130
between 1 and 5 years	11 762 697	12 109 707
over 5 years	7 706 227	8 788 903
Total	36 758 381	34 968 755

Investment debt securities according to currencies

	31.12.2017	31.12.2016
PLN	32 997 942	30 844 812
EUR	2 091 122	2 790 183
USD	1 669 317	1 333 760
Total	36 758 381	34 968 755

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in investment (placement) securities

	2017	2016
SECURITIES AVAILABLE FOR SALE (AFS)		
Opening balance	32 101 634	17 813 299
Increases (purchase)	62 240 875	89 733 305
Decreases (sale and redemption)	(61 393 997)	(75 816 126)
Changes in fair value	168 445	(460 735)
Exchange rate differences	(418 639)	170 926
Accrued interest	595 877	705 443
Other changes	129 836	(44 478)
Closing balance	33 424 031	32 101 634
DEBT SECURITIES HELD UNTIL MATURITY (HTM)		
Opening balance	3 018 985	3 368 424
Business combination	13 230	-
Increases (purchase)	2 954 891	6 660 966
Decreases (sale and redemption)	(2 564 407)	(7 069 725)
Accrued interest	43 327	28 096
Other changes	15 765	31 224
Closing balance	3 481 791	3 018 985
Net total investment (placement) securities	36 905 822	35 120 619

32. Reclassification of securities

IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures' provide, under certain conditions, the possibility for reclassification of financial instruments into other categories.

In 2017 and 2016, the Group did not reclassify any financial instruments into other categories.

On 1 October 2008, however, due to the exceptional situation related to the financial crisis, the Group made use of the possibility for reclassification of its financial instruments.

The tables below present the information on the reclassified financial assets

	AMOUNT OF RECLASSIFICATION	31.12.2017		31.12.2016	
		CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Financial assets reclassified from Available for Sale assets to Loans and advances to customers	1 331 580	59 836	60 808	64 381	61 109
Financial assets reclassified from Held for Trading assets to Held to Maturity assets	602 507	17 826	16 977	217 365	219 258
Total	1 934 087	77 662	77 785	281 746	280 367

Notes to the financial statements (cont.)

(In PLN thousand)

If the Group failed to perform the reclassification, the income and revaluation equity would have changed as follows

31.12.2017	NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	REVALUATION RESERVE
Financial assets reclassified from Available for Sale assets to Loans and advances to customers	-	4 015
Financial assets reclassified from Held for Trading assets to Held to Maturity assets	427	-
Total	427	4 015

31.12.2016	NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	REVALUATION RESERVE
Financial assets reclassified from Available for Sale assets to Loans and advances to customers	-	263
Financial assets reclassified from Held for Trading assets to Held to Maturity assets	(5 633)	-
Total	(5 633)	263

Net interest income on reclassified financial assets

	2017	2016
Financial assets reclassified from Available for Sale assets to Loans and advances to customers	1 493	1 580
Financial assets reclassified from Held for Trading assets to Held to Maturity assets	4 250	10 625
Total	5 743	12 205

33. Assets and liabilities held for sale

According to IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', the Group identified non-current assets meeting requirements of IFRS 5 (concerning classification of non-current assets as held for sale) from the item 'Assets held for sale'.

As at 31 December 2017, non-current assets classified as held for sale are as follows:

- real estate,
- other property, plant and equipment.

Assets held for sale and liabilities associated with assets held for sale are presented below

	31.12.2017	31.12.2016
ASSETS HELD FOR SALE		
Property, plant and equipment	42 197	25 703
Other assets	23 368	22 574
Total assets	65 565	48 277

Notes to the financial statements (cont.)

(In PLN thousand)

The changes in the balance of assets held for sale and liabilities associated with assets held for sale are presented in the table below

ASSETS HELD FOR SALE	2017	2016
Opening balance	48 277	45 302
Increases including:	18 477	11 541
transfer from property, plant and equipment	2 580	3 113
transfer from investment properties	15	8 295
Other	15 882	133
Decreases including:	(1 189)	(8 566)
transfer to property, plant and equipment	-	(1 250)
transfer to investment properties	-	(4 466)
disposal	(302)	(2 820)
other	(811)	(30)
Closing balance	65 565	48 277

The effect of disposal of property, plant and equipment and other assets is as follows

	2017	2016
Sales revenues	1 798	3 849
Net carrying amount of disposed assets (including costs to sell)	(307)	(2 820)
Profit/loss on sale before income tax	1 491	1 029

34. Investments in associates

The below tables present the information about associates that are material to the Group

NAME OF ASSOCIATE	COUNTRY OF INCORPORATION AND PLACE OF BUSINESS	PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING		MEASUREMENT METHOD	NATURE OF THE RELATIONSHIP
		31.12.2017	31.12.2016		
Dom Inwestycyjny Xelion Sp. z o.o. (*)	Poland	100.00	50.00	Equity method	The strategic Entity providing affluent customers with services of assets management.
Pekao Investment Management S.A. (**)	Poland	100.00	49.00	Equity method	The Entity deals with management of investment funds assets and is of strategic importance for the Group that distributes and supporting such products.

(*) On 11 December 2017, the Bank acquired the remaining 50% of the issued shares of Dom Inwestycyjny Xelion Sp. z o.o. and took control over the entity. The Group currently holds 100% of the issued shares of Dom Inwestycyjny Xelion Sp. z o.o. The transaction is detailed in the Note 2.

(**) On 11 December 2017, the Bank acquired the remaining 51% of the issued shares of Pekao Investment Management S.A. and took control over the entity. In consequence, the Group currently holds 100% of the issued shares of Pekao Investment Management S.A. and indirectly 100% of the issued shares of Pekao TFI S.A. The transaction is detailed in the Note 2.

Notes to the financial statements (cont.)

(In PLN thousand)

The summarized financial information of the associates are presented below.

	DOM INWESTYCYJNY XELION SP. Z O.O.		PEKAO INVESTMENT MANAGEMENT S.A.	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Current assets	64 813	53 997	358 065	281 275
Non-current assets	1 789	2 175	8 688	8 605
Total assets	66 602	56 172	366 753	289 880
Current liabilities	29 727	26 380	28 472	33 299
Non-current liabilities	5 994	4 348	5 162	4 541
Total Liabilities	35 721	30 728	33 634	37 840
Net assets	30 881	25 444	333 119	252 040

	DOM INWESTYCYJNY XELION SP. Z O.O.		PEKAO INVESTMENT MANAGEMENT S.A.	
	2017	2016	2017	2016
Revenue	64 105	57 129	339 136	324 839
Net profit (loss) for the period from continuing operations	5 438	4 359	81 218	74 437
Other comprehensive income	-	-	11	37
Total comprehensive income	5 438	4 359	81 229	74 474

Reconciliation of the summarized financial information to the carrying amount of the interests in associates

	DOM INWESTYCYJNY XELION SP. Z O.O.		PEKAO INVESTMENT MANAGEMENT S.A.		RAZEM	
	2017	2016	2017	2016	2017	2016
Group's interest in net assets at beginning of the year	12 721	10 542	123 500	138 423	136 221	148 965
Group's interest in net profit (loss) for the period (*)	2 562	2 179	36 875	36 401	39 437	38 580
Group's interest in other comprehensive income	-	-	-	18	-	18
Dividend received from associates	-	-	-	(51 342)	-	(51 342)
Group's interest in net assets at beginning of the year	15 283	12 721	160 375	123 500	175 658	136 221
Discontinuation of the equity method valuation	(15 283)	-	(160 375)	-	(175 658)	-
Carrying amount of the interests	-	12 721	-	123 500	-	136 221

(*) The Group's interest in the net profit (loss) for the period till the date when the Group has taken control over the entities (discontinuation of the equity method valuation)

Notes to the financial statements (cont.)

(In PLN thousand)

35. Intangible assets

	31.12.2017	31.12.2016
Intangible assets, including:	777 997	540 661
research and development expenditures	1 073	3 024
licenses and patents	490 762	455 647
Other	180 407	7 688
assets under construction	105 755	74 302
Goodwill	747 648	55 520
Total	1 525 645	596 181

The goodwill was transferred to Bank Pekao S.A. on integration with Bank BPH S.A. It represents the goodwill recognized upon acquisition of Pierwszy Komercyjny Bank S.A. in Lublin ('PKBL') by Bank BPH S.A. and relates to those branches of the PKBL which were transferred to Bank Pekao S.A. as a result of integration with Bank BPH S.A. It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 51 675 thousand.

Moreover in the line 'Goodwill' are presented:

- goodwill recognized upon acquisition of Spółdzielcza Kasa Oszczędnościowo – Kredytowa im. Mikołaja Kopernika by Bank Pekao S.A. It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 960 thousand,
- goodwill recognized upon acquisition of Pekao Leasing i Finanse S.A. (formerly BPH Leasing S.A.) by Pekao Leasing Holding S.A. (ex. BPH PBK Leasing S.A.). It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 2 885 thousand,
- goodwill recognized upon acquisition of Pekao Investment Management S.A. and indirectly Pekao TFI S.A. by Bank Pekao S.A. (the transaction is detailed in the Note 2). It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 692 128 thousand.

In respect to the goodwill, the impairment test is performed annually, irrespective of whether there is any indication that it may be impaired.

The impairment test is performed by comparing the carrying amount of the CGU, including the goodwill, with the recoverable amount of the CGU. The recoverable amount is estimated on the basis of value in use of the CGU. The value in use is the present, estimated value of the future cash flows for the period of 5 years, taking into account the residual value of the CGU. The residual value of the CGU is calculated based on an extrapolation of cash flows projections beyond the forecast period using the growth rate of 2.5%. The forecasts of the future cash flows are based on the assumptions included the Bank's budget for 2018 and financial plan for 2019-2022. To discount the future cash flows, it is applied the discount rate of 8.18%, which includes the risk-free rate and the risk premium.

The impairment test performed as at 31 December 2017 showed the surplus of the recoverable amount over the carrying amount of the CGU, and therefore no CGU impairment was recognized.

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Intangibles assets' in the course of the reporting period

2017	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	GOODWILL	TOTAL
GROSS VALUE						
Opening balance	90 174	2 430 512	35 193	74 302	55 520	2 685 701
Increases including:	-	199 837	176 657	225 676	692 128	1 294 298
acquisitions	-	4 795	-	225 532	-	230 327
business combination	-	1 509	175 064	-	692 128	868 701
transfer from investments outlays	-	192 630	1 593	-	-	194 223
other	-	903	-	144	-	1 047
Decreases, including:	(244)	(89 204)	(1 358)	(194 223)	-	(285 029)
liquidation	(244)	(89 200)	(1 358)	-	-	(90 802)
sale	-	(4)	-	-	-	(4)
transfer from investments outlays	-	-	-	(194 223)	-	(194 223)
Closing balance	89 930	2 541 145	210 492	105 755	747 648	3 694 970
ACCUMULATED AMORTIZATION						
Opening balance	87 150	1 974 865	27 505	-	-	2 089 520
Amortization	1 951	164 682	3 938	-	-	170 571
Liquidation	(244)	(89 160)	(1 358)	-	-	(90 762)
Other	-	(4)	-	-	-	(4)
Closing balance	88 857	2 050 383	30 085	-	-	2 169 325
IMPAIRMENT						
Opening balance	-	-	-	-	-	-
Increases	-	-	-	-	-	-
Decreases	-	-	-	-	-	-
Closing balance	-	-	-	-	-	-
NET VALUE						
Opening balance	3 024	455 647	7 688	74 302	55 520	596 181
Closing balance	1 073	490 762	180 407	105 755	747 648	1 525 645

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Intangibles assets' in the course of the reporting period

2016	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	GOODWILL	TOTAL
GROSS VALUE						
Opening balance	90 174	2 279 571	51 326	115 079	55 520	2 591 670
Increases including:	-	171 830	312	125 093	-	297 235
acquisitions	-	5 089	-	125 093	-	130 182
other	-	183	-	-	-	183
transfer from investments outlays	-	166 558	312	-	-	166 870
Decreases, including:	-	(20 889)	(16 445)	(165 870)	-	(203 204)
liquidation	-	(20 621)	(16 445)	-	-	(37 066)
other	-	(268)	-	-	-	(268)
transfer from investments outlays	-	-	-	(165 870)	-	(165 870)
Closing balance	90 174	2 430 512	35 193	74 302	55 520	2 685 701
ACCUMULATED AMORTIZATION						
Opening balance	82 226	1 832 584	29 182	-	-	1 943 992
Amortization	4 924	163 345	3 337	-	-	171 606
Liquidation	-	(21 064)	(5 014)	-	-	(26 078)
Other	-	-	-	-	-	-
Closing balance	87 150	1 974 865	27 505	-	-	2 089 520
IMPAIRMENT						
Opening balance	-	-	10 961	-	-	10 961
Increases	-	-	-	-	-	-
Decreases	-	-	(10 961)	-	-	(10 961)
Closing balance	-	-	-	-	-	-
NET VALUE						
Opening balance	7 948	446 987	11 183	115 079	55 520	636 717
Closing balance	3 024	455 647	7 688	74 302	55 520	596 181

In the period from 1 January to 31 December 2017, the Group acquired intangible assets in the amount of PLN 230 327 thousand (in 2016 - PLN 130 182 thousand).

In the period from 1 January to 31 December 2017 and in 2016 there have been no intangible assets whose title is restricted and pledged as security for liabilities.

Contractual commitments

As at 31 December 2017 the contractual commitments for the acquisition of intangible assets amounted to PLN 33 334 thousand, whereas as at 31 December 2016 - PLN 43 930 thousand.

Notes to the financial statements (cont.)

(In PLN thousand)

36. Property, plant and equipment

	31.12.2017	31.12.2016
Non-current assets, including:	1 327 191	1 308 234
land and buildings	972 863	1 000 882
machinery and equipment	262 673	245 479
transport vehicles	53 983	24 026
other	37 672	37 847
Non-current assets under construction and prepayments	98 278	114 696
Total	1 425 469	1 422 930

Changes in 'Property, plant and equipment' in the course of the reporting period

2017	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	2 264 209	1 469 173	80 760	320 824	114 696	4 249 662
Increases, including:	53 739	101 344	46 568	7 861	130 480	339 992
acquisitions	173	4 094	5 845	491	129 708	140 311
other	10 017	1 149	40 723	122	772	52 783
transfer from non-current assets under construction	43 549	96 101	-	7 248	-	146 898
Decreases, including:	(21 446)	(109 011)	(37 827)	(12 896)	(146 898)	(328 078)
liquidation and sale	(14 043)	(108 587)	(37 346)	(12 797)	-	(172 773)
transfer to non-current assets held for sale	(7 403)	(412)	-	(72)	-	(7 887)
other	-	(12)	(481)	(27)	-	(520)
transfer from non-current assets under construction	-	-	-	-	(146 898)	(146 898)
Closing balance	2 296 502	1 461 506	89 501	315 789	98 278	4 261 576
ACCUMULATED DEPRECIATION						
Opening balance	1 259 474	1 219 907	56 734	282 859	-	2 818 974
Increases, including:	77 398	82 842	14 904	7 491	-	182 635
depreciation	69 244	82 831	14 904	7 476	-	174 455
other	8 154	11	-	15	-	8 180
Decreases, including:	(18 291)	(106 738)	(36 120)	(12 381)	-	(173 530)
liquidation and sale	(13 468)	(106 341)	(35 879)	(12 295)	-	(167 983)
transfer to non-current assets held for sale	(4 823)	(386)	-	(72)	-	(5 281)
other	-	(11)	(241)	(14)	-	(266)
Closing balance	1 318 581	1 196 011	35 518	277 969	-	2 828 079
IMPAIRMENT						
Opening balance	3 853	3 787	-	118	-	7 758
Increases	1 205	114	-	67	-	1 386
Decreases	-	(1 079)	-	(37)	-	(1 116)
Closing balance	5 058	2 822	-	148	-	8 028
NET VALUE						
Opening balance	1 000 882	245 479	24 026	37 847	114 696	1 422 930
Closing balance	972 863	262 673	53 983	37 672	98 278	1 425 469

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Property, plant and equipment' in the course of the reporting period

2016	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	2 278 125	1 452 658	83 169	326 314	84 826	4 225 092
Increases, including:	21 640	81 249	4 882	4 996	133 837	246 604
acquisitions	1 969	5 233	1 412	630	133 837	143 081
other	2	610	3 470	48	-	4 130
transfer from non-current assets under construction	19 669	75 406	-	4 318	-	99 393
Decreases, including:	(35 556)	(64 734)	(7 291)	(10 486)	(103 967)	(222 034)
liquidation and sale	(32 398)	(64 257)	(7 291)	(8 837)	-	(112 783)
transfer to non-current assets held for sale	(2 886)	(149)	-	(78)	-	(3 113)
other	(272)	(328)	-	(1 571)	(4 574)	(6 745)
transfer from non-current assets under construction	-	-	-	-	(99 393)	(99 393)
Closing balance	2 264 209	1 469 173	80 760	320 824	114 696	4 249 662
ACCUMULATED DEPRECIATION						
Opening balance	1 219 079	1 203 090	48 999	284 821	-	2 755 989
Increases, including:	66 805	80 631	12 575	8 371	-	168 382
depreciation	66 805	80 326	12 575	8 371	-	168 077
other	-	305	-	-	-	305
Decreases, including: all	(26 410)	(63 814)	(4 840)	(10 333)	-	(105 397)
liquidation and sale	(25 385)	(63 376)	(4 783)	(10 255)	-	(103 799)
transfer to non-current assets held for sale	(1 025)	(147)	-	(78)	-	(1 250)
other	-	(291)	(57)	-	-	(348)
Closing balance	1 259 474	1 219 907	56 734	282 859	-	2 818 974
IMPAIRMENT						
Opening balance	3 899	3 851	-	118	583	8 451
Increases	-	-	-	-	-	-
Decreases	(46)	(64)	-	-	(583)	(693)
Closing balance	3 853	3 787	-	118	-	7 758
NET VALUE						
Opening balance	1 055 147	245 717	34 170	41 375	84 243	1 460 652
Closing balance	1 000 882	245 479	24 026	37 847	114 696	1 422 930

In the period from 1 January to 31 December 2017 the Group acquired property, plant and equipment in the amount of PLN 140 311 thousand (in 2016 - PLN 143 081 thousand), while the value of property, plant and equipment sold amounted to PLN 605 thousand (in 2016 - PLN 8 150 thousand).

The amount of compensations received from third parties for impairment of loss of property, plant and equipment items recognized in the income statement for 2017 stood at PLN 3 540 thousand (in 2016 - PLN 3 551 thousand).

In 2017 and 2016 there have been no restrictions to legal titles to property, plant and equipment, nor pledges in place as security for liabilities.

Contractual commitments

As at 31 December 2017 the contractual commitments for the acquisition of property, plant and equipment amounted to PLN 20 801 thousand, whereas as at 31 December 2016 - PLN 17 525 thousand.

Notes to the financial statements (cont.)

(In PLN thousand)

37. Investment property

The Group values investment property using the historical cost model.

The rights to sell the investment property and the rights to transfer related revenues and profits are not a subject to limitations.

Changes in 'Investment property' in the course of the reporting period

	2017	2016
GROSS VALUE		
Opening balance	55 564	66 253
Increases, including:	97	431
acquisitions	-	431
transfer from property plant and equipment	-	-
other	97	-
Decreases, including:	(11 612)	(11 120)
sale of real estate	-	(2 777)
transfer to non-current assets held for sale	(1 595)	(8 295)
transfer to property plant and equipment	(10 017)	-
other	-	(48)
Closing balance	44 049	55 564
ACCUMULATED DEPRECIATION		
Opening balance	23 659	27 350
Increases, including:	926	1 183
depreciation for the period	926	1 183
transfer from property plant and equipment	-	-
other	-	-
Decreases, including:	(8 874)	(4 874)
sale of real estate	-	(1 133)
transfer to non-current assets held for sale	(720)	(3 741)
transfer to property plant and equipment	(8 154)	-
Closing balance	15 711	23 659
IMPAIRMENT		
Opening balance	7 031	8 682
Increases, including:	-	-
impairment charges	-	-
Decreases, including:	(860)	(1 651)
sale of real estate	-	(926)
transfer to non-current assets held for sale	(860)	(725)
Closing balance	6 171	7 031
NET VALUE		
Opening balance	24 874	30 221
Closing balance	22 167	24 874

Notes to the financial statements (cont.)

(In PLN thousand)

The fair value of investment property as at 31 December 2017 stood at PLN 24 183 thousand (PLN 14 599 thousand as at 31 December 2016). The fair value of investment property are categorized in Level 3 of the fair value hierarchy. The fair value was measured based on valuations of the property appraisers, having appropriate professional qualifications and recent experience in the location of the properties being valued. The valuations of investment property are based on investment method or profits method, taking into account such unobservable input data as expected rental growth rate, void periods, occupancy rate, discount rate.

The following amounts of revenues and costs associated with investment properties have been recognized in the income statement

	2017	2016
Rental revenues from investment properties	4 531	4 069
Direct operating expenses associated with investment properties (including repair and maintenance costs) which generated rental revenues during the reporting period	(1 563)	(1 568)
Direct operating expenses associated with investment properties (including repair and maintenance costs) which did not generate rental revenues during the reporting period	-	-

38. Other assets

	31.12.2017	31.12.2016
Prepaid expenses	94 920	132 063
Perpetual usufruct rights	13 834	14 876
Accrued income	79 471	78 756
Interbank and interbranch settlements	2	156
Other debtors	295 437	325 351
Card settlements	573 321	479 996
Total	1 056 985	1 031 198

Prepaid expenses represent expenditures, which will be amortized against income statement in the forthcoming reporting periods.

Impairment allowances for other assets and their changes in 2017 and 2016 are presented in the Note 18.

Notes to the financial statements (cont.)

(In PLN thousand)

39. Assets pledged as collateral

As at 31 December 2017 the Group held the following financial assets pledged as security for liabilities

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transaction	bonds	1 088 646	1 045 716	1 089 876
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	763 927	770 200	-
Coverage of payment commitments to the guarantee fund for the Bank Guarantee Fund	bonds	32 488	32 000	26 858
Coverage of payment commitments to the resolution fund for the Bank Guarantee Fund	bonds	63 545	62 600	53 497
Lombard and technical loan	bonds	4 697 247	4 587 519	-
Other loans	bonds	320 074	317 300	234 731
Issue of mortgage bonds	receivables backed by mortgage, bonds	1 576 746	1 574 510	1 211 307
Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	bonds, cash deposit	50 593	50 446	-
Derivatives	bonds	648 671	653 999	574 882

As at 31 December 2016 the Group held the following financial assets pledged as security for liabilities

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transaction	bonds	1 774 747	1 678 677	1 775 808
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	750 701	720 200	-
Lombard and technical loan	bonds	4 808 629	4 515 159	-
Other loans	bonds	357 614	353 900	297 497
Issue of mortgage bonds	receivables backed by mortgage, bonds	1 678 258	1 679 057	1 222 018
Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	bonds, cash deposit	51 155	50 890	-
Derivatives	bonds	60 792	65 302	31 987

Notes to the financial statements (cont.)

(In PLN thousand)

The freeze on securities is a consequence of:

- in case of Repo and Sell-buy-back transactions – binding money market standards for such transactions,
- in case of freeze to the benefit of BFG – binding provisions of the Law on Banking Guaranty Fund BFG,
- in case of lombard and technical loans – policy and standards, applied by the National Bank of Poland NBP,
- in case of other loans, deposits and derivatives – terms and conditions of the agreement, entered between Bank Pekao S.A. and its clients,
- in case of issue of mortgage bonds – binding provisions of the Law on Mortgage Bonds and Mortgage Banks,
- in case of freeze to the benefit of KDPW – with the status of the clearing member for brokerage transactions.

40. Amounts due to other banks

Amounts due to other banks by product type

	31.12.2017	31.12.2016
Current accounts	995 307	902 856
Interbank deposits and other liabilities	653 917	309 837
Loans and advances received	3 006 353	3 249 417
Repo transactions	301 439	339 568
Cash in transit	24 275	21 762
Total	4 981 291	4 823 440

Amounts due to other banks by currencies

	31.12.2017	31.12.2016
PLN	1 635 684	1 442 611
CHF	591 405	731 657
EUR	2 654 770	2 592 591
USD	89 288	48 467
Other currencies	10 144	8 114
Total	4 981 291	4 823 440

Notes to the financial statements (cont.)

(In PLN thousand)

41. Amounts due to customers

Amounts due to customers by product type

	31.12.2017	31.12.2016
Amounts due to corporate, including:	57 397 810	57 989 927
current accounts	38 152 471	33 946 882
term deposits and other liabilities	19 245 339	24 043 045
Amounts due to budget entities, including:	12 192 129	7 809 235
current accounts	9 392 061	5 461 224
term deposits and other liabilities	2 800 068	2 348 011
Amounts due to individuals, including:	75 576 754	70 347 039
current accounts	43 101 222	39 682 587
term deposits and other liabilities	32 475 532	30 664 452
Repo transactions	788 436	1 436 241
Cash in transit	231 139	233 484
Total	146 186 268	137 815 926

Amounts due to customers by currencies

	31.12.2017	31.12.2016
PLN	119 945 891	115 090 198
CHF	336 479	315 787
EUR	16 487 441	13 400 735
USD	7 925 639	7 476 067
Other currencies	1 490 818	1 533 139
Total	146 186 268	137 815 926

42. Debt securities issued

Debt securities issued by type

	31.12.2017	31.12.2016
Liabilities from bonds	90 092	-
Certificates of deposit	1 470 000	300 945
Mortgage bonds	1 211 307	1 222 018
Total	2 771 399	1 522 963

The Group redeems its own debt securities issued on a timely basis.

Debt securities issued by currencies

	31.12.2017	31.12.2016
PLN	2 410 014	1 200 548
EUR	361 385	322 415
USD	-	-
Total	2 771 399	1 522 963

Changes in the balance sheet value of debt securities issued are presented in the Note 53.

Notes to the financial statements (cont.)

(In PLN thousand)

43. Subordinated liabilities

On 30 October 2017, the Bank issued 10 years subordinated bonds with a total nominal value of PLN 1.25 billion. The funds from the issue were designated – after receiving the approval of the Polish Financial Supervision Authority on 21 December 2017 – to increase the Bank's supplementary capital, pursuant to art. 127 para. 2 point 2 of the Banking Law and art. 63 of Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. The bonds were introduced to trading on the ASO Catalyst market.

Subordinated liabilities

TYPE OF TRANSACTION	NOMINAL AMOUNT	CURRENCY	INTEREST RATE	ISSUE DATE	MATURITY DATE	SPECIAL TERMS	BALANCE SHEET VALUE AS AT 31.12.2017
Subordinated bonds	1 250 000	PLN	variable, WIBOR 6M + margin	30.10.2017	29.10.2027	Call option giving the Bank the right of early redemption within 5 years from the issue date, subject to the approval of the PFSA	1 257 188

Changes in the balance sheet value of subordinated liabilities are presented in the Note 53.

44. Provisions

Change in provisions in the reporting period

2017	PROVISIONS FOR LITIGATION AND CLAIMS	PROVISIONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	8 551	294 014	220 983	36 844	560 392
Provision charges/revaluation	10 428	27 931	71 221	47 861	157 441
Provision utilization	(6 554)	(14 068)	-	(5 644)	(26 266)
Provision releases	(1 329)	(41)	(53 690)	(111)	(55 171)
Foreign currency exchange differences	-	-	(1 605)	-	(1 605)
Business combinations	1 061	974	-	5 382	7 417
Other changes	4 975	(8 562)	-	(35 999)	(39 586)
Closing balance	17 132	300 248	236 909	48 333	602 622
Short term	4 281	33 893	50 514	9 354	98 042
Long term	12 851	266 355	186 395	38 979	504 580

2016	PROVISIONS FOR LITIGATION AND CLAIMS	PROVISIONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	10 608	268 858	120 771	25 137	425 374
Provision charges/revaluation	4 092	26 635	160 561	23 386	214 674
Provision utilization	(3 405)	(13 020)	-	(11 207)	(27 632)
Provision releases	(3 202)	(19)	(61 341)	(442)	(65 004)
Foreign currency exchange differences	-	-	992	-	992
Other changes	458	11 560	-	(30)	11 988
Closing balance	8 551	294 014	220 983	36 844	560 392
Short term	3 214	47 435	67 159	14 201	132 009
Long term	5 337	246 579	153 824	22 643	428 383

Notes to the financial statements (cont.)

(In PLN thousand)

Provisions for litigation and claims

Provisions for litigation and claims include court, administrative and other legal proceedings. The provisions were estimated in the amount of expected outflow of resources embodying economic benefits.

Provisions for defined benefit plans

Detailed information in respect to provisions for defined benefit plans were presented in Note 46.

Other provisions

Other provisions include in particular provisions for other employee benefits.

45. Other liabilities

	31.12.2017	31.12.2016
Deferred income	132 629	115 137
Provisions for holiday leave	56 891	56 924
Provisions for other employee-related liabilities	237 922	251 582
Provisions for administrative costs	110 066	90 461
Other costs to be paid (*)	108 651	111 239
Other creditors	474 828	338 335
Interbank and interbranch settlements	1 385 384	1 029 899
Card settlements	286 771	304 475
Total	2 793 142	2 298 052

(*) in this as at 31 December 2017 is PLN 81 842 thousand of provision for future refunds of the part of the remuneration for sale of insurance products linked to loans (PLN 95 346 as at 31 December 2016).

46. Defined benefit plans

Based on internal regulations in respect to remuneration, the employees of the Group or their families are entitled to defined benefits other than remuneration:

- a) retirement benefits,
- b) death-in-service benefits.

The present value of such obligations is measured by an independent actuary using the projected unit credit method.

The amount of the retirement benefits and death-in-service benefits is dependent on length of service and amount of remuneration. The expected amount of the benefits is discounted actuarially, taking into account the financial discount rate and the probability of an individual get to the retirement age or die while working respectively. The financial discount rate is determined by reference to market yields at the end of reporting period on government bonds. The probability of an individual get to the retirement age or die while working is determined using the multiple decrement model, taking into consideration the following risks: possibility of dismissal from service, risk of total disability to work and risk of death.

These defined benefit plans expose the Group to actuarial risk, such as:

- interest rate risk – the decrease in market yields on government bonds would increase the defined benefit plans obligations,
- remuneration risk – the increase in remuneration of the Group's employees would increase the defined benefit plans obligations,
- longevity risk – the increase in life expectancy of the Group's employees would increase the defined benefit plans obligations.

Notes to the financial statements (cont.)

(In PLN thousand)

The principal actuarial assumptions as at 31 December 2017 are as follows:

- the discount rate at the level of 3.20% (3.50 % as at 31 December 2016),
- the future salary growth rate at the level of 2.50% (2.50 % as at 31 December 2016),
- the probable number of leaving employees calculated on the basis of historical data concerning personnel rotation in the Group,
- the mortality adopted in accordance with Life Expectancy Tables for men and women, published the Central Statistical Office, adequately adjusted on the basis of historical data of the Group.

Reconciliation of the present value of defined benefit plans obligations

The following table presents a reconciliation from the opening balances to closing balances for the present value of defined benefit plans obligations.

	2017	2016
Opening balance	294 014	268 858
Current service cost	17 612	18 845
Interest expense	10 278	7 771
Remeasurements of the defined benefit obligations:	(8 563)	11 560
actuarial gains and losses arising from changes in demographic assumptions	(2 832)	33 812
actuarial gains and losses arising from changes in financial assumptions	7 447	(16 128)
actuarial gains and losses arising from experience adjustments	(13 178)	(6 124)
Contributions paid by the employer	(14 068)	(13 020)
Business combination	975	-
Closing balance	300 248	294 014

Sensitivity analysis

The following table presents how the impact on the defined benefits obligations would have increased (decreased) as a result of a change in the respective actuarial assumptions by one percent.

31.12.2017	DEFINED BENEFIT PLANS OBLIGATIONS	
	1 PERCENT INCREASE	1 PERCENT DECREASE
Discount rate	(23 615)	27 451
Future salary growth rate	26 166	(23 026)

31.12.2016	DEFINED BENEFIT PLANS OBLIGATIONS	
	1 PERCENT INCREASE	1 PERCENT DECREASE
Discount rate	(23 580)	27 509
Future salary growth rate	26 278	(23 033)

Maturity of defined benefit plans obligations

The following table presents the maturity profile of the defined benefit plans obligations

	31.12.2017	31.12.2016
The weighted average duration of the defined benefit plans obligations (in years)	8.6	8.8

Notes to the financial statements (cont.)

(In PLN thousand)

47. Share-based payments

Incentive programs

In the current and comparative reporting periods the following incentive programs granted to employees of the Bank:

- The long-term UniCredit Group Incentive Program 2008 in respect to share options is realized by the Bank. The rights to exercise the option were acquired in 2012. Strike price is EUR 4.185. The option will expire in 2018,
- The long-term UniCredit Group Incentive Program 2007 has been finished in respect to share options. The options were expired in 2017,
- Employee Share Ownership Plan that offered to eligible the Bank Pekao S.A. Group employees the possibility to buy UniCredit ordinary shares has been finished.

The above mentioned share-based payments are recognized as cash-settled transactions.

The fair value of share options and shares of UniCredit S.p.A. was established based on the Hull and White model.

The tables below present changes in the number of stock options and performance shares of UniCredit S.p.A., as well as the weighted average exercise prices

2017	STOCK OPTIONS	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE (*)
Opening balance	2 265 548	17.51
Granted during the year	-	-
Redeemed during the year	(617 070)	-
Exercised during the year	-	-
Terminated during the year	(510 902)	-
Existing at the period-end	1 137 576	17.51
Executable at the period-end	1 137 576	17.51

(*)The value of PLN 17.51 relates to the stock options program 2008.

2016	STOCK OPTIONS	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE (*)
Opening balance	2 289 715	17.83/30.23
Granted during the year	-	-
Redeemed during the year	(24 167)	-
Exercised during the year	-	-
Terminated during the year	-	-
Existing at the period-end	2 265 548	17.83/30.23
Executable at the period-end	2 265 548	17.83/30.23

(*)The value of PLN 17.83 relates to the stock options program 2008, whereas the value of PLN 30.23 relates to the stock options program 2007.

Notes to the financial statements (cont.)

(In PLN thousand)

The fair value of granted rights to shares under Employee Share Ownership Plan until 31 December 2017 amounted to PLN 230 thousand as at 31 December 2017 (PLN 1 675 as at 31 December 2016).

The remuneration expenses for 2017 relating to the incentive programs granted to the employees of the Bank by UniCredit Group amounted to PLN minus 15 thousand (in 2016 - PLN 383 thousand).

System of Variable Remuneration for the Management Team

The system of variable remuneration is addressed to Employees defined in the Bank as persons in managerial positions, who are key employees for the fulfillment of the Bank's strategy, risk management and long-term increase of the Bank's income. The aim of the system is to support the execution of the Bank's operational strategy, its risk management and to limit conflict of interests.

Under the system the participant can receive the variable compensation, which is paid out based on a bonus pool approach providing for a comprehensive performance measurement at individual level, level of his/her organizational unit and results of the entire Bank as well as verification of the Participant's compliant behaviour with respect to law provisions and standards adopted by the Bank.

The compensation consists of cash payment and cash-settled share based payment realized in the form of phantom shares as cash equivalent amounting to the value of granted phantom shares.

Notes to the financial statements (cont.)

(In PLN thousand)

During the reporting period ending on 31 December 2016 the Bank had the following share-based payments transactions

	SYSTEM 2013	SYSTEM 2014	SYSTEM 2015	SYSTEM 2016	SYSTEM 2017
Transaction type	Cash-settled share based payments				
Start date of the assessment period	1 January 2013	1 January 2014	1 January 2015	1 January 2016	1 January 2017
Program announcement date	April 2013	June 2014	July 2015	June 2016	April 2017
Program granting date	12 June 2014	30 April 2015	16 June 2016	19 April 2017	Date of General Shareholders Meeting
Number of instruments granted (pcs)	76 013	68 040	93 359	127 256	Will be defined on granting date
Maturity date	31 July 2018	31 July 2020	31 July 2021	31 July 2022	31 July 2023
Vesting date for Management Board Members and Executive Vice President	<ul style="list-style-type: none"> 40% in the year of program granting (settlement after 2 years retention period) 40% after 2 years from program granting date (settlement after 1 year retention period) 20% after 3 years from program granting date (settlement after 1 year retention period) 	<ul style="list-style-type: none"> 40% in the year of program granting (settlement after 3 years retention period) 30% after 3 years from program granting date (settlement after 1 year retention period) 30% after 4 years from program granting date (settlement after 1 year retention period) 	<ul style="list-style-type: none"> 40% in the year of program granting (settlement after 2 years retention period) 24% after 2 years from program granting date (settlement after 1 year retention period) 12% after 3 years from program granting date (settlement after 1 year retention period) 24% after 4 years from program granting date (settlement after 1 year retention period) 	<ul style="list-style-type: none"> 40% in the year of program granting (settlement after 2 years retention period) 24% after 2 years from program granting date (settlement after 1 year retention period) 12% after 3 years from program granting date (settlement after 1 year retention period) 24% after 4 years from program granting date (settlement after 1 year retention period) 	<ul style="list-style-type: none"> 40% in the year of program granting (settlement after 2 years retention period) 24% after 2 years from program granting date (settlement after 1 year retention period) 12% after 3 years from program granting date (settlement after 1 year retention period) 24% after 4 years from program granting date (settlement after 1 year retention period)
Vesting date for remaining participants	<ul style="list-style-type: none"> 20% after 1 year from program granting date 40% after 2 years from program granting date 40% after 3 years from program granting date 	<ul style="list-style-type: none"> 60% in the year of program granting (settlement after 3 years retention period) 20% after 3 years from program granting date (settlement after 1 year retention period) 20% after 4 years from program granting date (settlement after 1 year retention period) 	<ul style="list-style-type: none"> 60% in the year of program granting (settlement after 3 years retention period) 20% after 3 years from program granting date (settlement after 1 year retention period) 20% after 4 years from program granting date (settlement after 1 year retention period) 	<ul style="list-style-type: none"> 60% in the year of program granting (settlement after 2 years retention period) 20% after 2 years from program granting date (settlement after 1 year retention period) 20% after 3 years from program granting date (settlement after 1 year retention period) 	<ul style="list-style-type: none"> 60% in the year of program granting (settlement after 2 years retention period) 20% after 2 years from program granting date (settlement after 1 year retention period) 20% after 3 years from program granting date (settlement after 1 year retention period)
Vesting conditions	Compliance assessment, Continuous employment, Reaching the aim based on financial results of the Bank for a given period				
Program settlement	<p>The participant will receive a cash payment amounting to the number the possessed phantom shares times the arithmetic mean of the Bank's share prices at the Warsaw Stock Exchange:</p> <ul style="list-style-type: none"> in case of the settlement made at the dates of instalment after the mandatory retention period, for a month preceding the day of General Meeting approving the financial statements for a given year, in case of settlement made in the voluntary retention period, for 10 working days following the day of release of the financial report in a given quarter, and benefits from acquired phantom shares in the amount equivalent to dividend paid to shareholders in the retention period for shares acquired by the participant 				

Notes to the financial statements (cont.)

(In PLN thousand)

For the System 2013, 2014, 2015 and 2016 the fair value of the program was estimated based upon the Bank's shares price on the WSE as of the balance sheet date and expected number of phantom shares to which the rights will be acquired.

For the System 2017, as of 31 December 2017 the Bank prepared the program valuation, presuming that the phantom shares were granted on 31 December 2017. This value will be changed at the actual date of granting the program.

The system of variable remuneration realized in the form of phantom shares is a program settled in cash, and therefore its fair value is adjusted on each balance sheet date until the the program settlement, which in case of this program coincides with the vesting date.

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 36 887 thousand as at 31 December 2017 (as at 31 December 2016 – PLN 22 532 thousand).

The total intrinsic value of liabilities for vested rights to phantom shares amounted to PLN 38 524 thousand as at 31 December 2017 (as at 31 December 2016 – PLN 26 446 thousand).

The remuneration expenses for 2017 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 19 714 thousand (in 2016 - PLN 9 189 thousand).

The table below presents changes in the number of Bank's phantom shares

	2017	2016
Opening balance	210 223	191 060
Granted during the year	127 256	93 359
Redeemed during the year	-	-
Exercised during the year	(39 996)	(74 196)
Terminated during the year	-	-
Existing at the period-end	297 483	210 223

The table above does not present the number of shares granted in respect of System 2017. This number will be determined in 2018 after approval of the financial statements for 2017 by the General Shareholder's Meeting. The hypothetical number of shares determined on the basis of the base value of the granted bonus to each of the program participants and arithmetic mean of the Bank's share price on the WSE in December 2017 amounts to 156 872.

System of Variable Remuneration for the Management Team of the subsidiaries Peko

In order to meet the requirements concerning the rules of establishing the policy of variable remuneration components for individuals holding managerial positions (Regulation of the Minister of Development and Finance on the risk management system and internal control system, remuneration policy and a detailed method of estimating internal capital in banks of 6 March 2017 [Official Journal from 2016, item 1988, 1948, 1997 and 2260 and from 2017, item 85), the Bank's subsidiaries: Centralny Dom Maklerski Pekao S.A., Pekao Bank Hipoteczny S.A., Pekao Leasing Sp.z o.o., Pekao Investment Banking S.A., Pekao Financial Services Sp.z o.o., Dom Inwestycyjny Xelion Sp. z o.o. and Pekao Faktoring Sp. z o.o. use a variable remuneration system for the management.

Within the system participant can receive the bonus depending on the performance and results of work of the participant, of the business unit and the company's results in the area of responsibility of the person, taking into account the results of the whole company, as well as verification of the compliance of Participant's behaviour with respect to law provisions and standards adopted by the company.

At least 40 % components of variable remunerations is settled and paid in the time-period of 3 to 5 years since the granting date.

The companies measure the future employees benefits at fair value of accepted liabilities, in accordance with IAS 19 'Employee benefits'. Results of liabilities measurement at fair value are presented in income statement as personnel expenses.

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 5 861 thousand as at 31 December 2017 (as at 31 December 2016 – PLN 4 026 thousand).

Notes to the financial statements (cont.)

(In PLN thousand)

The remuneration expenses for 2017 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 1 222 thousand (in 2016 - PLN 1 545 thousand).

48. Operating lease

The Group as a Lessor

In operating lease of buildings classified as investment properties the Group acts as a lessor.

The amount of future minimum lease payments expected to be received under non-cancellable operating lease can be summarized as follows

	31.12.2017	31.12.2016
Up to 1 year	10 832	8 016
Between 1 years and 5 years	4 374	3 436
Over 5 years	841	929
Total	16 047	12 381

The amount of the minimum operating lease payments classified as income in 2017 amounted to PLN 17 860 thousand (in 2016 - PLN 18 757 thousand in 2016).

The Group as Lessee

The Group is a lessee of buildings' lease contracts classified as operating lease.

The amount of future minimum lease payments expected to be paid under non-cancellable operating lease can be summarized as follows

	31.12.2017	31.12.2016
Up to 1 year	105 068	98 387
Between 1 years and 5 years	215 794	212 397
Over 5 years	22 039	62 118
Total	342 901	372 902

The amount of the minimum operating lease payments recognized as an expense in 2017 amounted to PLN 169 984 thousand (expense in 2016 amounted to PLN 172 411 thousand).

The lease agreements are usually entered into for an indefinite period. In case of lease agreements concluded for an indefinite term, the minimum lease payments are determined based upon notice of termination periods ensuing from relevant contracts. The notice period is usually fixed at 3 or 6 months. Lease agreements are denominated in PLN as well as in foreign currencies. Payments are made in PLN, regardless of the contract currency.

Notes to the financial statements (cont.)

(In PLN thousand)

49. Contingent commitments

Litigation

In the entire year of 2017 the total value of the litigation subject in the ongoing court proceedings against the Group was PLN 171 864 056 thousand (in 2016 it was PLN 1 091 638 thousand).

In 2017 still going on was the court litigation against the Group, brought by a minority shareholder of the Bank for an ascertainment of invalidity or alternatively for repealing the resolutions no 5 and 21 of the Ordinary General Meeting of Shareholders dated 19 April 2017 for an approval of financial statements for 2016 and for granting of approval of the performance by the member of the Management Board of his duties in 2016. In the opinion of the Bank, the claim is unfounded and the value of the litigation subject in the amount of PLN 170 988 852 thousand indicated by the plaintiff is incorrect, as confirmed by the value of the litigation subject by a decision of the District Court in Warsaw of 5 September 2017, the value of the litigation subject was set at PLN 6 850. As at 31 December 2017, the value of the litigation subject in the above case amounted to PLN 6 850.

In 2017 there were no proceedings before the court or state administration bodies related to the receivables or payables of the Bank and its subsidiaries in which the pursued claim value (amount to be paid) is at least 10% of the Group's equity.

In 2017 still going on was the court litigation against the Group entities, brought by private individuals for the payment of damage arising from the purchase of stocks and the financial compensation for the injury resulting from the execution process, in which the value of the litigation subject, as in 2017, was PLN 206 422 thousand (previously PLN 306 622 thousand). In the first half of 2015 the sentence dismissing the plaint against defendants was adjudicated. The plaintiffs lodged an appeal against the sentence, i.e. its part related to the amount of PLN 206 422 thousand. In the third quarter of 2016 was issued a judgment dismissing the appeal. The verdict of the Court of II instance has been appealed against by the plaintiffs by means of a cassation appeal. In the fourth quarter of 2017, the Supreme Court refused to accept the cassation appeal. In connection with the ruling of the Supreme Court, the case is finally ended in favor of the Bank.

Moreover against the Group currently are pending the following essential litigations, in which the Bank – in the current factual and legal circumstances – assess the risk of outflow as possible:

- proceedings instigated in the second quarter of 2014 as a result of the plaint brought by a guarantee beneficiary for the payment of PLN 55 996 thousand as the bank guarantee drawing,
- proceedings instigated in the first quarter of 2015 as a result of the plaint brought by guarantee beneficiary for the payment of PLN 29 205 thousand as the bank guarantee drawing,
- proceeding instigated in the fourth quarter of 2016 as a result plaint brought by private individual for the payment of PLN 38 916 thousand taken by the Bank way of settlement of term financial transactions.

The Group created provisions for litigations against the Group entities which, according to the legal opinion, are connected with a risk of the funds outflow resulting from the fulfillment of the obligation. The value of the provisions as at 31 December 2017 is PLN 17 132 thousand (PLN 8 551 thousand as at 31 December 2016).

Financial off-balance commitments granted

Financial commitments granted by entities

	31.12.2017	31.12.2016
Financial commitments to:		
financial entities	785 430	734 503
non - financial entities	32 495 145	31 088 328
budget entities	599 409	481 482
Total	33 879 984	32 304 313

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance guarantees issued

Guarantees issued by entities

	31.12.2017	31.12.2016
Issued to financial entities, including:	1 093 608	991 115
guarantees	1 093 608	991 115
Issued to non-financial entities, including:	9 970 336	9 999 478
guarantees	6 726 612	6 194 199
securities' underwriting guarantees	3 070 727	3 455 429
sureties	172 997	349 850
Issued to budget entities, including:	434 737	269 239
guarantees	13 186	11 279
securities' underwriting guarantees	421 551	257 960
Total	11 498 681	11 259 832

Securities underwriting

As at 31 December 2017, the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OF SECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 1	bonds	1 009 000	23.07.10 - 30.06.20
Client 2	bonds	484 880	23.10.13 - 31.05.22
Client 3	bonds	60 775	26.07.17 - 31.03.19
Client 4	bonds	32 600	27.01.14 - 27.04.18
Client 5	bonds	83 300	30.06.14 - 24.02.18
Client 6	bonds	2 940	15.09.14 - 30.06.18
Client 7	bonds	150 000	24.05.14 - 31.03.18
Client 8	bonds	100 000	23.02.15 - 30.11.22
Client 9	bonds	12 500	14.10.15 - 31.12.18
Client 10	bonds	33 576	18.12.15 - 27.04.18
Client 11	bonds	57 000	21.05.16 - 21.06.19
Client 12	bonds	4 000	06.07.16 - 31.12.18
Client 13	bonds	79 480	31.08.16 - 31.12.18
Client 14	bonds	323 600	31.08.16 - 30.12.19
Client 15	bonds	4 300	23.12.16 - 31.12.18
Client 16	bonds	2 050	23.12.16 - 31.12.18
Client 17	bonds	53 235	20.12.16 - 31.12.18
Client 18	bonds	9 000	03.03.17 - 31.12.19
Client 19	bonds	14 083	03.03.17 - 31.12.18
Client 20	bonds	1 530	03.03.17 - 31.12.18
Client 21	bonds	23 210	09.06.17 - 31.12.18
Client 22	bonds	4 132	27.06.17 - 31.12.19
Client 23	bonds	2 500	22.06.17 - 31.12.18
Client 24	bonds	1 000	28.06.17 - 31.12.18
Client 25	bonds	3 000	27.06.17 - 31.12.18

Notes to the financial statements (cont.)

(In PLN thousand)

NAME OF ISSUER	TYPE OF SECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 26	bonds	49 844	09.03.16 - 30.06.19
Client 27	bonds	1 500	04.07.17 - 31.12.18
Client 28	bonds	5 000	17.07.17 - 31.12.18
Client 29	bonds	9 739	23.08.17 - 31.12.18
Client 30	bonds	8 700	06.09.17 - 31.12.18
Client 31	bonds	6 200	08.09.17 - 31.12.19
Client 32	bonds	4 500	13.09.17 - 31.12.18
Client 33	bonds	116 900	15.09.17 - 29.06.19
Client 34	bonds	20 900	25.09.17 - 31.12.18
Client 35	bonds	20 625	26.09.17 - 31.12.19
Client 36	bonds	35 338	25.09.17 - 31.12.19
Client 37	bonds	10 400	27.09.17 - 31.12.19
Client 38	bonds	51 800	11.10.17 - 31.03.22
Client 39	bonds	67 800	11.10.17 - 20.04.22
Client 40	bonds	98 000	24.10.17 - 31.12.19
Client 41	bonds	25 000	24.10.17 - 31.12.19
Client 42	bonds	3 500	03.11.17 - 31.12.18
Client 43	bonds	80 000	03.11.17 - 31.08.19
Client 44	bonds	51 041	15.11.17 - 31.12.20
Client 45	bonds	2 000	21.11.17 - 31.12.18
Client 46	bonds	3 750	09.11.17 - 31.12.18
Client 47	bonds	17 000	15.11.17 - 31.12.19
Client 48	bonds	4 100	05.12.17 - 31.12.18
Client 49	bonds	7 000	11.12.17 - 31.12.19
Client 50	bonds	8 400	31.12.17 - 31.12.19
Client 51	bonds	6 000	15.12.17 - 31.12.18
Client 52	bonds	115 000	19.12.17 - 31.12.19
Client 53	bonds	17 100	11.12.17 - 31.12.19
Client 54	bonds	4 900	19.12.17 - 31.12.18
Client 55	bonds	5 000	21.12.17 - 31.12.18
Client 56	bonds	5 000	22.12.17 - 31.12.18
Client 57	bonds	8 500	27.12.17 - 31.12.18
Client 58	bonds	70 050	21.12.17 - 31.12.18

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

Notes to the financial statements (cont.)

(In PLN thousand)

As at 31 December 2016, the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OF SECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 1	bonds	1 385 000	23.07.10 - 30.06.20
Client 2	bonds	265 000	21.06.12 - 31.12.17
Client 3	bonds	484 880	22.10.13 - 31.05.22
Client 4	bonds	35 000	27.01.14 - 28.04.17
Client 5	bonds	110 510	30.06.14 - 31.03.17
Client 6	bonds	2 200	15.09.14 - 31.03.18
Client 7	bonds	20 000	15.09.14 - 31.03.18
Client 8	bonds	150 000	24.05.16 - 31.03.18
Client 9	bonds	49 000	22.12.14 - 30.06.17
Client 10	bonds	230 000	23.02.15 - 30.06.17
Client 11	bonds	100 000	23.02.15 - 30 11.22
Client 12	bonds	84 000	27.01.15 - 31.12.17
Client 13	bonds	30 000	14.10.15 - 31.12.17
Client 14	bonds	7 500	14.10.15 - 31.12.17
Client 15	bonds	119 985	18.12.15 - 28.04.17
Client 16	bonds	20 270	28.12.15 - 31.12.17
Client 17	bonds	19 504	09.03.16 - 30.06.17
Client 18	bonds	22 810	09.03.16 - 30.06.17
Client 19	bonds	53 500	21.05.16 - 21.06.19
Client 20	bonds	3 500	21.05.16 - 21.06.19
Client 21	bonds	8 000	06.07.16 - 31.12.18
Client 22	bonds	67 200	06.07.16 - 31.12.18
Client 23	bonds	8 680	06.07.16 - 31.12.18
Client 24	bonds	8 000	06.07.16 - 31.12.18
Client 25	bonds	310 600	31.08.16 - 30.12.19
Client 26	bonds	13 000	31.08.16 - 30.12.19
Client 27	bonds	6 000	08.11.16 - 31.12.17
Client 28	bonds	4 300	23.12.16 - 31.12.18
Client 29	bonds	1 000	22.12.16 - 30.12.16
Client 30	bonds	6 650	23.12.16 - 31.12.18
Client 31	bonds	66 000	20.12.16 - 31.12.20
Client 32	bonds	15 000	28.12.16 - 31.08.17
Client 33	bonds	6 300	29.12.16 - 31.08.17

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance commitments received

Commitments received by entities

	31.12.2017	31.12.2016
Financial commitments from:	384 961	209 107
financial entities	384 961	209 107
non - financial entities	-	-
budget entities	-	-
Guarantees from:	13 871 406	10 818 912
financial entities	3 116 556	1 552 730
non - financial entities	9 824 811	8 344 980
budget entities	930 039	921 202
Total	14 256 367	11 028 019

Moreover, the Group can to obtain financing from the National Bank of Poland pledged on securities.

50. Share capital

Shareholding structure

CLASS/ISSUE	TYPE OF SHARES	NUMBER OF SHARES	NOMINAL VALUE OF CLASS/ISSUE	EQUITY COVERAGE	REGISTRATION DATE	DIVIDEND RIGHTS (FROM DATE)
A	Common bearer stock	137 650 000	137 650	fully paid-up	21.12.1997	01.01.1998
B	Common bearer stock	7 690 000	7 690	fully paid-up	06.10.1998	01.01.1998
C	Common bearer stock	10 630 632	10 631	fully paid-up	12.12.2000	01.01.2000
D	Common bearer stock	9 777 571	9 777	fully paid-up	12.12.2000	01.01.2000
E	Common bearer stock	373 644	374	fully paid-up	29.08.2003	01.01.2003
F	Common bearer stock	621 411	621	fully paid-up	29.08.2003	19.05.2006 16.05.2007
G	Common bearer stock	603 377	603	fully paid-up	29.08.2003	15.05.2008
H	Common bearer stock	359 840	360	fully paid-up	12.08.2004	01.01.2004
I	Common bearer stock	94 763 559	94 764	fully paid-up	29.11.2007	01.01.2008
Total number of Shares (pcs)		262 470 034				
Total share capital in PLN thousand			262 470			
Nominal value per share = PLN 1.00						

Change in the number of shares (pcs)

2017	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

2016	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

Notes to the financial statements (cont.)

(In PLN thousand)

51. Other capital and reserves, retained earnings and profit for the period

The table below presents the structure of the Group's equity attributable to equity holders of the Bank

	31.12.2017	31.12.2016
Reserve capital, including:	9 491 652	9 480 043
issue of shares above face value	9 137 221	9 137 221
other	354 431	342 822
Revaluation reserve, including:	(56 528)	(223 394)
remeasurements of the defined benefit liabilities	(89 757)	(98 315)
deferred tax	17 054	18 680
revaluation of financial assets portfolio available for sale	13 389	(217 204)
deferred tax	(2 544)	41 269
revaluation of financial hedging instruments portfolio	6 580	39 724
deferred tax	(1 250)	(7 548)
General Banking Risk Fund	1 982 459	1 982 324
Other reserve capital	9 099 775	9 092 735
Bonds convertible into shares- equity component	28 819	28 819
Funds for brokerage activities	15 000	15 000
Total other capital	20 561 177	20 375 527
Profit (loss) from previous periods, allocated to Bank's shareholders	(30 962)	(20 253)
Net profit for the period, allocated to Bank's shareholders	2 475 129	2 279 275
Total retained earnings and profit for the period	2 444 167	2 259 022
Total	23 005 344	22 634 549

The net profit of the Bank for 2016 in the amount of PLN 2 278 375 thousand was distributed in the following way: PLN 2 278 240 thousand – to dividend, PLN 135 thousand – to General Banking Risk Fund.

From 1982 to 1984 and from 1988 to 1996, the Group operated in a hyperinflationary economic environment.

IAS 29 (Financial Reporting in Hyperinflationary Economies) requires restatement of each component of owners' equity (except for retained earnings and revaluation surplus) by applying a general price index for the period of hyperinflation. This retrospective application would have resulted in an increase in share capital and other reserves and a decrease in retained earnings in equivalent amounts. This restatement would not have any effect on the total amount of the Group's equity.

Notes to the financial statements (cont.)

(In PLN thousand)

52. Non - controlling interests

The below table presents the information for each of the subsidiaries that have non-controlling interests that are material to the Group

NAME OF THE SUBSIDIARY	COUNTRY OF INCORPORATION AND PLACE OF BUSINESS	PERCENTAGE SHARE OF NON-CONTROLLING INTERESTS IN SHARE CAPITAL / VOTING RIGHTS		NET PROFIT FOR THE PERIOD ATTRIBUTABLE TO NON-CONTROLLING INTERESTS		ACCUMULATED NON-CONTROLLING INTERESTS	
		31.12.2017	31.12.2016	2017	2016	31.12.2017	31.12.2016
Pekao Powszechne Towarzystwo Emerytalne S.A. (*)	Poland	-	35.00	579	489	-	14 924
TOTAL				579	489	-	14 924

(*) On 17 October 2017, the Bank acquired the remaining 35% of the issued shares of Pekao PTE S.A. The Group now holds 100% share in the equity of Pekao PTE S.A. The transaction is detailed in the Note 2.

The summarized financial information of each of the subsidiaries that are material to the Group are presented below

	PEKAO POWSZECHNE TOWARZYSTWO EMERYTALNE S.A.	
	31.12.2017	31.12.2016
Loans and advances to banks	14 778	15 256
Investments (placement) securities	30 217	27 214
Other items of assets	1 704	2 385
TOTAL ASSETS	46 699	44 855
Provisions	5 176	-
Other items of liabilities	1 999	2 217
TOTAL LIABILITIES	7 175	2 217

	PEKAO POWSZECHNE TOWARZYSTWO EMERYTALNE S.A.	
	2017	2016
Revenue	18 002	13 996
Net profit for the period	(3 116)	1 397
Total comprehensive income	(3 116)	1 397
Dividends paid to non-controlling interests	-	1 529
Cash flows from operating activities	2 010	1 911
Cash flows from investing activities	(2 486)	(27 280)
Cash flows from financing activities	-	(4 369)
Net change in cash and cash equivalents	(476)	(29 738)
Cash and cash equivalents at the beginning of the period	15 257	44 995
Cash and cash equivalents at the end of the period	14 781	15 257

Notes to the financial statements (cont.)

(In PLN thousand)

53. Additional information to the consolidated cash flow statement

Cash and cash equivalents

	31.12.2017	31.12.2016
Cash and amounts due from Central Bank	5 236 318	5 872 911
Loans and receivables from banks with maturity up to 3 months	2 108 722	2 793 179
Cash and Cash equivalents presented in the cash flow statement	7 345 040	8 666 090

Restricted availability cash and cash equivalents as at 31 December 2017 amounted to PLN 4 786 930 thousand (PLN 4 605 707 thousand as at 31 December 2016).

Changes in liabilities arising from financing activities

	BALANCE AS AT 1 JANUARY 2017	CHANGES FROM FINANCING CASH FLOWS	NON-CASH CHANGES			BALANCE AS AT 31 DECEMBER 2017	
			CHANGES ARISING FROM OBTAINING OR LOSING CONTROL OF SUBSIDIARIES OR OTHER BUSINESSES	THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES	CHANGES IN FAIR VALUES		OTHER CHANGES (*)
Debt securities issued	1 522 963	1 262 292	-	(19 514)	-	5 658	2 771 399
Subordinated liabilities	-	1 250 000	-	-	-	7 188	1 257 188
Loans and advances received	3 249 417	(139 462)	-	(103 531)	-	(71)	3 006 353
Total	4 772 380	2 372 830	-	(123 045)	-	12 775	7 034 940

(*)The item 'Other changes' refers to interest accruals and payments as well as discount/premium settlements.

	BALANCE AS AT 1 JANUARY 2016	CHANGES FROM FINANCING CASH FLOWS	NON-CASH CHANGES			BALANCE AS AT 31 DECEMBER 2016	
			CHANGES ARISING FROM OBTAINING OR LOSING CONTROL OF SUBSIDIARIES OR OTHER BUSINESSES	THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES	CHANGES IN FAIR VALUES		OTHER CHANGES (*)
Debt securities issued	2 903 233	(1 376 319)	-	11 885	-	(15 836)	1 522 963
Loans and advances received	3 263 303	(138 763)	-	125 391	-	(514)	3 249 417
Total	6 166 536	(1 515 082)	-	137 276	-	(16 350)	4 772 380

(*)The item 'Other changes' refers to interest accruals and payments as well as discount/premium settlements.

Notes to the financial statements (cont.)

(In PLN thousand)

54. Related party transactions

Transactions between the Bank and related parties are typical transactions arising from current operating activities conducted by the Bank. Such transactions mainly include loans, deposits, foreign currency transactions and guarantees.

The credit granting process applicable to the Bank's management and entities related to the Bank

According to the Banking Act, credit transactions with Members of the Bank Management Board and Supervisory Board, persons holding managerial positions at the Bank, with the entities related financially or organizationally therewith, shall be effected according to Regulation adopted by the Supervisory Board of the Bank.

The Regulation provides detailed decision-making procedures, applicable to transactions with such persons and entities, also defining the decision-making levels, authorized to take decisions. In particular, transactions with Members of the Bank's Management Board or Supervisory Board or with an entity related therewith financially or organizationally, are subject to decisions taken by the Bank's Management Board and Supervisory Board.

Members of the Bank's Management Board and entities related therewith financially or organizationally may take advantage of credit products offered by the Bank on standard terms and conditions of the Bank. In particular, the Bank may not offer more advantageous credit interest rates to such persons or entities.

Credit risk assessment is performed using the methodology applied by the Bank, tailored to the client's segment and type of transaction.

In case of entities related to the Bank, the standard credit procedures are applied, with transaction-related decisions taken exclusively at level of the Bank's Head Office.

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions

Related party transactions as at 31 December 2017

NAME OF ENTITY	RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
PZU S.A. – the Bank's parent entity	-	-	-	1 733	477 485	-	-
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	1 463	-	489	824	489 058	5 062	11
Key management personnel of the Bank Pekao S.A.	458	-	-	-	8 118	-	-
Total	1 921	-	489	2 557	974 661	5 062	11

Receivables from loans and deposits by contractual maturity

31.12.2017	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank's parent entity	-	-	-	-	-	-	-
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	900	110	-	192	261	-	1 463
Key management personnel of the Bank Pekao S.A.	-	-	-	6	28	424	458
Total	900	110	-	198	289	424	1 921

(*) Current receivables include Nostro accounts and cash collaterals.

Liabilities due to loans and deposits by contractual maturity

31.12.2017	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank's parent entity	3 978	473 507	-	-	-	-	477 485
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	6 249	482 809	-	-	-	-	489 058
Key management personnel of the Bank Pekao S.A.	5 511	-	2 607	-	-	-	8 118
Total	15 738	956 316	2 607	-	-	-	974 661

(*) Current liabilities include Loro accounts and cash collaterals.

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2017	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank's parent entity	-	-	-	-	-	-
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	93	-	-	1 370	-	1 463
Key management personnel of the Bank Pekao S.A.	-	-	387	71	-	458
Total	93	-	387	1 441	-	1 921

Liabilities due to loans and deposits by currency

31.12.2017	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank's parent entity	301	-	-	477 184	-	477 485
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	93	1	247	488 717	-	489 058
Key management personnel of the Bank Pekao S.A.	3 483	185	5	4 442	3	8 118
Total	3 877	186	252	970 343	3	974 661

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions as at 31 December 2016

NAME OF ENTITY	RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
UniCredit S.p.A. – the Bank's parent entity	187 357	-	-	443	9 261	-	1 674
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	682 836	9 719	32 072	1 306	614 127	620 819	2 972
Associates of Bank Pekao S.A. Group							
Dom Inwestycyjny Xelion Sp. z o.o.	-	-	-	48	28 682	-	-
Pekao Investment Management S.A.	-	-	-	-	137 850	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	-	-	-	15 199	112 949	-	-
Total Associates of Bank Pekao S.A. Group	-	-	-	15 247	279 481	-	-
Key management personnel of the Bank and UniCredit S.p.A.	7 948	-	-	-	28 457	-	-
Total	878 141	9 719	32 072	16 996	931 326	620 819	4 646

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

31.12.2016	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	12 342	175 015	-	-	-	-	187 357
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	597 829	85 007	-	-	-	-	682 836
Associates of Bank Pekao S.A Group	-	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	5 506	-	-	202	2 240	7 948
Total	610 171	265 528	-	-	202	2 240	878 141

(*) Current receivables include Nostro accounts and cash collaterals.

Liabilities due to loans and deposits by contractual maturity

31.12.2016	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	9 261	-	-	-	-	-	9 261
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	65 821	126 115	315	1 451	420 425	-	614 127
Associates of Bank Pekao S.A Group	17 348	91 256	170 877	-	-	-	279 481
Key management personnel of the Bank and UniCredit S.p.A.	8 501	3 226	15 748	982	-	-	28 457
Total	100 931	220 597	186 940	2 433	420 425	-	931 326

(*) Current liabilities include Loro accounts and cash collaterals.

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	2 160	10 180	-	175 017	-	187 357
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	561 564	113	7	99 082	22 070	682 836
Associates of Bank Pekao S.A Group	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	7 948	-	7 948
Total	563 724	10 293	7	282 047	22 070	878 141

Liabilities due to loans and deposits by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	543	-	-	8 718	-	9 261
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	52 131	-	391 206	167 723	3 067	614 127
Associates of Bank Pekao S.A Group	-	-	-	279 481	-	279 481
Key management personnel of the Bank and UniCredit S.p.A.	6 818	295	-	21 333	11	28 457
Total	59 492	295	391 206	477 255	3 078	931 326

Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2017 to 31 December 2017

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSION EXPENSE	POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME	NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES
PZU S.A. – the Bank 's parent entity (*)	49	(88)	3 041	-	48	(230)
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities (*)	451	(255)	6 740	(79)	788	(54)
UniCredit S.p.A. – the Bank's parent entity (**)	154	(153)	391	(1 197)	2 103	(3 901)
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities (**)	3 275	(2 055)	3 596	(78)	14 484	(1 801)
Associates of Bank Pekao S.A Group						
Dom Inwestycyjny Xelion Sp.z o.o. (***)	-	(366)	39	-	309	-
Pekao Investment Management S.A. (***)	-	(1 800)	9	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary) (***)	-	(1 189)	181 868	-	11	(4)
Total Associates of Bank Pekao S.A. Group	-	(3 355)	181 916	-	320	(4)
Key management personnel of the Bank Pekao S.A.	108	(198)	2	-	-	-
Total	4 037	(6 104)	195 686	(1 354)	17 743	(5 990)

(*) data from the date of taking control by PZU S.A.

(**) data until the day of loss of control by UniCredit S.p.A.

(***) data till the date when the Group has taken control over the entities (discontinuation of the equity method valuation)

Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2016 to 31 December 2016

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSION EXPENSE	POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME	NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES
UniCredit S.p.A. – the Bank's parent entity	(137)	(375)	1 239	(2 723)	3 158	(13 368)
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	13 416	(4 448)	9 282	(246)	18 580	(55 879)
Associates of Bank Pekao S.A Group						
Dom Inwestycyjny Xelion Sp.z o.o.	-	(323)	45	(171)	318	-
Pekao Investment Management S.A.	-	(1 862)	197	-	14	-
Pekao TFI S.A. (PIM S.A. subsidiary)	-	(1 370)	189 607	-	4	-
Total Associates of Bank Pekao S.A. Group	-	(3 555)	189 849	(171)	336	-
Key management personnel of the Bank and UniCredit S.p.A.	237	(318)	17	-	-	-
Total	13 516	(8 696)	200 387	(3 140)	22 074	(69 247)

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial liabilities and guarantees as at 31 December 2017

NAME OF ENTITY	GRANTED		RECEIVED	
	FINANCIAL	GUARANTEES	FINANCIAL	GUARANTEE
PZU S.A. – the Bank's parent entity	2 509	-	-	-
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	599	-	-	-
Key management personnel of the Bank Pekao S.A.	553	-	-	-
Total	3 661	-	-	-

Off-balance sheet financial commitments and guarantees by contractual maturity

31.12.2017	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
FINANCIAL COMMITMENTS GRANTED							
PZU S.A. – the Bank's parent entity	-	-	-	-	2 509	-	2 509
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	-	20	-	-	579	-	599
Key management personnel of the Bank Pekao S.A.	10	-	-	24	126	393	553
Total	10	20	-	24	3 214	393	3 661

Off-balance sheet financial commitments and guarantees by currency

31.12.2017	EUR	USD	CHF	PLN	OTHER	TOTAL
FINANCIAL COMMITMENTS GRANTED						
PZU S.A. – the Bank's parent entity	-	-	-	2 509	-	2 509
Entities of PZU S.A. Group excluding of Bank Pekao S.A. Group entities	-	-	-	599	-	599
Key management personnel of the Bank Pekao S.A.	-	-	-	553	-	553
Total	-	-	-	3 661	-	3 661

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees as at 31 December 2016

NAME OF ENTITY	GRANTED		RECEIVED	
	FINANCIAL	GUARANTEES	FINANCIAL	GUARANTEE
UniCredit S.p.A. – the Bank's parent entity	50 162	246 519	-	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	202 191	599 604	5 192	192 481
Associates of Bank Pekao S.A Group				
Pekao Investment Management S.A.	15	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	96	-	-	-
Total Associates of Bank Pekao S.A. Group	111	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	217	-	-	-
Total	252 681	846 123	5 192	246 444

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by contractual maturity

31.12.2016	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
FINANCIAL COMMITMENTS GRANTED							
UniCredit S.p.A. – the Bank's parent entity	-	-	-	-	-	50 162	50 162
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	-	-	-	202 191	202 191
Associates of Bank Pekao S.A Group	-	-	-	-	111	-	111
Key management personnel of the Bank and UniCredit S.p.A.	30	-	5	-	182	-	217
Total	30	-	5	-	293	252 353	252 681
GUARANTEES ISSUED							
UniCredit S.p.A. – the Bank's parent entity	-	2 624	-	50 190	81 659	112 046	246 519
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	9 343	24 475	113 978	293 599	158 209	599 604
Total	-	11 967	24 475	164 168	375 258	270 255	846 123
FINANCIAL COMMITMENTS RECEIVED							
Entities of UniCredit Group excluding Bank Pekao S.A. Group entities	-	5 192	-	-	-	-	5 192
Total	-	5 192	-	-	-	-	5 192
GUARANTEES RECEIVED							
UniCredit S.p.A. – the Bank's parent entity	-	4 645	752	33 619	13 399	1 548	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	3 322	75 122	11 062	102 975	192 481
Total	-	4 645	4 074	108 741	24 461	104 523	246 444

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
FINANCIAL COMMITMENTS GRANTED						
UniCredit S.p.A. – the Bank's parent entity	30 164	-	-	19 998	-	50 162
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	98 535	41 716	-	61 580	360	202 191
Associates of Bank Pekao S.A. Group	-	-	-	111	-	111
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	217	-	217
Total	128 699	41 716	-	81 906	360	252 681
GUARANTEES ISSUED						
UniCredit S.p.A. – the Bank's parent entity	12 167	-	-	234 352	-	246 519
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	53 077	-	-	546 527	-	599 604
Total	65 244	-	-	780 879	-	846 123
FINANCIAL COMMITMENTS RECEIVED						
Entities of UniCredit Group excluding Bank Pekao S.A. Group entities	-	-	-	-	5 192	5 192
Total	-	-	-	-	5 192	5 192
GUARANTEES RECEIVED						
UniCredit S.p.A. – the Bank's parent entity	29 130	-	-	24 833	-	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	109 606	-	-	82 090	785	192 481
Total	138 736	-	-	106 923	785	246 444

Notes to the financial statements (cont.)

(In PLN thousand)

Remuneration of Bank's Management Board and Supervisory Board Members

	VALUE OF BENEFITS	
	2017	2016
Management Board of the Bank		
Short-term employee benefits (*)	15 072	19 120
Post-employment benefits	448	-
Long-term benefits (**)	2 266	2 083
Paid termination benefits	6 642	-
Share-based payments (***)	7 050	5 393
Total	31 478	26 596
Supervisory Board of the Bank		
Short-term employee benefits (*)	1 225	1 069
Total	1 225	1 069

(*) Short-term employee benefits include: base salary, bonuses and other benefits due in next 12 months from the date of the balance sheet.

(**) The item 'Other long-term benefit' includes: provisions for deferred bonus payments.

(***) The value of share-based payments is a part of Personnel Expenses, recognized according to IFRS 2 during the reporting period in the income statement, representing the settlement of fair value of share options and shares, including phantom shares, granted to the Members of the Bank's Management Board.

The Bank's Management Board and Supervisory Board Members did not receive any remuneration from subsidiaries and associates in 2017 and 2016.

Remuneration of Supervisory Boards and Management Boards of subsidiaries

	VALUE OF BENEFITS	
	2017	2016
Companies' Management Boards		
Short-term employee benefits	14 127	14 810
Long-term benefits	33	-
Share-based payments	808	-
Total	14 968	14 810
Companies' Supervisory Boards		
Short-term employee benefits	267	343
Long-term benefits	40	-
Total	307	343

55. Repo and reverse repo transactions

The Group increases its funds by sales transactions with the repurchase promise granted (repo and sell-buy back) at the same price increased by interest.

Securities composing the balance sheet portfolio of the Group as well as securities with obligation of resale (reverse repo and buy-sell back transactions) may be a subject to repo and sell-buy back transactions.

Securities composing the balance sheet portfolio of the Group and treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Group holds all the benefits and the risk deriving from these assets.

Notes to the financial statements (cont.)

(In PLN thousand)

	31.12.2017		31.12.2016	
	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RESPECTIVE LIABILITIES	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RESPECTIVE LIABILITIES
Financial assets available for sale				
up to 1 month	915 423	916 637	1 599 015	1 599 789
from 1 to 3 months	49 425	49 427	-	-
Total financial assets available for sale	964 848	966 064	1 599 015	1 599 789
Financial assets held for trading				
up to 1 month	123 797	123 812	175 732	176 019
Total financial assets held for trading	123 797	123 812	175 732	176 019
Total	1 088 645	1 089 876	1 774 747	1 775 808

The Group purchases financial instruments with the obligations of repurchase or resale (reverse-repo and buy-sell back) at the same price increased by interest.

Securities treated as reverse-repo and buy-sell back transactions are not disclosed at the statement of financial position due to the fact that the Group do not holds all the advantages of risks and awareness deriving from these assets.

	31.12.2017		31.12.2016	
	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGE ASSETS	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGE ASSETS
Loans and advances from banks				
up to 1 month	494 706	492 418	703 635	700 960
Total loans and advances from bank	494 706	492 418	703 635	700 960
Total	494 706	492 418	703 635	700 960

Financial assets subject to reverse repo and buy-sell back transactions constitute collateral accepted by the Group, which the Group has the right to sell or pledge.

	31.12.2017	31.12.2016
Fair value of assets pledged as collaterals, in this:	492 418	700 960
Short sale	469 448	673 165
Reverse repo transactions/ buy-sell back	-	-

Notes to the financial statements (cont.)

(In PLN thousand)

56. Company Social Benefits Fund ('ZFŚS')

The Social Benefits Fund Act of 4 March 1994 with subsequent amendments introduced the requirement to create a Company's Social Benefits Fund by all employers employing over 20 employees. The Bank and Group companies employing at least 20 staff have created the ZFŚS Fund and are making periodic charges to the ZFŚS Fund in amounts required by the Act. The basic aim of the ZFŚS Fund is to subsidize social assistance in benefit of the employees, former employees (pensioners and the retired) and entitled members of their families.

The liabilities of the ZFŚS Fund represent the accumulated value of charges made by the Company towards the ZFŚS Fund decreased by the amount of non-returnable expenditures of the ZFŚS Fund.

In the consolidated statement of financial position, the Group netted the ZFŚS Fund assets against the ZFŚS Funds value, due to the fact that the assets of the ZFŚS Fund do not represent the assets of the Group. For this reason the amount pertaining to the ZFŚS Fund in the consolidated statement of financial position as at 31 December 2017 and 31 December 2016 was zero.

The table below presents the assets according to type and book value, the balance of the Fund and costs related to ZFŚS

	31.12.2017	31.12.2016
Loans granted to employees	33 345	39 022
Cash at ZFŚS account	2 668	3 760
ZFŚS assets	36 013	42 782
ZFŚS value	36 013	42 782
	2017	2016
Deductions made to ZFŚS during fiscal period	26 259	25 104

57. Subsequent events

There have been no significant subsequent events.

Signatures of all Management Board Members

26.02.2018	Michał Krupiński	President of the Management Board	
Date	Name/Surname	Position/Function	Signature
26.02.2018	Roksana Ciurysek-Gedir	Vice President of the Management Board	
Date	Name/Surname	Position/Function	Signature
26.02.2018	Andrzej Kopyrski	Vice President of the Management Board	
Date	Name/Surname	Position/Function	Signature
26.02.2018	Tomasz Kubiak	Vice President of the Management Board	
Date	Name/Surname	Position/Function	Signature
26.02.2018	Michał Lehmann	Vice President of the Management Board	
Date	Name/Surname	Position/Function	Signature
26.02.2018	Marek Lusztyn	Vice President of the Management Board	
Date	Name/Surname	Position/Function	Signature
26.02.2018	Tomasz Styczyński	Vice President of the Management Board	
Date	Name/Surname	Position/Function	Signature
26.02.2018	Marek Tomczuk	Vice President of the Management Board	
Date	Name/Surname	Position/Function	Signature

Glossary

Glossary

IFRS – International Financial Reporting Standards – the standards, interpretations and their structure adopted by the International Accounting Standards Board (IASB).

IAS – International Accounting Standards – previous name of the standards forming part of the current IFRS.

IFRIC – International Financial Reporting Interpretations Committee – the committee operating under the International Accounting Standards Board publishing interpretations of IFRS.

CIRS – Currency Interest Rate Swap – the transaction exchange of principal amounts and interest payments in different currencies between two counterparties.

IRS – Interest Rate Swap – the agreement between two counterparties, under which the counterparties pay each other (at specified intervals during the contract life) interest on contractual principal of the contract, charged at a different interest rate.

FRA – Forward Rate Agreement – the contract under which two counterparties fix the interest rate that will apply in the future for a specified amount expressed in currency of the transaction for a predetermined period.

CAP – the financial agreement, which limits the risk borne by lender on a variable interest rate, exposed to the potential loss as a result of increase in interest rates. Cap option is a series of call options on interest rates, in which the issuer guarantees the buyer the compensation of the additional interest costs, that the buyer must pay if the interest rate on loan increases above the fixed interest rate.

FLOOR – the financial agreement, which limits the risk of incurring losses resulting from decrease in interest rates by the lender providing the loan at a variable interest rate. Floor option is a series of put options on interest rates, in which the issuer guarantees the interest to be paid on the loan if the interest rate on the loan decreases below the fixed interest rate.

IBNR – Incurred But Not Reported losses.

PD – Probability Default – the parameter used in Internal Ratings-Based Approach which determines the likelihood that the debtor will be unable to meet its obligation. PD is a financial term describing the likelihood of a default over an one year time horizon.

LGD – Loss Given Default – the percentage of loss over the total exposure when bank's counterparty goes to default.

EAD – Exposure At Default.

EL – Expected Loss.

CCF – Credit Conversion Factor.

VaR – Value at Risk – the risk measure by which the market value of an asset or portfolio may be reduced for a given assumptions, probability and time horizon.

ICAAP – Internal Capital Adequacy Assessment Process – the process of assessing internal capital adequacy.