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Bank Polski

Financial statements of PKO Bank Polski SA for the year ended 31 December 2017

Report publication date:
12 March 2018

Bank Polski

SELECTED FINANCIAL DATA DERIVED FROM THE FINANCIAL STATEMENTS

SELECTED STAND-ALONE FINANCIAL DATA	PLN million		EUR million	
	period from 01.01.2017 to 31.12.2017	period from 01.01.2016 to 31.12.2016	period from 01.01.2017 to 31.12.2017	period from 01.01.2016 to 31.12.2016
Net interest income	7 901	7 368	1 861	1 684
Net fee and commission income	2 687	2 447	633	559
Operating profit	3 785	3 721	892	850
Profit before income tax	**3 785**	**3 721**	**892**	**850**
Net profit	**2 774**	**2 888**	**654**	**660**
Earnings per share for the period - basic (in PLN/EUR)	**2,22**	**2,31**	**0,52**	**0,53**
Earnings per share for the period - diluted (in PLN/EUR)	**2,22**	**2,31**	**0,52**	**0,53**
Total net comprehensive income	3 397	2 372	800	542
Net cash flows used in operating activities	22 871	10 500	5 388	2 400
Net cash flows used in investing activities	(6 502)	(8 310)	(1 532)	(1 899)
Net cash flows (generated from) /used in financing activities	(11 396)	(1 812)	(2 685)	(414)
Net change in cash and cash equivalents	4 973	378	1 172	86

SELECTED STAND-ALONE FINANCIAL DATA	PLN million		EUR million	
	As at 31.12.2017	As at 31.12.2016	As at 31.12.2017	As at 31.12.2016
Total assets	277 784	272 957	66 600	61 699
Total equity	35 987	32 590	8 628	7 367
Share capital	1 250	1 250	300	283
Number of shares (in million)	1 250	1 250	1 250	1 250
Book value per share (in PLN/EUR)	28,79	26,07	6,90	5,89
Diluted number of shares (in million)	1 250	1 250	1 250	1 250
Diluted book value per share (in PLN/EUR)	28,79	26,07	6,90	5,89
Capital adequacy ratio	19,59%	17,19%	19,59%	17,19%
Tier 1	32 597	28 673	7 815	6 481
Tier 2	1 700	2 456	408	555

Selected stand-alone financial statement items have been translated into EUR at the following exchange rates	31.12.2017	31.12.2016
average NBP exchange rates as at the last day of each month of the period	4,2447	4,3757
mid NBP exchange rates as at the last day of the period	4,1709	4,4240

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INCOME STATEMENT

	Note	2017	2016
Interest income	6	10 075	9 483
Interest expenses	6	(2 174)	(2 115)
Net interest income		**7 901**	**7 368**
Fee and commission income	7	3 611	3 298
Fee and commission expense	7	(924)	(851)
Net fee and commission income/(expense)		**2 687**	**2 447**
Dividend income	8	135	162
Net gain/(loss) on financial instruments measured at fair value	9	3	-
Gain/(loss) on investment securities	10	44	505
Net foreign exchange gains/(losses)	11	419	501
Other operating income	12	154	115
Other operating expenses	12	(97)	(115)
Net other operating income and expenses		**57**	**-**
Net impairment allowances and provisions	13	(1 530)	(1 408)
Administrative expenses	14	(5 037)	(5 034)
Tax on certain financial institutions	15	(894)	(820)
Operating profit/(loss)		**3 785**	**3 721**
Profit before income tax		**3 785**	**3 721**
Income tax expense	16	(1 011)	(833)
Net profit		**2 774**	**2 888**
Earnings per share	17		
– basic earnings per share for the period (PLN)		2,22	2,31
– diluted earnings per share for the period (PLN)		2,22	2,31
Weighted average number of ordinary shares during the period (in million)		1 250	1 250
Weighted average diluted number of ordinary shares during the period (in million)		1 250	1 250

(IN PLN MILLION)

STATEMENT OF COMPREHENSIVE INCOME

	Note	2017	2016
Net profit		**2 774**	**2 888**
Other comprehensive income		**623**	**(516)**
Items which may be reclassified to profit or loss		**622**	**(518)**
Cash flow hedges (gross)	22	18	(38)
Deferred tax	16; 22	(4)	7
Cash flow hedges (net)		14	(31)
Unrealized net gains on available-for-sale financial assets (gross)		750	(602)
Deferred tax	16	(142)	115
Unrealized net gains on available-for-sale financial assets (net)		608	(487)
Items which cannot be reclassified to profit or loss		**1**	**2**
Actuarial gains and losses (gross)		1	2
Deferred tax		-	-
Actuarial gains and losses (net)		1	2
Total net comprehensive income		**3 397**	**2 372**

STATEMENT OF FINANCIAL POSITION

	Note	31.12.2017	31.12.2016
ASSETS			
Cash and cash balances with the Central Bank	18	17 765	13 277
Amounts due from banks	19	8 769	8 471
Financial assets held for trading, excluding derivative financial instruments	20	472	358
Derivative financial instruments	21	2 805	2 895
Financial instruments designated at fair value through profit or loss upon initial recognition	23	6 409	11 744
Loans and advances to customers	24	186 892	189 067
Available-for-sale investment securities	25	42 009	35 773
Investment securities held to maturity	26	1 622	157
Investments in subsidiaries, joint ventures and associates	38	3 011	2 535
Non-current assets held for sale	27	359	361
Intangible assets	28	2 622	2 817
Property, plant and equipment	28	2 170	2 325
Deferred income tax asset	16	957	1 034
Other assets	29	1 922	2 143
TOTAL ASSETS		**277 784**	**272 957**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to the Central Bank		6	4
Amounts due to banks	30	4 299	18 717
Derivative financial instruments	21	2 741	4 229
Amounts due to customers	31	222 524	209 371
Debt securities in issue	32	5 204	1 693
Subordinated liabilities	33	1 720	2 539
Other liabilities	34	4 592	3 340
Current income tax liabilities		501	251
Provisions	35	210	223
TOTAL LIABILITIES		**241 797**	**240 367**
Equity			
Share capital	36	1 250	1 250
Other capital	36	31 963	28 452
Net profit or loss for the year	36	2 774	2 888
TOTAL EQUITY		**35 987**	**32 590**
TOTAL LIABILITIES AND EQUITY		**277 784**	**272 957**
Capital adequacy ratio	67	19,59%	17,19%
Book value (in PLN million)		35 987	32 590
Number of shares (in million)		1 250	1 250
Book value per share (in PLN)		28,79	26,07
Diluted number of shares (in million)		1 250	1 250
Diluted book value per share (in PLN)		28,79	26,07

(IN PLN MILLION)

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2017	Share capital	Other capital							Retained earnings	Net profit or loss for the year	Total equity
		Reserves			Other comprehensive income						
		Supplementary capital	General banking risk fund	Other reserves	Available-for-sale financial assets	Cash flow hedges	Actuarial gains and losses	Total other capital and reserves			
As at 1 January 2017	1 250	24 268	1 070	3 555	(342)	(89)	(10)	28 452	-	2 888	32 590
Transfer from retained earnings	-	-	-	-	-	-	-	-	2 888	(2 888)	-
Total comprehensive income, of which:	-	-	-	-	608	14	1	623	-	2 774	3 397
Net profit	-	-	-		-	-	-	-	-	2 774	2 774
Other comprehensive income	-	-	-	-	608	14	1	623	-	-	623
Transfer from retained earnings to reserves	-	2 850	-	38	-	-	-	2 888	(2 888)	-	-
As at 31 December 2017	1 250	27 118	1 070	3 593	266	(75)	(9)	31 963	-	2 774	35 987

FOR THE YEAR ENDED 31 December 2016	Share capital	Other capital							Retained earnings	Net profit or loss for the year	Total equity
		Reserves			Other comprehensive income						
		Supplementary capital	General banking risk fund	Other reserves	Available-for-sale financial assets	Cash flow hedges	Actuarial gains and losses	Total other capital and reserves			
As at 1 January 2016	1 250	20 518	1 070	3 484	145	(58)	(12)	25 147	1 250	2 571	30 218
Transfer from retained earnings	-	-	-	-	-	-	-	-	2 571	(2 571)	-
Total comprehensive income, of which:	-	-	-	-	(487)	(31)	2	(516)	-	2 888	2 372
Net profit	-	-	-	-	-	-	-	-	-	2 888	2 888
Other comprehensive income	-	-	-	-	(487)	(31)	2	(516)	-	-	(516)
Transfer from retained earnings to reserves	-	3 750	-	71	-	-	-	3 821	(3 821)	-	-
As at 31 December 2016	1 250	24 268	1 070	3 555	(342)	(89)	(10)	28 452	-	2 888	32 590

(IN PLN MILLION)

STATEMENT OF CASH FLOWS

	Note	2017	2016
Cash flows from operating activities			
Profit before income tax		**3 785**	**3 721**
Adjustments:		**19 086**	**6 779**
Amortization and depreciation		727	722
(Gains)/losses on investing activities	43	(57)	(4)
Interest and dividends	43	(608)	(382)
Change in:			
amounts due from banks	43	189	(2 642)
financial instruments designated at fair value through profit or loss upon initial recognition and financial assets held for trading		5 221	1 487
derivative financial instruments		(1 399)	1 055
loans and advances to customers	43	2 323	59
other assets and non-current assets held for sale	43	220	(1 158)
amounts due to banks		(1 412)	467
amounts due to customers	43	13 842	8 829
provisions and impairment allowances	43	(116)	(590)
other liabilities	43	1 252	331
Income tax paid		(830)	(809)
Other adjustments	43	(266)	(586)
Net cash used in operating activities		**22 871**	**10 500**
Cash flows from investing activities			
Inflows from investing activities		**96 065**	**51 079**
Redemption of capital of a subsidiary		-	50
Proceeds from sale of a subsidiary classified as held for sale		4	-
Proceeds from sale and interest on investment securities		95 816	50 809
Proceeds from sale of intangible assets and property, plant and equipment		110	58
Other inflows from investing activities (dividends)		135	162
Outflows from investing activities		**(102 567)**	**(59 389)**
Acquisition of a subsidiary		(14)	-
Increase in equity of a subsidiary		(464)	(522)
Increase in equity of an associate		(23)	(1)
Purchase of investment securities		(101 623)	(58 200)
Acquisition of intangible assets and property, plant and equipment		(443)	(666)
Net cash used in investing activities		**(6 502)**	**(8 310)**
Cash flows from financing activities			
Proceeds from debt securities in issue	32	5 909	2 662
Proceeds from issue of subordinated bonds	33	1 700	-
Redemption of debt securities	32	(2 339)	(2 741)
Repayment of a subordinated loan	33	(880)	-
Repayment of liabilities arising from subordinated bonds	33	(1 656)	-
Repayment of loans and borrowings	30;31	(13 693)	(1 267)
Repayment of interest on long-term borrowings		(437)	(466)
Net cash generated from/used in financing activities		**(11 396)**	**(1 812)**
Total net cash flows		**4 973**	**378**
of which currency translation differences on cash and cash equivalents		(332)	137
Cash equivalents at the beginning of the period		17 568	17 190
Cash equivalents at the end of the period	43	22 541	17 568

NOTES TO THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

BUSINESS ACTIVITIES OF THE BANK

Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna ("PKO Bank Polski SA" or "the Bank") was established in 1919 as Pocztowa Kasa Oszczędnościowa. In 1950, the Bank began operating as Powszechna Kasa Oszczędności Bank Państwowy (state-owned bank). Pursuant to the Decree of the Council of Ministers of 18 January 2000 (Journal of Laws of 2000 No. 5, item 55 as amended), Powszechna Kasa Oszczędności (a State-owned bank) was transformed into a State-owned joint-stock company, Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna with its registered office in Warsaw, ul. Puławska 15, 02-515 Warszawa, Poland.

On 12 April 2000, Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna was registered and entered into the Commercial Register maintained by the District Court for the City of Warsaw, Commercial Court, 16th Registration Department. At present, the court competent for the Bank's affairs is the District Court in Warsaw, the 13th Business Department of the National Court Register. The Bank was registered under the number KRS 0000026438 and was assigned the statistical number REGON 016298263.

According to the Warsaw Stock Exchange Bulletin (Ceduła Giełdowa), the Bank is classified under the macro-sector "Finance", sector "Banks".

PKO Bank Polski SA is a universal deposit and credit bank which serves individuals, legal entities and other entities, both Polish and foreign. The Bank may hold cash in foreign currencies and trade in those currencies, as well as conduct foreign exchange and foreign currency transactions, open and maintain bank accounts in banks abroad and deposit foreign currency in those accounts.

PKO Bank Polski SA is the parent entity of the PKO Bank Polski SA Group and a significant investor for associates and joint ventures of the Bank. Accordingly, PKO Bank Polski SA prepares consolidated financial statements of the Group, which include the financial data of these entities. The composition of the PKO Bank Polski SA Group and scope of its operations are presented in the note "Structure of the PKO Bank Polski SA Group and scope of activities of the Group entities".

Organizational entities operating in the Bank structure

The Bank's financial statements covering the financial data for the year ended 31 December 2017 and comparative financial data were prepared based on the financial data of all organizational entities comprising the Bank, through which the Bank conducts its operations. As at 31 December 2017, they comprised: the Bank's head office in Warsaw, Dom Maklerski PKO BP SA (the Brokerage House), 15 specialist organizational entities, 11 regional retail branches, 7 regional corporate branches, 32 corporate centres and 1143 branches. The Bank also conducts operating activities in the Federal Republic of Germany in the form of a branch ("the German Branch") and the Czech Republic ("the Czech Branch").

(IN PLN MILLION)

INFORMATION ON MEMBERS OF THE SUPERVISORY BOARD AND MANAGEMENT BOARD OF THE BANK

As at 31 December 2017, the Bank's Supervisory Board consisted of:

No.	Name	Function	Date of appointment
1.	Piotr Sadownik	Chairman of the Supervisory Board	appointed to the Supervisory Board on 25 February 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. The entity, authorized to exercise the rights carried by the shares held by the State Treasury, as the Authorized Shareholder, appointed Piotr Sadownik Chairman of the Supervisory Board. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017. The entity authorized to exercise the rights carried by the shares held by the State Treasury, as the Authorized Shareholder, appointed Piotr Sadownik Chairman of the Supervisory Board.
2.	Grażyna Ciurzyńska	Vice-Chair of the Supervisory Board	appointed to the Supervisory Board on 30 June 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. The entity, authorized to exercise the rights carried by the shares held by the State Treasury, as the Authorized Shareholder, appointed Grażyna Ciurzyńska Vice-Chair of the Supervisory Board. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017. The entity authorized to exercise the rights carried by the shares held by the State Treasury, as the Authorized Shareholder, appointed Grażyna Ciurzyńska Vice-Chair of the Supervisory Board.
3.	Zbigniew Hajłasz	Secretary of the Supervisory Board	appointed to the Supervisory Board on 30 June 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. Elected the Secretary of the Supervisory Board on 14 July 2016. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017. On 24 August 2017, reappointed Secretary of the Supervisory Board.
4.	Mariusz Andrzejewski	Member of the Supervisory Board	appointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.
5.	Mirosław Barszcz	Member of the Supervisory Board	appointed to the Supervisory Board on 25 February 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.
6.	Adam Budnikowski	Member of the Supervisory Board	appointed to the Supervisory Board on 25 February 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.
7.	Wojciech Jasiński	Member of the Supervisory Board	appointed to the Supervisory Board on 25 February 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.
8.	Andrzej Kisielewicz	Member of the Supervisory Board	appointed to the Supervisory Board on 25 February 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.
9.	Elżbieta Mączyńska - Ziemacka	Member of the Supervisory Board	reappointed to the Supervisory Board on 26 June 2014 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.
10.	Janusz Ostaszewski	Member of the Supervisory Board	appointed to the Supervisory Board on 25 February 2016 for the previous joint term, which commenced on the day of the Annual General Meeting convened for 26 June 2014. Reappointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.
11.	Jerzy Paluchniak	Member of the Supervisory Board	appointed to the Supervisory Board on 22 June 2017 for the current joint term, which commenced on the day of the Annual General Meeting convened for 22 June 2017.

As at 31 December 2017, the Bank's Management Board consisted of:

No.	Name	Function	Date of appointment
1.	Zbigniew Jagiełło	President of the Management Board	on 8 January 2014, reappointed President of the Management Board of PKO Bank Polski SA for the previous joint term of the Management Board. On 14 June 2017, he was reappointed President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.
2.	Rafał Antczak	Vice-President of the Management Board	on 14 June 2017, he was appointed Vice-President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.
3.	Maks Kraczkowski	Vice-President of the Management Board	on 30 June 2016, reappointed Vice-President of the Management Board of PKO Bank Polski SA for the previous joint term of the Management Board, with effect from 4 July 2016. On 14 June 2017, he was reappointed Vice-President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.
4.	Mieczysław Król	Vice-President of the Management Board	on 2 June 2016, appointed Vice-President of the Management Board of PKO Bank Polski SA for the previous joint term of the Management Board, with effect from 6 June 2016. On 14 June 2017, he was reappointed Vice-President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.
5.	Adam Marciniak	Vice-President of the Management Board	on 21 September 2017, appointed (with effect from 1 October 2017) Vice-President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.
6.	Piotr Mazur	Vice-President of the Management Board	on 8 January 2014, reappointed Vice-President of the Management Board of PKO Bank Polski SA for the previous joint term of the Management Board. On 14 June 2017, he was reappointed Vice-President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.
7.	Jakub Papierski	Vice-President of the Management Board	on 8 January 2014, reappointed to the position of Vice-President of the Management Board of PKO Bank Polski SA for the previous joint term of the Management Board. On 14 June 2017, he was appointed to Vice-President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.
8.	Jan Emeryk Rościszewski	Vice-President of the Management Board	on 14 July 2016, appointed Vice-President of the Management Board of PKO Bank Polski SA for the previous joint term of the Management Board, with effect from 18 July 2016. On 14 June 2017, he was reappointed Vice-President of the Management Board of PKO Bank Polski SA for the current joint term of the Management Board, which commenced on 2 July 2017.

On 9 August 2017, Mr Janusz Derda resigned from the Management Board with effect from 9 August 2017, close of business.

On 21 December 2017, Mr Bartosz Drabikowski was dismissed from the Management Board with effect from 21 December 2017 based on a Supervisory Board resolution.

On 21 December 2017, the Supervisory Board appointed Mr Rafał Kozłowski Vice-President of the Management Board with effect from 1 January 2018, for the current joint term, which started on 2 July 2017.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The financial statements of the Bank cover the year ended 31 December 2017 and comprise the comparative data for the year ended 31 December 2016. The financial data is presented in Polish zloty (PLN) in millions, unless indicated otherwise.

The financial data included in the financial statements of PKO Bank Polski SA for the year ended 31 December 2016 was presented in PLN millions, with one decimal place. In these financial statements, the comparative data has been rounded to one million zlotys and any differences in relation to previously published data may result from such rounding.

2.1 STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) as at 31 December 2017, and in the areas not regulated by these standards, in accordance with the requirements of the Accounting Act of 29 September 1994 and the respective secondary legislation issued on its basis, as well as the requirements relating to issuers of securities registered or applying for registration on an official stock market.

2.2 GOING CONCERN

The financial statements have been prepared on the basis of the assumption that the Bank will continue as a going concern for a period of at least 12 months from the publication date, i.e. from 12 March 2018. As at the date of signing these financial statements, the Bank's Management Board is not aware of any facts or circumstances that would indicate a threat to the Bank's ability to continue in operation as a going concern for 12 months following the publication date as a result of any intended or compulsory discontinuation or significant limitation of the Bank's existing operations.

2.3 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

These financial statements have been prepared on a fair value basis in respect of financial assets and liabilities measured at fair value through profit or loss, including derivatives and available-for-sale financial assets, except for those for which the fair value cannot be reliably estimated. Other financial assets (including loans and advances) are measured at amortized cost less impairment or at purchase price less impairment. The other financial liabilities are recognized at amortized cost. Non-current assets are measured at acquisition cost less accumulated depreciation and impairment allowances. Non-current assets (or groups of such assets) classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

While preparing financial statements, the Bank makes certain estimates and assumptions, which have a direct influence on both the financial statements and enclosed supplementary information. The estimates and assumptions that are used by the Bank in determining the value of assets and liabilities as well as revenues and costs, are made based on historical data and other factors which are available and considered appropriate in the given circumstances. Assumptions regarding the future and the available data are used for assessing the carrying amounts of assets and liabilities which cannot be clearly determined using other sources. In making estimates the Bank takes into consideration the reasons and sources of the uncertainties that are anticipated at the end of the reporting period. Actual results may differ from estimates.

Estimates and assumptions made by the Bank are subject to periodic reviews.

2.4 APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements, subject to review by the Audit Committee and adoption by the Supervisory Board of the Bank on 8 March 2018, were approved for publication by the Management Board on 27 February 2018.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Major accounting policies and estimates and judgements applied in the preparation of these financial statements are presented in the notes and below. These policies were applied consistently in all the years presented. Below is a summary of accounting policies and major estimates and judgements for the individual items of the income statement and the statement of financial position.

(IN PLN MILLION)

INCOME STATEMENT	Note	Accounting policies[1]
Interest income and expense	6	Y
Commission and fee income and expense	7	Y
Dividend income	8	Y
Net gain/(loss) on financial instruments measured at fair value	9	Y
Gain/(loss) on investment securities	10	Y
Net foreign exchange gains/(losses)	11	Y
Other operating income and expenses	12	Y
Net impairment allowances and provisions	13	Y
Administrative expenses	14	Y
Income tax expense	16	Y

[1] The letter Y indicates the presence of a particular accounting policy.

STATEMENT OF FINANCIAL POSITION	Note	Accounting policies1	Major estimates and judgements[1]
Cash and cash balances with the Central Bank	18	Y	
Amounts due from banks	19	Y	
Financial assets held for trading, exluding derivative financial instrument instruments	20	Y	
Derivative financial instruments	21	Y	Y
Derivative hedging instruments	22	Y	
Financial instruments designated at fair value through profit or loss upon initial recognition	23	Y	
Loans and advances to customers	24	Y	Y
Available-for-sale investment securities	25	Y	Y
Investment securities held to maturity	26	Y	
Investments in subsidiaries, joint ventures and associates	38	Y	
Non-current assets held for sale	27	Y	
Intangible assets	28	Y	Y
Property, plant and equipment	28	Y	Y
Deferred income tax asset	16	Y	
Other assets	29	Y	
Amounts due to banks	30	Y	
Amounts due to customers	31	Y	
Debt securities issued	32	Y	
Subordinated liabilities	33	Y	
Other liabilities	34	Y	
Provisions	35	Y	Y
Equity and shareholders	36	Y	

[1] The letter Y indicates the Banks presence of a particular accounting policy or major estimates and judgements.

3.1 FOREIGN CURRENCIES

FUNCTIONAL AND PRESENTATION CURRENCY

The financial statements are presented in Polish zlotys (PLN), which are the Bank's functional and presentation currency. Items of the statement of financial position of the German Branch are translated into the presentation currency from the functional currency (EUR) and items of the statement of financial position of the Czech Branch are translated into the presentation currency from the functional currency (CZK) using the average exchange rate at the end of the reporting period. Items in the Branches' profit and loss are translated into the presentation currency using the average exchange rate from the end of each month of the reporting period. The resulting exchange differences are recognized in other comprehensive income.

TRANSACTIONS AND BALANCES IN FOREIGN CURRENCIES

Foreign currency transactions are translated into the functional currency, i.e. into the currency of the basic economic environment, in which the entity operates, using exchange rate prevailing at the dates of the transactions. At each balance sheet date, items are translated by the Bank using the following principles:

- cash items denominated in foreign currency are translated using a closing rate i.e. the average rate announced by the National Bank of Poland prevailing as at the end of the reporting period;
- non-cash items measured at historical cost expressed in a foreign currency are translated using the exchange rate as at the date of the transaction;
- non-cash items measured at fair value in a foreign currency are translated using the exchange rates prevailing as at the date of determination of the fair value.

Foreign exchange gains and losses arising from the settlement of such transactions and from the valuation of monetary assets and liabilities expressed in foreign currencies are recognized in the income statement.

3.2 ACCOUNTING FOR TRANSACTIONS

Financial assets and financial liabilities, including forward transactions and standardized transactions, which carry an obligation or a right to purchase or sell in the future an agreed number of specified financial instruments at a fixed price, are entered into the books of account under the date of execution of the contract, irrespective of the settlement date provided in the contract.

3.3 DERECOGNITION OF FINANCIAL INSTRUMENTS FROM THE STATEMENT OF FINANCIAL POSITION

Financial assets are derecognized from the statement of financial position when contractual rights to the cash flows from the financial asset expire, or when the financial asset is transferred by the Bank to another entity. The financial asset is transferred when the Bank:

- transfers the contractual rights to collect cash flows from that financial asset to another entity, or
- retains the contractual rights to receive cash flows from the financial asset, but assumes a contractual obligation to pay cash flows to an entity outside the Bank.

Upon transfer of a financial asset, the Bank evaluates the extent to which it retains the risks and benefits associated with holding that financial asset. In such case:

- if substantially all risks and benefits associated with holding a given financial asset are transferred, the financial asset is eliminated from the statement of financial position;
- if the Bank retains substantially all risks and benefits associated with holding a given financial asset, the financial asset continues to be recognized in the statement of financial position;
- if substantially all risks and benefits associated with holding a given financial asset are neither transferred nor retained, the Bank determines whether it has maintained control of that financial asset. If the Bank has retained control, it continues to recognize the financial asset in the statement of financial position to the extent of its continuing involvement in the financial asset; if control has not been retained, then the financial asset is derecognized from the statement of financial position.

The Bank derecognizes a financial liability (or a part of a financial liability) from its statement of financial position when the obligation specified in the contract has been met or cancelled or has expired.

Usually the Bank derecognizes loans when they have been extinguished, when they are expired, or when they are not recoverable. Loans, advances and other receivables are written off against impairment allowances that were recognized for these accounts. If no allowances were recognized or the amount of the allowance is less than the amount of the loan, advance or other receivable, the amount of the impairment allowance is increased by the difference between the value of the receivable and the amount of the allowances that have been recognized to date before the receivable is written off.

4. Changes in accounting policies

4.1 Amendments to published standards and interpretations that are effective as of 1 January 2017

IAS 7 Statement of cash flows

Changes to IAS 7, Statement of Cash Flows, were published in January 2016 and approved for application in the European Union on 6 November 2017 by the Commission Regulation (EU) 2017/1990. They must be applied to financial statements prepared for annual periods commencing on or after 1 January 2017. These changes concern presentation and are aimed at providing better information on the entity's financial activities to the users of the financial statements. Therefore, the financial statements of the Bank contain more precise disclosures concerning cash flows from financing activities in the statement of cash flows.

Additionally, the notes on the Bank's liabilities contain more extensive information on the financing activities presented in the statement of cash flows (issues of debt securities and subordinated bonds, received loans and advances).

4.2 New standards and interpretations and amendments thereto that have been published and adopted by the EU, but have not come into force yet and are not applied by the Bank

The Management Board does not expect the adoption of the new standards, their changes and interpretations to have a significant impact on the accounting policies applied by the Bank with the exception of IFRS 9. The Bank intends to apply them in the periods indicated in the relevant standards and interpretations (without early adoption), provided that they are adopted by the EU.

4.2.1. IFRS 9 Financial instruments

IFRS 9 Financial Instruments was published in July 2014 and endorsed for application in the EU Member States on 22 November 2016 by the Commission Regulation (EU) 2016/2067. It is mandatory for financial statements prepared for annual periods commencing on or after 1 January 2018 (with the exception of insurance companies, which may apply the standard from 1 January 2021). The standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The amendments cover the classification and measurement of financial instruments, recognition and calculation of impairment and hedge accounting.

The total impact of the adjustments resulting from the implementation of IFRS 9 on the Bank's financial assets and liabilities and equity, net of tax, is presented in the following table:

(IN PLN MILLION)

	31.12.2017 (classification under IAS 39)	Classification and measurement: reclassification	Classification and measurement: remeasurement	Impairment	01.01.2018 (classification under IFRS 9)
FINANCIAL ASSETS					
Cash and cash balances with the Central Bank	17 765	-	-	-	17 765
Amounts due from banks	8 769	-	-	-	8 769
Derivative instruments	2 805	-	-	-	2 805
Securities	50 512	4 368	91	(19)	54 952
- held for trading	472	-	-	-	472
- financial instruments designated at fair value through profit or loss upon initial recognition	6 409	(6 409)	-	-	-
- available-for-sale investment securities	42 009	(42 009)	-	-	-
- investment securities held to maturity	1 622	(1 622)	-	-	-
- not held for trading, mandatorily measured at fair value through profit or loss	-	2 774	91	-	2 865
- designated at fair value through profit or loss (FVO)	-	-	-	-	-
- at fair value through OCI	-	45 644	-	(18)	45 626
- at at amortized cost		5 990	-	(1)	5 989
Loans and advances to customers	**186 892**	(4 368)	(102)	(706)	181 716
- not held for trading, mandatorily measured at fair value through profit or loss	-	1 055	-	13	1 068
- at fair value through OCI	-	8 343	(102)	(3)	8 238
- at at amortized cost	186 892	(13 766)	-	(716)	172 410
Other assets (other financial assets)	1 748	-	-	-	1 748
TOTAL FINANCIAL ASSETS	**268 491**	**-**	**(11)**	**(725)**	**267 755**
Deferred income tax asset	957	-	2	202	1 161

	31.12.2017 (classification under IAS 39)	Classification and measurement: reclassification	Classification and measurement: remeasurement	Impairment	01.01.2018 (classification under IFRS 9)
Amounts due to the Central Bank	6				6
Amounts due to banks	4 299				4 299
Derivative financial instruments	2 741				2 741
Amounts due to customers	222 524				222 524
Debt securities issued	5 204				5 204
Subordinated liabilities	1 720				1 720
Other liabilities (other financial liabilities)	3 812				3 812
Provisions for liabilities and guarantees granted	86	-	-	69	155
Deferred tax liability	501	-	-	52	553
TOTAL FINANCIAL LIABILITIES, PROVISION FOR LIABILITIES AND GUARANTEES GRANTED AND DEFERRED TAX PROVISION	**240 893**	**-**	**-**	**121**	**241 014**

IFRS 9 impact as at 1 January 2018:	31.12.2017 (classification under IAS 39)	Classification and measurement: reclassification	Classification and measurement: remeasurement	Impairment	01.01.2018 (classification under IFRS 9)
Other comprehensive income	182	-	(164)	-	18
Retained earnings	-	-	155	(644)	(489)
		-	-	-	-
Total impact on equity	**182**	**-**	**(9)**	**(644)**	**(471)**

According to our best knowledge, the impact of the adjustments resulting from the implementation of IFRS 9 on the Bank's financial assets, financial liabilities and equity presented here is the best estimate as at the date of the publication of these financial statements.

4.2.1.1 Implementation schedule

Since 2016, the Bank has carried out the "IFRS 9" project, which has been divided into two stages: "Gap analysis" and "Implementation".

The first stage comprised the business analysis of gaps in the preparation of the Bank for the IFRS 9 implementation. The project is divided into two areas:

1) classification and measurement, including hedge accounting and reporting and tax issues; and

2) impairment.

The first area was managed by the Bank's Accounting Division, and the second by the Risk Division. Additionally, the Bank established a Steering Committee whose task was to take key decisions and control the conduct of the project. The Steering Committee comprised the Directors of the Accounting Division, Risk Division and the following Departments: Credit Risk, Accounting and Reporting, Management Information and Development of Transactional Applications. The Steering Committee was supported by the Project Sponsors: the Vice-President of the Management Board responsible for Risk Management and the Vice-President of the Management Board responsible for Finance and Accounting. Apart from the accounting and reporting area, tax and risk area employees, the business, settlements and IT department employees were also involved in the project. The representatives of PKO Bank Hipoteczny SA (accounting and risk area) also participated in the project.

Since the beginning of 2017, the second stage of the project has been carried out, aimed at implementing the changes resulting from IFRS 9.

As in the first stage, which covered gap analysis, the project was divided into two cooperating areas:

1) classification and measurement, including hedge accounting and reporting and tax issues, and

2) impairment.

The second stage of the project comprised:

- developing solutions in IT systems and their implementation;
- determining business models and developing new business processes, including in the areas of: SPPI tests, benchmark tests and modifications of cash flows;
- amendments to the Bank's internal regulations, including accounting policies and impairment calculation methods;
- calculating opening balance adjustments (as at 1 January 2018) resulting from implementing IFRS 9, including those that will be recognized in the Bank's equity as at 1 January 2018.

In order to adapt the Bank's IT solutions to the requirements of IFRS 9 in the area of classification and measurement, the Bank has developed and implemented solutions for the integrated computer system supporting credit products and applications supporting treasury transactions (securities). Categories of financial assets have been modified in the source systems to reflect IFRS 9 requirements and solutions regarding modification/elimination of financial assets have been provided.

As far as impairment is concerned, the Bank has adjusted the applications dedicated to impairment measurement to the expected changes, in particular by modifying the scope of input and output data, implementing impairment measurement algorithms in accordance with the IFRS 9 requirements and optimizing the IT infrastructure to achieve efficiency of applications that is adequate to the scope of the calculations, which is significantly greater than under IAS 39.

The Bank has also extended the available applications in order to ensure the calculation of fair value adjustments for credit exposures which will be derecognized from the books of account and which are classified for measurement at fair value, as well as to identify POCI exposures.

The Bank developed methods for the business model, SPPI (cash flow characteristics) and benchmark testing (quantitative testing) and a method for the fair value measurement of financial assets. Moreover, the Bank completed the implementation of changes in business, accounting and other operating processes.

At the same time, the Bank worked on changes in the data warehouse and in the reporting applications constituting the basis for preparation of the financial statements.

4.2.1.2 CLASSIFICATION AND MEASUREMENT

a) THE PRINCIPLES FOR CLASSIFICATION OF FINANCIAL INSTRUMENTS

In connection with the application of IFRS 9, as of 1 January 2018 the Bank classifies financial assets into the following categories:

- measured at amortized cost;
- measured at fair value through other comprehensive income (FVOCI);
- measured at fair value through profit or loss (FVP&L).

Classification as at the date of acquisition or origin depends on the business model adopted by the Bank for the purposes of managing a particular group of assets and on the characteristics of the contractual cash flows resulting from a single asset or a group of assets. The Bank identifies the following business models:

- the "held to collect cash flows" model, in which financial assets originated or acquired are held in order to collect gains from contractual cash flows – this model is typical for lending activities;
- the "held to collect cash flows and to sell" model, in which financial assets originated or acquired are held to collect gains from contractual cash flows, but they may also be sold (frequently and in transactions of a high value) – this model is typical for liquidity management activities;
- the residual model – other than the "held to collect cash flows" or the "held to collect cash flows and to sell" model.

Financial instruments are classified at the moment of the first-time application of IFRS 9, i.e. as at 1 January 2018, and at the moment of recognition or modification of the instrument. A change in the classification of financial assets may be caused by a change in the business model or failing the SPPI test. Changes in the business model are caused by changes that occur within or outside the Bank or by discontinuation of a particular activity, and therefore they will occur very rarely. Failing the SPPI test is a result of a change in the characteristics of contractual cash flows, as a result of which the return on the instrument does not correspond exclusively to the amount of principal and interest.

BUSINESS MODEL

The business model is selected upon initial recognition of financial assets. The selection is performed at the level of individual groups of assets, in the context of the business area in connection with which the financial assets originated or were acquired, and is based, among other things, on the following factors:

- the method for assessment and reporting the financial assets portfolio;
- the method for managing the risk associated with such assets and the principles of remuneration of persons managing such portfolios.

In the "held to collect cash flows" business model, assets are sold occasionally, in the event of an increase in credit risk or a change in the laws or regulations. The purpose of selling the assets is to maintain the assumed level of regulatory capital. Assets are sold in accordance with the principles described in the portfolio management strategy or close to maturity, in the event of a decrease in the credit rating below the level assumed for a given portfolio, significant internal restructuring or acquisition of another business, execution of a contingency or recovery plan or another unforeseeable factor independent of the Bank.

ASSESSMENT OF CONTRACTUAL CASH FLOW CHARACTERISTICS

The assessment of the contractual cash flow characteristics establishes, based on a qualitative test of contractual cash flows, whether contractual cash flows are solely payments of principal and interest (hereinafter "SPPI"). Interest is defined as consideration for the time value of money, credit risk relating to the principal remaining to be repaid within a specified period and other essential risks and costs associated with granting loans, as well as the profit margin.

Contractual cash flow characteristics do not affect the classification of the financial asset if:

- their effect on the contractual cash flows from that asset could not be significant (de minimis characteristic);
- they are not genuine, i.e. they affect the contractual cash flows from the instrument only in the case of occurrence of a very rare, unusual or very unlikely event (non-genuine characteristic).

In order to make such a determination, it is necessary to consider the potential impact of the contractual cash flow characteristics in each reporting period and throughout the whole life of the financial instrument.

The SPPI test is performed for each financial asset in the “held to collect cash flows” or “held to collect cash flows and to sell” models upon initial recognition (and for modifications which are significant after subsequent recognition of a financial asset) and as at the date of change of the contractual cash flow characteristics.

If the qualitative assessment performed as part of the SPPI test is insufficient to determine whether the contractual cash flows are solely payments of principal and interest, a benchmark test (quantitative assessment) is performed to determine the difference between the (non-discounted) contractual cash flows and the (non-discounted) cash flows that would occur should the time value of money remain unchanged (the reference level of cash flows).

FINANCIAL ASSETS MEASURED AT AMORTIZED COST

Financial assets (debt financial assets) are measured at amortized cost, provided that both the following conditions are met:

- the financial asset is held in accordance with the “held to collect cash flows” business model;
- the terms and conditions of an agreement concerning the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding (the SPPI test is passed).

The initial value of a financial asset measured at amortized cost is adjusted for any commissions and fees which affect the effective return on such asset and constitute a part of the effective interest rate on such asset (the commissions and fees associated with the operations performed by the Bank which result in the origin of assets). Commissions and fees affecting the effective return on assets, which occur after the origination of the financial assets, result in changes in the schedules of future cash flows generated by such assets.

The present value of this category of assets is determined based on the effective interest rate described in item f, which is used for determining (calculating) the interest income generated by the asset in a given period. It is then adjusted for cash flows and allowances in respect of expected credit losses.

Assets for which a schedule of future cash flows necessary for calculating the effective interest rate cannot be determined are not measured at amortized cost. Such assets are measured at the amount of payment due, which comprises interest on the amount receivable, net of any allowance for expected credit losses. Commissions and fees arising upon the origin of such assets or determining their financial characteristics are settled over the asset's life on a straight-line basis and recognized in interest or commission income. Commissions and fees settled on a straight-line basis are recognized in the Bank's financial result regularly throughout the life of the asset. The specific commissions and fees are settled monthly.

FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (FVOCI)

Financial assets (including debt instruments) are measured at fair value through other comprehensive income if both the following conditions are met:

- financial assets are held in the business model whose purpose is to collect contractual cash flows and to sell financial assets; and
- the terms and conditions of an agreement concerning the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

Financial assets measured at fair value through other comprehensive income are measured at the fair value net of the allowances for expected credit losses.

The effect of changes in the fair value of such financial assets is recognized in other comprehensive income until a given financial asset is derecognized or reclassified, with the exception of interest income, gain or loss resulting from the allowance for expected credit losses and foreign exchange gains or losses, which are recognized in profit or loss. If a financial asset is no longer recognized, accumulated gains or losses, which were previously recognized in other comprehensive income, are reclassified from other comprehensive income to profit or loss in the form of a reclassification adjustment.

FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS (FVP&L)

If financial assets do not satisfy any of the above-mentioned criteria of measurement at amortized cost or at fair value through other comprehensive income, they are classified as financial assets measured at fair value through profit or loss.

Additionally, upon initial recognition a financial asset may be irrevocably classified as measured at fair value through profit or loss, if such an approach eliminates or significantly reduces inconsistencies in the measurement or recognition (accounting mismatch). This option is available for debt instruments both in the “held to collect cash flows” and “held to collect cash flows and to sell” model.

Financial assets measured at fair value through profit or loss will be presented in the financial statements of the Bank in the following manner:

1) held for trading – financial assets which:
   - have been acquired mainly for the purpose of their sale or redemption in the short term;
   - upon initial recognition constitute a part of a portfolio of financial instruments, which are managed jointly and which actually generate short-term gains on an ongoing basis; or
   - are derivative instruments (other than financial guarantee contracts or designated and effective hedging instruments);
2) financial assets that are not held for trading and must be measured at fair value through profit or loss - financial assets that have not passed the test of cash flow characteristics (irrespective of the business model).
3) financial assets designated for measurement at fair value through profit or loss upon initial recognition (the fair value through profit or loss option).

Gains or losses on the financial assets measured at fair value through profit or loss are recognized in profit or loss.

EQUITY INSTRUMENTS

Investments in equity instruments and contracts concerning such instruments are measured at fair value through profit or loss. Upon initial recognition, the entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value (the option of measurement at fair value through other comprehensive income) of an investment in an equity instrument that is not held for trading and does not constitute a contingent payment recognized by the Bank as part of a business combination in accordance with IFRS 3. If the option of measurement at fair value through other comprehensive income is selected, any dividends resulting from the investment are recognized in profit or loss. In the case of such instruments, gains/losses on measurement recognized in other comprehensive income are not reclassified to profit or loss.

In the case of investments in equity instruments, the Bank did not use the option of measurement at fair value through other comprehensive income.

b) RECLASSIFICATION OF FINANCIAL ASSETS

Financial assets are reclassified only in the event of a change in the business model relating to the asset or a group of assets resulting from the commencement or discontinuation of a significant part of the entity's operations. Such changes are very infrequent. Reclassification is presented prospectively, i.e. without changing the effects of fair value measurement, write-downs or accrued interest that have been recognized to date.

The following are not treated as changes in the business model:

1) changes in the intentions regarding specific financial assets (even in the event of significant changes in market conditions);
2) temporary discontinuation of a specific market for financial assets;
3) a transfer of financial assets between business areas that apply different business models.

No financial liabilities are reclassified.

In the event of reclassification of a financial asset from amortized cost to measurement at fair value through profit or loss, the fair value of the asset is determined as at the reclassification date. Any gains or losses arising from a difference between the previously recognized amortized cost of the financial asset and its fair value are recognized in the income statement.

In the event of reclassification of a financial asset from the fair value through profit or loss category to the amortized cost category, the fair value of the asset becomes its new gross carrying amount as at the reclassification date. The effective interest rate is determined based on the fair value of the asset as at the reclassification date.

In the event of reclassification of a financial asset from amortized cost to measurement at fair value through other comprehensive income, the fair value of the asset is determined as at the reclassification date. Any gains or losses arising from a difference between the previously recognized amortized cost of the financial asset and its fair value are recognized in other comprehensive income. The effective interest rate and expected credit losses are not adjusted as a result of such reclassification.

In the event of reclassification of a financial asset from the measurement at fair value through other comprehensive income category to the amortized cost category, the asset is reclassified at the fair value as at the reclassification date. Accumulated gains or losses previously recognized in other comprehensive income are removed from equity and adjusted based on the fair value of the financial asset as at the reclassification date. As a result, the financial asset is measured as at the reclassification date in such a manner as if it has always been measured at amortized cost. This adjustment concerns other comprehensive income and it does not affect the financial result; therefore, it is not a reclassification adjustment in accordance with IAS 1. The effective interest rate and expected credit losses are not adjusted as a result of such reclassification.

In the event of reclassification of a financial asset from the fair value through profit or loss category to the fair value through other comprehensive income category, the Group continues to measure the asset at fair value. The effective interest rate is determined based on the fair value of the asset as at the reclassification date.

In the event of reclassification of a financial asset from the fair value through other comprehensive income category to the fair value through profit or loss category, the Bank continues to measure the asset at fair value. Accumulated gains or losses previously recognized in other comprehensive income are reclassified from equity to profit or loss in the form of a reclassification adjustment in accordance with IAS 1 as at the reclassification date.

c) Changes in the estimated contractual cash flows – modifications

Modification - a change in the contractual cash flows in respect of a financial asset based on an annex to the contract. A modification may be significant or insignificant. A change in the contractual cash flows resulting from execution of the terms of the contract is not a modification.

If the contractual cash flows associated with a financial asset are renegotiated or otherwise modified, and such renegotiation or modification does not lead to such a financial asset no longer being recognized ("AN INSIGNIFICANT MODIFICATION"), the carrying amount of the financial asset is recalculated and gain or loss arising from such modification is recognized in the financial result. Adjustment of the carrying amount of a financial asset resulting from the modification is recognized in the interest income/ expenses over time using the effective interest rate method. The carrying amount of a financial asset is calculated as the present value of renegotiated or modified contractual cash flows, discounted using the original effective interest rate on the financial asset (or, in the case of credit-impaired purchased or issued financial assets, the effective interest rate adjusted for credit risk) or, if applicable (e.g. with respect to gain or loss on a hedged item resulting from hedging), the updated effective interest rate. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortized over the remaining part of the life of the modified financial asset.

In certain circumstances, renegotiation or modification of contractual cash flows associated with a financial asset may lead to derecognition of the financial asset. If an existing financial asset is derecognized due to its modification, and a modified asset is subsequently recognized, the modified asset is treated as a "new" financial asset ("A SIGNIFICANT MODIFICATION"). The new asset is recognized at the fair value and a new effective interest rate applicable to the new asset is calculated. If the characteristics of a modified new financial asset (after signing an annex) comply with the arm's length conditions, the carrying amount of that financial asset is equal to its fair value.

The assessment whether a given modification of financial assets is a significant or an insignificant modification depends on satisfaction of certain quantitative and qualitative criteria.

The following QUALITATIVE CRITERIA have been adopted:

- Currency translation;
- Change of debtor, other than caused by the debtor's death;
- Introducing or removing a contractual characteristic that adversely affects the test of cash flow characteristics;
- Concluding a composition or restructuring agreement with respect to a terminated contract.

The occurrence of at least one of these criteria results in a significant modification.

The quantitative criterion consists of a 10% test analysing the change in the contractual terms of a financial asset resulting in a difference between the amount of future cash flows arising from the changed financial asset discounted using the original effective interest rate and the amount of the future cash flows that would arise from the original financial asset discounted using the same interest rate.

In the event of the occurrence of a quantitative criterion (a difference) of more than 10%, the modification is considered significant, whereas a quantitative criterion of 10% or less means that the modification is considered insignificant.

The quantitative criterion is not applicable to loans that are subject to a restructuring process (i.e. their modification is treated as insignificant).

d) Measurement of purchased or originated credit impaired assets (POCI)

IFRS 9 distinguished a new category of purchased or originated credit-impaired assets (POCI).

POCI comprise debt financial assets measured at amortized cost and measured at fair value through other comprehensive income, i.e. loans and debt securities.

Such assets are initially recognized at the net carrying amount (net of write-downs), which corresponds to their fair value. Interest income on POCI assets is calculated based on the net carrying amount using the effective interest rate adjusted for credit risk recognized for the whole life of the asset. The interest rate adjusted for credit risk is calculated taking into account future cash flows adjusted for the effect of credit risk recognized over the whole life of the asset. Any changes in the estimates of future profits in the subsequent reporting periods are charged or credited to profit or loss.

e) Measurement of off-balance sheet instruments

Financial guarantees are recognized at fair value. In the subsequent periods, financial guarantees are measured at the higher of the following two amounts:

- the amount of allowance for expected credit losses, or
- the amount of initially recognized commission, amortized in accordance with IFRS 15.

f) Interest income

Interest income is calculated using the effective interest rate used for determining (calculating) interest income generated by the asset in a given period based on the carrying amount of the financial assets, except for:

1) purchased or originated credit-impaired financial assets (see item d). With respect to such financial assets, the Bank applies the effective interest rate adjusted for credit risk to the amount of amortized cost of the financial asset (net carrying amount) from the date of initial recognition (POCI assets).
2) financial assets other than purchased or originated credit-impaired financial assets, which subsequently became credit-impaired financial assets. With respect to such financial assets, the Bank applies the original effective interest rate (as at the date of recognition of an indication of impairment) to the amount of amortized cost of the financial asset (the net carrying amount) in the subsequent reporting periods.

g) Assessment of impact – classification and measurement

Change in the classification and measurement of financial assets concerns:

- NBP bills, which were measured at fair value through profit or loss on a portfolio basis in accordance with IAS 39. In accordance with IFRS 9, a portfolio of bills is measured at the fair value through other comprehensive income due to the fact that the “held to collect cash flows and to sell” model is applied,
- housing loans, which may be sold to PKO Bank Hipoteczny SA as part of the pooling process, which are measured at amortized cost in accordance with IAS 39 and as of 1 January 2018 will be measured at fair value through other comprehensive income. Due to the application of the “held to collect cash flows and to sell” model, such classification will be maintained for the purpose of preparing the Bank’s stand-alone financial statements From the perspective of the consolidated financial statements, the adjustment will not apply, because the loans subject to pooling will meet the business model criterion of “held to collect cash flows” within the Group,
- due to the occurrence of the leverage component (an interest formula based on a multiple that is higher than 1) in the interest rate formula for selected loan portfolios, the SPPI test has not been passed: ARiMR (the Agency for Restructuring and Modernization of Agriculture) investment loans, selected working capital loans, student loans, preferential housing loans with BGK financing, housing loans (Alicja), selected loans granted to local government units. If the SPPI test has not been passed despite the application of the “held to collect cash flows” model, it is necessary to change the measurement category for such loan portfolios from amortized cost to fair value through profit or loss,
- due to the SPPI test not being met, despite the application of the “held to collect cash flows” model, the fair value measurement through profit or loss will be applied to selected tranches of corporate bonds acquired by the Bank (one entity),

- corporate and municipal debt securities, which were previously presented under "Loans and advances granted to customers" and measured at amortized cost, are now recognized under securities measured at amortized cost (this reclassification does not affect the measurement).

In the case of investments in equity instruments, the Bank did not use the option of measurement at fair value through other comprehensive income.

The implementation of IFRS 9 as of 1 January 2018 has not affected the classification and measurement of the Bank's financial liabilities.

The Bank has estimated that, in connection with the IFRS 9 implementation on 1 January 2018, the total effect of adjustments arising from changes in the measurement and classification on equity (retained earnings or other comprehensive income) as at 1 January 2018 will amount to minus PLN 11 million (minus PLN 9 million after tax).

Furthermore, the Bank prospectively applied a method of recognition of modifications in cash flows from financial assets, which will be recognized in profit or loss on a one-off basis as at the date of the modification, and the change in the measurement as at the balance sheet date will be calculated using the original effective interest rate. Up to 31 December 2017, the effect of modifications was spread over time using the effective interest rate method throughout the remaining part of the product's life.

As the main POCI category, the Bank recognized impaired exposures acquired as a result of mergers and business combinations as at the date of the merger/business combination (the mergers with Nordea Bank Polska and SKOK "Wesoła" in Mysłowice) and exposures to corporate entities that satisfy the POCI criteria in the net carrying amount of PLN 574 million.

4.2.1.3 IMPAIRMENT

A fundamental change in the area of impairment is that IAS 39 is based on the concept of incurred losses, whereas IFRS 9 is based on the concept of expected losses.

IFRS 9 has introduced new concepts concerning impairment:

- credit-impaired financial asset – a financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred,
- credit loss – the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e. all cash shortfalls), discounted at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets),
- expected credit losses – the weighted average of credit losses with the respective risks of a default occurring as the weights;
- lifetime expected credit losses – the expected credit losses that result from all possible default events over the expected life of a financial instrument,
- 12-month expected credit losses – the portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date,
- loss allowance – the allowance for expected credit losses on financial assets measured at amortized cost, lease receivables and contract assets, the accumulated impairment amount for financial assets measured at fair value through other comprehensive income and the provision for expected credit losses on loan commitments and financial guarantee contracts.

The new impairment model is applicable to financial assets that are not measured at fair value through profit or loss, comprising:

- debt financial instruments comprising credit exposures and securities,
- lease receivables,
- off-balance sheet financial and guarantee liabilities.

In accordance with IFRS 9, expected credit losses are not recognized with respect to investments in equity instruments.

In accordance with the general principle, impairment will be measured as 12-month expected credit losses or lifetime expected credit losses. The basis of measurement will depend on whether a significant increase in credit risk has occurred since initial recognition. Loans will be allocated to 3 categories (stages):

Classification according to IAS 39	Classification according to IFRS 9	
Not impaired portfolio (IBNR according to IAS 39)	Stage 1 (assets with credit risk that has not increased significantly since initial recognition)	12-month expected credit losses
	Stage 2 (significant increase in credit risk)	lifetime expected credit losses
Impaired portfolio	Impaired loans (the portfolio includes purchased or originated credit-impaired assets – POCI)	lifetime expected credit losses

In order to assess a significant increase in credit risk, in the case of mortgage and other retail exposures, the Bank applies a model based on the marginal PD calculation, i.e. calculation of the probability of default in a specific month from the moment of commencement of the exposure. As a result, it is able to reproduce the credit quality diversification over the lifetime of the exposure that is characteristic of credit exposures to individuals. The Bank identifies the evidence of a significant increase in risk based on a comparison of the default probability curves over the life of an exposure as at the date of initial recognition and as at the reporting date. For each reporting date, only the parts of the original and current default probability curves which correspond to the period starting from the reporting date to the maturity of the exposure are compared. The comparison is based on the value of the average probability of default in the period analysed, adjusted for the current and forecast macroeconomic ratios.

In order to assess a significant credit risk increase for corporate customers, the Bank uses a model based on Markov chains. The curve of maximum acceptable credit quality deterioration in time, which is not identified as a significant credit risk increase, is calculated based on default probabilities estimated on the basis of customer migrations between rating and scoring categories.

In order to identify other evidence of a significant increase in credit risk, the Bank makes use of the full quantitative and qualitative information available, including:

- restructuring measures involving granting concessions to the debtor due to its financial difficulties – forbearance,
- a delay in repayments of more than 30 days,
- early warning signals identified as part of the monitoring process, indicating a significant increase in credit risk,
- a dispute in progress with a customer,
- an assessment by an analyst as part of the individualized analysis process,
- no credit risk assessment available for an exposure as at the date of initial recognition, preventing the Bank from assessing whether credit risk has increased,
- quarantine in Stage 2 for exposures in respect of which impairment indications ceased to exist in the last 3 months.

The expected loss is determined as the product of the following credit risk parameters: probability of default (PD), loss given default (LGD) and exposure at default (EAD), where each of these parameters has the form of a vector of the number of months representing the credit loss horizon. In the case of exposures classified as Stage 1, the Bank estimates the expected loss over a period of up to 12 months. In the case of exposures classified as Stage 2, the expected loss is estimated for a period up to the maturity or renewal of the exposure. With respect to retail exposures without a repayment schedule, the Bank determines the horizon based on historical behavioural data. The loss expected both during the life of an exposure and in a 12-month period is the total of the losses expected in the individual periods, discounted using the effective interest rate. In order to determine the value of an asset as at the default date in a given period, the Bank adjusts the parameter which determines the amount of the exposure as at the default date for future scheduled repayments and potential overpayments/underpayments.

In accordance with IFRS 9, the calculation of expected credit losses must take into account the estimates concerning forecast macroeconomic conditions. As regards the portfolio analysis, the impact of macroeconomic scenarios is included in the amounts of the individual parameters. The methodology of calculation of the individual risk parameters involves examining the relationship between these parameters and macroeconomic conditions based on historical data. For the purposes of calculating an expected loss, as in the case of identifying the indications of a significant credit risk increase, three macroeconomic scenarios developed based on the Bank's forecasts are used: the base scenario and two alternative scenarios. The forecast ratios include the GDP growth ratio, the unemployment rate, WIBOR 3M, Libor CHF 3M, CHF/PLN exchange rate, the real estate price index and the NBP reference rate. The ultimate expected loss is the probability-weighted average of losses expected in the individual scenarios. The Bank ensures the consistency of the macroeconomic scenarios used for calculating risk parameters with the macroeconomic scenarios used in credit risk budgeting processes. Both the process of assessment of a significant credit risk increase and the process of expected loss calculation will be performed monthly for the individual exposures. Due to the significantly higher complexity of the calculations compared with the process of calculating provisions under IAS 39, the Bank has significantly extended its IT infrastructure by adding a dedicated calculation environment, which allows obtaining results in comparable time and their distribution to the Bank's internal entities.

IMPACT ASSESSMENT – IMPAIRMENT

The Bank estimates that the implementation of IFRS 9 will result in a decrease in the net asset value of PLN 794 million (PLN 644 million after tax).

4.2.1.4 HEDGE ACCOUNTING

IFRS 9 increases the range of items that can be designated as hedged items, as well as allows designating as a hedging instrument financial assets or liabilities measured at fair value through profit or loss. The obligation of retrospective measurement of hedge effectiveness together with the previously applicable threshold of 80%-125% were eliminated (the condition to the application of hedge accounting is the economic relationship between the hedging instrument and the hedged item).

In addition, the scope of required disclosures regarding risk management strategies, cash flows arising from hedging transactions and the impact of hedge accounting on the financial statements were extended.

Due to the fact that the standard is still being worked on to introduce amendments relating to accounting for macro hedges, entities have a choice of applying hedge accounting provisions: they can either continue to apply IAS 39 or apply the new IFRS 9 standard with the exception of fair value macro hedges relating to interest rate risk.

Having completed an analysis of risks and benefits associated with adopting the hedge accounting solutions introduced in IFRS 9, the Bank decided to continue to apply IAS 39 with respect to hedge accounting and to continue the hedging relationships.

4.2.1.5 DISCLOSURES AND COMPARATIVE DATA

In the Bank's opinion, the application of IFRS 9 requires making considerable changes to the manner of presentation and the scope of disclosures concerning the area of financial instruments, including in the first year of its application, when extensive information about the opening balance and restatements made is required. The Bank intends to use the IFRS 9 provisions which exempt entities from the obligation to restate the comparative data for the prior periods with regard to changes resulting from classification and measurement as well as impairment. Differences in the carrying amounts of financial assets and liabilities resulting from the application of IFRS 9 will be recognized in retained earnings/accumulated losses in equity as at 1 January 2018.

4.2.1.6 The impact of IFRS 9 on ownfunds and capital adequacy measures

The impact of IFRS 9 on ownfunds and capital adequacy measures results from the following factors:

- a change in the classification and measurement of financial assets, which as at 1 January 2018 was recognized in ownfunds under retained earning/accumulated losses and other comprehensive income (impact of adjustments in respect of fair value measurement of loans measured at fair value through profit or loss);
- a change in the impairment model as at 1 January 2018, whose effect was also recognized in ownfunds under retained earnings/accumulated losses;
- any changes in the net value of deferred tax assets (adjustment of deferred income tax assets corresponding to retained earnings). The amount of the above-mentioned net deferred tax asset is taken into account in the calculation of risk exposure in accordance with the CRR requirements (applying the 250% risk weight or decreasing the amount of own funds). It is generally assumed that such assets are based on future profitability and result from temporary differences.

The impact of the provisions of IFRS 9 concerning changes in the impairment model on ownfunds and capital adequacy measures is regulated by 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. In accordance with this regulation, banks may apply transitional provisions with respect to own funds and increase Tier 1 capital associated with the implementation of a new impairment model in the period of 5 consecutive years from 1 January 2018. The scaling factor shall decrease from one period to another.

The Bank has decided to apply the transitional provisions in full and to spread the impact of adjustments resulting from IFRS 9 implementation on own funds and capital adequacy measures over time.

At the same time, in accordance with the above-mentioned Regulation of the European Parliament and of the Council of 12 December 2017, in the event of applying the transitional provisions the Bank is additionally obliged to disclose the following values as they would have been in the event that the transitional provisions are not applied: the amounts of own funds, Common Equity Tier 1 capital and Tier 1 capital, the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio, the total capital ratio and the leverage ratio.

As a result of adjusting the calculations of regulatory capital requirements that take into account the transitional solutions aimed at easing the impact of the IFRS 9 implementation as at 1 January 2018, the Bank's ownfunds calculated for capital adequacy purposes increased by approx. PLN 17 million; at the same time, due to impairment adjustments resulting from the implementation of IFRS 9, equity decreased by approx. PLN 32 million, and due to adjustments relating to changes in measurement methods it decreased by approx. PLN 21 million. At the same time, the Bank's equity increased by approx. PLN 71 million due to the fact that the transitional period provided for in the CRR for removing a specific percentage of unrealized gains on securities measured at fair value from equity ended (as at 31.12.2017, 20% of such gains was removed).

Had the transitional solutions not been applied, the Bank's ownfunds would be PLN 593 million lower. This decrease would comprise a decrease of PLN 642 resulting from impairment adjustments, a decrease of PLN 21 million resulting from changes in measurement methods, and a simultaneous increase of PLN 71 million resulting from the end of the transitional period provided for in the CRR.

As a result, the total capital ratio of PKO Bank Polski SA will decrease by 8 base points. If the transitional solutions relating to IFRS 9 were not applied and the total impact of the implementation of IFRS 9 was recognized, the total capital ratio would decrease by 36 base points.

According to our best knowledge, the impact of the adjustments resulting from the implementation of IFRS 9 on capital adequacy presented here is the best estimate as at the date of the publication of these financial statements.

4.2.2 IFRS 15 Revenue from contracts with customers

IFRS 15 replaces IAS 11 Construction contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the construction of real estate, IFRIC 18 Transfers of Assets from Customers, SIC 31 Revenue – barter transactions involving advertising services.

The main principle is to recognize revenue in such way as to reflect the transaction of transfer to the customer of goods or services in an amount that reflects the value of remuneration, which the company expects in exchange for those goods or services. For the purpose of recognizing revenue at the appropriate moment and amount, the standard presents a five-level analysis model, consisting of: identification of the contract with a customer and binding commitment, determination of the transaction price, its appropriate allocation and recognition of revenue when the obligation is met.

The scope of the standard does not include financial instruments (IAS 39), insurance contracts (IFRS 4) and lease transactions (IAS 17), and therefore the Bank estimates that the impact of this standard on its financial statements should not be significant.

4.2.3 IFRS 16 Leases

IFRS 16 was published by the International Accounting Standards Board on 13 January 2016 and it is mandatory for annual periods beginning on or after 1 January 2019. The new standard will replace the current IAS 17, Leases.

IFRS 16 introduces new principles for recognizing leases. The main change concerns elimination of the classification of leases by the lessee as either operating or financial. A single accounting model for leases is introduced instead. Under the single model, the lessee is obliged to recognize the leased assets and the corresponding liabilities in the statement of financial position, unless the lease term is 12 months or less or the underlying asset has a low value. The lessee is also obliged to recognize in the income statement depreciation of a leased asset separately from interest expenses on the lease liability.

The lessor continues to classify leases as either operating or financial and account for them as two separate types of lease.

In the Bank's opinion, the application of the new standard will affect the recognition, presentation, measurement and disclosure of assets held by the Bank as the lessee under operating lease contracts, as well as the corresponding liabilities, in the financial statements of the Bank.

4.3 New and amended standards and interpretations, which have been published, but not yet adopted by the European Union

- The amendments to IAS 12 concern clarification of the method of recognizing deferred tax assets relating to debt instruments measured at fair value. The amendments to IFRS 10 and IAS 28 concern the sale or contribution of assets by an investor to a joint venture or an associate. However, the implementation of these amendments has been postponed. The Bank does not expect the impact of the amendments to IAS 12, IAS 28 and IFRS 10 to be significant. The impact of the amendments to IFRS 4 (associated with IFRS 9) on the Bank's insurance activities has not yet been estimated.
- Amendments to IAS 40 and improvements to IFRS 2014-2016 (IFRS 1, IAS 28) will have no impact on the financial statements of the Bank.

5. Explanation of the differences between previously published financial statements and these financial statements

There are no differences between the data published in the financial statements of the Bank for the year ended 31 December 2016 and the data presented in these financial statements.

The financial data included in the financial statements of PKO Bank Polski SA for the year ended 31 December 2016 was presented in PLN millions, with one decimal place. In these financial statements, the comparative data has been rounded to one million zlotys and any differences in relation to previously published data may result from such rounding.

NOTES TO THE INCOME STATEMENT

6. INTEREST INCOME AND EXPENSES

Accounting policies
Interest and expenses resulting from sales of insurance products linked to loans and advances.
Financial information:
Interest income
Interest expenses

ACCOUNTING POLICIES

Interest income and expenses comprise interest, including premiums and discounts in respect of financial instruments measured at amortized cost and instruments measured at fair value. Interest income includes interest income on hedging derivatives. Interest income and expenses also include fees and commissions received and paid, which are deferred using the effective interest rate and which are taken into account in the measurement of the financial instrument.

Interest income and interest expenses are recognized on an accruals basis using the effective interest rate method that discounts estimated future cash inflows and payments made over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or liability. Calculation of the effective interest rate includes all commissions paid and received by parties to an agreement, transaction costs and all other premiums and discounts constituting an integral part of the effective interest rate.

Interest income in the case of financial assets or a group of similar financial assets for which an impairment allowance was recognized is calculated on the basis of the current values of receivables (i.e. net of the impairment allowance) by using the current interest rate used for discounting future cash flows for the purposes of estimating impairment losses.

The effect of the fair value measurement of financial assets acquired as part of business combinations between subsidiaries is also recognized in interest income.

INTEREST AND EXPENSES RESULTING FROM SALES OF INSURANCE PRODUCTS LINKED TO LOANS AND ADVANCES

Due to the fact that the Bank offers insurance products along with loans and advances and there is no possibility of purchasing from the Bank an insurance product that is identical as to the legal form, conditions and economic content without purchasing a loan or an advance, the payments received by the Bank for the insurance products sold are treated as an integral part of the remuneration for the financial instruments offered.

Remuneration received and receivable by the Bank for offering insurance products for the products directly associated with the financial instruments is settled using the effective interest rate method and recognized in interest income. Remuneration is recognized in commission income upon sale or renewal of an insurance product only in the part relating to the intermediation service provided.

Remuneration is divided into the commission portion and the interest portion based on the proportion of the fair value of the financial instrument and the fair value of the intermediation service to the sum of these two values.

Costs directly related to the sale of insurance products are settled in a similar manner to the settlement of revenues, i.e. as part of the amortized cost of a financial instrument or on a one-off basis.

The Bank makes periodical estimations of the remuneration amount that will be recoverable in the future due to the early termination of the insurance contract and reduces the recognized interest or commission income accordingly.

(IN PLN MILLION)

FINANCIAL INFORMATION

INTEREST INCOME ON:	2017	2016
loans to and other receivables from banks	202	155
loans and advances to customers, of which:	8 246	7 894
on impaired loans	237	266
investment securities	988	788
hedging derivatives	408	348
financial assets designated at fair value through profit or loss upon initial recognition	189	225
financial assets held for trading, excluding derivative financial instruments	42	69
other	-	4
Total	**10 075**	**9 483**

INTEREST EXPENSES ON:	2017	2016
amounts due to banks	(122)	(101)
amounts due to customers	(1 868)	(1 783)
issuance of debt securities and subordinated liabilities	(94)	(96)
available-for-sale debt securities	(69)	(79)
financial assets held for trading, excluding derivative financial instruments	(11)	(32)
financial assets designated at fair value through profit or loss upon initial recognition	(10)	(24)
Total	**(2 174)**	**(2 115)**

7. FEE AND COMMISSION INCOME AND EXPENSES

ACCOUNTING POLICIES

Fee and commission income is generally recognized on an accruals basis when the service has been provided. Fee and commission income includes one-off amounts charged by the Bank for services not related directly to the creation of loans, advances and other receivables, as well as amounts charged by the Bank for services performed over a period exceeding 3 months, which are recognized on a straight-line basis. Fee and commission income also includes fees and commissions recognized on a straight-line basis, received on loans and advances granted with an unspecified schedule of future cash flows for which the effective interest rate cannot be determined.

The accounting policies for recognizing commission income on sales of insurance products linked to loans and advances are described in the note “Interest income and expenses”.

(IN PLN MILLION)

FINANCIAL INFORMATION

FEE AND COMMISSION INCOME ON:	2017	2016
payment and credit cards	1 110	1 013
maintenance of bank accounts	835	863
loans and advances granted	637	617
offering insurance products	105	58
maintenance of investment funds and OFE (including management fees)	391	275
cash transactions	87	92
servicing foreign mass transactions	101	89
brokerage activities and issue arrangement	209	150
investment and insurance products	15	14
sale and distribution of court fee stamps	5	12
customer orders	44	44
fiduciary services	6	5
other	66	66
Total	**3 611**	**3 298**

FEE AND COMMISSION EXPENSE ON:	2017	2016
card activities	(615)	(544)
commission paid to external entities for product sales	(87)	(88)
cost of construction investment supervision and property valuation	(41)	(40)
settlement services	(29)	(33)
fee and commissions for operating services provided by banks	(17)	(17)
sending short text messages (SMS)	(21)	(16)
fees incurred by the Brokerage House	(21)	(17)
other[1]	(93)	(96)
Total	**(924)**	**(851)**

[1] among other things on servicing loans, servicing foreign mass transactions, central settlement of derivative transactions, issue of Euro bonds and canvassing services)

(IN PLN MILLION)

8. DIVIDEND INCOME

ACCOUNTING POLICIES

Dividend income is recognized at the record date.

FINANCIAL INFORMATION

DIVIDEND INCOME	2017	2016
from issuers not related to the Bank	12	10
from subsidiaries, joint ventures and associates, of which:	123	152
PKO Towarzystwa Funduszy Inwestycyjnych SA	60	57
CEUP eService Sp. z o.o.	13	11
PKO BP BANKOWY PTE SA	5	7
PKO BP Finat Sp. z o.o.	45	76
PKO Finance AB	-	1
Total	**135**	**162**

9. NET GAINS/(LOSS) ON FINANCIAL INSTRUMENTS MEASURED AT THE FAIR VALUE

ACCOUNTING POLICIES AND CLASSIFICATION

The gain/(loss) on financial instruments measured at fair value through profit or loss includes gains and losses arising from disposal of financial instruments designated as financial assets / liabilities measured at fair value through profit or loss (both held for trading and designated at fair value through profit or loss at initial recognition) and the effect of their measurement at fair value. This item also includes the ineffective portion of cash flow hedges in the case of hedging strategies in which IRS contracts are the hedging instrument, as well as gains and losses on the hedging instrument and hedged item relating to the hedged risk (fair value hedges).

FINANCIAL INFORMATION

NET GAIN/(LOSS) ON FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	2017	2016
Debt instruments	3	(17)
Equity instruments	1	1
Derivative instruments (of which an ineffective portion of cash flow hedges)	-	10
Other, including gains and losses on the hedging instrument and the hedged item relating to the hedged risk (fair value hedges)	(1)	6
Total	**3**	-

(IN PLN MILLION)

10. Gain/(loss) on investment securities

Accounting policies

Gain/(loss) on investment securities include gains and losses arising from disposal of financial instruments classified as available for sale.

Financial information

GAIN/(LOSS) ON INVESTMENT SECURITIES	2017	2016
Equity securities[1]	1	419
Debt securities	43	86
Total	**44**	**505**

[1] In 2016, the Bank recognized profit on the settlement of Visa transactions in the amount of PLN 418 million (the transactions are described in detail in the note "Investment securities available for sale").

11. Net foreign exchange gains/ (losses)

Accounting policies and classification

Foreign exchange gains (losses) comprise foreign exchange gains and losses, both realized and unrealized, resulting from valuation of assets and liabilities denominated in foreign currencies and from the fair value valuation of foreign currency derivatives (FX forward, FX swap, CIRS and currency options). In the case of the hedging strategies in which CIRS contracts are the hedging instrument, this item also includes the ineffective portion of cash flow hedges.

Impairment allowances for loans, advances and other foreign currency-denominated receivables, which are recorded in PLN, are revalued when the measurement of the underlying foreign currency-denominated assets changes. The effect of such revaluation is recognized in foreign exchange gains/losses.

NET FOREIGN EXCHANGE GAINS/(LOSSES)	2017	2016
Net foreign exchange gains/(losses)	419	501
Total	**419**	**501**

12. Other operating income and expense

Accounting policies

Other operating income and expenses comprise income and costs not directly related to banking activities. Other operating income mainly includes gains on sale/scrapping of fixed assets, intangible assets and foreclosed collateral, sale of shares in subsidiaries, unrecoverable receivables collected, legal damages, fines and penalties, income from lease/rental of properties. Other operating expenses mainly include losses on sale /scrapping of fixed assets, intangible assets and foreclosed collateral, and donations made.

(IN PLN MILLION)

FINANCIAL INFORMATION

OTHER OPERATING INCOME	2017	2016
gains on sale and disposal of property, plant and equipment, intangible assets and assets held for sale[1]	74	34
sundry income	27	26
recovery of receivables expired, forgiven or written off	2	6
other	51	49
Total	**154**	**115**

[1] Gain on sale of real estate realized in 2017 amounted to PLN 32 million.

OTHER OPERATING EXPENSES	2017	2016
losses on sale or scrapping of property, plant and equipment, intangible assets and assets held for sale	(17)	(31)
donations	(23)	(31)
sundry expense	(16)	(18)
other	(41)	(35)
Total	**(97)**	**(115)**

13. NET IMPAIRMENT ALLOWANCE AND PROVISIONS

ACCOUNTING POLICIES

The accounting policies relating to the recognition of net impairment allowance and write-downs are discussed for the individual items in the notes indicated in the table below. Net impairment allowance and write-downs comprise impairment allowances and provisions recorded and released.

FINANCIAL INFORMATION

NET IMPAIRMENT ALLOWANCES AND PROVISIONS	Note	2017	2016
Available-for-sale investment securities	25	(64)	(52)
Loans and advances to customers	24	(1 389)	(1 466)
Non-current assets held for sale	27	(8)	148
Property, plant and equipment	28	(8)	(8)
Investments in subsidiaries, associates and joint ventures	38	(25)	(29)
Other receivables (other assets)		(12)	(10)
Provision for legal claims, lending commitments and guarantees granted	35	(22)	10
Provision for future liabilities (other provisions)	35	(2)	(1)
Total		**(1 530)**	**(1 408)**

14. ADMINISTRATIVE EXPENSES

ACCOUNTING POLICIES AND CLASSIFICATION

EMPLOYEE BENEFITS	Employee benefits comprise salaries and wages and social insurance (including contributions for retirement benefits, which are discussed in detail in the note "Provisions"), as well as costs of the employee pension scheme constituting a defined contribution scheme and the programme of variable remuneration components for persons occupying managerial positions, a part of which is recorded as a liability in respect of share-based payments settled in cash, in accordance with IFRS 2 Share-based payments (the programme of variable remuneration components has been discussed in detail in the note entitled "Benefits for the PKO Bank Polski SA key management"). The Employee Pension Programme (EPP) has been in place at the Bank since 2013. As part of the EPP (for employees who joined the Programme), the Bank accrues the basic contribution of 3% of the salary components on which social insurance contributions are accrued. Employees are entitled to declare additional contributions which are paid to the EPP by the Employer and deducted from the Employee's salary. EPP is managed by PKO Towarzystwo Funduszy Inwestycyjnych SA. Moreover, as part of wages and salaries the Bank creates a provision for future liabilities in respect of compensation and severance bonuses paid out to employees with whom the employment relationship is terminated for reasons not related to the employees; and accruals related to costs attributable to the current period, which will be incurred in the next period, including bonuses and holiday pay, taking account of all unused holiday.
OVERHEADS	The balance includes the following items: maintenance and lease of fixed assets, IT and telecommunications services, costs of administration, promotion and advertising, property protection and training. Lease payments under an operating lease and subsequent instalments are recognized as an expense in the income statement and are recognized on a straight-line basis over the lease term.
AMORTIZATION AND DEPRECIATION	Depreciation/amortization principles have been described in detail in the note "Intangible assets and property, plant and equipment".
CONTRIBUTION AND PAYMENTS TO THE BANK GUARANTEE FUND	According to IFRIC 21 Levies, fees paid by the Bank to the Bank Guarantee Fund are recognized in profit or loss upon the occurrence of the obligating event. In 2016, the Bank was obliged to make contributions comprising the annual fee and the prudential fee on a quarterly basis, therefore the respective costs were recognized in profit or loss on a quarterly basis. From 2017, the Bank makes contributions to the banks' guarantee fund (quarterly) and the banks' forced restructuring fund (annually). The obligation to make the contribution to the banks' forced restructuring fund arises on each 1 January; therefore, such contribution was recognized in the costs of the 1st quarter of 2017. Contributions to the guarantee fund and the forced restructuring fund are not tax-deductible.
TAXES AND FEES	The following items are recorded here: property tax, payments made to the State Fund for Rehabilitation of Disabled Persons, municipal and administration fees.

(IN PLN MILLION)

FINANCIAL INFORMATION

ADMINISTRATIVE EXPENSES	2017	2016
Employee benefits	(2 640)	(2 576)
Overheads	(1 218)	(1 228)
Amortization and depreciation	(727)	(722)
Contributions to the Bank Guarantee Fund (BGF)	(401)	(434)
Taxes and other charges	(51)	(50)
Costs of an additional contribution to BGF[1]	-	(24)
Total	**(5 037)**	**(5 034)**

[1] On 28 October 2016, the Bank was informed by the BGF that the Bank was obliged to make a compulsory contribution for the payment of guaranteed funds in respect of deposits maintained by the Cooperative Bank in Nadarzyn (Bank Spółdzielczy w Nadarzynie). On 28 October 2016, BGF published resolution no. 308/DGD/2016 of the BGF Management Board on the payment of guaranteed funds to holders of deposits with the Cooperative Bank in Nadarzyn and informed the Bank that it was obliged to make a contribution of PLN 24 million to BGF by 2 November 2016. The Bank made the payment on 2 November 2016.

The amount of the Bank's contribution to the guarantee fund for the year 2017 was PLN 192 million, and the amount of the contribution to the banks' forced restructuring fund was PLN 209 million. The mandatory contribution for 2016 amounted to PLN 295 million, and the prudential fee amounted to PLN 139 million.

EMPLOYEE BENEFITS	2017	2016
Wages and salaries, of which:	(2 214)	(2 155)
contributions to the employee pension plan	(47)	(46)
Social insurance, of which:	(359)	(348)
contributions to retirement and disability benefits	(234)	(285)
Other employee benefits	(67)	(73)
Total	**(2 640)**	**(2 576)**

OPERATING LEASE

The costs of operating lease on the part of the lessee are recognized in administrative expenses under overheads. Rental and lease contracts concluded by the Bank as part of its normal operating activities also meet the definition of operating lease. All contracts are concluded on an arm's length basis.

The lease and sub-lease payments recognized in the costs of a current period in 2017 amounted to PLN 234 million (in 2016 they amounted to PLN 242 million).

TOTAL FUTURE LEASE PAYMENTS UNDER IRREVOCABLE OPERATING LEASES	31.12.2017	31.12.2016
For a period:		
up to 1 year	210	226
from 1 to 5 years	367	429
over 5 years	93	137
Total	**670**	**792**

(IN PLN MILLION)

15. TAX ON CERTAIN FINANCIAL INSTITUTIONS

As of 1 February 2016, the Act of 15 January 2016 on tax on certain financial institutions came into force, which covered, among other things, banks and insurance companies. The tax is charged on the surplus of an entity's total assets above PLN 4 billion; in the case of banks, the assessment is based on the trial balance as at the end of each month. Banks are entitled to reduce the tax base by deducting such items as e.g. own funds or the value of Treasury securities. Additionally, banks reduce the tax base by the value of assets acquired from the NBP, constituting collateral of a refinancing loan granted by the NBP. The tax rate for all taxpayers is 0.0366% per month, and the tax is paid monthly by the 25th of the month following the month to which it relates. The tax was paid for the first time for February 2016. The tax paid is not tax-deductible for corporate income tax purposes.

	2017	2016
Tax on certain financial institutions	(894)	(820)

16. INCOME TAX

Accounting policies
Financial information:
- Income tax expense
- Reconciliation of the effective tax rate
- Deferred tax assets, net

ACCOUNTING POLICIES

Corporate income tax comprises current and deferred tax. The current income tax is recognized in the income statement. Deferred income tax, depending on the source of temporary differences, is recorded in the income statement or in other comprehensive income.

CURRENT INCOME TAX

Current income tax is calculated on the basis of gross accounting profit adjusted by non-taxable income, taxable income that does not constitute accounting income, non-tax deductible expenses and tax-deductible costs which are not accounting costs, in accordance with tax regulations. These items mainly include income and expenses relating to accrued interest receivable and payable, impairment allowances on receivables and provisions for off-balance sheet liabilities.

DEFERRED INCOME TAX

Deferred tax is recognized in the amount of the difference between the tax value of the assets and liabilities and their carrying amounts for the purpose of financial reporting. The Bank records deferred tax provisions and assets, which are recognized in the statement of financial position. Changes in the balance of deferred tax provisions and assets are recognized in mandatory charges to profit, with the exception of the effects of the measurement of available-for-sale financial assets, hedging instruments and actuarial gains and losses, which are recognized in other comprehensive income, where changes in the balance of deferred tax provisions and assets are recognized in other comprehensive income. In determining deferred income tax, the deferred tax assets and provisions as at the beginning and as at the end of the reporting period are taken into account.

The carrying amounts of deferred tax assets are verified at each balance sheet date and decreased adequately if it is no longer likely that taxable income sufficient to realize a deferred tax asset in part or in full will be earned.

(IN PLN MILLION)

Deferred tax assets and provisions are valued using the tax rates which are expected to be in force in the period in which the asset will crystallize or the provision will be utilized, based on the tax rates (and tax regulations) binding as at the balance sheet date or tax rates and tax regulations that as at the balance sheet date are believed to be binding in the future.

Deferred tax assets are offset by the Bank against deferred tax provisions only when it has an enforceable legal title to offset current income tax receivables against current income tax liabilities and deferred income tax is related to the same taxpayer and the same tax authority.

FINANCIAL INFORMATION

INCOME TAX EXPENSE

	2017	2016
Current income tax expense	(1 080)	(1 102)
Deferred income tax on temporary differences	69	269
Income tax expense recognized in the income statement	**(1 011)**	**(833)**
Income tax expense on temporary differences recognized in other comprehensive income	(146)	122
Total	**(1 157)**	**(711)**

RECONCILIATION OF THE EFFECTIVE TAX RATE

	2017	2016
Profit before income tax	3 785	3 721
Tax calculated using the enacted rate in force in Poland (19%)	(719)	(707)
Effect of permanent timing differences:	(301)	(181)
Tax on certain financial institutions	(170)	(156)
Contributions to BGF	(76)	(26)
Non-tax-deductible impairment allowances on loans and advances	(61)	(16)
Recognizing a non-tax-deductible impairment allowance on investments in subsidiaries, associates and joint ventures	(5)	(6)
Dividend income	25	31
Other permanent differences	(14)	(8)
Effect of other timing differences, including new technologies tax relief and donations	9	55
Income tax expense recognized in the income statement	**(1 011)**	**(833)**
Effective tax rate	**26,71%**	**22,39%**

According to regulations on expiration of tax liabilities, tax authorities can verify the correctness of income tax settlements within 5 years from the end of the accounting year in which the tax return should have been submitted.

The Bank's current corporate income tax liability for the year 2017 will be settled within the statutory deadlines.

DEFERRED TAX ASSETS, NET

DEFERRED TAX PROVISION	31.12.2016	Income statement	Other comprehensive income	31.12.2017
Interest accrued on receivables (loans)	237	(20)	-	217
Capitalized interest on performing housing loans	118	(12)	-	106
Interest on securities	43	18	-	61
Valuation of securities	-	(55)	62	7
Difference between carrying amount and tax value of property, plant and equipment and intangible fixed assets	329	(3)	-	326
Gross deferred tax provision	**727**	**(72)**	**62**	**717**
Deferred tax asset				
Interest accrued on liabilities	105	4	-	109
Valuation of derivatives	186	(45)	(3)	138
Valuation of securities	134	(53)	(81)	-
Provision for employee benefits	84	3	-	87
Impairment allowances on loan exposures	596	59	-	655
Adjustment of straight-line valuation method and effective interest rate	572	49	-	621
Provision for costs to be incurred	29	-	-	29
Other deductible temporary differences	55	(20)	-	35
Gross deferred tax asset	**1 761**	**(3)**	**(84)**	**1 674**
DEFERRED TAX ASSET (presented in the statement of financial position)	**1 034**	**69**	**(146)**	**957**

17. Earnings per share

EARNINGS PER SHARE	2017	2016
Net profit	2 774	2 888
Weighted average number of ordinary shares during the period (in million)	1 250	1 250
Earnings per share (in PLN per share)	**2,22**	**2,31**

In the years 2017 and 2016, there were no dilutive instruments. Therefore, the amount of diluted earnings per share is the same as the amount of basic earnings per share.

(IN PLN MILLION)

NOTES TO THE STATEMENTS OF FINANCIAL POSITION

18. CASH AND BALANCES WITH THE CENTRAL BANK

ACCOUNTING POLICIES

The item "Cash and balances with the Central Bank" presents cash recognized at nominal value, and funds in the current account and deposits with the Central Bank measured at amounts due, including interest on those funds.

FINANCIAL INFORMATION

CASH AND BALANCES WITH THE CENTRAL BANK	31.12.2017	31.12.2016
Current account with the Central Bank	11 171	7 444
Cash in hand	4 629	4 153
Deposits with the Central Bank	1 965	1 680
Total	**17 765**	**13 277**

During the course of the working day, the Bank may use funds from the obligatory reserve accounts for ongoing payments, on the basis of an instruction submitted to the National Bank of Poland (NBP). However, the Bank must ensure that the average monthly balance on this account complies with the requirements set in the obligatory reserve declaration.

Funds on the obligatory reserve account bear interest of 0.9 of the reference rate. As at 31 December 2017 and 2016, this interest rate was 1.35%.

19. AMOUNTS DUE FROM BANKS

ACCOUNTING POLICIES

Amounts due from banks comprise financial assets measured at amortized cost using the effective interest rate method, less potential impairment allowances, with the exception of cash in transit which is measured at nominal value. If no future cash flow schedule can be determined for a financial receivable, and thus the effective interest rate cannot be determined, the receivable is measured at the amount due.

Buy-sell-back securities are recognized as amounts due from banks, if the counterparty is a bank. Buy-sell-back transactions are measured at amortized cost. The difference between the buy and repurchase (sell) price is treated as interest income and settled over the period of the contract using the effective interest rate.

(IN PLN MILLION)

FINANCIAL INFORMATION

AMOUNTS DUE FROM BANKS	31.12.2017	31.12.2016
Deposits with bank	3 724	3 851
Amount due from PKO Bank Hipoteczny SA in respect of the sale of mortgage-secured housing loans by the Bank	2 498	3 038
Current accounts	1 041	429
Loans and advances granted	1 506	492
Receivables in respect of repurchase agreements	-	661
Gross total	**8 769**	**8 471**
Net total	**8 769**	**8 471**

AMOUNTS DUE FROM BANKS - EXPOSURE TO CREDIT RISK	Exposure	
	31.12.2017	31.12.2016
Amounts due form banks not impaired, not past due	8 769	8 471
Gross total	**8 769**	**8 471**
Net total	**8 769**	**8 471**

20. FINANCIAL ASSETS HELD FOR TRADING EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS

ACCOUNTING POLICIES

The Bank classifies to this category financial instruments acquired or drawn mainly for the purpose of sale or redemption in the short term, the Bank's so-called trading portfolio and instruments in the portfolio of the Brokerage House. They are measured at fair value, both on initial recognition and on subsequent valuation, and the effects of the valuation are recognized in profit or loss. The Bank also recognizes derivative financial instruments as financial assets held for trading (presented in a separate note), excluding derivatives classified as cash flow hedges.

FINANCIAL INFORMATION

FINANCIAL ASSETS HELD FOR TRADING, EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS	31.12.2017	31.12.2016
Debt securities	446	344
Treasury bonds in PLN	151	186
Treasury bonds in foreign currencies	138	6
municipal bonds in PLN	23	42
corporate bonds in PLN	94	76
corporate bonds in foreign currencies	1	2
covered bonds	39	32
Shares in other entities - listed	19	11
Investment certificates, rights to shares, pre-emptive rights	7	3
Total	**472**	**358**

The item "Treasury bonds in PLN and in foreign currencies" comprises bonds issued by the State Treasury of the Republic of Poland.

(IN PLN MILLION)

DEBT SECURITIES BY MATURITY (AT CARRYING AMOUNTS)	31.12.2017	31.12.2016
up to 1 month	9	20
1 to 3 months	6	-
3 months to 1 year	48	66
1 to 5 years	290	146
over 5 years	93	112
Total	**446**	**344**

21. Derivative financial instruments

Accounting policies

In the course of its activities, the Bank uses derivative financial instruments designated for the purpose of managing the risks associated with its operations. The most frequently used derivative instruments include: IRS, CIRS, FX Swap, options, commodity swap, FRA, Forward and Futures.

Derivative financial instruments are recognized at fair value from the transaction date. A derivative instrument is presented under "Derivative financial instruments" as an asset if its fair value is positive, and as a liability if its fair value is negative.

The Bank recognizes changes in the fair values of derivative instruments not classified as cash flow hedges and the result on the settlement of those instruments in the result on financial instruments measured at fair value through profit or loss, or in net foreign exchange gains, depending on the type of derivative.

Embedded derivative instruments

With respect to embedded derivatives, the Bank assesses whether a given contract contains an embedded derivative instrument as at the moment of concluding the contract. A reassessment can only be made when there is a change in the terms of the contract that significantly modifies the cash flows resulting from the contract. Derivative instruments separated from host contracts and recognized separately in the books of account are measured at fair value. Valuation is presented in the statement of financial position under "Derivative financial instruments". Changes in the fair value measurement of derivative instruments are recorded in the income statement under the item "Net gain/(loss) on financial instruments measured at fair value" or "Net foreign exchange gains/(losses)".

Estimates and judgements

The fair value of non-option derivatives is determined using valuation models based on discounted cash flows expected to be received from the given financial instrument. Options are valued using option pricing models. The variables and assumptions used in a valuation include, where available, data derived from observable markets.

The fair value of derivatives includes the Bank's own credit risk, DVA (debit value adjustment) as well as counterparty credit risk, CVA (credit value adjustment). The process of calculation of CVA and DVA adjustments includes the selection of method determining the spread of the counterparty's or the Bank's credit risk (e.g. a market price method based on the continuous price quotations of debt instruments issued by the counterparty, a method of spread implied from Credit Default Swap contracts), an estimation of the probability of default by the counterparty or the Bank and the recovery rate, and calculation of the amount of CVA and DVA adjustments.

(IN PLN MILLION)

The valuation techniques used by the Bank for non-option derivative instruments are based on yield curves based on available market data (deposit margins on interbank market, IRS quotations).

FINANCIAL INFORMATION

DERIVATIVE FINANCIAL INSTRUMENTS	31.12.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
Hedging instruments	1 104	204	382	1 163
Other derivative instruments	1 701	2 537	2 513	3 066
Total	**2 805**	**2 741**	**2 895**	**4 229**

TYPE OF CONTRACT	31.12.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
IRS	966	1 420	1 388	2 098
CIRS	1 091	230	570	1 422
FX SWAP	161	380	205	164
Options	243	250	443	341
Commodity swap	129	128	97	96
FRA	1	1	2	2
Forward	206	324	177	106
Futures	7	8	-	-
Other	1	-	13	-
Total	**2 805**	**2 741**	**2 895**	**4 229**

(IN PLN MILLION)

NOMINAL AMOUNTS OF UNDERLYING INSTRUMENTS BY MATURITY (BOTH SALE AND PURCHASE) AS AT 31.12.2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Interest rate transactions						
Cap Floor Collar Swaption	-	-	**154**	**442**	**131**	**727**
Purchase	-	-	43	221	65	329
Sale	-	-	111	221	66	398
IRS	**12 318**	**21 090**	**73 808**	**162 768**	**29 044**	**299 028**
Purchase	6 159	10 545	36 904	81 384	14 522	149 514
Sale	6 159	10 545	36 904	81 384	14 522	149 514
FRA	**1 663**	**1 000**	**8 400**	**500**	-	**11 563**
Purchase	1 352	-	3 300	250	-	4 902
Sale	311	1 000	5 100	250	-	6 661
Interest rate futures	-	**1**	**4**	**2**	-	**7**
Purchase	-	1	3	2	-	6
Sale	-	-	1	-	-	1
Transactions in equity securities						
Equity options	**98**	**82**	**185**	**82**	-	**447**
Purchase	49	41	93	41	-	224
Sale	49	41	92	41	-	223
FX transactions						
Forward	**5 557**	**5 482**	**9 860**	**6 304**	**6**	**27 209**
Purchase of foreign currencies	2 776	2 742	4 905	3 102	3	13 528
Sale of foreign currencies	2 781	2 740	4 955	3 202	3	13 681
FX swap	**32 286**	**7 203**	**2 435**	**1 227**	-	**43 151**
Purchase of foreign currencies	16 104	3 530	1 218	627	-	21 479
Sale of foreign currencies	16 182	3 673	1 217	600	-	21 672
CIRS	-	-	**2 365**	**38 201**	**22 082**	**62 648**
Purchase of foreign currencies	-	-	1 178	19 352	11 213	31 743
Sale of foreign currencies	-	-	1 187	18 849	10 869	30 905
FX options	**2 100**	**8 579**	**29 007**	**3 620**	-	**43 306**
Purchase of foreign currencies	973	4 381	15 380	1 839	-	22 573
Sale of foreign currencies	1 127	4 198	13 627	1 781	-	20 733
Transactions in precious metals and commodities	**1 138**	**1 332**	**1 403**	**667**	-	**4 540**
Purchase	569	666	702	334	-	2 271
Sale	569	666	701	333	-	2 269
Other	**946**	-	-	-	-	**946**
Purchase	5	-	-	-	-	5
Sale	941	-	-	-	-	941
Total derivatives	56 106	44 769	127 621	213 813	51 263	493 572

(IN PLN MILLION)

NOMINAL AMOUNTS OF UNDERLYING INSTRUMENTS BY MATURITY (BOTH SALE AND PURCHASE) AS AT 31.12.2016						
	up to 1 month	1 to 3 months	3 months to 1 year	between 1 and 5 years	over 5 years	Total
Interest rate transactions						
Cap Floor Collar Swaption	**-**	**259**	**-**	**916**	**148**	**1 323**
Purchase	-	-	-	458	74	532
Sale	-	259	-	458	74	791
IRS	**5 968**	**18 128**	**121 250**	**164 722**	**37 828**	**347 896**
Purchase	2 984	9 064	60 625	82 361	18 914	173 948
Sale	2 984	9 064	60 625	82 361	18 914	173 948
FRA	**-**	**-**	**18 477**	**1 250**	**-**	**19 727**
Purchase	-	-	7 087	500	-	7 587
Sale	-	-	11 390	750	-	12 140
Interest rate futures	**-**	**1**	**400**	**-**	**-**	**401**
Purchase	-	-	400	-	-	400
Sale	-	1	-	-	-	1
Transactions in equity securities						
Equity futures	**15**	**-**	**-**	**-**	**-**	**15**
Purchase	8	-	-	-	-	8
Sale	7	-	-	-	-	7
Equity options	**-**	**57**	**202**	**371**	**-**	**630**
Purchase	-	55	127	133	-	315
Sale	-	2	75	238	-	315
FX transactions						
Forward	**5 921**	**3 679**	**9 115**	**4 655**	**12**	**23 382**
Purchase of foreign currencies	2 972	1 833	4 555	2 301	6	11 667
Sale of foreign currencies	2 949	1 846	4 560	2 354	6	11 715
FX swap	**23 514**	**5 908**	**8 404**	**1 563**	**-**	**39 389**
Purchase of foreign currencies	11 771	2 962	4 214	795	-	19 742
Sale of foreign currencies	11 743	2 946	4 190	768	-	19 647
CIRS	**3 605**	**2 550**	**1 722**	**22 389**	**12 732**	**42 998**
Purchase of foreign currencies	1 734	1 275	861	10 706	6 508	21 084
Sale of foreign currencies	1 871	1 275	861	11 683	6 224	21 914
FX options	**990**	**1 957**	**21 111**	**4 473**	**-**	**28 531**
Purchase of foreign currencies	613	1 062	10 762	2 506	-	14 943
Sale of foreign currencies	377	895	10 349	1 967	-	13 588
Transactions in precious metals and commodities	**997**	**512**	**1 027**	**863**	**-**	**3 399**
Purchase	499	256	514	432		1 701
Sale	498	256	513	431		1 698
Other	**2 079**	**-**	**-**	**-**	**-**	**2 079**
Purchase	-	-	-	-	-	-
Sale	2 079	-	-	-	-	2 079
Total derivatives	**43 089**	**33 051**	**181 708**	**201 202**	**50 720**	**509 770**

CALCULATION OF ESTIMATES

The Bank conducted a simulation to assess the potential influence of changes in the yield curves on the transaction value.

ESTIMATED CHANGE IN VALUATION FOLLOWING A PARALLEL MOVEMENT IN YIELD CURVES:	31.12.2017		31.12.2016	
	+50 bp scenario	-50 bp scenario	+50 bp scenario	-50 bp scenario
IRS	(84)	85	(120)	122
CIRS	(74)	76	(31)	32
other instruments	7	(7)	(4)	4
Total	**(151)**	**154**	**(155)**	**158**

As at 31 December 2017, the amount of CVA and DVA adjustments amounted to PLN 2 million (as at 31 December 2016 PLN 7 million).

22. DERIVATIVE HEDGING INSTRUMENTS

ACCOUNTING POLICIES

THE USE OF HEDGE ACCOUNTING

The Bank applies hedge accounting when all the terms and conditions below have been met:

1) upon setting up the hedge, a hedge relationship, the hedging relationship, the purpose of risk management by the entity and the hedging strategy were officially established and documented,
2) the hedge is expected to be highly effective,
3) the planned hedged transaction must be highly probable and must be exposed to the variability of cash flows which may, as a result, have an impact on the income statement,
4) the effectiveness of the hedge may be reliably assessed,
5) the hedge is regularly assessed and its high effectiveness is confirmed in all the reporting periods for which the hedge had been designated.

As at 31 December 2017, the Bank applied fair value hedge accounting. As at 31 December 2016, it did not apply such hedging.

DISCONTINUATION OF HEDGE ACCOUNTING:

- A HEDGE INSTRUMENT EXPIRES, IS SOLD, RELEASED OR EXERCISED – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective are recognized in a separate item in other comprehensive income until the planned transaction occurs;
- THE HEDGE CEASES TO MEET THE HEDGE ACCOUNTING CRITERIA – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective are recognized in a separate item in other comprehensive income until the planned transaction occurs;
- THE PLANNED TRANSACTION IS NO LONGER CONSIDERED PROBABLE – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective, are recognized in the income statement;
- THE HEDGING RELATIONSHIP CEASED TO BE VALID – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective are recognized in a separate item in other comprehensive income until the planned transaction occurs.

CASH FLOW HEDGE

Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognized directly in other comprehensive income in respect of the portion constituting the effective portion of the hedge. The ineffective portion of a hedge is recognized in the income statement in the item “Net gain/(loss) on financial instruments measured at fair value” or “Net foreign exchange gains (losses)”.

Amounts transferred directly to other comprehensive income are transferred to the income statement in the same period or periods in which the hedged planned transaction affects the income statement. Interest and foreign exchange gains/losses are shown in the income statement, in “Net interest income” and “Net foreign exchange gains (losses)”, respectively.

The effectiveness tests comprise the valuation of hedging transactions, net of interest accrued and foreign exchange gains (losses) on the nominal value of the hedging transactions (in the case of CIRS transactions). Hedge effectiveness is verified through the use of prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.

FAIR VALUE HEDGES

Changes in the fair value of a derivative hedging instrument designated as fair value hedge are recognized in "Net income from financial instruments designated at fair value", net of the interest component. The interest component is presented in the same line item as interest income on the hedged item, i.e. in "Net interest income". A change in the adjustment of the measurement of a hedged item at fair value is recognized in "Net gain/(loss) on financial instruments measured at fair value".

The effectiveness tests comprise the measurement of hedging transactions net of accrued interest. Hedge effectiveness is verified through the use of prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.

TYPES OF HEDGING STRATEGIES APPLIED BY THE BANK

STRATEGY 1	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN CHF AND NEGOTIATED TERM DEPOSITS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING CIRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate loans denominated in CHF and negotiated term deposits in PLN, resulting from fluctuations in reference interest rates in CHF and PLN, and changes in CHF/PLN foreign exchange rates using CIRS transactions during the hedged period
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Bank pays coupons based on 3M CHF LIBOR, and receives coupons based on 3M WIBOR on the nominal value defined in CHF and PLN respectively
HEDGED ITEM	the portfolio of floating interest mortgage loans in CHF and the portfolio of short-term negotiated term deposits, including their future renewals (high probability of occurrence)
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – October 2026

STRATEGY 2	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate PLN loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS transactions where the Bank pays coupons based on floating 3M WIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of loans in PLN indexed to the floating 3M WIBOR rate
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – December 2021

STRATEGY 3	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN CHF, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate CHF loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS transactions where the Bank pays coupons based on floating 3M CHF LIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of loans in CHF indexed to the floating 3M CHF LIBOR rate
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – November 2021

STRATEGY 4	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN FOREIGN CURRENCIES, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND FROM FOREIGN EXCHANGE RATE RISK AND HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FIXED INTEREST RATE FINANCIAL LIABILITY IN A FOREIGN CURRENCY, RESULTING FROM FOREIGN EXCHANGE RATE RISK, USING CIRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of fluctuations in cash flows from floating interest rate loans in foreign currencies, resulting from the risk of fluctuations in interest rates and from foreign exchange rate risk and elimination of the risk of fluctuations in cash flows from fixed interest rate financial liability in a foreign currency, resulting from foreign exchange rate risk, using CIRS transactions in the hedged period
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Bank pays coupons based on floating 3M CHF LIBOR rate, and receives coupons based on a USD or EUR fixed rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of floating interest rate mortgage loans denominated in CHF and fixed interest rate financial liability denominated in USD
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – September 2022

STRATEGY 5	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN FOREIGN CURRENCIES OTHER THAN CHF AND NEGOTIATED TERM DEPOSITS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING CIRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate loans denominated in foreign currencies other than CHF and negotiated term deposits in PLN, resulting from fluctuations in reference interest rates and changes in foreign exchange rates using CIRS transactions during the hedged period
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Bank pays coupons based on 3M EURIBOR rate, and receives coupons based on WIBOR 3M rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of floating interest mortgage loans in EUR and the portfolio of short-term negotiated deposits, including their future renewals (high probability of occurrence)
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – March 2021

STRATEGY 6	HEDGING AGAINST CHANGES IN CASH FLOWS ASSOCIATED WITH MORTGAGE LOANS IN FOREIGN CURRENCIES AND DEPOSITS NEGOTIATED IN PLN, RESULTING FROM INTEREST RATE AND FOREIGN EXCHANGE RISK, WITH THE USE OF TWO HEDGING INSTRUMENTS: IRS AND CIRS-EP
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of changes in cash flows generated by mortgage loans denominated in foreign currencies and deposits negotiated in PLN, resulting from changes in reference interest rates and changes in foreign exchange rates, with the use of two hedging instruments: IRS and CIRS-EP, in the period covered by hedging
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS-EP (Cross-Currency Interest Rate Swap – Extension Period) transactions with extended maturities, where the Bank pays coupons based on a fixed rate in EUR and receives coupons based on a variable WIBOR 3M reference rate on the nominal amount, and IRS transactions, where the Bank pays coupons based on a variable EURIBOR 3M rate and receives coupons based on a fixed EUR rate on the nominal amount. In the event of bankruptcy of the underlying entity (the entity whose bankruptcy is monitored as part of the transaction), the CIRS-EP transaction is extended automatically on the terms and conditions defined on the date of concluding the transaction
HEDGED ITEM	the portfolio of floating interest mortgage loans in EUR and the portfolio of short-term negotiated deposits, including their future renewals (high probability of occurrence)
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – February 2024

STRATEGY 7	HEDGING AGAINST CHANGES IN CASH FLOWS ASSOCIATED WITH MORTGAGE LOANS IN FOREIGN CURRENCIES AND DEPOSITS NEGOTIATED IN PLN, RESULTING FROM INTEREST RATE AND FOREIGN EXCHANGE RISK, WITH THE USE OF TWO HEDGING INSTRUMENTS: CIRS AND CIRS-EP
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of changes in cash flows generated by mortgage loans denominated in foreign currencies and deposits negotiated in PLN, resulting from changes in reference interest rates and changes in foreign exchange rates, with the use of two hedging instruments: CIRS and CIRS-EP, in the period covered by hedging
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS-EP (Cross-Currency Interest Rate Swap – Extension Period) transactions with extended maturities, where the Bank pays coupons based on a fixed rate in EUR and receives coupons based on a variable WIBOR 3M reference rate on the nominal amount, and CIRS transactions, where the Bank pays coupons based on a variable LIBOR CHF 3M rate and receives coupons based on a fixed EUR rate on the nominal amount. In the event of bankruptcy of the underlying entity (the entity whose bankruptcy is monitored as part of the transaction), the CIRS-EP transaction is extended automatically on the terms and conditions defined on the date of concluding the transaction
HEDGED ITEM	the portfolio of floating interest mortgage loans in CHF and the portfolio of short-term negotiated term deposits, including their future renewals (high probability of occurrence)
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – January 2023

STRATEGY 8	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN FOREIGN CURRENCIES AND REGULAR SAVINGS PRODUCTS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING CIRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate loans denominated in CHF and floating interest rate regular savings products in PLN, resulting from fluctuations in reference interest rates in CHF and PLN, and changes in CHF/PLN foreign exchange rates using CIRS transactions during the hedged period
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Bank pays coupons based on 3M CHF LIBOR, and receives coupons based on 3M WIBOR on the nominal value defined in CHF and PLN respectively
HEDGED ITEM	the portfolio of floating interest rate mortgage loans in CHF and the portfolio of floating interest rate regular savings products in PLN
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – July 2023

STRATEGY 9	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN FOREIGN CURRENCIES AND REGULAR SAVINGS PRODUCTS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING TWO HEDGING INSTRUMENTS: CIRS AND CIRS-EP
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of changes in cash flows generated by floating interest rate mortgage loans denominated in foreign currencies and regular savings products in PLN, resulting from changes in reference interest rates and changes in foreign exchange rates, with the use of two hedging instruments: CIRS and CIRS-EP, in the period covered by hedging
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS-EP (Cross-Currency Interest Rate Swap – Extension Period) transactions with extended maturities, where the Bank pays coupons based on a fixed rate in EUR and receives coupons based on a variable WIBOR 3M reference rate on the nominal amount, and CIRS transactions, where the Bank pays coupons based on a variable LIBOR CHF 3M rate and receives coupons based on a fixed EUR rate on the nominal amount. In the event of bankruptcy of the underlying entity (the entity whose bankruptcy is monitored as part of the transaction), the CIRS-EP transaction is extended automatically on the terms and conditions defined on the date of concluding the transaction
HEDGED ITEM	the portfolio of floating interest rate mortgage loans in CHF and the portfolio of floating interest rate regular savings products in PLN
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – August 2024

STRATEGY 10	HEDGES AGAINST FLUCTUATIONS IN THE FAIR VALUE OF FIXED INTEREST LOANS IN FOREIGN CURRENCIES, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of fluctuations in the fair value of fixed interest loans in foreign currencies, resulting from the risk of fluctuations in interest rates, during the hedged period.
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS (Interest Rate Swap) transactions in foreign currencies, where the Bank pays coupons based on a fixed rate (the market IRS rate) and receives coupons based on a floating reference rate without an additional margin
HEDGED ITEM	a component of the interest rate risk relating to a fixed interest rate loan in a foreign currency, which corresponds to the market IRS rate

In 2017, the Bank introduced Strategies 7, 8 and 9, which concern cash flow hedging, and Strategy 10, which concerns fair value hedging. These strategies are described above.

(IN PLN MILLION)

FINANCIAL INFORMATION

CARRYING AMOUNT OF HEDGING INSTRUMENTS	31.12.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
Cash flow hedges				
Hedges of interest rate risk	90	35	90	32
IRS	90	35	90	32
Hedges of currency and interest rate risks	1 014	169	292	1 131
CIRS	1 014	169	292	1 131
Total	**1 104**	**204**	**382**	**1 163**

NOMINAL VALUE OF HEDGING INSTRUMENTS BY MATURITY AS AT 31 DECEMBER 2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Cash flow hedges						
Hedges of interest rate risk						
IRS PLN fixed - float	700	1 610	3 030	2 806	-	**8 146**
IRS EUR fixed - float (original currency)	-	-	-	499	25	**524**
IRS CHF fixed - float (original currency)	-	-	-	400	-	**400**
Hedges of currency and interest rate risks						
CIRS float CHF/float PLN						
float CHF	-	-	95	1 750	150	**1 995**
float PLN	-	-	325	6 329	573	**7 227**
CIRS fixed USD/float CHF						
fixed USD	-	-	-	875	-	**875**
float CHF	-	-	-	818	-	**818**
CIRS float EUR/float PLN						
float EUR	-	-	-	125	-	**125**
float PLN	-	-	-	545	-	**545**
CIRS float PLN/fixed EUR						
float PLN	-	-	-	2 383	4 374	**6 757**
fixed EUR	-	-	-	553	1 024	**1 577**
CIRS fixed EUR/float CHF						
fixed EUR	-	-	-	802	999	**1 801**
float CHF	-	-	-	889	1 112	**2 001**
Fair value hedges						
Hedges of interest rate risk						
IRS EUR fixed - float (original currency)	-	-	-	46	-	**46**

NOMINAL VALUE OF HEDGING INSTRUMENTS BY MATURITY AS AT 31 DECEMBER 2016	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Cash flow hedges						
Hedges of interest rate risk						
IRS PLN fixed - float	-	250	9 030	6 846	-	**16 126**
IRS EUR fixed - float (original currency)	-	-	-	-	499	**499**
Hedges of currency and interest rate risks						
CIRS float CHF/float PLN						
float CHF	300	-	-	1 720	25	**2 045**
float PLN	1 098	-	-	6 171	88	**7 357**
CIRS fixed USD/float CHF					-	
fixed USD	-	-	-	-	875	**875**
float CHF	-	-	-	-	815	**815**
CIRS float EUR/float PLN					-	
float EUR	-	-	-	125	-	**125**
float PLN	-	-	-	545	-	**545**
CIRS float PLN/fixed EUR						
float PLN	-	-	-	-	499	**499**
fixed EUR	-	-	-	-	2 155	**2 155**

(IN PLN MILLION)

CHANGE IN OTHER COMPREHENSIVE INCOME RELATING TO CASH FLOW HEDGE AND INEFFECTIVE PORTION OF CASH FLOW HEDGES	2017	2016
Other comprehensive income at the beginning of the period, gross	(109)	**(71)**
Gains/losses recognized in other comprehensive income during the period	2 162	(64)
Amounts transferred from other comprehensive income to the cash flow statement, of which:	(2 144)	26
- interest income	(408)	(348)
- net foreign exchange gains/(losses)	(1 736)	374
Other comprehensive income at the end of the period, gross	**(91)**	**(109)**
Tax effect	16	20
Other comprehensive income at the end of the period, net	**(75)**	**(89)**
Impact on other comprehensive income during the period, gross	**18**	**(38)**
Tax effect	(4)	7
Impact on other comprehensive income during the period, net	**14**	**(31)**
Ineffective portion of cash flow hedges recognized in the income statements, including in:	**6**	**(11)**
Net foreign exchange gains/(losses)	3	(2)
Net gain/(loss) on financial instruments measured at fair value	3	(9)

GAINS OR LOSSES ON HEDGING INSTRUMENTS AND HEDGED ITEMS ATTRIBUTABLE TO HEDGED RISKS	31.12.2017	31.12.2016
Hedges of interest rate risk	**(1)**	-
Fair value measurement of the hedging derivative instrument	-	-
IRS EUR fixed - float	-	-
Fair value adjustment of the hedged instrument attributable to the hedged risk	(1)	-
Loans in EUR fixed	(1)	-

CALCULATION OF ESTIMATES

ESTIMATED CHANGE IN VALUATION FOLLOWING A PARALLEL MOVEMENT IN YIELD CURVES:	31.12.2017		31.12.2016	
	+50 bp scenario	-50 bp scenario	+50 bp scenario	-50 bp scenario
IRS	(107)	109	(143)	147
CIRS	(74)	75	(31)	32
Total	**(181)**	**184**	**(174)**	**179**

(IN PLN MILLION)

23. FINANCIAL INSTRUMENTS DESIGNATED UPON INITIAL RECOGNITION AT FAIR VALUE THROUGH PROFIT AND LOSS

ACCOUNTING POLICIES

The Bank classifies a financial instrument in this category when:

1) it is a combined instrument containing one or more embedded derivatives that qualify for separate recognition, provided, however, that the embedded derivative does not change the cash flows resulting from the host contract significantly or the derivative cannot be separated;
2) such classification of an instrument eliminates or significantly reduces the inconsistency in measurement or recognition (the so-called accounting mismatch resulting from different measurement methods for assets and liabilities and different recognition of the related gains or losses), e.g. financial instruments economically hedged without applying hedge accounting;
3) the results on a group of financial instruments are assessed on a fair value basis, pursuant to the Bank's risk management principles or investment strategy.

The Bank has a policy of financial assets and liabilities management according to which financial assets and liabilities classified as held for trading portfolio and financial assets and liabilities designated upon initial recognition at fair value through the profit or loss portfolio are managed separately.

Financial instruments classified in this category are designated at fair value with changes in fair value recognized in profit and loss, in net income from financial instruments designated at fair value.

FINANCIAL INFORMATION

FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION AS AT 31.12.2017	31.12.2017	31.12.2016
NBP money market bills	4 199	8 999
Treasury bonds (in PLN)	1 134	1 432
Treasury bonds (in foreign currencies)	893	1 075
municipal bonds (in PLN)	106	111
corporate bonds (in foreign currencies)	77	127
TOTAL	**6 409**	**11 744**

The item “Treasury bonds in PLN and in foreign currencies” comprises bonds issued by the State Treasury of the Republic of Poland.

DEBT SECURITIES BY MATURITY (AT CARRYING AMOUNTS)	31.12.2017	31.12.2016
up to 1 month	4 199	8 999
1 to 3 months	106	-
3 months to 1 year	1 065	-
1 to 5 years	1 039	2 701
over 5 years	-	44
Total	**6 409**	**11 744**

24. LOANS AND ADVANCES TO CUSTOMERS

ACCOUNTING POLICIES

Loans and advances to customers include financial assets which are not derivatives, with determined or possible to be determined payments, which are not quoted on an active market. The group includes loans and advances granted, corporate and municipal debt securities which based on the entity's decision are classified to this category and receivables due from repurchase agreements, where the bank is not a counterparty to the transaction.

At initial recognition they are measured at fair value plus transaction costs, which can be directly attributed to the purchase or issuance of a financial asset.

After initial recognition, these assets are measured at amortized cost using the effective interest rate method, less impairment allowances. In the case of loans and advances for which it is not possible to reliably estimate the schedule of future cash flows and the effective interest rate, they are measured at the amount due.

Buy-sell-back securities are recognized under amounts due from banks or loans and advances to customers, depending on the counterparty to the transaction. Receivables due from repurchase agreements are measured at amortized cost. The difference between the sale price and the repurchase price is recognized as interest expense/income respectively and is settled over the term of the contract using the effective interest rate.

Loans and advances to customers also include an adjustment for hedging accounting of fair value for loans disclosed in the hedged item in Strategy 10 "Hedging the fair value volatility of fixed-rate loans in convertible currencies resulting from the risk of changes in interest rates using IRS transactions" (Note "Derivative hedging instruments").

ESTIMATES AND JUDGEMENTS – IMPAIRMENT ALLOWANCES

An impairment loss is incurred when there is objective evidence of impairment due to one or more events that occurred after the initial recognition of the asset ("a loss event"), and the event has a reliably measurable impact on the expected future cash flows from the financial asset or a group of financial assets. Future cash flows are assessed by the Bank on the basis of estimates based on historical parameters.

The Bank performs a monthly review of loan exposures in order to identify loan exposures exposed to potential impairment, measure the impairment of loan exposures and recognize impairment allowances on loans and advances or provisions for off-balance sheet exposures.

The process of determining impairment allowances on loans and advances and provisions includes the following stages:

- identifying impairment triggers and events significant from the perspective of identifying those triggers,
- registering in the Bank's IT systems the events that are significant from the perspective of identifying impairment triggers on loan exposures,
- determining the method of measuring impairment,
- measuring impairment and determining an impairment allowance or provision,

- verifying and aggregating the results of the impairment measurement,
- recording the results of impairment measurement.

The method of determining the amount of impairment allowances depends on the type of impairment triggers identified and the individual significance of a given loan exposure. The loss events considered as impairment triggers are, in particular, as follows:

- breach of the contract by the debtor, i.e. for example, delay in the payment of principal or interest longer than 90 days (when determining the loan overdue period, the Bank takes into account the amounts of overdue interest or principal instalments exceeding the fixed threshold values),
- a decline in the debtor's rating to a level indicating a significant threat to the repayment of debt (with respect to non-financial clients 'H1' rating, with respect to financial institutions – G, H rating) resulting from significant financial difficulties of the debtor,
- entering into a restructuring agreement or granting a concession concerning debt repayment (the impairment trigger is recognized, if the concessions are granted to the client for economic or legal reasons resulting from financial difficulties),
- high probability of bankruptcy or reorganization of the debtor,
- the debt being declared as due and payable,
- enforcement proceedings against the debtor,
- declaration of the debtor's bankruptcy or filling a motion to declare bankruptcy,
- the amount of the debt being challenged by the debtor,
- commencement of corporate recovery proceedings against the debtor,
- establishing imposed administration over the debtor or suspending the debtor's activities,
- additional impairment triggers identified for exposures to housing cooperatives arising from housing loans of the so-called 'old portfolio', covered by State Treasury guarantees.

The Bank categorizes its loans and advances based on the exposure amounts. PKO Bank Polski SA applies three methods of estimating impairment:

- individual basis applied in respect of individually significant loans, for which the objective evidence of impairment was identified or requiring individual assessment due to the specifics of the transactions and resulting from events determining the repayment of exposure. In the portfolio of individually significant loan exposures, each individual loan exposure is subject to individual assessment of impairment triggers and the level of recognized loss.
- portfolio basis applied in respect of individually insignificant loans, for which objective evidence of individual impairment was identified. For individually insignificant exposures recognition and measurement of loss are made using portfolio risk parameters estimated with statistical methods. If loss is recognized for an individual loan exposure, the adequate impairment allowance is recognized.
- group basis (IBNR) applied in respect of the loans, for which objective evidence of impairment was not identified, but there is a possibility of losses being incurred but not recognized. If for individual loan exposure a loss is not recognized, the exposure is classified to a portfolio of assets with similar characteristics which is assessed on a group basis and is subject to impairment allowance set up for the given group due to incurred but not reported losses (IBNR allowance).

Loan exposures, in respect of which no objective evidence of individual impairment was identified, or in spite of their occurrence no impairment loss was recognized, are assessed for impairment on a basis of exposures with the same characteristics.

Impairment allowance in respect of a loan exposure corresponds to the difference between the carrying amount of the exposure and the present value of the expected future cash flows from a given exposure:

(IN PLN MILLION)

- while assessing impairment allowances on an individual basis, the expected future cash flows are estimated for each loan exposure individually, taking into account the possible scenarios relating to contract execution, weighted by the probability of their realization;
- an impairment allowance in respect of loan exposures assessed on a portfolio basis or a group basis corresponds to the difference between the carrying amount of the exposures and the present value of the expected future cash flows (excluding future credit losses that have not been incurred).

Future cash flows of a group of financial assets assessed for impairment on a collective basis are estimated on the basis of cash flows generated from loan agreements and historical recovery parameters generated from assets with similar risk characteristics.

Historical recovery parameters are adjusted on the basis of data from current observations to take into account the impact of current conditions and exclude factors that were relevant in the past but which currently do not occur. In subsequent periods if the amount of impairment loss is reduced because of an event subsequent to the impairment loss being recognized (e.g. improvement in the debtor's credit rating), the impairment loss that was previously recognized is reversed by making an appropriate adjustment to the impairment allowances balance. The amount of the reversal is recognized in the income statement.

IBNR allowance is estimated using the portfolio parameters. These parameters are estimated for the group of exposures with the same risk characteristics.

The calculation of the present value of estimated cash flows relating to financial assets for which collateral is held takes into account cash flows arising from the foreclosure of the collateral, less costs to foreclose and sell.

The Bank plans that the adopted methodology used for estimating impairment allowances will be developed in line with the further possibilities of gathering information on impairment from the existing and implemented applications and information systems. As a consequence, new data obtained could influence the level of impairment allowances in the future.

The methodology and assumptions used in the estimates are reviewed on a regular basis to minimize the differences between the estimated and actual loss amount.

FINANCIAL INFORMATION

LOANS AND ADVANCES TO CUSTOMERS	31.12.2017 Net	31.12.2016 Net
Loans and advances to customers (excluding adjustments relating to fair value hedge accounting)	186 893	189 067
Adjustment relating to fair value hedge accounting	(1)	-
Total loans and advances to customers	**186 892**	**189 067**

LOANS AND ADVANCES TO CUSTOMERS BY PRODUCT TYPE (excluding adjustments relating to fair value hedge accounting)	31.12.2017			31.12.2016		
	Gross	Impairment allowances	Net	Gross	Impairment allowances	Net
Loans	**188 783**	**(7 160)**	**181 623**	**190 100**	**(7 243)**	**182 857**
housing	92 134	(1 925)	90 209	100 010	(2 144)	97 866
corporate	70 719	(3 580)	67 139	65 810	(3 667)	62 143
consumer	25 930	(1 655)	24 275	24 280	(1 432)	22 848
Debt securities	**4 378**	**(10)**	**4 368**	**4 948**	**(77)**	**4 871**
Debt securities (corporate)	1 859	(4)	1 855	2 352	(69)	2 283
Debt securities (municipal)	2 519	(6)	2 513	2 596	(8)	2 588
Receivables in respect of repurchase agreements	**902**	**-**	**902**	**1 339**	**-**	**1 339**
Total	**194 063**	**(7 170)**	**186 893**	**196 387**	**(7 320)**	**189 067**

LOANS AND ADVANCES TO CUSTOMERS BY METHOD OF CALCULATING IMPAIRMENT ALLOWANCES (excluding adjustments relating to fair value hedge accounting)	31.12.2017			31.12.2016		
	Gross	Impairment allowances	Net	Gross	Impairment allowances	Net
individual basis, of which:	4 793	(1 665)	3 128	5 714	(2 159)	3 555
impaired	3 757	(1 660)	2 097	4 420	(2 150)	2 270
not impaired	1 036	(5)	1 031	1 294	(9)	1 285
portfolio basis	7 118	(4 880)	2 238	7 022	(4 656)	2 366
group basis (IBNR)	182 152	(625)	181 527	183 651	(505)	183 146
Total	**194 063**	**(7 170)**	**186 893**	**196 387**	**(7 320)**	**189 067**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS – EXPOSURE TO CREDIT RISK (excluding adjustments relating to fair value hedge accounting)	31.12.2017			31.12.2016		
	Gross	Impairment	Net	Gross	Impairment	Net
impaired, of which:	10 875	(6 540)	4 335	11 442	(6 806)	4 636
assessed on an individual basis	3 757	(1 660)	2 097	4 420	(2 150)	2 270
not impaired, of which:	183 188	(630)	182 558	184 945	(514)	184 431
with recognized individual impairment trigger	1 016	(5)	1 011	1 234	(9)	1 225
not past due	751	(4)	747	1 022	(8)	1 014
past due	265	(1)	264	212	(1)	211
without a recognized individual impairment trigger/IBNR	182 172	(625)	181 547	183 711	(505)	183 206
not past due	179 574	(477)	179 097	180 830	(348)	180 482
past due	2 598	(148)	2 450	2 881	(157)	2 724
Total	**194 063**	**(7 170)**	**186 893**	**196 387**	**(7 320)**	**189 067**

LOANS AND ADVANCES TO CUSTOMERS BY CUSTOMER SEGMENT(excluding adjustments relating to fair value hedge accounting)	31.12.2017	31.12.2016
Loans and advances to customers, gross, of which:	**194 063**	**196 387**
mortgage banking	85 515	93 078
corporate (including receivables due from repurchase agreements)	62 499	58 458
retail and private banking	25 930	24 280
small and medium enterprises	20 119	20 571
Impairment allowances on loans and advances	(7 170)	(7 320)
Loans and advances to customers, net	**186 893**	**189 067**

LOAN QUALITY RATIOS (excluding adjustments relating to fair value hedge accounting)	31.12.2017	31.12.2016
Share of impaired loans	5,6%	5,8%
Coverage ratio of impaired loans*	65,9%	64,0%
Share of loans overdue for more than 90 days in gross loans and advances to customers	4,3%	4,4%

[1] The coverage ratio of loans and advances to customers is calculated as the ratio of total impairment allowance (both on impaired loans and advances to customers and IBNR) to the total gross exposure of impaired loans and advances to customers.

IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES TO CUSTOMERS - RECONCILIATION OF MOVEMENTS IN 2017	As at the beginning of the period	Recognized during the period	Reversed during the period	Derecognition of assets and settlements	Other	As at the end of the period	Recoveries of exposures written off*	Net – impact on the income statement
housing loans	2 144	692	(516)	(263)	(132)	1 925	16	(160)
business loans	3 667	2 171	(1 351)	(755)	(152)	3 580	71	(749)
consumer loans	1 432	1 229	(734)	(214)	(58)	1 655	8	(487)
debt securities (corporate)	69	4	(9)	(60)	-	4	-	5
debt securities (municipal)	8	-	(2)	-	-	6	-	2
Total	**7 320**	**4 096**	**(2 612)**	**(1 292)**	**(342)**	**7 170**	**95**	**(1 389)**

[1] The item is related to amounts recovered from repayments from customers and sales of loans.

IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES TO CUSTOMERS - RECONCILIATION OF MOVEMENTS IN 2016	As at the beginning of the period	Recognized during the period	Reversed during the period	Derecognition of assets and settlements	Other	As at the end of the period	Recoveries of exposures written off*	Net – impact on the income statement
housing loans	2 291	1 222	(878)	(486)	(5)	2 144	11	(333)
business loans	3 987	2 259	(1 411)	(952)	(216)	3 667	56	(792)
consumer loans	1 540	1 129	(788)	(397)	(52)	1 432	5	(336)
debt securities (corporate)	69	-	-	-	-	69	-	-
debt securities (municipal)	3	5	-	-	-	8	-	(5)
Total	**7 890**	**4 615**	**(3 077)**	**(1 835)**	**(273)**	**7 320**	**72**	**(1 466)**

[1] The item is related to amounts recovered from repayments from customers and sales of loans.

(IN PLN MILLION)

RECLASSIFICATION OF SECURITIES

In 2012 due to the change of intention as regards holding a selected portfolio of non-Treasury securities classified as available for sale upon initial recognition, the Bank reclassified them to the category of loans and advances to customers. As a result of the reclassification of the portfolio, the valuation methods for the portfolio have changed, i.e. from measured at fair value to measured at amortized cost.

PORTFOLIO RECLASSIFIED IN 2012	31.12.2017		31.12.2016	
	fair value	carrying amount	fair value	carrying amount
Municipal bonds	506	511	623	628
Corporate bonds	-	-	8	8
Total	**506**	**511**	**631**	**636**

PORTFOLIO RECLASSIFIED IN 2012 AS AT THE RECLASSIFICATION DATE	nominal value	fair value	carrying amount
Municipal bonds	1 219	1 237	1 237
Corporate bonds	1 289	1 294	1 294
Total	**2 508**	**2 531**	**2 531**

The change in fair value which would have been recognized in the income statement and/or in other comprehensive income if there was no reclassification, would have amounted to PLN (13) million for the period from the date of reclassification until 31 December 2017 (31 December 2016 PLN (39) million). As at 31 December 2017, the average effective interest rate for the debt securities portfolio was 3.20% (3.30% as at 31 December 2016).

CALCULATION OF ESTIMATES – IMPAIRMENT ALLOWANCES

The impact of an increase/decrease in cash flows for the Bank's loans and advances portfolio assessed for impairment on the basis of an individual analysis of future cash flows arising both from own payments and foreclosure of collaterals, i.e. the exposures for which an individual method is applied and the impact of an increase/decrease in the portfolio parameters for the Bank's loans and advances portfolio assessed on a portfolio and group basis is presented in the table below:

ESTIMATED CHANGE IN IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES IN THE SCENARIOS OF IMPROVING OR DETERIORATING RISK PARAMETERS, OF WHICH:[1]	31.12.2017		31.12.2016	
	scenario +10%	scenario -10%	scenario +10%	scenario -10%
changes in the present value of estimated future cash flows for the Group's portfolio of individually impaired loans and advances assessed on an individual basis	(191)	290	(196)	320
changes in the probability of default	47	(48)	49	(49)
changes in recovery rates	(312)	313	(352)	353

[1](in plus – increase in allowances, in minus – decrease in allowances)

25. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

ACCOUNTING POLICIES

Available-for-sale investment securities are debt and equity securities which have been designated as available for sale.

At initial recognition they are measured at fair value plus direct transaction costs and then remeasured to fair value and the effects of fair value changes (with the exception of impairment losses) are recognized in other comprehensive income until a given asset is derecognized from the statement of financial position when the accumulated gain/loss is recognized in profit or loss as the result on investment securities. Interest accrued using the effective interest rate on available-for-sale assets is recognized in net interest income.

Impairment allowances on these assets are recognized in the income statement under net impairment allowance and provisions, which results in the derecognition from other comprehensive income accumulated losses on valuation which were previously recorded there and recognizing them in the income statement.

In subsequent periods, if the fair value of debt securities increases, and the increase may be objectively related to an event subsequent to the impairment loss being recognized in the income statement, the impairment loss is reversed and the amount of the reversal is recognized in the income statement.

Impairment losses recognized on equity instruments are not reversed through profit and loss.

ESTIMATES AND JUDGEMENTS

IMPAIRMENT ALLOWANCES

At each balance sheet date, the Bank assesses, whether there is objective evidence that a given financial asset classified to available-for sale financial assets is impaired. If such evidence exists, the Bank determines the amounts of impairment allowances.

Objective evidence that an available-for-sale financial asset or group of assets is impaired includes the following events:

1) significant financial difficulties of the issuer,
2) breach of contract by the issuer, such as lack of contracted payments of interest or principal or late payments;
3) granting a concession by the lender to the issuer, for economic or legal reasons relating to the borrower's financial difficulty, that the lender would not otherwise consider ("forbearance practices"),
4) deterioration in the issuer's financial condition in the period of maintaining the exposure,
5) high probability of bankruptcy or reorganization of the issuer,
6) an increase in the risk of a certain industry in the period of maintaining a significant exposure, in which the issuer operates, reflected by the industry being qualified by the Bank as an elevated risk industry.

The Bank firstly assesses if impairment on an individual basis for individually significant receivables exists.

If there is objective evidence of impairment on financial assets classified as available-for-sale debt securities not issued by the State Treasury, an impairment allowance is calculated as the difference between the asset's carrying amount and the present fair value estimated as the value of future cash flows discounted using the original effective interest rate.

(IN PLN MILLION)

CVA ADJUSTMENTS

The fair value of non-quoted available-for-sale debt securities is determined using valuation models based on discounted cash flows expected to be received from the given financial instrument. In the valuation of non-quoted available-for-sale debt securities, assumptions are also made about the counterparty's credit risk, which may have an impact on the valuation of the instruments. The credit risk of the securities, for which there is no reliable market price available, is included in the margin, for which the valuation methodology is consistent with the calculation of credit spreads to determine CVA adjustments.

FINANCIAL INFORMATION

AVAILABLE-FOR-SALE INVESTMENT SECURITIES	31.12.2017	31.12.2016
Debt securities, gross	41 806	35 588
Treasury bonds (in PLN)	32 095	25 147
Treasury bonds (in foreign currencies)	-	457
municipal bonds (in PLN)	4 928	4 552
corporate bonds (in PLN)	4 304	4 791
corporate bonds (in foreign currencies)	479	641
Impairment	(246)	(274)
corporate bonds (in PLN)	(246)	(210)
corporate bonds (in foreign currencies)	-	(64)
Total debt securities, net	**41 560**	**35 314**
Equity securities, gross	249	162
not admitted to public trading	148	128
admitted to public trading	101	34
Impairment allowances	(52)	(1)
Total equity securities, net	**197**	**161**
Participation units in a collective investment undertaking	252	298
Total available-for-sale investment securities, net	**42 009**	**35 773**

PLN Treasury bonds and foreign currency Treasury bonds include the Treasury Bonds of the Republic of Poland.

AVAILABLE-FOR-SALE INVESTMENT DEBT SECURITIES – THE BANK'S EXPOSURE TO CREDIT RISK	Exposure	
	31.12.2017	31.12.2016
impaired, assessed on an individual basis	819	1 293
not impaired, not past due	40 987	34 295
with an external rating	35 840	29 207
with an internal rating	5 147	5 088
Total, gross	**41 806**	**35 588**
Impairment allowances	(246)	(274)
Total carrying amount, net	**41 560**	**35 314**

(IN PLN MILLION)

AVAILABLE-FOR-SALE DEBT SECURITIES BY MATURITY (AT CARRYING AMOUNTS)	31.12.2017	31.12.2016
up to 1 month	309	16
1 to 3 months	4	35
3 months to 1 year	4 072	1 716
1 to 5 years	21 956	19 582
over 5 years	15 219	13 965
Total	**41 560**	**35 314**

IMPAIRMENT ALLOWANCES – RECONCILIATION OF MOVEMENTS IN 2017	As at the beginning of the period	Recognized during the period	Reversed during the period	Other	As at the end of the period	Net – impact on the income statement
Debt securities	274	79	(66)	(41)	246	(13)
Equity securities	1	51	-	-	52	(51)
Total	**275**	**130**	**(66)**	**(41)**	**298**	**(64)**

IMPAIRMENT ALLOWANCES – RECONCILIATION OF MOVEMENTS IN 2016	As at the beginning of the period	Recognized during the period	Reversed during the period	Other	As at the end of the period	Net – impact on the income statement
Debt securities	53	52	-	169	274	(52)
Equity securities	-	-	-	1	1	-
Total	**53**	**52**	**-**	**170**	**275**	**(52)**

SIGNIFICANT TRANSACTION

In 2016, the Bank participated in the acquisition of Visa Europe Limited by Visa Inc. The final settlement of the Bank's share in the transaction comprised:

- EUR 71 million in cash paid to the Bank's account on 21 June 2016,
- 25 612 preference C-series shares of Visa Inc., the value of which as at the transaction date was estimated at USD 21 million,
- a receivable due to deferred payment in cash equivalent to 0.5435987989% of EUR 1.12 billion, i.e. the amount attributable to all transaction participants, paid on the 3rd anniversary of the transactions, subject to potential adjustments, in the case of the occurrence of situation described in the transaction terms; the value of the above-mentioned receivable as at 21 June 2016 amounted to EUR 6 million.

In 2016, the Bank recognized in the income statement due to settlement of the transaction the total amount of PLN 418 million (the profit before taxation). Within this amount, the amount settled in other comprehensive income due to the valuation of Visa Europe Limited shares amounted to PLN 337 million.

Received preference C-series shares will be converted to ordinary Visa Inc. shares, and the terms of the transaction provide progressive shares conversion. The conversion of all preference shares will occur not later than in 2028. The conversion ratio granted at the moment of the settlement of the transaction and the current ratio as at 31 December 2017 amounts to 13,952 and may be reduced in the period to 2028, which is dependent on potential liabilities in respect of legal claims in that period relating to the acquired company, i.e. Visa Europe Limited.

The preference C-series shares were reclassified to available-for-sale securities and are measured at fair value based on the market price of listed ordinary shares, taking into account a discount for the limited liquidity of the preference shares and the conditions for converting the shares (adjustments resulting from court litigation).

(IN PLN MILLION)

The fair value of Visa Inc. shares held by the Bank as at 31 December 2017 was estimated at USD 35 million (an equivalent of PLN 123 million according to the NBP average exchange rate as at the end of 2017). The fair value of the above-mentioned shares as at 31 December 2016 amounted to USD 22 million (equivalent to PLN 92 million according to the NBP average exchange rate as at the end of 2016).

26. INVESTMENT SECURITIES HELD TO MATURITY

ACCOUNTING POLICIES

Financial assets held to maturity are financial assets which are not derivatives, with determined or determinable payments and maturities, which were acquired with the intention of holding and the Bank is able to hold them to maturity, other than those designated by the Bank as measured at fair value through profit or loss upon initial recognition, designated by the Bank as available for sale, meeting the definition of loans and advances.

These assets are measured at amortized cost using the effective interest rate, net of impairment losses.

FINANCIAL INFORMATION

INVESTMENT SECURITIES HELD TO MATURITY	31.12.2017	31.12.2016
Debt securities, including:	1 622	157
Treasury bonds (in PLN)	1 622	157
Total	**1 622**	**157**

PLN Treasury bonds and foreign currency Treasury bonds include the Treasury Bonds of the Republic of Poland.

DEBT SECURITIES IN THE HELD-TO-MATURITY PORTFOLIO AT CARRYING AMOUNT - BY MATURITY	31.12.2017	31.12.2016
1 to 5 years	533	157
over 5 years	1 089	-
Total	**1 622**	**157**

Debt securities held to maturity as at 31 December 2017 and 31 December 2016 are Treasury bonds which are not overdue and not impaired.

27. NON-CURRENT ASSETS HELD FOR SALE

ACCOUNTING POLICIES

Only assets available for immediate sale in the current condition are classified by the Bank as non-current assets, when such sale is highly probable, i.e. the entity has determined to sell the asset, started to actively seek a buyer and finish the sale process. In addition, such assets are offered for sale at a price which is reasonable with respect to their current fair value and it is expected that the sale will be recognized as completed within one year from the date of classification of the asset into this category.

These assets are recognized at the lower of their carrying amount and fair value less costs to sell. Impairment allowances on non-current assets held for sale are recognized in the income statement for the period in which the allowances were made. Amortization is not charged on assets classified to this category.

When the respective classification criteria to this category are no longer met, the Bank reclassifies them from non-current assets held for sale to appropriate other asset categories. Non-current assets withdrawn from assets held for sale are measured at the lower of: 1) the carrying amount from before the moment of their classification to non-current assets held for sale, less amortization/depreciation that would have been recorded had the asset (or disposal group) not been classified as held for sale; 2) the recoverable amount as at the date of the decision to discontinue the sale.

(IN PLN MILLION)

FINANCIAL INFORMATION

NON-CURRENT ASSETS HELD FOR SALE	31.12.2017	31.12.2016
Investments in subsidiaries	339	351
Finansowa Kompania „Prywatne Inwestycje" Sp. z o. o.	21	29
"Inter-Risk Ukraina" Spółka z dodatkową odpowiedzialnością	-	4
Qualia Development Sp. z o. o.	318	318
Land and buildings	20	10
Total	**359**	**361**

RECONCILIATION OF MOVEMENTS IN IMPAIRMENT ALLOWANCES	2017	2016
As at the beginning of the period	278	427
Recognized during the period	8	5
Reversed during the period	-	(153)
Other	(24)	(1)
As at the end of the period	**262**	**278**
Net – impact on the income statement	**8**	**(148)**

28. INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

ACCOUNTING POLICIES

INTANGIBLE ASSETS

SOFTWARE – Acquired computer software licenses are recognized in the amount of costs incurred on the purchase and preparation of the software for use, taking into consideration accumulated amortization and impairment allowances. Further expenditure related to the maintenance of the computer software is recognized as expense when incurred.

GOODWILL – The Bank recognizes (since the legal merger with a subsidiary) goodwill related to the acquisition of this entity as intangible assets. Goodwill was recognized in the amount of excess of consideration paid over the value of the identifiable assets acquired and liabilities assumed, measured at fair value as at the acquisition date. Subsequent to the initial recognition goodwill is measured at the amount initially recognized less any cumulative impairment allowances.

CUSTOMER RELATIONS – As a result of the settlement of purchase transactions, customer relationships depreciable using the declining balance method based on the rate of consumption of economic benefits arising from their use, were identified.

OTHER INTANGIBLE ASSETS – Other intangible assets acquired by the Bank are recognized at acquisition cost or production cost, less accumulated amortization and impairment allowances.

Development costs – Research and development costs are included in intangible assets in connection with future economic benefits and meeting specific terms and conditions, i.e. if there is a possibility and intention to complete and use the internally generated intangible asset, there are appropriate technical and financial resources to finish the development and to use the asset and it is possible to measure reliably the expenditure attributable to the intangible asset during its development which can be directly associated to the creation of the intangible asset.

Property, plant and equipment

Property, plant and equipment – are valued according to the purchase price or cost of production, less accumulated depreciation and impairment allowances.

Investment properties – are valued according to accounting principles applied to property, plant and equipment.

Capital expenditure accrued – Carrying amount of property, plant and equipment and intangible assets is increased by additional expenditure incurred during their maintenance.

Depreciation / amortization

Depreciation begins on the first day of the month following the month in which the asset has been brought into use, and ends no later than at the time when:

1) the amount of depreciation or amortization charges becomes equal to the initial cost of the asset, or
2) the asset is designated for liquidation, or
3) the asset is sold, or
4) the asset is found to be missing, or
5) it is found – as a result of verification – that the expected residual value of the asset exceeds its (net) carrying amount, taking into account the expected residual value of the asset upon scrapping, i.e. the net amount that the Bank expects to obtain at the end of the useful life of the asset, net of its expected costs to sell.

For non-financial non-current assets it is assumed that the residual value is nil, unless there is an obligation of a third party to buy back the asset, or if there is an active market which will continue to exist at the end of the asset's period of use and when it is possible to determine the value of the asset on this market.

Costs relating to the acquisition or construction of buildings are allocated to significant parts of the building (components), when such components have different useful lives or when each of the components generates benefits for the Bank in a different manner. Each component of the building is depreciated separately. Intangible assets with indefinite useful lives, which are subject to an annual impairment test are not amortized.

Impairment allowances on non-financial non-current assets

Impairment allowance is recognized in the income statement under net impairment allowance if the carrying amount of an asset or a cash generating unit (CGU) exceeds the recoverable amount.

Impairment allowances in the case of CGU firstly reduce goodwill attributable to them, and then proportionately reduce the carrying amount of other assets in the CGU.

In respect of other assets, the impairment allowance may be reversed if there was a change in the estimates used to determine the recoverable amount.

If there are impairment triggers for a group of assets, which do not generate cash flows irrespective of other assets or asset groups, and the recoverable amount of a single asset included in common assets cannot be determined, the Bank determines the recoverable amount at the level of the cash-generating unit to which the asset belongs.

ESTIMATES AND JUDGEMENTS

USEFUL ECONOMIC LIVES OF PROPERTY, PLANT AND EQUIPMENT, INTANGIBLE ASSETS AND INVESTMENT PROPERTIES

In estimating the useful economic lives the following factors are considered:

1) expected physical wear and tear, estimated based on the average period of use recorded to date, reflecting the normal physical wear and tear rate, intensity of use etc.;
2) technical or market obsolescence;
3) legal and other limitations on the use of the asset;
4) expected use of the asset assessed based on the expected production capacity or volume;
5) other factors affecting useful lives of such assets.

When the period of use of a given asset results from a contract term, the useful economic life of such an asset corresponds to the period defined in the contract. If the estimated useful life is shorter than the period defined in the contract, the estimated useful economic life is applied. The adopted depreciation / amortization method and useful life for property, plant and equipment, investment properties and intangible assets are reviewed on an annual basis.

Depreciation /amortization periods for basic groups applied by PKO Bank Polski SA:

Tangible assets	**Period**
Buildings, premises, cooperative rights to premises (including investment properties)	From 40 to 60 years
Leasehold improvements (buildings, premises)	10 years (or the period of the lease, if shorter)
Machinery and equipment	From 3 to 15 years
Computer hardware	From 4 to 10 years
Vehicles	5 years
Intangible assets	**Period**
Software	From 2 to 17 years
Other intangible assets	5 years

IMPAIRMENT ALLOWANCES

At each balance sheet date, the Bank makes an assessment of whether there is objective evidence of impairment of any non-financial non-current assets (or cash-generating units). If any such evidence exists, and annually in the case of intangible assets which are not amortized, the Bank estimates the recoverable amount being the higher of the fair value less costs to sell or the value in use of a non-current asset (or a cash-generating unit), if the carrying amount of an asset exceeds its recoverable amount, the Bank recognizes an impairment loss in the income statement. The estimation for the above-mentioned values requires making assumptions, among other things, about future expected cash flows that the Bank may receive from the continued use or disposal of the non-current asset (or a cash-generating unit). The adoption of different assumptions with reference to the valuation of future cash flows could affect the carrying amount of certain non-current assets.

(IN PLN MILLION)

FINANCIAL INFORMATION

INTANGIBLE ASSETS

FOR THE YEAR ENDED 31 DECEMBER 2017	Software	Goodwill	Customer relationships	Other, including capital expenditure	Total
Carrying amount as at the beginning of the period, gross	4 367	871	86	368	5 692
Purchase	-	-	-	241	241
Transfers from capital expenditure	320	-	-	(320)	-
Other	17	-	-	(5)	12
Carrying amount as at the end of the period, gross	4 704	871	86	284	5 945
Accumulated amortization as at the beginning of the period	(2 769)	-	(52)	(39)	(2 860)
Depreciation charge for the period	(435)	-	(10)	(3)	(448)
Accumulated amortization as at the end of the period	(3 204)	-	(62)	(42)	(3 308)
Impairment allowances as at the beginning of the period	(15)	-	-	-	(15)
Impairment allowances as at the end of the period	(15)	-	-	-	(15)
Net carrying amount as at the beginning of the period	1 583	871	34	329	2 817
Net carrying amount as at the end of the period	1 485	871	24	242	2 622

FOR THE YEAR ENDED 31 DECEMBER 2016	Software	Goodwill	Customer relationships	Other, including capital expenditure	Total
Carrying amount as at the beginning of the period, gross	4 036	871	86	241	5 234
Purchase	-	-	-	457	457
Transfers from capital expenditure	324	-	-	(324)	-
Sale and disposal	(8)	-	-	(1)	(9)
Other	15	-	-	(5)	10
Carrying amount as at the end of the period, gross	4 367	871	86	368	5 692
Accumulated amortization as at the beginning of the period	(2 348)	-	(38)	(35)	(2 421)
Depreciation charge for the period	(426)	-	(14)	(4)	(444)
Other	5	-	-	-	5
Accumulated amortization as at the end of the period	(2 769)	-	(52)	(39)	(2 860)
Impairment allowances as at the beginning of the period	(15)	-	-	-	(15)
Impairment allowances as at the end of the period	(15)	-	-	-	(15)
Net carrying amount as at the beginning of the period	1 673	871	48	206	2 798
Net carrying amount as at the end of the period	1 583	871	34	329	2 817

With regard to the Bank, a significant item of intangible assets relates to expenditures on the Integrated Information System (IIS). The total capital expenditure incurred for the IIS system in the years 2007-2017 amounted to PLN 921 million. The net carrying amount of the Integrated Information System (IIS) amounted to PLN 632 million as at 31 December 2017 (PLN 679 million as at 31 December 2016). The expected useful life of the IIS system is 17 years. As at 31 December 2017, the remaining useful life is 6 years.

(IN PLN MILLION)

GOODWILL

NET GOODWILL	31.12.2017	31.12.2016
Nordea Bank Polska SA	863	863
Centrum Haffnera Sp. z o.o.	8	8
Total	**871**	**871**

As at 31 December 2017, the Bank performed mandatory impairment tests in respect of goodwill on the acquisition of Nordea Bank Polska SA. The impairment test is conducted by comparing the carrying amounts of Cash Generating Units ('CGUs') with their recoverable amount. Two CGUs were identified to which goodwill on acquisition of Nordea Bank Polska SA was allocated – the retail and corporate CGU.
The recoverable amount is estimated based on the value in use of the CGUs. The value in use is the present estimated value of future cash flows in 10 years, taking into consideration the residual value of the CGUs. The residual value of a CGU has been calculated by extrapolating the cash flow projections beyond the period of the forecast, using the growth rate adopted at a level of 2.7%. Cash flow projections are based on the assumptions included in the financial plan of the Bank for 2018. For the discounting of the future cash flows a discount rate of 8.16% was used, taking into account the risk-free rate and risk premium.
The impairment test performed as at 31 December 2017 showed a surplus of the recoverable amount over the carrying amount of each CGU and therefore no CGU impairment was recognized.

PROPERTY, PLANT AND EQUIPMENT

FOR THE YEAR ENDED 31 DECEMBER 2017	Land and buildings	Machinery and equipment	Assets under construction	Other	Total
Gross carrying amount of property, plant and equipment as at the beginning of the period	**2 639**	**1 486**	**104**	**611**	**4 840**
Purchase	-	-	202	-	202
Transfers from capital expenditure	43	93	(176)	40	-
Sale and disposal	(120)	(88)	-	(44)	(252)
Other, including reclassification to assets held for sale	(43)	3	(2)	(13)	(55)
Gross carrying amount of property, plant and equipment as at the end of the period	**2 519**	**1 494**	**128**	**594**	**4 735**
Accumulated depreciation as at the beginning of the period	**(1 015)**	**(1 058)**	**-**	**(414)**	**(2 487)**
Depreciation charge for the period	(93)	(149)	-	(37)	(279)
Scrapping and sale	97	88	-	45	230
Accumulated depreciation as at the end of the period	**(1 011)**	**(1 119)**	**-**	**(406)**	**(2 536)**
Impairment allowances as at the beginning of the period	**(22)**	**-**	**-**	**(6)**	**(28)**
Recognized during the period	(7)	-	-	(1)	(8)
Other	2	-	-	5	7
Write-downs as at the end of the period	**(27)**	**-**	**-**	**(2)**	**(29)**
Net carrying amount as at the beginning of the period	**1 602**	**428**	**104**	**191**	**2 325**
Net carrying amount as at the end of the period	**1 481**	**375**	**128**	**186**	**2 170**

FOR THE YEAR ENDED 31 DECEMBER 2016	Land and buildings	Machinery and equipment	Assets under construction	Other	Total
Gross carrying amount of property, plant and equipment as at the beginning of the period	**2 459**	**1 761**	**265**	**597**	**5 082**
Purchase	-	-	209	-	209
Transfers from capital expenditure	122	193	(368)	53	-
Sale and disposal	(93)	(468)	-	(43)	(604)
Other	151	-	(2)	4	153
Gross carrying amount of property, plant and equipment as at the end of the period	**2 639**	**1 486**	**104**	**611**	**4 840**
Accumulated depreciation as at the beginning of the period	**(991)**	**(1 374)**	**-**	**(419)**	**(2 784)**
Depreciation charge for the period	(94)	(146)	-	(38)	(278)
Scrapping and sale	70	462	-	43	575
Accumulated depreciation as at the end of the period	**(1 015)**	**(1 058)**	**-**	**(414)**	**(2 487)**
Impairment allowances as at the beginning of the period	**(14)**	**-**	**-**	**(6)**	**(20)**
Recognized during the period	(9)	-	-	-	(9)
Reversed during the period	-	-	-	1	1
Other	1	-	-	(1)	-
Impairment allowances as at the end of the period	**(22)**	**-**	**-**	**(6)**	**(28)**
Net carrying amount as at the beginning of the period	**1 454**	**387**	**265**	**172**	**2 278**
Net carrying amount as at the end of the period	**1 602**	**428**	**104**	**191**	**2 325**

CALCULATION OF ESTIMATES

The impact of change in the economic useful life of assets being subject to depreciation and classified as land and buildings, resulting in a change in the financial result, is presented in the table below (in PLN million):

CHANGE IN ESTIMATED USEFUL LIVES OF DEPRECIABLE ASSETS IN THE "LAND AND BUILDINGS" CATEGORY	31.12.2017		31.12.2016	
	scenario +10 years	scenario -10 years	scenario +10 years	scenario -10 years
Depreciation	(39)	279	(42)	308

29. OTHER ASSETS

Accounting policies
Financial information:
- Other assets
- Other assets – the Bank's exposure to credit risk

Management of foreclosed collateral

ACCOUNTING POLICIES

Financial assets recognized in this item are stated at amounts due, comprising also potential interest on such assets, taking into consideration impairment allowances. Non-financial assets are measured in accordance with the valuation principles applicable to specific categories of assets recognized in this item.

(IN PLN MILLION)

FINANCIAL INFORMATION

OTHER ASSETS	31.12.2017	31.12.2016
Settlements in respect of card transactions	1 136	1 235
Settlements of financial instruments (including unpaid option premium)	284	382
Receivables in respect of cash settlements	158	125
Receivables and settlements in respect of trading in securities	63	80
Settlements relating to selling foreign currencies	2	26
Assets for sale	57	78
Prepayments and deferred costs	62	54
Trade receivables	94	77
Other	66	86
Total	**1 922**	**2 143**
of which financial assets	1 748	1 791

OTHER FINANCIAL ASSETS - THE BANK'S EXPOSURE TO CREDIT RISK	31.12.2017	31.12.2016
impaired	98	105
not impaired, of which:	1 749	1 791
not past due	1 739	1 780
past due	10	11
Total, gross	1 847	**1 896**
Impairment	(99)	(105)
Total carrying amount, net	**1 748**	**1 791**

MANAGEMENT OF FORECLOSED COLLATERAL– ITEM "ASSETS FOR SALE"

Foreclosed collaterals as a result of restructuring or debt collection activities are either designated for sale or used by PKO Bank Polski SA for internal purposes. Details of the foreclosed assets are analysed in order to determine whether they can be used by the Bank for internal purposes. All of the assets foreclosed as a result of restructuring and debt collection activities in the years ended 31 December 2017 and 31 December 2016, respectively, were designated for sale. Activities undertaken by the Bank are aimed at selling assets as soon as possible. The primary procedure for the sale of assets is an open tender. In justified cases, the sale follows a different procedure depending on the specifics of the sold property.

30. AMOUNTS DUE TO BANKS

ACCOUNTING POLICIES

Amounts due to banks are financial liabilities measured at amortized cost using the effective interest rate method. In the case of financial liabilities for which it is not possible to estimate the schedule of future cash flows and the effective interest rate, they are measured at the amount due.

This item also includes securities subject to sell-buy-back transactions with a repurchase or resale clause specifying a contractual date and price. Securities subject to sell-buy-back transactions are not derecognized from the statement of financial position and are measured at the terms and conditions specified for particular securities portfolios. The difference between the sale price and the repurchase price is recognized as interest expense and it is settled over the term of the contract using the effective interest rate.

(IN PLN MILLION)

FINANCIAL INFORMATION

AMOUNTS DUE TO BANKS	31.12.2017	31.12.2016
Loans and advances received	2 596	17 109
Deposits from banks	1 077	793
Liabilities in respect of repurchase agreements	-	206
Current accounts	583	567
Other monetary market deposits	43	42
Total	**4 299**	**18 717**

In 2017, the Bank partly repaid the loan from Nordea Bank AB (publ), including: CHF 3,339 million (PLN 12,535 million), USD 4 million (PLN 13 million) and EUR 107 million (PLN 456 million). In 2016, the Bank did not repay any loans received.

31. AMOUNTS DUE TO CUSTOMERS

ACCOUNTING POLICIES

Amounts due to customers are measured at amortized cost using the effective interest rate method. In the case of financial liabilities for which it is not possible to estimate the schedule of future cash flows and the effective interest rate, they are measured at the amount due.

FINANCIAL INFORMATION

AMOUNTS DUE TO CUSTOMERS BY TYPE OF PRODUCT	31.12.2017	31.12.2016
Amounts due to retail customers	150 537	147 392
Current accounts and overnight deposits	86 612	72 196
Fixed term deposits	63 719	74 876
Other liabilities	206	320
Deposits from corporates	60 578	53 570
Current accounts and overnight deposits	39 719	30 661
Fixed term deposits	11 992	12 168
Loans and borrowings received	7 882	9 680
Other liabilities	937	1 061
Amounts due from repurchase agreements	48	-
Amounts due to public entities	11 409	8 409
Current accounts and overnight deposits	9 555	8 163
Fixed term deposits	1 820	187
Other liabilities	34	59
Total	**222 524**	**209 371**

(IN PLN MILLION)

AMOUNTS DUE TO CUSTOMERS BY SEGMENT	31.12.2017	31.12.2016
Amounts due to customers, of which		
retail and private banking	141 870	139 423
corporate	49 140	38 025
loans and advances received	7 882	9 680
small- and medium-sized enterprises	23 584	22 243
amounts due from repurchase agreements	48	-
Total	222 524	209 371

LOANS RECEIVED FROM PKO FINANCE AB

Date of receipt of the loan by the Bank	Nominal value	Currency	Maturity	carrying amount as at 31.12.2017	carrying amount as at 31.12.2016
25.07.2012	50	EUR	25.07.2022	211	222
26.09.2012	1 000	USD	26.09.2022	3 530	4 224
23.01.2014	500	EUR	23.01.2019	2 141	2 259
Total				5 882	6 705

LOANS AND ADVANCES FROM INTERNATIONAL FINANCIAL INSTITUTIONS

Date of receipt of the loan by the Bank	Nominal value	Currency	Maturity	carrying amount as at 31.12.2017	carrying amount as at 31.12.2016
30.04.2009	76	CHF	30.04.2019	108	187
23.12.2009	50	EUR	23.12.2019	83	132
23.10.2009	45	CHF	23.10.2017	-	187
23.10.2009	182	CHF	23.10.2019	649	748
23.12.2010	75	EUR	23.12.2020	188	265
25.09.2013	75	EUR	25.09.2023	313	332
29.11.2013	185	CHF	29.11.2023	659	762
15.09.2014	100	PLN	15.03.2017	-	100
15.09.2014	261	PLN	15.06.2017	-	262
Total				2 000	2 975

In 2017, the Bank partly repaid loans and advances received from international financial institutions totalling PLN 689 million. In 2016, the Bank partly repaid loans and advances received from international financial institutions totalling PLN 1 267 million.

(IN PLN MILLION)

32. Debt securities in issue

Accounting policies

Securities in issue are measured at amortized cost using the effective interest rate, or in respect of banking securities at fair value through profit or loss.

If no future cash flow schedule can be determined for a financial liability measured at amortized cost, and thus the effective interest rate cannot be determined, this liability is measured at the amount due.

Financial information

DEBT SECURITIES IN ISSUE	31.12.2017	31.12.2016
bank bonds, including:	5 204	1 693
in PLN	645	809
in EUR, translated into PLN	3 132	884
in CHF, translated into PLN	1 427	-
Total	**5 204**	**1 693**

LIABILITIES IN RESPECT OF DEBT SECURITIES IN ISSUE - BY MATURITY	31.12.2017	31.12.2016
3 months to 1 year	646	1 693
1 to 5 years	4 558	-
Total	**5 204**	**1 693**

Information on the issue, redemption and repayment of debt securities and equity securities

ADDITIONAL INFORMATION	31.12.2017	31.12.2016
issuance of debt securities during the period (nominal value)		
in PLN	1 320	1 815
in original currency (EUR)	750	200
in original currency (CHF)	400	-
redemption of debt securities during the period (nominal value)		
in PLN	1 485	1 860
in original currency (EUR)	200	200

In 2017, the Bank issued banking bonds with a nominal value of PLN 1,320 million, and Eurobonds with a nominal value of EUR 750 million, and Eurobonds with a nominal value of CHR 400 million, and at the same time, it repurchased EUR banking bonds of EUR 200 million and PLN banking bonds of PLN 1,485 million.

The Bank held two issues of Eurobonds:

- On 18 July 2017, the Bank issued 4-year Eurobonds of EUR 750 million with the 0.75% coupon (Mid Swap+65 b.p.). The bonds are listed on the Luxembourg Securities Exchange and on the Warsaw Securities Exchange. This issue is the first one held under the new EMTN programme opened in May 2017 for a total of EUR 3 billion. The programme provides for the issue of unsecured senior Eurobonds and subordinated bonds in EUR, USD, CHF and PLN.

(IN PLN MILLION)

- On 19 October 2017, the Bank placed its Eurobonds under the EMTN programme amounting to CHF 400 million, with 4-year maturity and 0.30% coupon (Mid Swap + 58 b.p.). The bonds are listed on the Zurich Securities Exchange. The Bank aims at introducing the bonds to alternative trading on the Warsaw Securities Exchange.

In 2016, the Bank issued banking bonds in EUR with a nominal value of EUR 200 million, and redeemed banking securities with a nominal value of PLN 1,860 million and EUR banking bonds with a nominal value of EUR 200 million. These bonds are measured at amortized cost.

33. SUBORDINATED LIABILITIES

ACCOUNTING POLICIES

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

FINANCIAL INFORMATION

	Nominal value in a foreign currency	Currency	Period	Special terms	Balance in PLN	
					31.12.2017	31.12.2016
Subordinated bonds	1 700	PLN	28.08.2017 - 28.08.2027	right to early redemption within 5 years from the issue date	1 720	-
Subordinated bonds	1 601	PLN	14.09.2012 - 14.09.2022	right to early redemption within 5 years from the issue date	-	1 617
Subordinated loan from Nordea Bank AB (publ)	224	CHF	24.04.2012 - 24.04.2022		-	922
Total					**1 720**	2 539

Both the subordinated bonds and the subordinated loan were designated on approval of the Polish Financial Supervision Authority for increasing the Bank's supplementary funds.

On 25 April 2017, the subordinated loan from Nordea Bank AB (publ) was repaid in the amount of CHF 224 million.

On 23 August 2017, the Bank placed an issue of subordinated bonds with a total nominal value of PLN 1,700 million and issue price of one bond of PLN 0.1 million. The bonds bear interest in semi-annual interest periods, and interest on the bonds is assessed on the nominal value at a variable interest rate of WIBOR 6M increased by a margin of 155 pb. over the entire issue period. The issue was settled on 28 August 2017. The bonds mature after 10 years, whereas the Bank is entitled to the early repurchase of the bonds within 5 years from the issue date, subject to approval by the Polish Financial Supervision Authority. On 30 August 2017, the PFSA agreed to designate the proceeds from the issue of subordinated loans for an increase in the Bank's and Group's supplementary funds. As of 27 September 2017, the bonds are listed on the Catalyst market.

On 30 August 2017, the Group obtained the PFSA's approval for exercising its call option in respect of subordinated bonds. On 14 September 2017, the Bank repurchased all its subordinated bonds series OP0922, with a total nominal value of PLN 1,600.7 million, issued on 14 September 2012. The legal basis for early repurchase referred to the terms and conditions of the issue of subordinated bonds series OP0922, which allowed the Bank to repurchase all subordinated OP0922 bonds earlier, after the lapse of 5 years from the issue.

34. OTHER LIABILITIES

ACCOUNTING POLICIES

Liabilities included in this item are measured at amounts due which cover potential interest on the liabilities, and the accrual for future payments in reliably estimated, justified amounts necessary to meet the present obligation as at the end of the reporting period. Non-financial liabilities are measured in accordance with the measurement policies binding for particular liability categories recognized in this item.

(IN PLN MILLION)

FINANCIAL INFORMATION

	31.12.2017	31.12.2016
Expenses to be paid	514	463
Deferred income	495	425
Liability in respect of tax on certain financial institutions	75	76
Interbank settlements	1 313	813
Liabilities arising from investing activities and internal operations	295	324
Amounts due to suppliers	74	61
Liabilities and settlements in respect of trading in securities	502	209
Settlements of financial instruments (including unpaid option premium)	281	356
Liabilities in respect of contribution to the Bank Guarantee Fund[1]	120	-
Liabilities under the public law	148	83
Liabilities in respect of foreign exchange activities	350	217
Liabilities in respect of payment cards	259	111
Settlements relating to buying foreign currencies	-	26
Other[2]	166	176
Total	**4 592**	**3 340**
of which financial liabilities	3 812	2 693

[1] The item "Liabilities in respect of contributions to the Bank Guarantee Fund" includes an obligation to pay contributions to BGF (see Note 49 Assets pledged to secure liabilities and financial assets transferred).
[2] The item "Other" includes amounts due to insurance companies and liabilities in respect of interest charges on the interest temporarily repurchased from the State Budget.

As at 31 December 2017, and as at 31 December 2016, PKO Bank Polski SA did not have any liabilities in respect of which it did not meet its contractual obligations.

35. PROVISIONS

Accounting policies
Estimates and judgements
Financial information
Calculation of estimates

ACCOUNTING POLICIES

PROVISIONS FOR LEGAL CLAIMS

A provision for disputes with employees, business partners, customers and external institutions (e.g. UOKiK), which is created on obtaining information from the competent person in the Legal Department or another person representing the Bank before courts and other adjudicating bodies as part of providing legal assistance with a high probability of a court case being lost (litigation pending has been discussed in detail in note "Legal claims").

Provisions for legal claims are created in the amount of the expected outflow of economic benefits.

PROVISION FOR RETIREMENT AND DISABILITY BENEFITS

The provision for retirement and disability benefits resulting from the Labour Code is created individually for each employee on the basis of an actuarial valuation. The basis for calculation of these provisions are internal regulations, in particular the Collective Labour Agreement being in force at the Bank.

PROVISION FOR LOAN COMMITMENTS AND GUARANTEES GRANTED

A provision for off-balance sheet loan exposures is recognized in the amount equal to the resulting expected (possible to estimate) loss of economic benefits. When determining a provision for off-balance sheet loan exposures, the Bank:

- assesses on an individual basis in respect of the individually significant credit exposures on unconditional liabilities with the evidence of individual impairment or those relating to debtors whose other exposures fulfil such evidence, and the individually significant exposures which do not fulfil the evidence of individual impairment, for which determining provisions using the portfolio parameters would not be reasonable,
- assesses on a portfolio basis (if an exposure fulfils evidence of individual impairment) or a group basis (if an exposure does not show evidence of impairment) – in respect of the remaining off-balance sheet loan exposures.

The provision is determined as the difference between the expected amount of exposure in the statement of financial position, which will arise as a result of off-balance sheet liabilities granted (from the date at which the assessment is performed until the date of overdue amounts treated as an individual impairment trigger) and the present value of the expected future cash flows obtained from the exposure in the statement of financial position arising out of the liability.

When assessing a provision on an individual basis, the expected future cash flows are estimated for each loan exposure separately.

When assessing a provision on a portfolio basis or a group basis, the portfolio parameters are used, estimated using statistical methods, based on the historical observation of exposures with the same characteristics.

OTHER PROVISIONS

Other provisions include mainly restructuring provision and provisions for potential claims on the sale of impaired loan portfolios, details of which have been presented in the note “Sale of receivable portfolios”.

Provisions for future payments are measured at reliably estimated, justified amounts necessary to meet the present obligation as at the end of the reporting period. All provisions are recognized in the profit and loss account, excluding actuarial gain and losses recognized in other comprehensive income.

If the effect of the time value of money is material, the amount of the provision is determined by discounting the estimated future cash flows to their present value, using the discount rate before tax which reflects the current market assessments of the time value of money and the potential risk related to a given obligation.

ESTIMATES AND JUDGEMENTS

Valuation of the employee benefits provision is performed using actuarial techniques and assumptions. The calculation of the provision includes all retirement and pension benefits which it is expected will be paid in the future. The provision was created on the basis of a list of persons with all necessary employee information, in particular the length of their service, age and gender. The provisions calculated are equal to discounted future payments, taking into account staff turnover, and are related to the period ending on the balance sheet date.

(IN PLN MILLION)

FINANCIAL INFORMATION

FOR THE PERIOD ENDED 31 DECEMBER 2017	Provisions for legal claims	Provision for disability and retirement benefits	Provisions for loan commitments and guarantees granted	Other provisions[1]	Total
As at 1 January 2017, of which:	20	45	67	91	223
Short-term provisions	20	7	51	91	169
Long-term provisions	-	38	16	-	54
Increase/reassessment	10	4	256	5	275
Utilization	(4)	(3)	-	(38)	(45)
Release of provisions	(8)	-	(236)	(3)	(247)
Other changes and reclassifications	-	(1)	(1)	6	4
As at 31 December 2017, of which:	**18**	**45**	**86**	**61**	**210**
Short-term provisions	18	7	61	61	147
Long-term provisions	-	38	25	-	63

[1] The item "Other provisions" comprises, among other things, restructuring provision of PLN 21 million and a provision for potential claims related to the sale of receivables in the amount of PLN 2 million, and provisions for disputes, including litigation related to remuneration of PLN 1 million.

FOR THE PERIOD ENDED 31 DECEMBER 2016	Provisions for legal claims	Provision for disability and retirement benefits	Provisions for loan commitments and guarantees granted	Other provisions[1]	Total
As at 1 January 2016, of which:	19	45	83	98	245
Short-term provisions	19	3	64	98	184
Long-term provisions	-	42	19	-	61
Increase/reassessment	13	4	238	23	278
Utilization	(6)	(2)	-	(18)	(26)
Release of provisions	(6)	-	(255)	(12)	(273)
Other changes and reclassifications	-	(2)	1	-	(1)
As at 31 December 2016, of which:	**20**	**45**	**67**	**91**	**223**
Short-term provisions	20	7	51	91	169
Long-term provisions	-	38	16	-	54

[1] The item "Other provisions" comprises, among other things, restructuring provision of PLN 59 million and a provision for potential claims related to the sale of receivables in the amount of PLN 3 million, and provisions for disputes, including litigation related to remuneration of PLN 0.4 million.

CALCULATION OF ESTIMATES

The Bank performed a reassessment of its estimates as at 31 December 2017, on the basis of calculation conducted by an independent external actuary. The provisions calculated are equal to discounted future payments, taking into account staff turnover, and are related to the period ending on the balance sheet date. An important factor affecting the amount of the provision is the financial discount rate which was adopted by the Bank at the level of 3,25%. As at 31 December 2016, the adopted financial discount rate amounted to 3,50%.

The impact of an increase/decrease in the financial discount rate and the planned increase in the provision base of 1 pp. on a decrease/increase in the amount of the provision for retirement and disability benefits as at 31 December 2017 and as at 31 December 2016 is presented in the tables below:

ESTIMATED CHANGE IN PROVISIONS AS AT 31.12.2017	Financial discount rate		Planned increase in base amounts	
	scenariusz +1pp	scenario -1pp	scenario +1pp	scenario -1pp
Provision for pension and disability benefits	(4)	4	5	(3)

ESTIMATED CHANGE IN PROVISIONS AS AT 31.12.2016	Financial discount rate		Planned increase in base amounts	
	scenariusz +1pp	scenario -1pp	scenario +1pp	scenario -1pp
Provision for pension and disability benefits	(4)	4	5	(3)

36. EQUITY AND SHAREHOLDING STRUCTURE OF THE BANK

Accounting policies
Financial information:
- Equity
- Shareholding structure of the Bank
- Structure of PKO Bank Polski SA's share capital

ACCOUNTING POLICIES

Equity components, with the exception of treasury shares, are measured at their nominal amounts. Treasury shares are measured at cost.

Equity constitutes capital and reserves created in accordance with the legal regulations. The classification to particular components discussed below results from the Polish Commercial Companies Code, the Banking Law and the requirements of IAS 1.7, IAS 1.78.e, IAS 1.54.q-r and IAS 1.79.b.

Equity components:

- Share capital is stated at nominal value in accordance with the Articles of Association and the Register of Businesses.
- Supplementary capital is created according to the Articles of Association of the Bank, from the appropriation of profits and from share premium less issue costs and it is to cover the potential losses which might result from the Bank's activities.
- The general banking risk fund in PKO Bank Polski SA is created from profit after tax in accordance with the Banking Law, and it is to cover unidentified risks of the Bank's operations.
- Other reserves are created from the appropriation of net profit. Other reserves are only intended to cover any potential balance-sheet losses.
- Other comprehensive income comprises the effects of valuation of available-for-sale financial assets, the effective part of cash flow hedges resulting from hedge accounting as well as actuarial gains and losses. Deferred tax on those items is recognized in other comprehensive income. Moreover, the item includes foreign exchange differences on translation to Polish currency of the net result of the foreign operations (branch in Germany) at the rate constituting the arithmetic mean of foreign exchange rates for the currency as at the last day of each of the months in the financial year published by the National Bank of Poland.

(IN PLN MILLION)

FINANCIAL INFORMATION

EQUITY	31.12.2017	31.12.2016
Share capital	1 250	1 250
Supplementary capital	27 118	24 268
General banking risk fund	1 070	1 070
Other reserves	3 593	3 555
Other comprehensive income, of which:	182	(441)
Available-for-sale financial assets	266	(342)
Cash flow hedges	(75)	(89)
Actuarial gains and losses;	(9)	(10)
Net profit or loss for the year	2 774	2 888
Total	**35 987**	**32 590**

SHAREHOLDING STRUCTURE OF THE BANK

According to the information available as at 31 December 2017 the Bank's shareholding structure is as follows:

NAME OF SHAREHOLDER	Number of shares held	% of voting rights	Nominal value of 1 share	Interest held (%)
At 31 December 2017				
State Treasury	367 918 980	29,43	PLN 1	29,43
Nationale-Nederlanden Open Pension Fund (ING Open Pension Fund until 23.06.2015)1	103 388 120	8,27	PLN 1	8,27
Aviva Otwarty Fundusz Emerytalny[1]	95 163 966	7,61	PLN 1	7,61
Other shareholders[2]	683 528 934	54,69	PLN 1	54,69
Total	**1 250 000 000**	**100,00**	---	**100,00**
At 31 December 2016				
State Treasury	367 918 980	29,43	PLN 1	29,43
Nationale-Nederlanden Open Pension Fund (ING Open Pension Fund until 23.06.2015)1	120 748 753	9,66	PLN 1	9,66
Aviva Otwarty Fundusz Emerytalny[1]	87 463 966	7,00	PLN 1	7,00
Other shareholders[2]	673 868 301	53,91	PLN 1	53,91
Total	**1 250 000 000**	**100,00**	---	**100,00**

[1] Calculation of shareholdings as at the end of the year published by PTE in annual information about the structure of fund assets and quotation from the securities exchange official list (*Ceduła Giełdowa*).

[2] Including Bank Gospodarstwa Krajowego which, as at the date of the publication of this report, held 24 487 297 shares, constituting a 1.96% share at the General Shareholders' Meeting

All the shares of PKO Bank Polski SA carry the same rights and obligations. Shares are not preference shares, in relation to voting rights or dividends. However, the Articles of Association of PKO Bank Polski SA restricts the voting rights of shareholders holding more than 10% of the total number of votes at the General Shareholders' Meeting and forbids those shareholders to execute more than 10% of the total number of votes at the General Shareholders' Meeting. The above does not apply to:

- those shareholders who on the date of passing the resolution of the General Shareholders' Meeting introducing the limitation of the voting rights had rights from the shares representing more than 10% of the total number of votes at the Bank (i.e. the State Treasury and BGK),
- shareholders who have the rights from A-series registered shares (the State Treasury), and
- shareholders acting jointly with the shareholders referred to in point (2) based on an agreement concerning the joint execution of voting rights from shares.

Moreover, limitation of the voting rights shall expire when the share of the State Treasury in the Bank's share capital drops below 5%.

(IN PLN MILLION)

In accordance with § 6 (2) of the PKO Bank Polski SA's Articles of Association, the conversion of A-series registered shares into bearer shares and the transfer of these shares requires the approval of the Council of Ministers in the form of a resolution. Conversion into bearer shares or transfer of A-series registered shares, after obtaining the afore-mentioned approval, results in the expiry of the above-mentioned restrictions in respect of shares subject to conversion into bearer shares or transfer, to the extent to which this approval was granted.

Pursuant to Art. 13 (20) of the Act dated 16 December 2016 on the rules for managing State property, the shares of PKO Bank Polski SA owned by the State Treasury may not be sold. Moreover, according to Art. 14 of the aforesaid Act, shares in PKO Bank Polski SA, (which – in line with the Regulation of the Chairman of the Council of Ministers on determining a list of companies of high importance for the State economy - was classified as a company of high importance for the State economy), owned by the State Treasury may not be donated to a local self-government unit or an association of local self-government units.

The Bank's shares are listed on the Warsaw Securities Exchange.

STRUCTURE OF PKO BANK POLSKI SA'S SHARE CAPITAL:

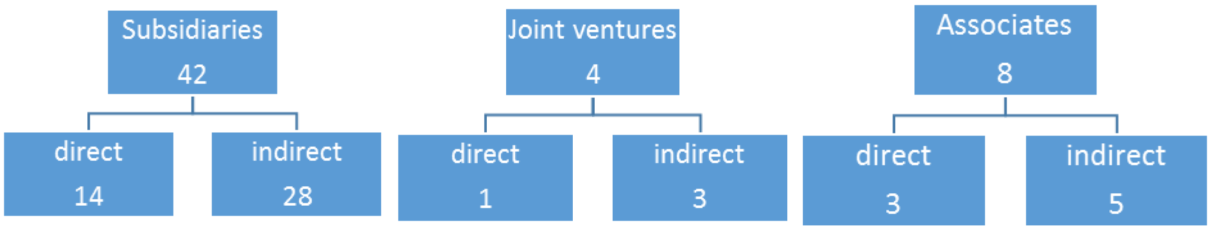
Series	Type of shares	Number of shares	Nominal value of 1 share	Nominal value of the series
Series A	ordinary registered shares	312 500 000	PLN 1	PLN 312 500 000
Series A	ordinary bearer shares	197 500 000	PLN 1	PLN 197 500 000
Series B	ordinary bearer shares	105 000 000	PLN 1	PLN 105 000 000
Series C	ordinary bearer shares	385 000 000	PLN 1	PLN 385 000 000
Series D	ordinary bearer shares	250 000 000	PLN 1	PLN 250 000 000
Total	---	**1 250 000 000**	---	**PLN 1 250 000 000**

In 2017 and in 2016, there were no changes in the amount of the share capital of PKO Bank Polski SA. Shares of PKO Bank Polski SA issued are not preference shares and are fully paid up.

(IN PLN MILLION)

INFORMATION ABOUT MEMBERS OF THE PKO BANK POLSKI SA GROUP, JOINT VENTURES AND ASSOCIATES

PKO BANK POLSKI SA – the parent company



37. STRUCTURE OF THE PKO BANK POLSKI SA GROUP AND THE SCOPE OF ACTIVITIES OF THE GROUP ENTITIES

The PKO Bank Polski SA Group consists of the following subsidiaries:

No.	NAME OF ENTITY	REGISTERED OFFICE	% SHARE IN EQUITY	
	DIRECT SUBSIDIARIES		31.12.2017	31.12.2016
1	PKO Towarzystwo Funduszy Inwestycyjnych SA	Warsaw	100	100
2	PKO BP BANKOWY PTE SA	Warsaw	100	100
3	PKO Leasing SA	Łódź	100	100
4	PKO BP Finat Sp. z o.o.	Warsaw	100	100
5	PKO Życie Towarzystwo Ubezpieczeń SA	Warsaw	100	100
6	PKO Towarzystwo Ubezpieczeń SA	Warsaw	100	100
7	PKO Bank Hipoteczny SA	Gdynia	100	100
8	PKO Finance AB	Sztokholm, Szwecja	100	100
9	KREDOBANK SA	Lviv, Ukraine	99,6293	99,6293
10	Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o.[1]	Kiev, Ukraine	95,4676	95,4676
11	Qualia Development Sp. z o.o.[2]	Warsaw	100	100
12	ZenCard Sp. z o.o.[3]	Warsaw	100	-
13	Merkury - fiz an[4]	Warsaw	100	100
14	NEPTUN - fizan[4]	Warsaw	100	100

[1] The other shareholder of the company is "Inter-Risk Ukraina" additional liability company; the company is disclosed in non-current assets held for sale.
[2] The company is disclosed in non-current assets held for sale
[3] The company was acquired on 26 January 2017.
[4] PKO Bank Polski SA has investment certificates of the Fund; the share in the Fund's investment certificates of the Fund is presented in the item "Share in equity".

(IN PLN MILLION)

No.	NAME OF ENTITY INDIRECT SUBSIDIARIES	REGISTERED OFFICE	% SHARE IN EQUITY* 31.12.2017	 31.12.2016
	The PKO Leasing SA[1] GROUP			
1	PKO Leasing Sverige AB	Stockholm, Sweden	100	100
2	PKO Faktoring SA	Warsaw	100	100
3	PKO Leasing Nieruchomości Sp. z o.o.[2]	Warsaw	100	100
4	PKO Agencja Ubezpieczeniowa Sp. z o.o.[3]	Warsaw	100	100
	PKO Leasing Finanse Sp. z o.o.[4]	Warsaw	100	100
5	ROOF Poland Leasing 2014 DAC[5]	Dublin, Ireland	-	-
	The PKO BP Finat Sp. z o.o. GROUP			
6	KBC Towarzystwo Funduszy Inwestycyjnych SA[6]	Warsaw	100	-
	Net Fund Administration Sp. z o.o.	Warsaw	100	-
	The PKO Życie Towarzystwo Ubezpieczeń SA GROUP			
7	Ubezpieczeniowe Usługi Finansowe Sp. z o.o.	Warsaw	100	100
	The KREDOBANK SA GROUP			
8	Finansowa Kompania "Idea Kapitał" Sp. z o.o.	Lviv, Ukraine	100	100
	The Qualia Development Sp. z o.o.[7] GROUP			
9	Qualia Sp. z o.o.	Warsaw	100	100
10	Qualia 2 Sp. z o.o.	Warsaw	100	100
11	Qualia 3 Sp. z o.o.	Warsaw	100	100
12	Qualia 3 spółka z ograniczoną odpowiedzialnością – Neptun Park Sp. k.	Warsaw	99,9975	99,9975
13	Qualia 2 spółka z ograniczoną odpowiedzialnością – Nowy Wilanów Sp. k.	Warsaw	99,9750	99,9750
14	Qualia spółka z ograniczoną odpowiedzialnością – Zakopane Sp. k.	Warsaw	99,9123	99,9123
15	Qualia Hotel Management Sp. z o.o.	Warsaw	100	100
16	Qualia - Residence Sp. z o.o.	Warsaw	100	100
17	Sarnia Dolina Sp. z o.o.	Warsaw	100	100
18	FORT MOKOTÓW Sp. z o.o. w likwidacji	Warsaw	51	51
	Giełda Nieruchomości Wartościowych Sp. z o.o.[8]	Warsaw	-	100
	Qualia sp. z o.o. – Sopot Sp. k.[8]	Warsaw	-	99,9787
	Qualia spółka z ograniczoną odpowiedzialnością – Projekt 1 Sp. k.[9]	Warsaw	-	50
	Merkury - fiz an			
19	"Zarząd Majątkiem Górczewska" Sp. z o.o.	Warsaw	100	100
20	Molina Sp. z o.o.	Warsaw	100	100
21	Molina spółka z ograniczoną odpowiedzialnością 1 S.K.A.	Warsaw	100	100
22	Molina spółka z ograniczoną odpowiedzialnością 2 S.K.A.	Warsaw	100	100
23	Molina spółka z ograniczoną odpowiedzialnością 3 S.K.A.	Warsaw	100	100
24	Molina spółka z ograniczoną odpowiedzialnością 4 S.K.A.	Warsaw	100	100
25	Molina spółka z ograniczoną odpowiedzialnością 5 S.K.A.	Warsaw	100	100
26	Molina spółka z ograniczoną odpowiedzialnością 6 S.K.A.	Warsaw	100	100
	NEPTUN - fizan			
27	Bankowe Towarzystwo Kapitałowe SA	Warsaw	100	100
	"Inter-Risk Ukraina" Spółka z dodatkową odpowiedzialnością[10]	Kiev, Ukraine	99,90	-
28	"CENTRUM HAFFNERA" Sp. z o.o.	Sopot	72,9766	72,9766
	"Sopot Zdrój" Sp. z o.o.	Sopot	100	100
	"Promenada Sopocka" Sp. z o.o.	Sopot	100	100

* share in equity of the direct parent

[1] On 28 April 2017 Raiffeisen-Leasing Polska SA (as the acquiree) was merged with PKO Leasing SA (as the acquirer); until 27 April 2017, Raiffeisen-Leasing Polska SA was a direct subsidiary of PKO Leasing SA.
[2] Former name: Raiffeisen-Leasing Real Estate Sp. z o.o.; until 27 April 2017, the company was a direct subsidiary of Raiffeisen-Leasing Polska SA.
[3] Former name: "Raiffeisen Insurance Agency" Sp. z o.o.; until 27 April 2017, the company was a direct subsidiary of Raiffeisen-Leasing Polska SA.
[4] Former name: Raiffeisen-Leasing Service Sp. z o.o.
[5] PKO Leasing SA (as the legal successor of Raiffeisen-Leasing Polska SA), in accordance with IFRS 10, exercises control over the company, although it has no interest in the company's share capital.
[6] The company was acquired on 12 December 2017.
[7] In the limited partnerships of the Qualia Development Sp. z o.o. Group, Qualia Development Sp. z o.o. is the limited partner, and general partners are, respectively: Qualia Sp. z o.o., Qualia 2 Sp. z o.o. and Qualia 3 Sp. z o.o.; according to the Articles of the aforesaid partnerships, the limited partner participates in 99.9% in profits, losses and assets of the limited partnership in the case of its liquidation, and the general partner - in 0.1%.; in the statement the limited partner's share in the capital is presented in the amount of contributions made.
[8] On 13 October 2017, there was a merger of Qualia sp. z o.o. - Sopot Sp.k. and Giełda Nieruchomości Wartościowych Sp. z o.o. (as acquirees) with Qualia Sp. z o.o. (as acquirer).
[9] In 2017, the partnership was dissolved without liquidation proceedings.
[10] The second partner of the company is Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o.; up until 27 April 2017, it was a direct subsidiary of PKO Bank Polski SA.

NAME OF THE SUBSIDIARY	CORE BUSINESS
FORUM TOWARZYSTWO FUNDUSZY INWESTYCYJNYCH S.A.	The core business of the company is the creation, representation towards third parties and the management of open and closed investment funds and management of the clients' portfolio, which include one or more financial instruments. The company also offers specialized investment programs and conducts employee pension programs (PPE).
PKO LEASING SA	The Company, together with its subsidiaries – PKO Leasing Sverige AB and PKO Leasing Nieruchomości Sp. z o.o. provides lease services. The companies offer finance and operating leases: cars, vans, trucks, machinery and equipment, technological lines, medical equipment, real estate, IT hardware and software, ships, aircraft and railway equipment. The offer includes a fleet management service. Moreover, a subsidiary – PKO Leasing Finanse Sp. z o.o. is involved in storing, preparing and selling post-debt-collection and post-contract items and PKO Agencja Ubezpieczeniowa Sp. z o.o. provides specialist services within the scope of creating insurance products and programmes for the clients of financial institutions. This Group also includes a special purpose vehicle with its registered office in Ireland, established for the securitization of lease receivables. The PKO Leasing SA Group also includes PKO Faktoring SA, which provides services of domestic and export factoring with assuming the risk and without assuming the risk, reverse factoring and service of factoring program for the suppliers.
PKO BANK HIPOTECZNY SA	The core purpose of the company is to issue mortgage bonds which constitute the main source of long-term financing of loans secured with mortgage. The company specializes in granting mortgage housing loans to individual clients and it also purchases receivables relating to such loans from PKO Bank Polski SA.
PKO BP BANKOWY PTE SA	The company's activities consist of creating and managing an open and voluntary pension fund and representing it in contacts with third parties. The company manages PKO BP Bankowy Otwarty Fundusze Emerytalny (OFE) and PKO Dobrowolny Fundusz Emerytalny (DFE), within which the Individual Retirement Account (*Indywidualne Konto Emerytalne* – IKE) and Individual Retirement Security Account (*Indywidualne Konto Zabezpieczenia Emerytalnego* – IKZE) are offered.
PKO BP FINAT SP. Z O.O.	PKO BP Finat Sp. z o.o. provides comprehensive services to companies in the financial sector – including transfer agent, fund and company accounting. It also specializes in competency outsourcing of IT specialists, project teams and IT processes. On the basis of the authorization of the Polish Financial Supervision Authority, the Company also provides services as a national payment institution. Its clients are both companies of the Group, as well as companies outside the Group. In 2016, the Company began to handle group insurance dedicated to the products offered by the Bank. From December 2017, the PKO BP Finat Sp. z o.o. Group also comprises KBC Towarzystwo Funduszy Inwestycyjnych SA and Net Fund Administration Sp. z o.o. The core business of KBC Towarzystwo Funduszy Inwestycyjnych SA is the creation, representation towards third parties and the management of open and closed investment funds and the management of client portfolios, which include one or more financial instruments. Net Fund Administration Sp. z o.o. provides transfer agent services, and IT services.

PKO Życie Towarzystwo Ubezpieczeń SA	The company's core business consists of insurance activities in respect of insurance sector I – life insurance. The scope of the company's activities comprises policies in all groups specified in the PFSA licence (1, 2, 3, 4, 5 Section I). The Company offers a wide range of insurance products. It focuses on life and health insurance for its clients. It has both separate products and products supplementing the banking products offered by the Bank.
PKO Towarzystwo Ubezpieczeń SA	The company's core business consists of insurance activities in respect of insurance sector II – other personal insurance and property insurance. The scope of the company's activities comprises policies in all groups specified in the PFSA licence (1, 2, 7, 8, 9, 13, 14, 15, 16, 17, 18 Section II). PKO TU SA focuses on insuring against loss of income, private third party liability insurance and sickness insurance as well as real property insurance for loan recipients and clients who draw mortgage loans. The company offers a wide range of insurance products addressed to customers of PKO Bank Polski SA and other members of the Bank's Group.
PKO Finance AB	The company conducts financial activities, mainly by seeking financing from international markets by issue of bonds and by lending the funds obtained to other members of the Bank's Group, including PKO Bank Polski SA.
Qualia Development Sp. z o.o.	The core business of the members of the Qualia Development Sp. z o.o. Group is development activities, including in particular housing construction projects in all parts of Poland. Moreover, the Group is engaged in the hotel business, and intermediary activity in real estate turnover. In 2017, the Group continued activities related to the execution of current projects and selling selected property and companies.
KREDOBANK SA	KREDOBANK SA is a universal bank, focused on the customer service of retail clients and small- and medium-sized enterprises running the business mainly in the western part of Ukraine and in Kiev. At the same time the Company strives to attract corporate customers with high creditworthiness. The company offers services including maintaining the bank accounts of individuals and businesses, collecting deposits, lending, issuing warranties and guarantees, checks and bills trading, operations on the currency market, as well as operations on the securities market. The core business of Finansowa Kompania "Idea Kapitał" Sp. z o.o. – a subsidiary of KREDOBANK SA – is providing various financial services, including factoring services consisting in the acquisition of rights to the assignment of monetary claims under loan agreements in accordance with Ukrainian law.
Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o.	The core company's business is providing various financial services, including factoring services consisting in the acquisition of rights to the assignment of monetary claims under loan agreements in accordance with Ukrainian law.
ZenCard Sp. z o.o.	The company conducts activities in respect of information technology and computer services; it specializes in creating solutions connected with using payment cards in discount and loyalty programmes. The Company built a platform for sellers to create discount and loyalty programmes, which at the same time allows for the virtualization of loyalty cards. This platform is integrated with a payment terminal and allows resignation from numerous separate loyalty cards or separate applications installed on mobile phones in return for a customer payment card which at the same time is a virtual loyalty card of each vendor. The company's strategic partner is CEUP eService Sp. z o.o. – one of the largest settlement agents in Poland.

MERKURY – FIZ AN	The fund's activities comprise investing money raised by non-public offer to purchase investment certificates. The Fund is managed by PKO TFI SA. The fund conducts investment activities through subsidiaries whose business is buying and selling real estate on its own account and property management.
NEPTUN – FIZ AN	The fund's activities comprise investing money raised by non-public offer to purchase investment certificates. The Fund is managed by PKO TFI SA. PKO Bank Polski SA sells to the Fund shares of companies whose business is not complementary to the offer of financial services offered by the Bank.

38. INVESTMENTS IN SUBSIDIARIES, JOINT VENTURES AND ASSOCIATES

ACCOUNTING POLICIES

Investments in subsidiaries, joint ventures and associates are measured at cost less impairment losses. In case of sale of investments in subsidiaries, which results in a loss of control, the Bank performs a valuation to fair value of the remaining investment and accepts this value as a new cost for the purpose of subsequent valuation. The excess of the fair value of the investment over the carrying amount is recognized by the Bank in other operating income.

At each balance sheet date, the Bank makes an assessment of whether there is any objective evidence of impairment of investments in subsidiaries, joint ventures and associates. If any such evidence exists, the Bank estimates the value in use of the investment or the fair value of the investment less costs to sell, depending on which of these values is higher, and in case when carrying amount of an asset exceeds its value in use, the Bank recognizes an impairment loss in the income statement. The above projection for the value in use requires making assumptions, among other things, about future cash flows that the Bank may receive from dividends or the cash inflows from a potential disposal of the investment, less costs to sell.

(IN PLN MILLION)

FINANCIAL INFORMATION

INVESTMENTS IN SUBSIDIARIES, JOINT VENTURES AND ASSOCIATES

AS AT 31 DECEMBER 2017	Gross book value	Impairment	Carrying amount
SUBSIDIARIES			
PKO Bank Hipoteczny SA	1 200	-	1 200
KREDOBANK SA	1 070	(793)	277
PKO Życie Towarzystwo Ubezpieczeń SA	241	-	241
PKO Towarzystwo Funduszy Inwestycyjnych SA (investment fund manc	187	-	187
PKO Leasing SA	178	-	178
PKO BP BANKOWY PTE SA	151	-	151
NEPTUN - fizan[1]	132	-	132
Merkury - fiz an[1]	120	-	120
PKO Towarzystwo Ubezpieczeń SA	110	-	110
PKO Finance AB	24	-	24
PKO BP Finat Sp. z o.o.	21	-	21
ZenCard Sp. z o.o.	18	-	18
JOINT VENTURES			
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	197	-	197
ASSOCIATES			
Bank Pocztowy SA	184	(54)	130
FERRUM SA	25	-	25
"Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o.	2	(2)	-
Total	**3 860**	**(849)**	**3 011**

[1] PKO Bank Polski SA holds investment certificates of the Fund which allow to control the Fund in accordance with IFRS.

AS AT 31 DECEMBER 2016	Gross book value	Impairment	Carrying amount
SUBSIDIARIES			
KREDOBANK SA	1 070	(793)	277
PKO Bank Hipoteczny SA	800	-	800
PKO Życie Towarzystwo Ubezpieczeń SA	241	-	241
PKO Towarzystwo Funduszy Inwestycyjnych SA (investment fund manc	187	-	187
PKO Leasing SA	178	-	178
PKO BP BANKOWY PTE SA	151	-	151
Merkury - fiz an[1]	120	-	120
PKO Towarzystwo Ubezpieczeń SA	110	-	110
NEPTUN - fizan[1]	95	-	95
PKO BP Finat Sp. z o.o.	22	-	22
PKO Finance AB	-	-	-
JOINT VENTURES			
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	197	-	197
ASSOCIATES			
Bank Pocztowy SA	161	(29)	132
FERRUM SA	25	-	25
"Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o.	2	(2)	-
Total	**3 359**	**(824)**	**2 535**

[1] PKO Bank Polski SA holds investment certificates of the Fund which allow to control the Fund in accordance with IFRS.

(IN PLN MILLION)

IMPAIRMENT ALLOWANCES

According to IAS 36 "Impairment of assets", the recoverable amount of investments in subsidiaries, joint ventures and associates has been assessed.

In 2017 the Bank, on the basis of valuation, recognized an impairment loss on investment in Bank Pocztowy SA in the amount of PLN 25 million (PLN 29 million in 2016). The impairment test was based on discounted dividend model.

IMPAIRMENT ALLOWANCES – RECONCILIATION OF MOVEMENTS	2017	2016
As at the beginning of the period	824	795
Recognized during the period	25	29
As at the end of the period	849	824
Net increase - impact on the income statement	**(25)**	**(29)**

SELECTED INFORMATION ON ASSOCIATES AND JOINT VENTURES

The Bank holds the following associates and joint ventures:

No.	NAME OF ENTITY	REGISTERED OFFICE	% SHARE IN EQUITY*	
			31.12.2017	31.12.2016
	Joint ventures of PKO Bank Polski SA			
1	Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	Warsaw	34	34
	1 EVO Payments International Sp. z o.o.	Warsaw	100	100
	2 EVO Payments International s.r.o.	Prague, the Czech Republic	100	100
	Joint venture of NEPTUN - fizan			
	3 "Centrum Obsługi Biznesu" Sp. z o.o.	Poznań	41,44	41,44
	Associates of PKO Bank Polski SA			
1	Bank Pocztowy SA	Bydgoszcz	25,0001	25,0001
	1 Centrum Operacyjne Sp. z o.o. w likwidacji[1]	Bydgoszcz	100	100
	2 Spółka Dystrybucyjna Banku Pocztowego Sp. z o.o.	Warszawa	100	100
2	"Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o	Poznań	33,33	33,33
3	FERRUM SA	Katowice	22,14	22,14
	3 FERRUM MARKETING Sp. z o.o.	Katowice	100	100
	4 Zakład Konstrukcji Spawanych FERRUM SA	Katowice	100	100
	5 Walcownia Rur FERRUM Sp. z o.o. w likwidacji[2]	Katowice	100	-

* share in equity of direct parent entity / entity exercising significant influence

[1] In July 2017, the Extraordinary Shareholders' Meeting adopted resolution on dissolving the company.
[2] In June 2017, the Shareholders' Meeting adopted resolution on dissolving the company.

NAME OF JOINT VENTURES AND ASSOCIATES	CORE BUSINESS
CENTRUM ELEKTRONICZNYCH USŁUG PŁATNICZYCH ESERVICE SP. Z O.O.	The company offers services which consist of processing transactions involving payment instruments conducted both through POS terminals in Poland and abroad and online, lease of POS terminals, top-ups of mobile phone cards and servicing of gift cards. PKO Bank Polski SA, together with the company, offer comprehensive services which involve attracting and servicing entities which use POS terminals and settling transactions conducted with payment instruments using such terminals. Both entities jointly participate in tenders, and the cooperation is governed by agreements on, among other things: • servicing cashless transactions concluded using payment instruments for bilateral agreements with merchants; • marketing cooperation in respect of services of fundamental importance to the functioning of the products and services offered both by the Bank and the company; • the provision of services relating to withdrawals of cash in the Bank's agent and branch offices and in post offices using Visa and MasterCard payment cards using POS terminals; • cooperation in providing services associated with attracting retail outlets which accept payment instruments, The company has two direct subsidiaries and exerts full control over these subsidiaries.
BANK POCZTOWY SA	Bank Pocztowy SA specializes in standard banking products offered to retail clients and a supplementary offer for micro-businesses and institutional clients. It also operates in the segment of settlements and treasury. As part of the strategic partnership with Poczta Polska SA (a shareholder with 75% minus 10 shares of the company) it uses the potential of a shareholder and develops a range of products in collaboration with stakeholders across the Poczta Polska Group. The company has two direct subsidiaries in which it exercises full control, whereas one of them has been put into liquidation.
"POZNAŃSKI FUNDUSZ PORĘCZEŃ KREDYTOWYCH" SP. Z O.O.	The company specializes in supporting the development of small- and medium-sized enterprises by providing guarantees and various types of services for business. The company grants guarantees for loans and advances extended by banks, including PKO Bank Polski SA, as well as bank guarantees, lease and factoring transactions, and bid bond guarantees. The entity cooperates with PKO Leasing SA. The company's offer also includes guarantees for small- and medium-sized enterprises, under the JEREMIE (Join European Resources for Micro to Medium Enterprises), which are re-underwritten mutually at 70% or 80% from the Wielkopolski Regionalny Program Operacyjny, managed by Bank Gospodarstwa Krajowego. As part of its services for businesses, the company, among other things, prepares business plans, feasibility studies, recovery and restructuring programmes, prepares financial documentation and seeks appropriate forms of financing enterprise operations.
FERRUM SA	The company's operations comprise manufacturing welded steel tubes, hollow profiles and insulating tubes. The company has three direct subsidiaries in which it exercises full control, whereas one of them has been put into liquidation.[1] The company's shares were taken up under the debt recovery actions (foreclosure of collateral). The Company is a public company whose shares are listed on the Warsaw Securities Exchange.

[1] Data consistent with the consolidated financial statements of the FERRUM SA Group for the 3rd quarter of 2017.

(IN PLN MILLION)

A summary of the financial data separately for each joint venture and each associate of the Group was presented below. The amounts presented are derived from the financial statements of the specific entities prepared in accordance with IFRS or Polish Accounting Standards (PAS).[2] The data for 2016 has been derived from audited financial statements.

Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o. (in accordance with IFRS)	31.12.2017	31.12.2016
Current assets	198	140
Non-current assets	228	199
Current liabilities	161	118
Non-current liabilities	26	32
	01.01-31.12.2017	01.01-31.12.2016
Revenue	477	490
Profit (loss) on continuing operations	88	98
Profit/(loss) for the period	88	98
Other comprehensive income	6	1
Total comprehensive income	94	99
Dividend received from an entity classified as a joint venture	12	11

Bank Pocztowy SA (in accordance with IFRS, data as published by the Company)	30.06.2017	31.12.2016
Total assets	7 107	6 937
Total liabilities	6 572	6 413
	01.01-30.06.2017	01.01-31.12.2016
Revenue	221	469
Profit (loss) on continuing operations	2	3
Profit/(loss) for the period	2	3
Other comprehensive income	9	(21)
Total comprehensive income	11	(18)

"Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o. (in accordance with PAS)	31.12.2017	31.12.2016
Current assets	24	23
Current liabilities	4	3
Non-current liabilities	2	3
	01.01-31.12.2017	01.01-31.12.2016
Revenue	2	3
Profit/(loss) for the period	-	-

FERRUM SA (in accordance with IFRS, data as published by the Company)	30.09.2017	31.12.2016
Current assets	137	97
Non-current assets	143	168
Current liabilities	210	201
Non-current liabilities	52	15
	01.01-30.09.2017	01.01-31.12.2016
Revenue	245	316
Profit (loss) on continuing operations	(30)	1
Profit/(loss) for the period	(30)	1
Total comprehensive income	(30)	1

[2] In the case of entities which have subsidiaries, the data presented is derived from the consolidated financial statements of such entities.

39. OTHER CHANGES TO COMPANIES COMPRISING THE GROUP

In 2017, the following events which had impact on the PKO Bank Polski SA Group's structure and relating to joint ventures and associates, including capital injection, took place.

ZENCARD SP. Z O.O.

On 26 January 2017, PKO Bank Polski SA purchased 1 374 shares in ZenCard Sp. z o.o. with a nominal value of PLN 50 PLN each, representing 100% of the company's share capital and 100% shares at the shareholders' meeting. At the same time, on 26 January 2017, the Extraordinary Shareholders' Meeting of ZenCard Sp. z o.o. (represented by PKO Bank Polski SA as the sole shareholder) adopted a resolution on increasing the company's share capital by PLN 22 050 by creating 441 new shares with a nominal value of PLN 50 each. The said changes were registered in the National Court Register on 14 March 2017. As at 31 December 2017, the company's share capital amounted to PLN 90,750 thousand and was divided into 1 815 shares with a nominal value of PLN 50 each.

ZenCard Sp. z o.o. is a technological company. The Bank is interested in using the company's and its founders' know-how in respect of solutions developed by the company, in particular in respect of creating loyalty programmes with the use of payment cards and supporting its own promotional campaigns.

PKO BANK HIPOTECZNY SA

In 2017 (on 12 April, 11 September, and 16 November, respectively) an increase of the company's share capital totalling PLN 400,000,000 was recorded in the National Court Register (KRS). All shares in the increased share capital were taken up by the existing sole shareholder, PKO Bank Polski SA. As at 31 December 2017, the company's share capital amounted to PLN 1 200 000 000 thousand and was divided into 1 200 000 000 shares with a nominal value of PLN 1 each.

NEPTUN – FUNDUSZ INWESTYCYJNY ZAMKNIĘTY AKTYWÓW NIEPUBLICZNYCH (FIZ AN)

On 25 April 2017, PKO Bank Polski SA purchased 2 000 000 E-series investment certificates issued by NEPTUN – fundusz inwestycyjny zamknięty aktywów niepublicznych (closed-ended investment fund of non-public assets).

"INTER-RISK UKRAINA" ADDITIONAL LIABILITY COMPANY

On 28 April 2017, PKO Bank Polski SA sold within the Group, 100% of its shares in the share capital of "Inter-Risk Ukraina" an additional liability company, of which: 99.9% shares – to Bankowe Towarzystwo Kapitałowe SA, and 0.1% to Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. On 28 April 2017, an amendment to the Articles of Association of "Inter-Risk Ukraina" additional liability company with the aforesaid ownership changes was registered in the Single national register of legal entities, individuals-entrepreneurs and organizations of the Ukraine.

PKO LEASING SA GROUP

On 28 April 2017, the merger of PKO Leasing SA (as the acquirer) and Raiffeisen-Leasing Polska SA (as the acquiree) was registered in the National Court Register (KRS) competent for the acquirer. The merger was carried out by way of transferring all assets of Raiffeisen-Leasing Polska SA to PKO Leasing SA (merger through acquisition), without increasing the share capital of PKO Leasing SA and without replacing the shares. Therefore, PKO Leasing SA assumed all the rights and obligations of Raiffeisen-Leasing Polska SA. The process of integration of the companies will be completed with an operating merger, which will be concluded in 2018.

On 28 April 2017, the following changes in the names of companies in the PKO Leasing SA Group were registered in KRS:

- ✓ Raiffeisen-Leasing Real Estate Sp. z o.o. to PKO Leasing Nieruchomości Sp. z o.o.,
- ✓ "Raiffeisen Insurance Agency" Sp. z o.o. to PKO Agencja Ubezpieczeniowa Sp. z o.o.,
- ✓ Raiffeisen-Leasing Service Sp. z o.o. to PKO Leasing Finanse Sp. z o.o.

BANKOWE TOWARZYSTWO KAPITAŁOWE SA

On 18 July 2017, the company's share capital increase of PLN 30 000 000 was registered in KRS. All shares in the increased share capital were taken up by the existing sole shareholder – NEPTUN – fundusz inwestycyjny zamknięty aktywów niepublicznych, whose 100% investment certificates are held by PKO Bank Polski SA.

As at 31 December 2017, the company's share capital amounted to PLN 63 243 900 thousand and was divided into 632 439 shares with a nominal value of PLN 100 each.

PKO Finance AB

On 1 August 2017, the company's share capital increase of EUR 5 491 884 was registered in the Swedish register of business activities (Bolagsverket). All shares in the increased share capital were taken up by the existing sole shareholder, PKO Bank Polski SA.

As at 31 December 2017, the company's share capital amounted to EUR 5 547 358 thousand and was divided into 500,000 shares with a nominal value of EUR 11.09 each.

PKO BP Finat Sp. z o.o. Group

On 8 September 2017, PKO Bank Polski SA (as the guarantor) and its subsidiary - PKO BP Finat Sp. z o.o. (as the acquirer) signed a preliminary agreement with KBC Asset Management NV with its registered office in Belgium (as the seller) on the purchase of 100% of shares in KBC Towarzystwo Funduszy Inwestycyjnych SA (KBC TFI SA). The transaction was closed on 12 December 2017, upon prior approval of the President of the Office for Competition and Consumer Protection (UOKiK), and Polish Financial Supervision Authority (KNF). As a result of the aforementioned transaction, PKO BP Finat Sp. z o.o. purchased 25 257 983 ordinary shares in KBC TFI SA with a nominal value of PLN 1 (one) each, representing 100% of the share capital of KBC TFI SA and entitling to 100% of the voting rights at the General Shareholders' Meeting of the Company.

The company's core activities include is creating and managing investment funds.

As a result of the acquisition of KBC TFI SA, the PKO BP Finat Sp. z o.o. Group included its subsidiary, Net Fund Administration Sp. z o.o. (NetFA Sp. z o.o.), with the core activities comprising provision of transfer agent services. As at 31 December 2017, the Company's share capital amounted to PLN 6 652 500 thousand and is divided into 13 305 shares with a nominal value of PLN 500 each. Ultimately, in 2018, KBC TFI SA is to be merged with PKO TFI SA, and NetFA Sp. z o.o. is to be merged with PKO BP Finat Sp. z o.o.

Qualia Development Sp. z o.o. Group

- **Qualia Hotel Management Sp. z o.o.**

On 6 February 2017, the company's share capital increase of PLN 1 149 700 was registered in KRS. All shares were taken up and paid up in October 2016 by the existing sole shareholder – Qualia Development Sp. z o.o.

As at 31 December 2017, the Company's share capital amounted to PLN 1 411 500 thousand and is divided into 28 230 shares with a nominal value of PLN 50 each.

- **Sarnia Dolina Sp. z o.o.**

On 6 April 2017, the company's share capital increase of PLN 5 000 was registered in KRS. All shares were taken up by the existing sole shareholder – Qualia Development Sp. z o.o.

As at 31 December 2017, the company's share capital amounted to PLN 6 979 000 thousand and was divided into 13 958 shares with a nominal value of PLN 500 each. On 7 April 2017, the Extraordinary Shareholders' Meeting of Sarnia Dolina Sp. z o.o. adopted a resolution on returning to Qualia Development Sp. z o.o. shareholder's contributions totalling PLN 21 549 527 brought to the company in accordance with Art. 177-179 of the Commercial Companies Code. On the same day, the funds were transferred.

- **Qualia spółka z ograniczoną odpowiedzialnością – Projekt 1 Sp. k.**

On 10 March 2017, the company's shareholders adopted a resolution on dissolving the company without liquidation proceedings. On 5 May 2017, the company was deleted from the National Court Register (KRS) (the date of deletion from KRS becoming valid).

- **Qualia 2 spółka z ograniczoną odpowiedzialnością – Nowy Wilanów Sp. k.**

On 27 April 2017, the company's partners adopted a resolution on reducing the capital share of the limited partner – Qualia Development Sp. z o.o. by PLN 28 000 000 through the distribution of funds accumulated in the partnership's reserves arising from additional contributions brought to the partnership in accordance with Art. 177-179 of the Commercial Companies Code, before transforming the entity from a limited liability company to a limited partnership. The funds were transferred in April 2017.

- **QUALIA 3 SPÓŁKA Z OGRANICZONĄ ODPOWIEDZIALNOŚCIĄ – NEPTUN PARK SP. K.**

On 12 September 2017, the company's partners adopted a resolution on reducing the capital share of the limited partner – Qualia Development Sp. z o.o. by PLN 15 000 000 through the distribution of funds accumulated in the partnership's reserves arising from additional contributions brought to the partnership in accordance with Art. 177-179 of the Commercial Companies Code, before transforming the entity from a limited liability company to a limited partnership. The funds were transferred in September 2017.

- **BUSINESS COMBINATION OF SELECTED SUBSIDIARIES IN THE QUALIA DEVELOPMENT SP. Z O.O. GROUP**

On 13 October 2017, a business combination of Qualia sp. z o.o. – Sopot Sp. k. and Giełda Nieruchomości Wartościowych Sp. z o.o. (the acquirees) with Qualia Sp. z o.o. (the acquirer) by transferring all the acquirees' assets to the acquirer. The merger plan announced on 26 June 2017 in *Monitor Sądowy i Gospodarczy*, only provided for increasing the share capital of the acquirer and exchange of shares.

Before the business combination in 2017 (on 18 January and 10 April, respectively) amendments to the Articles of Association of Qualia sp. z o.o. – Sopot Sp. k. were registered in the KRS, in respect of reducing the contribution of the limited partner – Qualia Development Sp. z o.o. from PLN 10 200 000 to PLN 2 200 000, and a reduction in the general amount from PLN 4 700 000 to PLN 2 200 000. The funds from the reduction in the limited partner's contribution were returned to Qualia Development Sp. z o.o., including the amount of PLN 5 500 000 in December 2016.

As at 31 December 2017, the share capital of Qualia Sp. z o.o. amounted to PLN 65,600 thousand and was divided into 1 312 shares with a nominal value of PLN 50 each. Qualia Development Sp. z o.o. is the company's sole shareholder.

RELATING TO JOINT VENTURES AND ASSOCIATES

- **BANK POCZTOWY SA GROUP**

On 29 November 2017, an increase in the share capital of Bank Pocztowy SA of PLN 18 145 200 was registered in KRS. PKO Bank Polski SA took up 453 630 shares with a total nominal value of PLN 4 536 300 and with a total issue value of PLN 22 500 048. The remaining shares were taken up by Poczta Polska SA. Eventually, Bank Pocztowy SA received a capital injection from its existing shareholders amounting to PLN 90 000 192. As a result of the aforesaid share capital increase, PKO Bank Polski SA still holds 25% of the company's share capital plus 10 shares.

As at 31 December 2017, the share capital of Bank Pocztowy SA amounted to PLN 128 278 080 thousand and was divided into 12 827 808 shares with a nominal value of PLN 10 each. In 2017, the fact that Centrum Operacyjne Sp. z o.o. (a subsidiary of Bank Pocztowy SA) was put into liquidation, was registered in the KRS.

- **CENTRUM ELEKTRONICZNYCH USŁUG PŁATNICZYCH ESERVICE SP. Z O.O. GROUP**

In 2017 (on 11 January and 1 March, respectively) an increase in the share capital of EVO Payments International Sp. z o.o. totalling PLN 364 400 was recorded in the National Court Register (KRS). Shares in the increased share capital of the company were taken up in 2016 by the sole shareholder – Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o. (a joint venture of PKO Bank Polski SA).

- **FERRUM SA GROUP**

In 2017, the fact that Walcowania Rur FERRUM Sp. z o.o. was put into liquidation, was registered in the KRS. The company is a subsidiary of FERRUM SA – an associate of PKO Bank Polski SA. Until 7 February 2017, the company operated under the name Walcowania Blach Grubych Batory Sp. z o.o. and was a direct subsidiary of FERRUM SA.

OTHER NOTES

40. DIVIDENDS PER SHARE

On 9 March 2017, PKO Bank Polski SA obtained an individual recommendation from the PFSA to retain the entire profit generated in the period from 1 January 2016 to 31 December 2016.

On 22 June 2017, the Annual General Shareholders' Meeting of PKO Bank Polski SA passed a resolution (No. 7/2017, Resolution on Profit Allocation) on the allocation of profit of PKO Bank Polski SA earned in 2016, according to which the entire profit of PLN 2 888 million was allocated to the equity as follows:

- supplementary capital of PLN 2 850,
- other reserves of PLN 38 million.

Retaining the profit for 2016 of PLN 2 888 million resulted effectively in an increase in own funds of PLN 1 299 million, because part of the profit generated in the period from 1 January 2016 to 30 September 2016 of PLN 1 589 million was already allocated to own funds upon the consent of the PFSA in 2016.

The general principle of the Bank's dividend policy is the stable execution of dividend payments over a long period in keeping with the principle of prudent management of the Bank and the Bank's Group, in line with the Bank's and Group's financial capabilities, taking into account the PFSA requirements and recommendations in respect of dividend policy. The applicable dividend policy assumes the possibility of making distributions from the surplus of the capital over the minimum level of capital ratios defined by the PFSA for dividend distribution purposes.

41. CONTINGENT LIABILITIES AND OFF-BALANCE LIABILITIES RECEIVED AND GRANTED

ACCOUNTING POLICIES

As part of its operating activities, the Bank concludes transactions which, at the time of conclusion, are not recognized as assets or liabilities in the statement of financial position, but which give rise to contingent liabilities. A contingent liability is:

1) a potential obligation resulting from past events whose existence will be confirmed at the moment of occurrence or non-occurrence of one or more uncertain future events which are not fully under the Bank's control; or
2) a current obligation which arises as a result of past events but is not recognized in the statement of financial position because it is not probable that cash or other assets would have to be expended to meet the obligation or the amount of the liability could not be assessed reliably.

Upon initial recognition a financial guarantee agreement is measured at fair value.

(IN PLN MILLION)

FINANCIAL INFORMATION

SECURITIES PROGRAMMES COVERED WITH UNDERWRITING AGREEMENTS (GROUP'S MAXIMUM COMMITMENT TO TAKE UP SECURITIES)

ISSUER OF UNDERWRITTEN SECURITIES	Type of underwritten securities	Off-balance sheet liabilities resulting from underwriting agreements	Contract expiry date
As at 31 December 2017			
Company A	corporate bonds	1 453	31.12.2020
Company B	corporate bonds	769	31.07.2020
Company C	corporate bonds	58	31.12.2022
Total		**2 280**	

ISSUER OF UNDERWRITTEN SECURITIES	Type of underwritten securities	Off-balance sheet liabilities resulting from underwriting agreements	Contract expiry date
As at 31 December 2016			
Company A	corporate bonds	1 126	31.12.2020
Company B	corporate bonds	1 055	31.07.2020
Company D	corporate bonds	512	15.06.2022
Company C	corporate bonds	69	31.12.2022
Company E	corporate bonds	9	31.12.2026
Total		**2 771**	

All contracts relate to the Agreement for the Organization, Conducting and Servicing of the Bond Issuance Programme.

All securities of the Bank under the underwriting programme have unlimited transferability, are not listed on the stock exchange and are not traded on a regulated OTC market.

CONTRACTUAL COMMITMENTS

VALUE OF CONTRACTUAL COMMITMENTS CONCERNING:	31.12.2017	31.12.2016
intangible assets	17	34
property, plant and equipment	72	9
Total	**89**	**43**

FINANCIAL LIABILITIES GRANTED

NOMINAL VALUE OF LOAN COMMITMENTS GRANTED	31.12.2017	31.12.2016
Credit lines and limits		
to financial entities	6 568	7 607
to non-financial entities	35 338	37 899
to public entities	4 273	3 856
Total	**46 179**	**49 362**
of which irrevocable loan commitments	33 607	31 078

(IN PLN MILLION)

GUARANTEE LIABILITIES GRANTED

GUARANTEES AND PLEDGES GRANTED	31.12.2017	31.12.2016
Guarantees granted in domestic and foreign trading	8 404	7 780
Guarantees and pledges granted – domestic corporate bonds	4 335	4 769
Letters of credit issued	1 430	1 600
Guarantees and warranties granted – payment guarantee	205	151
Guarantees and pledges granted - domestic municipal bonds	316	351
Total	**14 690**	**14 651**
of which performance guarantees granted	2 630	2 447

Information about the provisions recognized for off-balance sheet financial and guarantee liabilities is presented in the Note 'Provisions'.

LIABILITIES GRANTED BY MATURITY

OFF-BALANCE SHEET LIABILITIES GRANTED BY MATURITY AS AT 31.12.2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Loan commitments granted	7 547	2 672	13 253	14 915	7 792	46 179
Guarantee liabilities granted	751	506	3 232	8 010	2 191	14 690
Total	**8 298**	**3 178**	**16 485**	**22 925**	**9 983**	**60 869**

OFF-BALANCE SHEET LIABILITIES GRANTED BY MATURITY AS AT 31.12.2016	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Loan commitments granted	12 669	5 749	13 408	11 104	6 432	49 362
Guarantee liabilities granted	263	569	3 700	8 583	1 536	14 651
Total	**12 932**	**6 318**	**17 108**	**19 687**	**7 968**	**64 013**

OFF-BALANCE SHEET LIABILITIES RECEIVED

OFF-BALANCE SHEET LIABILITIES RECEIVED BY NOMINAL VALUE	31.12.2017	31.12.2016
financial	95	81
guarantees	14 066	7 385
Total	**14 161**	**7 466**

Due to the provisions of the Agreement which require the Nordea Bank AB (publ) Group to participate in the default risk of the Mortgage Portfolio, on 1 April 2014, PKO Bank Polski SA and Nordea Bank AB (publ) concluded a special indemnity agreement (the 'Special Indemnity Agreement'), according to which Nordea Bank AB (publ) covers, for a period of 4 years following the Closing Date, 50% of the excess of the Mortgage Portfolio cost of risk over the annual cost of risk set at 40 basis points for each year of the above-mentioned four-year contract period of the Special Indemnity Agreement.

As part of the work related to the settlement of the transaction, the Bank has made a valuation of the Special Indemnity Agreement based on the analysis conducted of the probability of cash flows arising from the Agreement. The estimated expected value is zero.

On 21 December 2017, after obtaining the necessary corporate consents, the Bank concluded a guarantee agreement with the counterparty which ensured unfunded credit protection in respect of a portfolio of selected corporate loan receivables of the Bank, in accordance with the CRR Regulation ("Guarantee").

The total value of the Bank's portfolio of receivables covered by the Guarantee amounts to PLN 5,495 million, and the portfolio comprises a portfolio of bonds with a value of PLN 1,097 million ("Portfolio A") and a portfolio of other receivables of PLN 4 398 million ("Portfolio B"). The Guarantee coverage ratio amounts to 90% - in respect of Portfolio A and 80% - in respect of Portfolio B, therefore the total Guarantee amounted to PLN 4 505 million. The maximum period of the Guarantee amounts to 60 months, whereas the Bank is entitled to terminate the Guarantee before the end of the period.

RIGHT TO SELL OR PLEDGE COLLATERAL ESTABLISHED FOR THE BANK

As at 31 December 2017, and as at 31 December 2016 there were no collaterals established for the benefit of the Bank, which the Bank was entitled to sell or pledge, if all obligations of the collateral holder were performed.

42. LEGAL CLAIMS

As at 31 December 2017, the total value of court proceedings in which the Bank is a defendant was PLN 1 658,9 million (as at 31 December 2016 amounted to PLN 383.4 million), while the total value of court proceedings in which the Bank is the plaintiff as at 31 December 2017 was PLN 1 189,9 million (as at 31 December 2016 amounted to PLN 1 027,4 million).

The most significant legal claims of PKO Bank Polski SA are described below:

a) UNFAIR COMPETITION PROCEEDINGS

PROCEEDING AGAINST PRACTICES THAT LIMIT COMPETITION IN THE PAYMENTS MARKET USING PAYMENT CARDS IN POLAND:

The Bank is a party to proceedings initiated by the President of the Competition and Consumer Protection Office (*Urząd Ochrony Konkurencji i Konsumentów* – UOKiK) on the basis of a decision dated 23 April 2001 upon the request of the Polish Trade and Distribution Organization – Employers Association (*Polska Organizacja Handlu i Dystrybucji - Związek Pracodawców* - POHiD) against operators of the Visa and Europay payment systems and banks issuing Visa and Europay/ Eurocard/ Mastercard banking cards. The claims under these proceedings relate to the use of practices limiting competition on the market of banking card payments in Poland, consisting of applying pre-agreed 'interchange' fees for transactions made using the above cards as well as limiting access to this market for external entities. On 29 December 2006, UOKiK decided that the practices, consisting of joint determination of the 'interchange' fee, did limit market competition and ordered that any such practices should be discontinued, and imposed a fine on, among other things, PKO Bank Polski SA, in the amount of PLN 16.6 million.

The Bank appealed against the decision of the President of UOKiK to CCCP (Court for the Competition and Consumer Protection / *Sąd Ochrony Konkurencji i Konsumentów* - SOKiK). By judgement of 21 November 2013 SOKiK reduced the penalty imposed on the Bank to PLN 10.4 million. On 7 February 2014 the judgement was appealed against on behalf of the Bank and eight plaintiffs represented by the Bank's attorney. The judgement was also appealed against by other participants to the proceedings, i.e. by the President of the UOKiK and of POHiD (appeals aimed to impose stricter financial penalties on the participants to the agreements), and: Visa Europe Ltd., Bank Pocztowy S.A., Bank Gospodarki Żywnościowej S.A., mBank S.A., Deutsche Bank PBC S.A., HSBC Bank Polska S.A. (appeals aimed at primarily at changing the verdict in respect of the classification of the agreements as violating the competition law, and imposing stricter fines on participants to the agreement). The Court of Appeal in Warsaw in its judgment of 6 October 2015, dismissed the appeal of the banks and Visa Europe Ltd., while accepting the appeal of the UOKiK, and restored the original amount of the imposed penalties stipulated in the decision of the UOKiK, i.e. the penalty in the amount of PLN 16.6 million (penalty imposed on PKO Bank Polski SA) and the penalty in the amount of PLN 4.8 million (penalty imposed on Nordea Bank Polska SA). The penalties were paid by the Bank in October 2015 (the cost of the respective provision was incurred in previous periods and the amount of the provision was updated depending on the course of the litigation). On 28 April 2016, the Bank filed a cassation complaint along with the other participants in the proceedings. In its judgment of 25 October 2017, the Supreme Court waived the disputed judgement of the Court of Appeal in Warsaw and referred the case for re-consideration by that Court. The date of the appeal trial was set at 17 April 2018.

Proceedings resulting from a decision of the President of the UOKiK in respect of the possibility of using prohibited contractual provisions in templates of individual agreements (IKE), which was appealed by the Bank to the SOKiK

The proceedings in respect of using prohibited contractual provisions in templates of individual agreements (IKE) was concluded with a final win by the Bank.

On 19 December 2012, the President of UOKiK imposed a fine on the Bank totalling PLN 14.7 million, of which:

1) PLN 7.1 million for not indicating in the IKE agreements the responsibility of the Bank for timely and proper carrying out monetary settlements and the amount of compensation for the delay in execution of a holder instruction,
2) PLN 4.7 million for application in the template of IKE agreements, an open list of termination conditions,
3) PLN 2.9 million for application a clause, entered in the register, defining - in respect of disputes with customers - a court competent for the registered office of PKO Bank Polski SA's branch which maintains the IKE deposit account.

The Bank appealed to SOKiK against the decision of the President of UOKiK on 2 January 2013. SOKiK reduced the penalty imposed on the Bank to the amount of PLN 4 million by the judgement of 25 November 2014 (in respect of the practices described in points 1 and 2 above; and in respect of the practice described in point 3, the penalty was waived, because the Court stated that the Bank practice did not violate the collective interests of consumers).

In January 2015 both the Bank and the President of the UOKiK appealed against the judgment. The Court of Appeal in its judgment of 10 February 2016 dismissed the appeal of the Bank and the appeal of the President of UOKiK. The Bank brought a cassation appeal against this judgment. In its judgment of 8 November 2017, the Supreme Court waived the judgement of the Court of Appeal, and changed the judgement of the SOKiK and the decision of the President of UOKiK of 19 December 2012, so that it repealed of the provisions of the decision of the President of UOKiK which declared the practices described in points 1 and 2 as violating collective consumers' interests and provisions relating to the penalty for the aforesaid practices. Moreover, the Supreme Court indicated that the aforesaid judgement was a reformatory judgement, i.e. the UOKiK may not initiate new proceedings in this case (concluded proceedings).

As at 31 December 2017, the Bank was the party to the following proceedings:

Proceedings resulting from a decision of the President of the UOKiK in respect of the suspicion of using prohibited contractual provisions in templates of consumer loan agreements, with the exclusion of credit card agreements, which was appealed by the Bank to the SOKiK

By decision of 31 December 2013, the Bank's activities were considered to be practices violating the collective interests of consumers and a fine in the amount of PLN 29 million was imposed on the Bank by the President of UOKiK. The Bank appealed against this decision to SOKiK. By judgement of 9 July 2015 SOKiK waived the entire decision of the President of the UOKiK. On 21 August 2015 the President of UOKiK appealed against that judgement. In its judgement of 31 May 2017, the Court of Appeal in Warsaw upheld the SOKiK judgment in respect of waiving point I of the Decisions' sentence, i.e. determining that the Bank violated collective interests of consumers by applying the so-called "variable interest rate clauses". As a result, the Court of Appeal upheld the judgement on waiving the penalty in the amount of PLN 17 million. In respect of the second alleged prohibited practice (one-day information form), the Court of Appeal accepted UOKiK's appeal as justified, but only in part. It was stated that the application of a form with one-day "validity" was contrary to the purposes of Directive 2008/48/WE and did not allow consumers to become acquainted with the terms and conditions of a loan and to compare the offers of various banks. The Court of Appeal reduced the penalty levied by UOKiK from PLN 12 million to PLN 6 million. The penalty was repaid in July 2017 (the cost was incurred in the second quarter of 2017). On 23 October 2017, the Bank lodged a cassation appeal against the judgement of the Court of Appeal. On 21 November 2017, a response of the President of the UOKiK to the Bank's cassation appeal was received. The Bank awaits a decision of the Supreme Court on accepting the cassation appeal for consideration.

- **Before SOKiK: three proceedings initiated by individuals for:**

1) the recognition as abusive and for prohibiting the Bank from using in its trading with customers the provisions in template agreements on loans denominated in CHF, indicating that the currency conversion rules used by the Bank for the purposes of loan payment and for the purposes of conversion of loan instalments as well as provisions concerning interest rates were against good practice and grossly violated consumer interests (proceeding suspended);

2) the recognition as illegal of the provisions in templates of mortgage loan agreement Nordea-Habitat and the surety agreement;
3) the recognition as illegal of the provisions in template mortgage loan agreement "Własny Kąt hipoteczny" relating to the insurance of low initial contribution.

As at 31 December 2017, the Bank did not have a provision for these proceedings, because the probability of unfavourable verdicts was regarded as low.

- **BEFORE THE PRESIDENT OF UOKIK**

Three proceedings are pending before the President of UOKiK - two in respect of practices which allegedly violated the consumers' collective interests and one in respect of regarding the template's provisions as prohibited:

1) in respect of the alleged practices applied by PKO Bank Polski SA which violate the collective interests of consumers who are party to an agreement for payment services and have access to the electronic banking system, by informing of the proposed changes to the conditions of the agreement for the payment services during its performance exclusively using electronic communications sent through electronic banking channels, which do not constitute a permanent information carrier, and not including in the information appendices in the form of electronic documents (regulations and banking fee and commission tariffs for individuals) sent to consumers on the changes introduced to PKO Bank Polski SA and Inteligo branded products, i.e.: bank accounts and debit cards, credit cards, payment cards, and thus making the verification of the admissibility of changing the conditions of an agreement by consumers impossible. In its pleading of 22 February 2017, the Bank commented on the charges raised by the President of UOKiK and filed an application for an obligating decision referred to in Article 28 of the Act on the competition protection, together with proposed actions aimed at stopping the violation and removing its effects. In its letter of 7 September 2017, (which did not resolve the case), the President of UOKiK informed that he did not anticipated taking into account the Bank's proposed obligations at the current stage of the proceedings. At the same time, the President of UOKiK indicated that the decision dated 10 May 2017 issued against Credit Agricole Bank Polska S.A. should be an indication for the Bank with regard to, among other things, the method of removing the effects of practices which violated collective consumer interests, the form of consumer benefits, or the position of the President of UOKiK connected with a fixed information carrier under electronic banking. The deadline for concluding the proceedings was extended till 12 June 2018.
2) for regarding the provisions of the agreement template as prohibited due to using in the Bank's templates, annexes to mortgage loan and advances agreements revalued/ indexed/ denominated in foreign currencies and appendices thereto, which can be regarded as prohibited provisions, referred to in Art. 385 § 1 of the Civil Code. In its letter of 9 August 2017, the Bank commented on the charges raised by the President of UOKiK. In its letter of 24 October 2017, the Bank filed an application for considering evidence in the form of a document – a summary and comparison of CHF, EUR and USD exchange rates applied by the Bank in the period from 3 January 2011 to 31 July 2017 with CHF, EUR and USD announced in the same period by NBP in its exchange rate table A with regard to the stability of the relation of the Bank's and the NBP exchange rates in the period discussed. In its letter of 15 November 2017, the President of UOKiK called for the Bank to indicate the date on which it started applying the contractual provisions (points 2, 3, 4, 5, 7, 8 and 10) of the appendix to the annex in the template agreements, annexes to mortgage loan and advance agreements revalued/ indexed/ denominated in foreign currencies, which the Bank did in its letter of 30 November 2017. In his letter of 4 December 2017, the President of the UOKiK informed about the extension of the deadline for concluding the proceedings to 31 March 2018. In his letter of 14 February 2018, the President of UOKiK presented to the Bank his detailed justification of the charges posed against the Bank in these proceedings. The President of UOKiK upheld his argumentation presented initially in the decision to initiate the proceedings.
3) in respect of the Bank applying practices which violate collective consumer interests by establishing principal and interest instalments of mortgage-backed loans and advances denominated in foreign currencies, and collecting these instalments from consumers in an amount exceeding the level of the cost of servicing loan exposure on the assumption that there is an increase in the PLN value of the principal loan exposures as a result of the appreciation of the foreign currency against PLN, whereas this level was presented to consumers upon concluding loan/advances agreements as an element of the information on currency risk and was defined as the level of potential increase, which resulted from the initial (arising on the conclusion of the agreement) transfer of the potential currency risk onto the consumer, and which at the same time may violate good practices, and therefore distort borrowers' behaviours on the market in respect of the aforesaid loans and advances by forcing consumers to repay loan instalments in an unjustified amount and by actual preventing them from earlier repayment, conversion of the loans and advances to another currency, or terminating the aforesaid mortgage loans and

(IN PLN MILLION)

advances agreements due to the revaluation of borrowers' liabilities to a level exceeding the level of potential increase in the cost of loan exposure which was presented upon concluding the agreement - which can constitute unfair market practices referred to in Art. 4 (1) of the Act of 23 August 2007 on countervailing unfair market practices, and at the same time may violate collective consumer interests. The Bank responded to the charges in its letter of 23 September 2017. No further steps were taken in this case by the date of approval of these financial statements.

Moreover, there are sixteen explanatory proceedings pending before the President of UOKiK connected with the Bank's activities (under Art. 49a of the Act on competition and consumers protection).

As at 31 December 2017, the Bank did not set up any provisions for these proceedings.

b) Re-privatizations claims relating to properties used by the Bank

As at the date of the financial statements, six proceedings were conducted, including three suspended, in respect of the Bank's properties, relating to declaring invalid the decisions which denied the Bank the right to temporary ownership which would transfer the properties under its administration and on obtaining ex officio the right of perpetual usufruct to the land and ownership of the building, return of real property, and regulation of the legal status of the property.

The Management Board of PKO Bank Polski SA believes that the probability of serious claims against the Bank as a result of the aforesaid proceedings is small.

43. Notes to the cash flow statement

Cash and cash equivalents
Restricted cash and cash equivalents
Cash flows from interests and dividends, both received and paid
Cash flow from operating activities – other adjustments
Explanation of differences between the statement of financial position and changes in these items presented under operating activities in the cash flow statement
Reconciliation of items presented in the statement of financial position with financing activities in the consolidated cash flow statement

Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, cash on nostro accounts and a deposit with the National Bank of Poland, as well as current amounts due from banks, as well as other cash equivalents with maturities up to 3 months from the date of acquisition.

CASH AND CASH EQUIVALENTS	31.12.2017	31.12.2016
Cash and balances with the Central Bank	15 800	11 597
Deposits with the Central Bank	1 965	1 680
Current amounts due from banks	4 765	4 278
Restricted cash and cash equivalents	11	13
Total	**22 541**	**17 568**

Restricted cash and cash equivalents

Cash and cash equivalents of PLN 11 million (as at 31 December 2016: PLN 13 million) pledged as collateral for securities' transactions conducted by the Dom Maklerski PKO BP SA brokerage house are deposited in the National Depository for Securities (KDPW_CCP), as part of the Guarantee Fund for the Settlement of Stock Exchange Transactions. Each direct participant who holds the status of a settlement-making participant is obliged to make payments to the settlement fund which guarantees proper settlement of the stock exchange transactions covered by that fund. The amount of the payments depends on the value of the transactions made by each participant and is updated by KDPW_CCP on a daily basis.

(IN PLN MILLION)

CASH FLOWS FROM INTERESTS AND DIVIDENDS, BOTH RECEIVED AND PAID

INTEREST INCOME RECEIVED ON:	2017	2016
loans to and other receivables from banks	163	122
loans and advances to customers	7 359	7 047
investment securities	892	659
hedging derivatives	391	470
financial assets designated at fair value through profit or loss upon initial recognition	189	226
financial assets held for trading, excluding derivative financial instruments	42	68
Total	**9 036**	**8 592**

INTEREST EXPENSE PAID ON:	2017	2016
amounts due to banks	(142)	(97)
amounts due to customers	(1 804)	(2 094)
issuance of debt securities and subordinated liabilities	(78)	(94)
available-for-sale debt securities	(72)	(32)
financial assets held for trading, excluding derivative financial instruments	(11)	(33)
financial assets designated at fair value through profit or loss upon initial recognition	(8)	(22)
Total	**(2 115)**	**(2 372)**

DIVIDEND INCOME - RECEIVED	2017	2016
Dividend received from subsidiaries, joint ventures and associates	123	152
Dividend received from other entities	12	10
Total	**135**	**162**

CASH FLOW FROM OPERATING ACTIVITIES – OTHER ADJUSTMENTS

OTHER ADJUSTMENTS	2017	2016
Accrued interest, discount, premium on debt securities, own issues and subordinated liabilities	(298)	(501)
Hedge accounting	14	(31)
Actuarial gains and losses	1	2
Remeasurement of and write-downs of shares in subordinated entities joint ventures and associates, and other changes	4	(31)
Scrapping of and impairment allowances on property, plant and equipment and intangible assets	13	(25)
Total	**(266)**	**(586)**

(IN PLN MILLION)

EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF FINANCIAL POSITION AND CHANGES IN THESE ITEMS PRESENTED UNDER OPERATING ACTIVITIES IN THE CASH FLOW STATEMENT

(GAIN)/LOSS ON INVESTING ACTIVITIES RELATING TO SALE OR SCRAPPING OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS	2017	2016
Proceeds from sale or scrapping of property, plant and equipment and intangible assets	(74)	(35)
Costs of sale or scrapping of property, plant and equipment and intangible assets	17	31
Total	**(57)**	**(4)**

INTEREST AND DIVIDENDS	2017	2016
Interest received on investment securities	(910)	(686)
Dividends received presented in investing activities	(135)	(162)
Repayment of interest on loans obtained	366	387
Repayment of interest on debt securities issued and subordinated liabilities	71	79
Total	**(608)**	**(382)**

CHANGES IN AMOUNTS DUE FROM BANKS	2017	2016
Change in the balance sheet	(298)	(3 449)
Exclusion of the change in cash and cash equivalents	487	807
Total	**189**	**(2 642)**

CHANGE IN LOANS AND ADVANCES TO CUSTOMERS	2017	2016
Change in the balance sheet	2 175	(515)
Change in write-downs of loans and advances to customers	150	571
Exclusion of the change in cash and cash equivalents	(2)	3
Total	**2 323**	**59**

CHANGE IN AMOUNTS DUE TO CUSTOMERS	2017	2016
Change in the balance sheet	13 153	7 562
Presentation of long-term loans from financial institutions other than banks in financing activities	689	1 267
Total	**13 842**	**8 829**

(IN PLN MILLION)

CHANGE IN PROVISIONS AND IMPAIRMENT ALLOWANCES	2017	2016
Change in the balance sheet	(13)	(23)
Change in impairment allowances on loans and advances to customers	(150)	(570)
Change in impairment allowances on shares in subsidiaries, joint ventures and associates, other receivables and investment securities	47	3
Total	**(116)**	**(590)**

RECONCILIATION OF ITEMS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION WITH FINANCING ACTIVITIES IN THE CONSOLIDATED CASH FLOW STATEMENT

	Note	31.12.2016	Recognized in financing activities in the cash flow statement		Recognized in operating activities in the cash flow statement	31.12.2017
			Incurred	Repaid	Other changes, including foreign exchange differences	
Loans and borrowings received		26 789	-	(13 693)	(2 618)	10 478
from banks	30	17 109	-	(13 004)	(1 509)	2 596
from customers	31	9 680		(689)	(1 109)	7 882
Debt securities issued	32	1 693	5 909	(2 339)	(59)	5 204
Subordinated liabilities	33	2 539	1 700	(2 536)	17	1 720
subordinated loan		922	-	(880)	(42)	-
subordinated bonds		1 617	1 700	(1 656)	59	1 720
Total		**31 021**	**7 609**	**(18 568)**	**(2 660)**	**17 402**

	Note	31.12.2015	Recognized in financing activities in the cash flow statement		Recognized in operating activities in the cash flow statement	31.12.2016
			Incurred	Repaid	Other changes, including foreign exchange differences	
Loans and borrowings received		26 807	-	(1 267)	1 249	26 789
from banks	30	16 371	-	-	738	17 109
from customers	31	10 436	-	(1 267)	511	9 680
Debt securities issued	32	1 718	2 662	(2 741)	54	1 693
Subordinated liabilities	33	2 499	-	-	40	2 539
subordinated loan		882	-	-	40	922
subordinated bonds		1 617	-	-	-	1 617
Total		**31 024**	**2 662**	**(4 008)**	**1 343**	**31 021**

44. TRANSACTIONS WITH THE STATE TREASURY AND RELATED PARTIES

Transactions with the State Treasury
Significant transactions with the State Treasury's related entities
Related-party transactions – capital links
Related-party transactions – personal links

TRANSACTIONS WITH THE STATE TREASURY

The State Treasury has control over the Bank as it holds a 29.43% interest in the Bank's share capital. The Bank's shareholding structure is described in detail in the note 'Equity and shareholding structure of the Bank' to these financial statements.

Receivables, securities and liabilities arising from transactions conducted with the State Treasury, budgetary units and entities in which the State Treasury is the shareholder are disclosed in the Bank's statement of financial position.

(IN PLN MILLION)

Pursuant to the Act of 30 November 1995 on state support in the repayment of certain housing loans, reimbursement of guarantee bonuses paid, and amendments to certain Acts, PKO Bank Polski SA receives payments from the State budget as the repurchase of interest receivable on housing loans.

INCOME FROM TEMPORARY REDEMPTION BY THE STATE TREASURY OF INTEREST ON HOUSING LOANS IN THE "OLD" PORTFOLIO	2017	2016
Income recognized on an accruals basis	60	65
Income recognized on a cash basis	30	25
Difference – "Loans and advances to customers"	30	40

The Act on covering the repayment of certain loans with State Treasury guarantees was passed on 29 November 2000 and came into force on 1 January 2001. In the performance of the provisions of the Act, on 3 August 2001 PKO Bank Polski SA signed an agreement with the Minister of Finance acting on behalf of the State Treasury under which the Bank was granted a pledge for repayment of the debt arising from housing loans in the so-called 'old' portfolio.

On 29 December 2011, the validity period of the agreement (originally until 31 December 2011) was extended until 31 December 2017. As a result of covering the so-called 'old' portfolio housing loan receivables with guarantees of the State Treasury, the default risk on these loans was mitigated.

As of 1 January 2018, pursuant to the Act of 30 November 1995 on state support in the repayment of certain housing loans, reimbursement of guarantee bonuses paid, and amendments to certain Acts, loan recipients will obtain the right to extinguish their remaining debt, which will be charged to the State budget, as a result of which the 'old portfolio' housing loans will be fully settled.

The Bank conducts settlements in respect of the repurchase of interest on housing loans by the State budget and the respective commission in 2017 and 2016 amounted to PLN 3 million.

As of 1 January 1996, the Bank became the general distributor of court fee stamps. The Bank receives commissions in this respect from the State Treasury –PLN 5 million in 2017 and PLN 12 million in 2016.

Dom Maklerski PKO Banku Polskiego SA plays the role of an agent for the issue of retail treasury bonds under the agreement signed with the Ministry of Finance on 11 February 2003. Under this agreement, the Brokerage House of PKO Bank Polski SA receives a fee for providing the services of an agent for the issue of bonds – PLN 56 million in 2017 and PLN 37 million in 2016.

SIGNIFICANT TRANSACTIONS WITH THE STATE TREASURY'S RELATED ENTITIES

The Bank's exposure and the value of the Bank's liabilities to 10 entities related to the State Treasury with the highest total exposure are presented below. The transactions were concluded on arm's length terms.

	BALANCE SHEET EXPOSURE, INCLUDING EXPOSURE TO LOANS AND DEBT INSTRUMENTS		OFF-BALANCE SHEET EXPOSURE		LIABILITIES IN RESPECT OF DEPOSITS	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
counterparty 1	-	-	2 450	2 450	-	-
counterparty 2	2 936	-	-	-	-	-
counterparty 3	1 004	1 327	1 825	1 529	55	3
counterparty 4	2 024	1 503	308	869	186	126
counterparty 5	29	46	1 832	1 521	4 093	350
counterparty 6	284	386	1 463	385	290	271
counterparty 7	333	332	1 269	1 206	-	533
counterparty 8	1 017	144	548	360	-	-
counterparty 9	1 270	1 289	51	193	-	-
counterparty 10	286	37	815	1 069	-	1 085

(IN PLN MILLION)

In 2017, interest and commission income on the transactions with the 10 counterparties referred to above amounted to PLN 68 million (PLN 3 million in 2016), and the respective interest expense amounted to PLN 9 million (PLN 14 million in 2016). As at 31 December 2017 and as at 31 December 2016, respectively, no impairment allowances were recognized on an individual basis for the above-mentioned receivables. In the Bank's opinion, all transactions with entities related to the State Treasury are at arm's length.

RELATED-PARTY TRANSACTIONS – CAPITAL LINKS

In 2017, the Bank did not conclude any significant transactions with related parties otherwise than on an arm's length basis.

Margins on loan transactions are within a range of 0.60% – 6.23%. Repayment terms are within a range of from one month to fifteen years.

AS AT 31 DECEMBER 2017 / ENTITY	Receivables	of which loans	Liabilities	Off-balance sheet liabilities granted
KREDOBANK SA and its subsidiaries	93	-	9	105
Merkury - fizan and its subsidiaries	-	-	10	-
NEPTUN - fizan and its subsidiaries	203	203	57	-
PKO Bank Hipoteczny SA	4 258	1 477	5	2 912
PKO BP BANKOWY PTE SA	-	-	12	-
PKO BP Finat Sp. z o.o.	1	-	42	1
PKO Finance AB	-	-	5 882	-
PKO Leasing SA and its subsidiaries	12 550	12 546	66	5 332
PKO Towarzystwo Funduszy Inwestycyjnych SA (investment fund management company)	26	-	67	-
PKO Towarzystwo Ubezpieczeń SA	-	-	8	-
PKO Życie Towarzystwo Ubezpieczeń SA	-	-	441	1
Qualia Development Sp. z o.o. and its subsidiaries	-	-	238	-
ZenCard Sp. z o.o.	-	-	-	-
Total subsidiaries	**17 131**	**14 226**	**6 837**	**8 351**

AS AT 31 DECEMBER 2017 / ENTITY	Receivables	of which loans	Liabilities	Off-balance sheet liabilities granted
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	49	6	37	25
"Centrum Obsługi Biznesu" Sp. z o.o.	19	19	9	-
Bank Pocztowy SA	-	-	-	1
"Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o.	-	-	16	-
Total joint ventures and associates	**68**	**25**	**62**	**26**

AS AT 31 DECEMBER 2016 / ENTITY	Receivables	of which loans	Liabilities	Off-balance sheet liabilities granted
KREDOBANK SA and its subsidiaries	194	98	6	134
Merkury - fizan and its subsidiaries	-	-	13	-
NEPTUN - fizan and its subsidiaries	243	243	44	-
PKO Bank Hipoteczny SA	3 468	394	13	1 506
PKO BP BANKOWY PTE SA	-	-	1	-
PKO BP Finat Sp. z o.o.	-	-	71	1
PKO Finance AB	-	-	6 704	-
PKO Leasing SA and its subsidiaries	10 710	10 709	67	6 112
PKO Towarzystwo Funduszy Inwestycyjnych SA (investment fund management company)	19	-	57	-
PKO Towarzystwo Ubezpieczeń SA	-	-	14	-
PKO Życie Towarzystwo Ubezpieczeń SA	-	-	352	1
Qualia Development Sp. z o.o. and its subsidiaries	-	-	130	-
Total subsidiaries	**14 634**	**11 444**	**7 472**	**7 754**

(IN PLN MILLION)

AS AT 31 DECEMBER 2016 / ENTITY	Receivables	of which loans	Liabilities	Off-balance sheet liabilities granted
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	10	10	18	21
"Centrum Obsługi Biznesu" Sp. z o.o.	28	28	10	-
Bank Pocztowy SA	-	-	1	1
"Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o.	-	-	8	-
Walcownia Rur Ferrum Sp. z o.o.	-	-	2	-
Total joint ventures and associates	**38**	**38**	**39**	**22**

FOR THE PERIOD ENDED 31 DECEMBER 2017 / ENTITY	Total income	of which interest and commission income	Total expense	of which interest and commission income
KREDOBANK SA and its subsidiaries	5	4	-	-
Merkury - fizan and its subsidiaries	-	-	-	-
NEPTUN - fizan and its subsidiaries	5	5	-	-
PKO Bank Hipoteczny SA	171	158	1	-
PKO BP BANKOWY PTE SA	6	-	-	-
PKO BP Finat Sp. z o.o.	48	-	21	1
PKO Finance AB	-	-	305	305
PKO Leasing SA and its subsidiaries	272	265	19	-
PKO Towarzystwo Funduszy Inwestycyjnych SA (investment fund management company)	335	273	1	1
PKO Towarzystwo Ubezpieczeń SA	61	61	1	1
PKO Życie Towarzystwo Ubezpieczeń SA	40	40	3	3
Qualia Development Sp. z o.o. and its subsidiaries	-	-	5	2
Total subsidiaries	**943**	**806**	**356**	**313**

FOR THE PERIOD ENDED 31 DECEMBER 2017 / ENTITY	Total income	of which interest and commission income	Total expense	of which interest and commission income
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	347	332	124	124
Total joint ventures and associates	**347**	**332**	**124**	**124**

FOR THE PERIOD ENDED 31 DECEMBER 2016 / ENTITY	Total income	of which interest and commission income	Total expense	of which interest and commission income
KREDOBANK SA and its subsidiaries	9	8	-	-
Merkury - fizan and its subsidiaries	1	1	-	-
Neptun - fizan and its subsidiaries	4	4	-	-
BRE Bank Hipoteczny SA	99	88	1	-
PKO BP BANKOWY PTE SA	9	-	-	-
PKO BP Finat Sp. z o.o.	77	-	5	1
PKO Finance AB	1	-	266	266
PKO Leasing SA and its subsidiaries	147	140	19	-
PKO Towarzystwo Funduszy Inwestycyjnych SA (investment fund management company)	285	227	1	1
PKO Towarzystwo Ubezpieczeniowe SA	45	45	-	-
PKO Życie Towarzystwo Ubezpieczeń SA	50	50	1	1
Qualia Development Sp. z o.o. and its subsidiaries	5	4	2	1
Total subsidiaries	**732**	**567**	**295**	**270**

FOR THE PERIOD ENDED 31 DECEMBER 2016 / ENTITY	Total income	of which interest and commission income	Total expense	of which interest and commission income
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	270	259	115	115
"Centrum Obsługi Biznesu" Sp z o.o.	1	1	-	-
Total joint ventures and associates	**271**	**260**	**115**	**115**

RELATED-PARTY TRANSACTIONS – PERSONAL LINKS

As at 31 December 2017 and 31 December 2016, one entity was related to the Bank through the key management personnel of PKO Bank Polski SA or close family members of the key management personnel. In 2017 and in 2016, no transactions were conducted between the Bank and that entity.

45. BENEFITS FOR THE PKO BANK POLSKI SA KEY MANAGEMENT

ACCOUNTING POLICIES

Short-term employee benefits are employee benefits, which are settled in full within 12 months from the end of the annual reporting period in which the employees performed the respective work. Short-term employee benefits include, apart from the base salary, also the part of the variable remuneration component paid in cash which is not deferred.

The deferred part of the variable remuneration component paid in cash was recognized as other long-term benefits.

Non-deferred and deferred remuneration components granted in the form of financial instruments i.e. phantom shares (for which conversion into cash is carried out after an additional period of retention) are recognized as share-based payments settled in cash in accordance with the principles described below.

VARIABLE REMUNERATION COMPONENTS FOR KEY MANAGEMENT PERSONNEL IN THE BANK

The variable remuneration components are granted in the form of:

- non-deferred (in the first year after the calendar year constituting an appraisal period);
- deferred (for the following three years after the first year of the appraisal period),

whereas both the non-deferred and deferred remuneration, is awarded in equal parts in cash and in the form of financial instruments, i.e. phantom shares (for which conversion into cash is carried out after an additional period of retention).

The remuneration component in the form of the financial instrument is converted into phantom shares after granting a particular component – taking into consideration the median of the daily average prices of the Bank's shares (Volume Weighted Average Price) on the Warsaw Securities Exchange, published in the Thomson Reuters or Bloomberg information systems – in the fourth quarter of the appraisal period. Next, after a period of retention and deferral period, the shares are converted into cash – taking into consideration the median of the daily average prices of the Bank's shares (Volume Weighted Average Price) on the Warsaw Securities Exchange in the third quarter of the calendar year preceding the payment (the Management Board) and the third quarter of the calendar year, in which the payment is made (other persons in management positions), published in the Thomson Reuters or Bloomberg information systems.

The deferred remuneration may be reduced in the event of a deterioration in the financial performance of the Bank, a loss incurred by the Bank or deterioration in other variables related to the performance in the period of appraisal of key management personnel and results of the organizational units/cells supervised or managed by these people, which were revealed after the appraisal period.

FINANCIAL INFORMATION

REMUNERATION RECEIVED BY MEMBERS OF THE SUPERVISORY BOARD FROM THE BANK (IN PLN THOUSAND)

REMUNERATION RECEIVED FROM PKO BANK POLSKI SA (in PLN THOUSAND)		
Name	**2017**	**2016**
Supervisory Board of the Bank		
Piotr Sadownik	170	167
Grażyna Ciużyńska	177	92
Zbigniew Hajłasz	134	72
Mariusz Andrzejewski	61	-
Mirosław Barszcz	120	104
Adam Budnikowski	119	107
Wojciech Jasiński	118	103
Andrzej Kisielewicz	118	106
Elżbieta Mączyńska - Ziemacka	119	128
Janusz Ostaszewski	117	103
Jerzy Paluchniak	62	-
Supervisory Board of the Bank	**1 315**	**982**
Jerzy Góra	-	44
Agnieszka Winnik-Kalemba	-	58
Mirosław Czekaj	-	28
Małgorzata Dec-Kruczkowska	-	72
Zofia Dzik	-	23
Krzysztof Kilian	-	19
Piotr Marczak	-	20
Marek Mroczkowski	-	22
Members of the Supervisory Board who ceased to perform their functions in 2016[1]	**-**	**286**
Total	**1 315**	**1 268**

[1] including post-employment benefits

Employee benefits for members of the Management Board due or potentially due from the Bank (in PLN thousand)

	Short-term employee benefits, including variable remuneration paid in cash - not deferred		Other long-term benefits - deferred variable remuneration paid in cash		Share-based payments settled in cash		
Name	remuneration in 2017[1]	other received in 2017	received in 2017	contingent, due as at 31.12.2017	received in 2017	due as at 31.12.2017	contingent, due as at 31.12.2017
Zbigniew Jagiełło	1 404	373	252	566	501	768	566
Rafał Antczak	342	-	-	-	-	-	-
Maks Kraczkowski	1 098	144	-	96	-	193	96
Mieczysław Król	1 104	165	-	110	-	222	110
Adam Marciniak	172	-	-	-	-	-	-
Piotr Mazur	1 149	305	175	387	355	594	387
Jakub Papierski	1 124	305	185	395	402	604	395
Jan Emeryk Rościszewski	1 077	132	-	88	-	177	88
Management Board of the Bank	**7 470**	**1 423**	**611**	**1 642**	**1 258**	**2 558**	**1 642**
						-	
Piotr Alicki	6	255	176	356	397	529	356
Janusz Derda	453	12	-	8	-	16	8
Bartosz Drabikowski	1 184	328	203	450	434	655	450
Jarosław Myjak	-	70	141	178	284	239	178
Jacek Obłękowski	4	69	178	232	395	280	232
Members of the Management Board who ceased to perform their functions in 2017 and 2016	**1 647**	**733**	**698**	**1 224**	**1 510**	**1 719**	**1 224**
Total	**9 117**	**2 156**	**1 310**	**2 865**	**2 768**	**4 277**	**2 865**

[1] Includes basic remuneration and additional benefits under employee pension programs (PPE), additional insurance, medical care and company social benefits fund (ZFŚS).

	Short-term employee benefits, including variable remuneration paid in cash - not deferred		Other long-term benefits - deferred variable remuneration paid in cash		Share-based payments settled in cash		
Name	remuneration in 2016[1]	other received in 2016	received in 2016	contingent, due as at 31.12.2016	received in 2016	due as at 31.12.2016	contingent, due as at 31.12.2016
Zbigniew Jagiełło	2 080	359	232	506	357	501	506
Janusz Derda	56	-	-	-	-	-	-
Bartosz Drabikowski	1 740	321	188	410	295	434	410
Maks Kraczkowski	698	-	-	-	-	-	-
Mieczysław Król	805	-	-	-	-	-	-
Piotr Mazur	1 567	298	108	353	213	355	353
Jakub Papierski	1 554	298	173	371	286	402	371
Jan Emeryk Rościszewski	629	-	-	-	-	-	-
Management Board of the Bank	**9 129**	**1 276**	**702**	**1 640**	**1 151**	**1 692**	**1 640**
Piotr Alicki	1 312	298	166	361	278	397	361
Jarosław Myjak	394	189	152	271	250	284	271
Jacek Obłękowski	398	298	162	362	274	395	362
Members of the Management Board who ceased to perform their functions in 2017 and 2016	**2 104**	**785**	**480**	**994**	**802**	**1 076**	**994**
Total	**11 233**	**2 061**	**1 182**	**2 634**	**1 953**	**2 768**	**2 634**

[1] Includes basic remuneration and additional benefits under employee pension programs (PPE), additional insurance, medical care and company social benefits fund (ZFŚS).

BENEFITS IN RESPECT OF EMPLOYMENT TERMINATION (IN PLN THOUSAND)

BENEFITS IN RESPECT OF EMPLOYMENT TERMINATION FOR MEMBERS OF THE MANAGEMENT BOARD WHO CEASED TO PERFORM THEIR FUNCTIONS IN 2017 AND 2016	2017	2016
Piotr Alicki	488	1 097
Jarosław Mujak	-	1 108
Jacek Obłękowski	-	1 108
Bartosz Drabikowski	344	-
Members of the Management Board who ceased to perform their functions in 2017 and 2016	**832**	**3 313**

POST-EMPLOYMENT BENEFITS (IN PLN THOUSAND)

On 13 March 2017, the Extraordinary Shareholders' Meeting (ESM) adopted a resolution on the principles for determining the remuneration of members of the Management Board and Supervisory Board proposed by the State Treasury represented by the Minister of Development and Finance who exercised the rights from the Bank shares owned by the State Treasury. The Resolution concerned adapting the remuneration policy for members of the Management and Supervisory Boards of PKO Bank Polski SA to the provisions of the Act on principles of remunerating people who manage certain companies. On the basis of the resolution, the Supervisory Board introduced a new policy of employing and remunerating members of the Management Board which were defined in accordance with the provisions of the Act on principles of remunerating people who manage certain companies.

On 22 June 2017, service agreements were concluded with members of the Management Board, which replaced the existing employment agreements. Benefits paid in respect of the change in the employment relationship are presented below.

POST-EMPLOYMENT BENEFITS	2017	2016
Zbigniew Jagiełło	798	-
Maks Kraczkowski	108	-
Mieczysław Król	42	-
Piotr Mazur	246	-
Jakub Papierski	238	-
Jan Emeryk Rościszewski	109	-
Management Board	**1 541**	-
Piotr Alicki	25	417
Jarosław Mujak	15	262
Jacek Obłękowski	19	487
Janusz Derda	29	-
Bartosz Drabikowski	224	-
Members of the Management Board who ceased to perform their functions in 2017 and 2016	**312**	**1 166**
Total benefits	**1 853**	**1 166**

REMUNERATION OF MEMBERS OF THE MANAGEMENT BOARD RECEIVED FROM RELATED ENTITIES (OTHER THAN THE STATE TREASURY AND ITS RELATED ENTITIES) (IN PLN THOUSAND)

In 2017, no member of the Management Board received any remuneration from the Bank's related entities (remuneration for 2016 amounted to PLN 22 thousand).

LOANS AND ADVANCES GRANTED BY THE BANK TO THE MANAGEMENT AND SUPERVISORY BOARDS (IN PLN THOUSAND)

LOANS AND ADVANCES GRANTED BY THE BANK TO THE MANAGEMENT		
	31.12.2017	31.12.2016
The Bank's Supervisory Board	666	608
Management Board	1 355	930
Total	**2 021**	**1 538**

(IN PLN MILLION)

The interest rates and repayment terms do not differ from the arm's-length conditions for similar banking products.

The Bank provides the key management personnel, members of the Supervisory Board and their families with standard financial services which comprise, among other things, operating bank accounts, accepting deposits, granting loans and providing other financial services.

VARIABLE REMUNERATION COMPONENTS

PROVISION FOR VARIABLE REMUNERATION COMPONENTS	31.12.2017 (for 2013-2017)	31.12.2016 (for 2012-2016)
Management Board (including members who ceased to perform their functions in 2017 and 2016)	18	17
Other Risk Takers (persons holding managerial positions other than members of the Bank's Management Board)	30	31
Total provision	**48**	**48**
Remuneration paid during the year	**2017 (for 2013-2017)**	**2016 (for 2012-2016)**
- granted in cash	**11**	**11**
Management Board (including members who ceased to perform their functions in 2017 and 2016)	4	3
Other Risk Takers (persons holding managerial positions other than members of the Bank's Management Board)	7	8
- granted in the form of financial instruments	**12**	**9**
Management Board (including members who ceased to perform their functions in 2017 and 2016)	3	2
Other Risk Takers (persons holding managerial positions other than members of the Bank's Management Board)	9	7
Total remuneration paid	**23**	**20**

46. FAIR VALUE HIERARCHY

ACCOUNTING POLICIES, AND ESTIMATES AND JUDGEMENTS

The fair value is the price that would be received for the sale of an asset or paid for transfer of a liability in a transaction carried out under regular conditions on the main (or most advantageous) market at the valuation date in the current market conditions (i.e. exit price), regardless of whether this price is directly observable or estimated using another valuation technique.

Depending on the classification of financial assets and liabilities to a specific level of the hierarchy, different methods of fair value measurement are used.

LEVEL 1: PRICES QUOTED ON ACTIVE MARKETS

Financial assets and liabilities whose fair value is stated directly at prices quoted (not adjusted) on active markets for identical assets and liabilities. In this category, the Bank classifies financial and equity instruments for which there is an active market and for which the fair value is determined with reference to the market value, which is a bid price:

- debt securities valued using fixing from Bondspot platform or Bloomberg or Reuters information services;
- debt and equity securities which are traded on regulated market, including in the Brokerage House portfolio;
- derivative instruments, which are traded on a regulated market.

LEVEL 2: VALUATION TECHNIQUES BASED ON OBSERVABLE MARKET DATA

Financial assets and liabilities whose fair value is determined using valuation models where all significant entry data are observable on the market directly (as prices) or indirectly (based on prices). In this category, the Bank classifies financial instruments for which there is no active market:

FINANCIAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	VALUATION METHOD (TECHNIQUE)	OBSERVABLE INPUTS
DERIVATIVE FINANCIAL INSTRUMENTS – CIRS, IRS, FRA	The discounted future cash flows model based on yield curves.	Yield curves are built based on market rates, market data of the money market, market transactions of FRA, IRS, basis swap.
DERIVATIVE FINANCIAL INSTRUMENTS – CURRENCY OPTION, INTEREST RATE OPTIONS, EQUITY EXOTIC OPTIONS, FX FORWARD, FX SWAP TRANSACTIONS	Valuation models specific for a particular type of a currency option. The model of discounted future cash flows based on yield curves for FX forward and FX swap transactions. The prices of equity exotic options embedded in structured products are obtained from the market (market prices).	Yield curves built based on money market rates, market rate of swap points, volatility levels for specific currency pairs, NBP fixing exchange rates. For the purpose of valuation of equity exotic options embedded in structured products, market prices of these options are obtained.
NBP MONEY MARKET BILLS	Yield curve method	Yield curves are built based on money market data and OIS (overnight index swap) transactions market.
MUNICIPAL BONDS IN EUR	Accepted valuation model.	Market rates, market data from the money market, IRS transactions market, CDS transactions market, volatility of interest rate options market.
MUNICIPAL BONDS IN PLN	Yield curve and risk margin model.	Yield curves are built based on market rates, money market data, IRS transactions market.
CORPORATE BONDS	Yield curve and risk margin model.	Yield curves are built based on market rates, money market data, IRS transactions market.
COMMODITY SWAP TRANSACTIONS	Commodity price yield curve.	Commodity price yield curves are built based on money market data, market rate SWAP points.

LEVEL 3: OTHER VALUATION TECHNIQUES

Financial assets and liabilities whose fair value is determined using valuation models for which input data is not based on observable market data (unobservable input data). In this category, the Bank classifies financial instruments, which are valued using internal valuation models:

(IN PLN MILLION)

FINANCIAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	VALUATION METHOD (TECHNIQUE)	UNOBSERVABLE INPUT
PARTICIPATION UNITS IN MUTUAL FUND	Method of the net asset value (NAV) of the Fund i.e. the fair value of investment projects (companies) comprised in the Fund, which are subject to semi-annual review or audit performed by a registered auditor	Net asset value of the Fund.
C-SERIES PREFERENCE SHARES OF VISA INC.	Estimating the fair value based on the current market value of the listed ordinary shares of Visa Inc., including a discount which takes into account the limited liquidity of C-series shares and the terms and conditions of the conversion of C-series shares into ordinary shares.	Discount taking into account the limited liquidity of C-series shares and the terms of converting the C-series shares into ordinary shares.
CORPORATE BONDS	Yield curve and risk margin model. Yield curves are built based on market rates, money market data and the IRS transactions market.	Credit spread (credit margins determined on the basis of initial margins modified by credit indices quotes ascribed to issuers based on their ratings and business sectors)

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ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31.12.2017	Note	Carrying amount	Level 1	Level 2	Level 3
			Quoted prices on active markets	Valuation techniques based on observable market data	Other valuation techniques
Financial assets held for trading, excluding derivative financial instruments	20	472	470	2	-
Debt securities		446	444	2	-
Shares in other entities		19	19	-	-
Investment certificates, rights to shares, pre-emptive rights		7	7	-	-
Derivative financial instruments	21	2 805	1	2 804	-
Hedging instruments		1 104	-	1 104	-
Trading instruments		1 701	1	1 700	-
Financial instruments designated at fair value through profit or loss upon initial recognition	23	6 409	2 027	4 382	-
Available-for-sale investment securities	25	41 985	32 795	7 024	2 166
Debt securities		41 560	32 745	7 024	1 791
Equity securities		173	50	-	123
Participation units in a collective investment undertaking		252	-	-	252
Total financial assets measured at fair value		**51 671**	**35 293**	**14 212**	**2 166**
Derivative financial instruments	21	2 741	-	2 741	-
Hedging instruments		204	-	204	-
Trading instruments		2 537	-	2 537	-
Total financial liabilities measured at fair value		**2 741**	**-**	**2 741**	**-**

(IN PLN MILLION)

FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION AS AT 31.12.2017	Carrying amount	Level 1	Level 2	Level 3
NBP money market bills	4 199	-	4 199	-
Treasury bonds (in PLN)	1 134	1 134	-	-
Treasury bonds (in foreign currencies)	893	893	-	-
municipal bonds (in PLN)	106	-	106	-
corporate bonds (in foreign currencies)	77	-	77	-
TOTAL	6 409	2 027	4 382	-

AVAILABLE-FOR-SALE INVESTMENT SECURITIES AS AT 31.12.2017	Carrying amount	Level 1	Level 2	Level 3
Securities available for sale	41 560	32 745	7 024	1 791
Treasury bonds (in PLN)	32 095	32 095	-	-
Treasury bonds (in foreign currencies)	-	-	-	-
municipal bonds (in PLN)	4 928	-	4 928	-
corporate bonds (in PLN)	4 058	321	2 096	1 641
corporate bonds (in foreign currencies)	479	329	-	150
Equity securities	173	50	-	123
Participation units in a collective investment undertaking	252	-	-	252
TOTAL	41 985	32 795	7 024	2 166

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31.12.2016	Note	Carrying amount	Level 1	Level 2	Level 3
			Quoted prices on active markets	Valuation techniques based on observable market data	Other valuation techniques
Financial assets held for trading, excluding derivative financial instruments	20	358	358	-	-
Debt securities		344	344	-	-
Shares in other entities		11	11	-	-
Investment certificates, shares rights, pre-emptive rights		3	3	-	-
Derivative financial instruments	21	2 895	3	2 892	-
Hedging instruments		382	-	382	-
Trading instruments		2 513	3	2 510	-
Financial instruments designated at fair value through profit or loss upon initial recognition	23	11 744	2 507	9 237	-
Available-for-sale investment securities	25	35 739	26 674	5 691	3 374
Debt securities		35 314	26 639	5 691	2 984
Equity securities		127	35	-	92
Participation units in a collective investment undertaking		298	-	-	298
Total financial assets measured at fair value		**50 736**	**29 542**	**17 820**	**3 374**
Derivative financial instruments	21	4 229	1	4 229	-
Hedging instruments		1 163	-	1 163	-
Trading instruments		3 066	1	3 066	-
Total financial liabilities measured at fair value		**4 229**	**1**	**4 229**	-

(IN PLN MILLION)

FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION AS AT 31.12.2016	Carrying amount	Level 1	Level 2	Level 3
NBP money market bills	8 999	-	8 999	-
Treasury bonds (in PLN)	1 432	1 432	-	-
Treasury bonds (in foreign currencies)	1 075	1 075	-	-
municipal bonds (in PLN)	111	-	111	-
corporate bonds (in foreign currencies)	127	-	127	-
TOTAL	11 744	2 507	9 237	-

AVAILABLE-FOR-SALE INVESTMENT SECURITIES AS AT 31.12.2016	Carrying amount	Level 1	Level 2	Level 3
Securities available for sale	35 314	26 639	5 691	2 984
Treasury bonds (in PLN)	25 147	25 147	-	-
Treasury bonds (in foreign currencies)	457	457	-	-
municipal bonds (in PLN)	4 552	-	4 552	-
corporate bonds (in PLN)	4 581	692	1 139	2 749
corporate bonds (in foreign currencies)	577	343	-	235
Equity securities	127	35	-	92
Participation units in a collective investment undertaking	298	-	-	298
TOTAL	35 739	26 674	5 691	3 374

IMPACT OF ESTIMATES ON FAIR VALUE MEASUREMENT OF LEVEL 3 FINANCIAL INSTRUMENTS	31.12.2017		31.12.2016	
	Fair value acc. to		Fair value acc. to	
	positive scenario	negative scenario	positive scenario	negative scenario
Available-for-sale investment securities				
Participation units in a collective investment undertaking[1]	264	239	313	283
Equity securities (shares in Visa Inc.)[2]	129	103	100	70
Corporate bonds[3]	1 799	1 783	2 992	2 977

[1] Scenario assuming an increase/decrease in the Fund's net asset value of +/- 5%, respectively.
[2] Scenario assuming a discount ratio of 0%/100%, respectively.
[3] Scenario assuming a change in the credit spread of +/-10%.

RECONCILIATION O FAIR VALUE CHANGES OF LEVEL 3 FINANCIAL INSTRUMENTS DURING THE PERIOD	2017	2016
Opening balance at the beginning of the period	3 374	3 635
Total gains or losses	40	113
in the profit or loss	(37)	68
in other comprehensive income	77	45
Taking up new issues of the Fund	58	67
Taking up shares in Visa Inc.	-	81
Sale of shares in Visa Europe Limited	-	(337)
Other issues and redemptions (including settlements)	(1 213)	(185)
Reduction of capital involvement in the Fund	(93)	-
Total	**2 166**	**3 374**

In 2017 and 2016 the Bank did not reclassify financial instruments to level 3 of the fair value hierarchy.

47. Financial assets and financial liabilities not presented at fair value in the statement of financial position

The Bank holds financial assets and financial liabilities which are not presented at fair value in the statement of financial position

For many financial instruments, the market values are unattainable hence the presented fair values are estimated with the use of range of measurement techniques. The fair value of financial instruments was measured using a model based on estimating the present value of future cash flows by discounting them using appropriate discount rates.

All model calculations include certain simplifications and are therefore sensitive to those assumptions. A summary of the major methods and assumptions used when estimating the fair values of financial instruments not measured at fair value is presented below.

For certain categories of financial instruments, it has been assumed that their carrying amount approximately equals their fair values, which is due to the lack of expected material differences between their carrying amount and fair value resulting from the features of these categories (such as short term nature, high correlation with market parameters, the unique nature of the instrument). This applies to the following groups of financial instruments:

- loans and advances to customers: a part of the housing loan portfolio (the 'old' housing loan portfolio), loans with no specific repayment schedule, loans due as at the moment of valuation;
- amounts due to customers, liabilities with no specific repayment schedule, other specific products for which no active market exists;
- interbank deposits and placements with maturities of up to 7 days or with variable interest;
- variable interest loans or advances granted and received on the interbank market (with interest rate changes occurring every 3 months or less);
- cash and balances with the Central Bank and amounts due to the Central Bank;
- other financial assets and financial liabilities.

For non-impaired loans and advances to customers, the model based on estimating the present value of future cash flows by discounting cash flows using current interest rates is applied. The model takes into account the credit risk margin and adjusted maturities stemming from the loan agreements. The current level of margins was determined for transactions concluded in the last quarter ending on the balance sheet date involving instruments with a similar credit risk profile. The current margin for loans in PLN adjusted for the cost of foreign currency acquisition in basis-swap transactions was applied to loans in foreign currencies. Valuation excludes the risk of the effect of the proposed potential systemic solutions which could result in the Bank incurring losses on the portfolio of mortgage loans in CHF. For impaired loans, it is assumed that the fair values are equal to carrying amounts.

For deposits and other amounts due to customers other than banks with fixed maturities, the fair value was estimated based on expected cash flows discounted using the current interest rates appropriate for individual deposit products. The fair value is calculated for each deposit and each of the liabilities, and then the fair values for the entire deposit portfolio are grouped by product type and by customer segment. For demand deposits, it is assumed that their fair value equals the carrying value.

The fair value of the Bank's subordinated debt was estimated based on the expected cash flows discounted based on the yield curve.

The fair value of a liability in respect of debt securities issued by PKO Bank Polski SA was estimated based on the expected cash flows discounted using the current interbank market rates.

(IN PLN MILLION)

The fair value of interbank placements and deposits was estimated based on expected cash flows discounted using the current interbank market rates.

	level of fair value hierarchy	valuation method	31.12.2017 carrying amount	31.12.2017 fair value
Cash and cash balances with the Central Bank	n/a	at amounts due	17 765	17 765
Amounts due from banks	2	discounted cash flows	8 769	8 769
Loans and advances to customers			**186 893**	**184 479**
housing	3	discounted cash flows	90 209	86 008
corporate	3	discounted cash flows	67 139	67 093
consumer	3	discounted cash flows	24 275	26 108
debt securities (corporate)	3	discounted cash flows	1 855	1 855
debt securities (municipal)	3	discounted cash flows	2 513	2 513
buy-sell back transactions	2	discounted cash flows	902	902
Investment securities held to maturity	1	market quotations	1 622	1 622
Other financial assets	3	at amounts due less impairment allowance	1 748	1 748
Amounts due to the Central Bank	2	at amounts due	6	6
Amounts due to banks	2	discounted cash flows	4 299	4 299
Amounts due to customers			**222 524**	**222 761**
to corporates	3	discounted cash flows	60 578	60 879
to public entities	3	discounted cash flows	11 409	11 409
to retail cosutomers	3	discounted cash flows	150 537	150 473
Debt securities issued	2	discounted cash flows	5 204	5 204
Subordinated liabilities	2	discounted cash flows	1 720	1 720
Other financial liabilities	3	at amounts due	3 812	3 812

	level of fair value hierarchy	valuation method	31.12.2016 carrying amount	31.12.2016 fair value
Cash and cash balances with the Central Bank	n/a	at amounts due	13 277	13 277
Amounts due from banks	2	discounted cash flows	8 471	8 470
Loans and advances to customers			**189 067**	**187 433**
housing	3	discounted cash flows	97 866	94 091
corporate	3	discounted cash flows	62 143	62 941
consumer	3	discounted cash flows	22 848	24 265
debt securities (corporate)	3	discounted cash flows	2 283	2 209
debt securities (municipal)	3	discounted cash flows	2 588	2 588
buy-sell back transactions	2	discounted cash flows	1 339	1 339
Investment securities held to maturity	1	market quotations	157	157
Other financial assets	3	at amounts due less impairment allowance	1 791	1 791
Amounts due to the Central Bank	2	at amounts due	4	4
Amounts due to banks	2	discounted cash flows	18 717	18 717
Amounts due to customers			**209 371**	**209 559**
to corporates	3	discounted cash flows	53 570	53 813
to public entities	3	discounted cash flows	8 409	8 409
to retail cosutomers	3	discounted cash flows	147 392	147 337
Debt securities issued	2	discounted cash flows	1 693	1 695
Subordinated liabilities	2	discounted cash flows	2 539	2 526
Other financial liabilities	3	at amounts due	2 693	2 693

(IN PLN MILLION)

48. Offsetting financial assets and financial liabilities

Accounting policies

The Bank offsets financial assets and liabilities and presents them in the statement of financial position in net amounts if there is a legally enforceable right to offset the recognized amounts and an intention to settle them on a net basis or to realize a given asset and settle the liability simultaneously. In order for offsetting to be possible, a legal right may not be contingent on the occurrence of a specific future event.

The Bank enters into offsetting arrangements, i.e. International Swaps and Derivatives Association Master Agreements (ISDA) and Global Master Repurchase Agreements (GMRA), which make it possible to offset financial assets and liabilities (so-called close out netting) in the event of an infringement with respect to one of the parties to the agreement. These agreements are of particular importance to mitigate the risk posed by derivative instruments, because they enable offsetting both matured liabilities (mitigating the settlement risk) and the non-matured liabilities of the parties (mitigating the pre-settlement risk). However, these agreements do not meet the requirements set out in IAS 32, because the right to offset is conditional on the occurrence of a specific future event (instances of infringement).

Exposures arising from derivatives are further secured by margin deposits provided by counterparties as part of executing CSA (Credit Support Annex).

Financial information

31.12.2017	Total financial assets	Derivative instruments	Amounts due from repurchase agreements
Recognized financial assets, gross	3 710	2 808	902
Financial liabilities subject to offsetting, gross	(3)	(3)	-
Financial assets recognized in the statement of financial position, net	3 707	2 805	902
Maximum potential amount subject to offsetting	2 097	2 082	15
Financial liabilities subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 337	1 337	-
Cash or securities received as collateral	760	745	15
Net amount	**1 610**	**723**	**887**

31.12.2017	Total financial liabilities	Derivative instruments	Amounts due from repurchase agreements
Recognized financial liabilities, gross	2 792	2 744	48
Financial liabilities subject to offsetting, gross	(3)	(3)	-
Financial assets recognized in the statement of financial position, net	2 789	2 741	48
Maximum potential amount subject to offsetting	1 895	1 895	-
Financial assets subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 337	1 337	-
Cash or securities received as collateral	558	558	-
Net amount	**894**	**846**	**48**

(IN PLN MILLION)

31.12.2016	Total financial assets	Derivative instruments	Amounts due from repurchase agreements
Recognized financial assets, gross	4 891	2 891	2 000
Financial liabilities subject to offsetting, gross	(4)	(4)	-
Financial assets recognized in the statement of financial position, net	4 895	2 895	2 000
Maximum potential amount subject to offsetting	2 096	2 096	-
Financial liabilities subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 698	1 698	-
Cash or securities received as collateral	398	398	-
Net amount	**2 799**	**799**	**2 000**

31.12.2016	Total financial liabilities	Derivative instruments	Amounts due from repurchase agreements
Recognized financial liabilities, gross	4 439	4 233	206
Financial liabilities subject to offsetting, gross	(4)	(4)	-
Financial assets recognized in the statement of financial position, net	4 435	4 229	206
Maximum potential amount subject to offsetting	3 257	3 223	34
Financial assets subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 698	1 698	-
Cash or securities received as collateral	1 559	1 525	34
Net amount	**1 178**	**1 006**	**172**

49. ASSETS PLEDGED AS COLLATERAL FOR LIABILITIES AND TRANSFERRED FINANCIAL ASSETS

Liabilities in respect of repurchase transactions
Liabilities from the negative valuation of derivative instruments
Preliminary settlement deposit of the National Depository for Securities (KDPW)
Bank Deposit Guarantee Fund
Funds securing liabilities in respect of contributions to the Bank Guarantee Fund (BGF)
Legal limitations relating to the Bank's title
Transferred financial assets

LIABILITIES IN RESPECT OF REPURCHASE TRANSACTIONS

Financial assets which the Bank does not derecognize include assets pledged as collateral for liabilities in respect of repurchase transactions (Treasury bonds).

CARRYING AMOUNT	31.12.2017	31.12.2016
Debt securities	48	182
Transactions with repurchase agreement	48	206
Net balance	-	(24)

LIABILITIES FROM THE NEGATIVE VALUATION OF DERIVATIVE INSTRUMENTS

Cash deposits with banks include assets held as collateral for own liabilities, including settlements relating to the negative valuation of derivative instruments. As at 31 December 2017, such assets amounted to PLN 558 million (PLN 1 525 million as at 31 December 2016).

(IN PLN MILLION)

Preliminary settlement deposit of the National Depository for Securities (KDPW)

The Brokerage House of PKO Bank Polski SA holds bonds in the National Depository for Securities as collateral for the settlement of transactions with the Clearing House.

CARRYING AMOUNT / FAIR VALUE	31.12.2017	31.12.2016
Value of the deposit	10	8
Nominal value of the collateral	10	8
Type of collateral	Treasury bonds	Treasury bonds
Carrying amount of the collateral	10	8

Bank Deposit Guarantee Fund

	31.12.2017	31.12.2016
Value of the fund	1 133	1 005
Nominal value of the collateral	1 200	1 060
Type of collateral	Treasury bonds	Treasury bonds
Maturity of the collateral	25.01.2024	25.01.2024
Carrying amount of the collateral	1 193	1 021

Assets include Treasury bonds with maturities sufficient to secure their carrying amount over the period defined by the Act. The Fund is increased or decreased on 1 July of each year, in proportion to the amount representing the basis for calculating the mandatory reserve deposits. These assets are treated as assets pledged as collateral for own liabilities.

Funds securing liabilities in respect of contributions to the Bank Guarantee Fund (BGF)

	31.12.2017
Value of the contribution made in the form of payables	120
Nominal value of the assets in which funds corresponding to payables were invested	175
Type of collateral	Treasury bonds
Maturity of the collateral	25.01.2024
Carrying amount of the collateral	174

Starting from 2017, the value of contributions in the form of payment obligations represents 30% of the contributions to the Bank Guarantee Fund (“the BGF”) for the Deposit Guarantee Fund or the Bank Resolution Fund. Assets securing payment obligations include Treasury bonds pledged for BGF in an amount which ensures maintaining the ratio of the value of property rights securing payment obligations to the amount of payment obligations of no less than 110%.

For the purposes of establishing the minimum ratio of assets to the amount of payment commitment, the value of property rights securing payment obligations is determined at the amount specified based on the last fixing rate of the day in the electronic market for Treasury securities organized by the minister responsible for budgetary matters, plus interest due as at the valuation date, unless interest has already been included in the fixing rate.

Such assets funds are treated as assets pledged as collateral for own liabilities, they cannot be pledged or encumbered in any way, are excluded from judicial or administrative enforcement proceedings and do not form part of the estate in bankruptcy.

The amount of funds securing payment obligations relating to contributions to the BGF will be increased on payment dates of contributions to the Deposit Guarantee Fund (quarterly) and the Bank Resolution Fund (in the third quarter of a given year) representing not more than 30% of the contribution established by the BGF. The amount of these funds may decrease if the Bank is called by the BGF to transfer in cash the amount corresponding to the value of payment commitments.

LEGAL LIMITATIONS RELATING TO THE BANK'S TITLE

In the years ended 31 December 2017 and 31 December 2016, respectively, there were no intangible assets or property, plant and equipment items to which the Bank's legal title would be limited and pledged as collateral for the Bank's liabilities

TRANSFERRED FINANCIAL ASSETS

As at 31 December 2017 and 31 December 2016, the Bank had no transferred financial assets fully derecognized in respect of which the Bank held an exposure.

50. FIDUCIARY ACTIVITIES

The Bank is a direct participant in the Central Securities Depository of Poland (Krajowy Depozyt Papierów Wartościowych) and the Securities Register (at the National Bank of Poland). The Bank maintains securities accounts and handles transactions on domestic and foreign markets, provides fiduciary services and is a depository of pension and investment funds. Assets held by the Bank as part of providing fiduciary services have not been disclosed in these financial statements since they do not meet the definition of the Bank's assets.

51. INFORMATION ON THE ENTITY AUTHORIZED TO AUDIT THE FINANCIAL STATEMENTS

On 26 January 2017, the Supervisory Board of PKO Bank Polski SA selected KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa as the entity authorized to audit the financial statements of the Bank and consolidated financial statements of the PKO Bank Polski SA Group for 2017–2019. The same entity had audited the Bank's and the Group's financial statements for 2015-2016. KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa with its registered office in Warsaw, ul. Inflancka 4A is entered in the list of audit companies maintained by the National Board of Registered Auditors with the number 3546. The selection of the entity authorized to audit and review the financial statements was made by the Supervisory Board in accordance with the applicable regulations and professional standards, on the basis of §15 section 1, point 4 of the Bank's Articles of Association.

On 12 April 2017, the Supervisory Board of PKO Bank Polski SA concluded another agreement with KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa for the audit and review of the financial statements of the Bank and consolidated financial statements of the PKO Bank Polski SA Group for 2017 2019.

The total net remuneration of KPMG Audyt Spółka z ograniczoną odpowiedzialnością sp.k. for the audit of the stand-alone and consolidated financial statements of PKO Bank Polski S.A. for 2017 amounted to PLN 1 389 thousand (PLN 1 250 thousand for 2016) and for other assurance services, including a review of the financial statements, it amounted to PLN 2 051 thousand in 2017 (PLN 2,381 thousand in 2016). The net remuneration paid in respect of their services amounted to PLN 68 thousand in 2017 (PLN 68 thousand in 2016).

(IN PLN MILLION)

OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT

52. Risk management at PKO Bank Polski SA

Risk management is one of the most important internal processes in PKO Bank Polski SA. It is aimed at ensuring the profitability of the business activities monitoring the risk level, keeping the risks within the risk tolerances and limits adopted by the Bank, in a changing macroeconomic and legal environment. The level of risk is an important part of the planning processes.

The Bank identified risks which are to be managed, and some these risks are considered material. Materiality assessments of the risks associated with the Bank's operations are conducted at least once a year. In particular, an assessment of materiality is conducted more often than once a year if the scope of the Bank's operations or its risk profile change significantly. When determining the criteria for classifying a given risk as material, the impact of the significance of the risk on the Bank's activities is taken into account. When assessing the materiality of the risks to the Bank, a list of material, monitored and immaterial risks in determined at Bank level. The following risks are considered material for the Bank: credit risk, insolvency risk, currency risk, interest rate risk, liquidity risk (including financing risk), operating risk, business risk, risk of macroeconomic changes and model risk.

Type of risk	Section
CREDIT RISK	53, 54, 56, 57
CONCENTRATION RISK	55
RISK OF FOREIGN CURRENCY MORTGAGE LOANS	58
INTEREST RATE RISK	59
CURRENCY RISK	60
LIQUIDITY RISK, INCLUDING FINANCING RISK	61
COMMODITY PRICES RISK	62
EQUITY SECURITIES PRICES	62
OTHER PRICE RISKS	62
DERIVATIVES RISK	63
OPERATING RISK	64
COMPLIANCE AND CONDUCT RISK	65
BUSINESS (STRATEGIC) RISK	65
REPUTATION RISK	65
MODELS RISK	65
RISK OF MACROECONOMIC CHANGES	65
CAPITAL RISK	65
EXCESSIVE LEVERAGE RISK	65

A detailed description of the management policies for material risks is presented in the Report on Capital Adequacy and other information subject to publication in the PKO Bank Polski SA Group.

RISK MANAGEMENT OBJECTIVE

The objective of the risk management is to strive to maintain the level of risk within the accepted tolerances in order to:

- protect shareholder value:
- protect customer deposits;
- support the Bank in conducting efficient operations.

The risk management objectives are achieved, in particular, by providing appropriate information on the risk, so that decisions are made in full awareness of the particular risks involved.

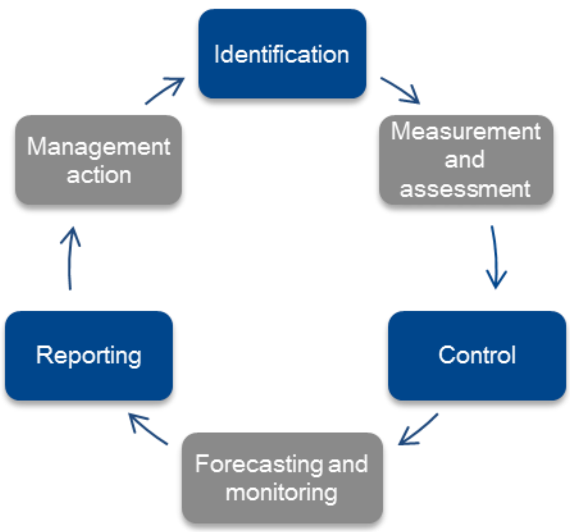
MAIN PRINCIPLES OF RISK MANAGEMENT

Risk management at PKO Bank Polski SA is based, in particular, on the following principles:

1) the Bank manages all the risks identified;
2) the risk management process is appropriate from the perspective of the scale of operations and materiality, scale and complexity of a given risk, and adjusted on an on-going basis to take account of the new risks and their sources;
3) risk management methods (especially models and their assumptions) and risk management measurement or assessment systems are tailored to the scale and complexity of individual risks, the current and planned operations of the Bank and its operating environment, and are periodically verified and validated;
4) the area of risk management remains organizationally independent from business activities;
5) risk management is integrated into the planning and controlling systems;
6) the level of risk is monitored on an on-going basis;
7) the risk management process supports the implementation of the Bank's strategy in compliance with the Risk Management Strategy, in particular with respect to the level of risk tolerance.

THE RISK MANAGEMENT PROCESS

The process of risk management in PKO Bank Polski SA consists of the following stages:



- **RISK IDENTIFICATION:**

Risk identification consists of recognizing the existing and potential sources of risk and estimating the significance of its potential impact on the Bank's operations. As part of risk identification, the risks considered to be material in the Bank's operations are identified.

- **RISK MEASUREMENT AND ASSESSMENT:**

Risk measurement covers determining the risk assessment measures adequate to the type and significance of the risk, data availability and quantitative risk assessment by means of determined measures, as well as risk assessment aimed at identifying the scale or scope of risk, taking into account achieving the risk management objectives. As part of risk measurement, valuation of the risks for the purpose of the Bank's pricing policy and stress-testing is conducted based on assumptions which ensure a sound assessment of the risk. Stress-test scenarios include, among other things, the requirements stemming from Recommendations of the Polish Financial Supervision Authority. In addition, the Bank conducts comprehensive stress tests (CST) which are an integral element of the risk management and which supplement stress tests specific for individual risks. CST also covers an analysis of the impact of changes in the environment (in particular, the macroeconomic environment) and the Bank's functioning on the Bank's financial position.

- **RISK CONTROL:**

Risk control involves determining the tools to be used for measuring or reducing the level of risk in specific areas of the Bank's activities. This includes establishing control mechanisms adjusted to the scale and complexity of the Bank's activities especially in the form of strategic tolerance limits for the individual types of risk.

- **RISK FORECASTING AND MONITORING:**

Risk forecasting and monitoring involves preparing risk level forecasts and monitoring deviations from forecasts or the adopted benchmarks (e.g. limits, thresholds, plans, prior period measurements, recommendations and instructions issued by supervisory and regulatory authorities), and performing (specific and comprehensive) stress tests. Risk level forecasts are verified. The frequency of risk monitoring is adequate to the significance and variability of specific risks.

- **RISK REPORTING:**

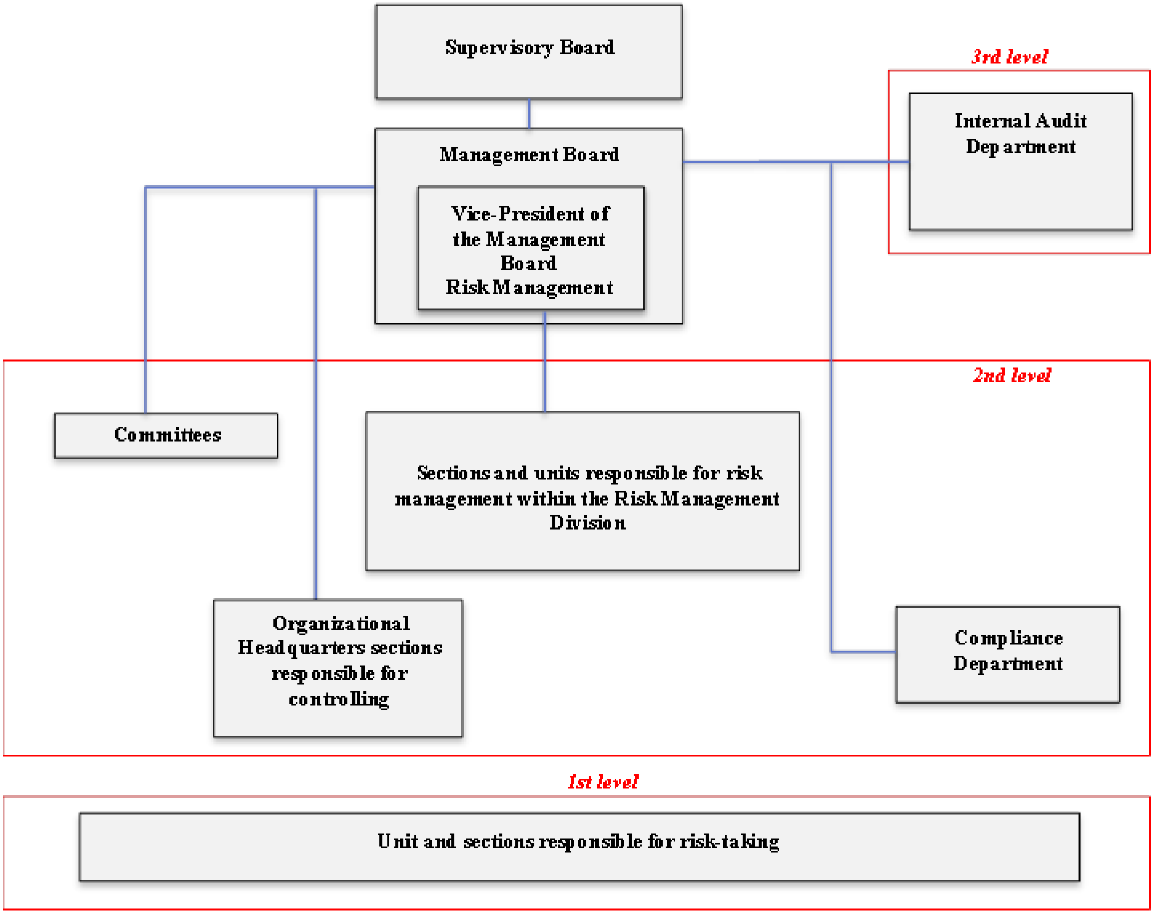
Risk reporting consists of regularly providing information to the Bank's governing bodies on the results of the risk measurement or assessment, actions taken and follow-up recommendations. The scope, frequency and form of the reporting are adjusted to the managerial level of the recipients.

- **MANAGEMENT ACTIONS:**

Management actions consist particularly in issuing internal regulations affecting the management processes relating to different types of risk, establishing the level of risk tolerance, establishing limits and thresholds, issuing recommendations, and making decisions, including decisions to use tools supporting risk management. The objective of management actions is to shape the risk management process and risk levels.

ORGANIZATION OF RISK MANAGEMENT IN THE BANK

Risk management in the Bank takes place in all of the organizational units of the Bank.
The organization of risk management is presented in the diagram below:



The risk management system is supervised by the Supervisory Board of the Bank which controls and evaluates the adequacy and effectiveness of the system. The Supervisory Board evaluates whether or not individual elements of the risk management system support proper execution of the process for setting and achieving specific objectives of the Bank. In particular, the Supervisory Board verifies whether the system applies formal rules to establish the size of the risk taken and risk management principles, as well as formal procedures to identify, measure or estimate and monitor the risks associated with the Bank's operations, taking into account the anticipated level of risk in the future. The Supervisory Board verifies if formal limits restricting the risk and the rules of conduct in the case when limits are exceeded are applied, and if the adopted management reporting system enables monitoring the risk levels. The Supervisory Board evaluates whether the risk management system is updated on an on-going basis to take into account new risk factors and sources. The Supervisory Board is supported by the following committees: the Supervisory Board Remuneration Committee, the Supervisory Board Risk Committee and the Supervisory Board Audit Committee.

In respect of risk management, the Management Board of PKO Bank Polski SA is responsible for strategic risk management, including supervising and monitoring actions taken by the Bank in respect of risk management. The Management Board makes major decisions affecting the risk profile of the Bank and adopts internal regulations concerning risk management. In its risk management activities, the Management Board is supported by the following committees:

1) the Risk Committee;
2) the Asset and Liability Committee (ALCO);
3) The Bank's Credit Committee;
4) the Operating Risk Committee.

The risk management process is carried out in three independent but complementary levels:

THE FIRST LEVEL is formed of organizational structures responsible for product management, executing sales of products and customer servicing, and of other structures which perform risk-generating operating tasks based on the internal regulations of PKO Bank Polski SA. The function is realized in all of the Bank's organizational units and in all organizational units of the Head Office.

THE SECOND LEVEL – covers operations of the compliance unit and the identification, measurement, evaluation or control, monitoring and reporting of significant types of risks, as well as identified the threats and irregularities; the tasks are executed by specialized organizational structures acting on the basis of the applicable internal regulations of PKO Bank Polski SA; the objective of these structures is to ensure that the tasks performed as part of the first level are properly governed in the internal regulations of PKO Bank Polski SA and that they effectively limit the risk, support risk measurement, assessment and analysis and contribute to operational efficiency. The function is performed, in particular. by the Risk Management Area, the Compliance Department and relevant committees. The second level supports actions undertaking in order to eliminate unfavourable deviations from the financial plan, to the extent applicable to figures which affect the quantitative strategic risk tolerance limits adopted in the financial plan. These tasks are performed in particular in the organizational units of the Head Office responsible for controlling.

THE THIRD LEVEL consists of the internal audit function which performs independent audits of components of the Bank's management system, including the risk management system, and of the internal control system; the internal audit operates separately of the first and second levels and may support their actions by consultations, but without participating in their decision-making.

The independence of the levels consists of preserving organizational independence in the following areas:

- the function of the second level with regards to creating system solutions is independent of the function of the first level;
- the function of the third level is independent of the functions of the first and second levels..

SPECIFIC ACTIVITIES IN THE AREA OF RISK MANAGEMENT UNDERTAKEN IN 2017

PKO Bank Polski SA's top priority is to maintain a strong capital position, including effective management of capital adequacy, to retain stable sources of founding which form the basis for business development, to support the Polish entrepreneurship, ensuring customer satisfaction, engagement in developing new market standards, preventing cyberthreats, without compromising priorities in terms of operational efficiency, effective cost control and an appropriate assessment of the risk level.

To this end, in 2017, the Bank took the following steps, among other things:

- replacing the maturing own short-term bonds with an issue of new bonds amounting to PLN 670 million (in May) and PLN 650 million (in November);
- in April, redeeming its own maturing short-term bond of EUR 200 million;
- in August, placed an issue of subordinated bonds with a total nominal value of PLN 1 700 million and the maturity of ten years, with an option of early redemption of all bonds 5 years after the issue date (28 August 2017), subject to the consent of the Polish Financial Supervision Authority;
- in September, executed an early redemption of subordinated bonds with a total nominal value of PLN 1 600 million;
- issued own bonds as part of the EMTN programme: in July, of EUR 750 million and with a maturity of 4 years and in November, of CHF 400 million and a maturity of 4 years;
- on 21 December 2017, having obtained the necessary corporate consents, concluded a guarantee agreement with a counterparty ensuring unfunded credit protection with regard to the portfolio for the selected corporate loan receivables of the Bank, in accordance with the CRR Regulation. The total value of the Bank's portfolio covered by the Guarantee is PLN 5 495 million, and the portfolio comprises bonds amounting to PLN 1 097 million and a portfolio of other receivables of PLN 4 398 million.
- In 2017, as part of operating risk management, the Bank conducted preparatory work associated with opening a new branch in the Czech Republic. The Branch began operating on 3 April 2017. As part of this work, in February 2017, the Bank obtained consent from the Polish Financial Supervision Authority to jointly apply an advanced

measurement approach (AMA) and the basic indicator approach (BIA) to calculate the capital requirement relating to own funds in respect of operating risk using the BIA method to the operations of the Bank's branch in Germany and in the Czech Republic, and the AMA approach for the remaining operations of the Bank.

53. CREDIT RISK MANAGEMENT

DEFINITION

Credit risk is defined as the risk of occurrence of losses due to customer's default of payments due to Bank or as a risk of decrease in the economic value of amounts due to the Bank as a result of deterioration of a customer's ability to repay amounts due to the Bank.

RISK MANAGEMENT OBJECTIVE

The objective of credit risk management is to minimize losses on the loan portfolio as well as minimize the risk of the occurrence of loans exposed to impairment, while maintaining the expected level of profitability and value of the loan portfolio.

The Bank follows the following principles of credit risk management:

- each loan transaction is subject to comprehensive credit risk assessment, which is reflected in an internal rating or credit scoring,
- credit risk relating to loan transactions is measured at the stage of examining a loan application and on a regular basis, as part of the monitoring process, taking into consideration changes in the external conditions and in the financial standing of the borrowers,
- credit risk assessment of exposures is separated from the sales function by ensuring an appropriate organizational structure, independence in developing and validating tools supporting the assessment of credit risk and the independence of the decisions approving deviations from the suggestions resulting from the use of these tools,
- the terms and conditions of a loan transactions offered to a customer depend on the assessment of credit risk level generated by the transaction,
- credit decisions may be taken solely by authorized persons,
- credit risk is diversified, in particular, in terms of geographical area, industry, products and customers,
- an expected credit risk level is mitigated by collateral received by the Bank, margins from customers and impairment allowances (provisions) on loan exposures.

The above-mentioned principles are executed by the Bank through the use of advanced credit risk management methods, both at the level of individual credit exposures and the entire loan portfolio of the Bank. These methods are verified and developed to ensure compliance with the requirements of the internal rating-based method (IRB), i.e. an advanced credit risk measurement method which may be used to calculate the capital requirements for credit risk, subject to approval by the Polish Financial Supervision Authority.

MEASUREMENT AND ASSESSMENT OF CREDIT RISK

- **CREDIT RISK MEASUREMENT AND ASSESSMENT METHODS**

In order to assess the level of credit risk and the profitability of its loan portfolios, the Bank uses different credit risk measurement and valuation methods, including:

- probability of default (PD),
- expected loss (EL),
- unexpected loss (UL),
- loss given default (LGD),
- credit value at risk (CVaR),

- share and structure of impaired loans,
- coverage ratio of impaired loans with impairment allowances,
- cost of credit risk.

The Bank systematically expands the scope of credit risk measures used, taking into account the requirements of the IRB method, and extends the use of risk measures to cover the entire loan portfolio of the Bank with these methods.

The portfolio credit risk measurement methods allow, among other things, to reflect the credit risk in the price of products, determine the optimum conditions of financing availability and determine the rates of impairment allowances.

The Bank performs analyses and stress-tests relating to the impact of the potential changes in the macroeconomic environment on the quality of the Bank's loan portfolio, and the results are presented in reports to the Bank's authorities. The above-mentioned information enables the identification and implementation of the measures mitigating the negative effects of the impact of unfavourable market conditions on the Bank's outcome.

- **RATING AND SCORING METHODS**

An assessment of the risk of individual loan transactions is performed by the Bank using the scoring and rating methods which are supported by specialist IT applications. The risk assessment method is defined in the Bank's internal regulations whose main aim is to ensure a uniform and objective evaluation of the credit risk during the lending process.

The Bank evaluates the credit risk of retail customers in two dimensions: creditworthiness assessed qualitatively and quantitatively. A quantitative creditworthiness assessment consists of examining a customer's financial situation, whereas the qualitative assessment involves scoring and evaluating a customer's credit history obtained from the Bank's internal records and external databases.

In the case of corporate customers in the small and medium enterprises segment who meet certain criteria, the Bank assesses credit risk using the scoring method. Such assessment refers to low-value, non-complex loan transactions and it is performed in two dimensions: a customer's borrowing capacity and his creditworthiness. An assessment of the borrowing capacity involving examining a customer's economic and financial position, whereas the assessment of creditworthiness involves scoring and evaluating the customer's credit history obtained from the Bank's internal records and external databases.

In other cases, the rating method is used for institutional customers.

The evaluation of credit risk associated with financing institutional customers is performed by the Bank in two dimensions: the customer and the transaction. The measures involved include an evaluation of the customer's creditworthiness, i.e. the rating, and an assessment of the transaction risk, i.e. the customer's ability to repay the liabilities due in the amounts and on the dates specified.

Rating models for institutional customers are developed using the Bank's internal data, thus ensuring that they are tailored to the risk profiles of the Bank's customers. Models are based on a statistical dependence analysis between the default and the customer's risk scoring. The scoring includes an evaluation of financial ratios, qualitative factors and behavioural factors. A customer's risk assessment depends on the size of the enterprise assessed. In addition, the Bank applies a model for the assessment of credited entrepreneurs in the formula of specialized lending, which allows an adequate credit risk assessment of large projects involving real estate financing (e.g. office space, retail space, industrial space) and infrastructure projects (e.g. telecommunication, industrial or public utility infrastructure).

In order to examine the correctness of functioning of the methods applied by the Bank, credit risk assessment methodologies relating to individual loan exposures are subject to periodical reviews.

The credit risk assessment process in the Bank takes into account the requirements of the Polish Financial Supervision Authority as defined in Recommendation S concerning good practices for the management of mortgage-secured loan exposures and Recommendation T concerning good practices for the management of retail credit exposures.

Information on rating and scoring assessments is widely used in PKO Bank Polski SA to manage credit risk, in the system of credit decision authorizations, to determine the amounts triggering the credit risk assessment services and in the credit risk measurement and reporting system.

CREDIT RISK MONITORING

Credit risk is monitored at the level of individual loan transactions and at portfolio level.

Credit risk monitoring at the individual loan transaction level is governed, in particular, by the Bank's internal regulations concerning:

- the principles for the recognition of impairment allowances for loan exposures and impairment allowances on receivables in respect of unsettled forward transactions,
- the rules of functioning the Early Warning System at the Bank,
- early monitoring of delays in the collection of receivables,
- the principles for the classification of loan exposures and determining the level of specific provisions.

In order to shorten the time of reaction to the warning signals noted, signaling an increased credit risk level, the Bank uses and develops an IT application, Early Warning System (EWS).

Credit risk monitoring at the portfolio level consists of:

- supervising the level of the portfolio credit risk based on the tools used for measuring credit risk, taking into consideration the identified sources of credit risk and analysing the effects and actions taken as part of system management;
- recommending preventive measures in the event of identifying an increased level of credit risk.

CREDIT RISK REPORTING

The Bank prepares monthly and quarterly credit risk reports. The reporting of credit risk covers cyclic information on the scale of the risk exposure of the loan portfolio.

MANAGEMENT ACTIONS RELATING TO CREDIT RISK

The basic credit risk management tools used in the Bank include:

- minimum transaction requirements (risk parameters) determined for a given type of transaction (e.g. minimum LTV value, maximum loan amount, required collateral),
- the principles of defining credit availability, including cut-offs – the minimum number of points awarded in the process of creditworthiness assessment with the use of a scoring system (for retail customers and SMEs) or the customer's rating class (for corporate clients), which a client must obtain to receive a loan,
- concentration limits – limits defined in the Regulation of the European Parliament and the Council (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms (CRR Regulation) and the Polish Banking Law, or internal limits defining the concentration risk appetite,
- industry-related limits – limits which reduce the risk level related to financing institutional customers conducting business activities in industries characterized by high level of credit risk,
- limits on credit exposures related to the Bank's customers – the limits defining the appetite for credit risk resulting from, among other things, Recommendations S and T,
- credit limits defining the Bank's maximum exposure to a given customer or a country in respect of wholesale market transactions, settlement limits and limits for the period of exposure,
- competence limits – the limits defining the maximum level of credit decision-making powers with regard to the Bank's customers; the limits depend primarily on the amount of the Bank's exposure to a given customer (or group of related customers) and the lending period; the competence limits depend on the level (in the Bank's organizational structure) at which credit decisions are made,
- minimum credit margins – credit risk margins relating to a given credit transaction concluded by the Bank with a given corporate customer, but the interest rate offered to the customer cannot be lower than the reference rate plus credit risk margin.

USE OF CREDIT RISK MITIGATION TECHNIQUES – COLLATERAL

The collateral management policy plays a significant role in establishing credit transaction terms. The Bank's collateral management policy is intended to properly protect it against credit risk to which the Bank is exposed, including above all the fact of establishing collateral that is as liquid as possible. Collateral may be considered liquid if it is possible to be sold without a significant decrease in its price and at a time which does not expose the Bank to a change in the collateral value due to price fluctuations typical for a given collateral.

The Bank strives to diversify collateral in terms of forms and assets used as collateral.

The Bank evaluates collateral from the perspective of the actual possibility of using it to satisfy its claims.

In addition, when assessing collateral, the Bank takes into account the following factors:

- the economic, financial and economic or social and financial position of entities which provide personal guarantees,
- the condition and market value of the assets accepted as collateral and their vulnerability to depreciation in the period of maintaining the collateral (the impact of the technological wear and tear of a collateralized asset on its value),
- potential economic benefits of the Bank resulting from a specific method of securing receivables, including, in particular, the possibility of reducing impairment allowances,
- the method of establishing collateral, including the typical duration and complexity of formalities, as well as the necessary costs (the costs of maintaining collateral and enforcement against the collateral), using the Bank's internal regulations concerning the assessment of collateral,
- the complexity, time-consuming nature and economic and legal conditions for the effective realization of collateral, in the context of enforcement restrictions and the applicable principles for the distribution of the sums obtained from individual enforcement or in the course of bankruptcy proceedings, the ranking of claims.

Establishing the certain types of collateral depends on the level of risk of a given customer or transaction.

When granting loans intended to finance housing and commercial properties, a mortgage is an obligatory type of collateral. Until an effective protection is established (depending on the type and amount of a loan), the Bank may accept temporary collateral in different form.

With regard to consumer loans, usually personal guarantees are used or collateral is established on the customer's bank account, car or securities.

The collateral for loans intended for the financing of small and medium-sized enterprises as well as corporate customers is established, among other things: on receivables from business operations, bank accounts, movables, real estate or securities or in the form of BGK guarantees (universally used in respect of small and medium-sized enterprises),

The collateral management policy is set out in the Bank's internal regulations.

(IN PLN MILLION)

54. CREDIT RISK – FINANCIAL INFORMATION

EXPOSURE TO CREDIT RISK

EXPOSURE TO CREDIT RISK – ITEMS IN THE STATEMENT OF FINANCIAL POSITION (excluding adjustments relating to fair value hedge accounting)	31.12.2017	31.12.2016
Current account and deposits with the Central Bank	13 136	9 124
Amounts due from banks	8 769	8 471
Financial assets held for trading - debt securities	446	344
Derivative financial instruments	2 805	2 895
Financial instruments designated at fair value through profit or loss upon initial recognition - debt securities	6 409	11 744
Loans and advances to customers	186 893	189 067
housing	90 209	97 866
corporate	67 139	62 143
consumer	24 275	22 848
debt securities (corporate)	1 855	2 283
debt securities (municipal)	2 513	2 588
receivables in respect of repurchase agreements	902	1 339
Available-for-sale investment securities - debt securities	41 560	35 314
Investment securities held to maturity	1 622	157
Other assets - other financial assets	1 748	1 791
Total	**263 388**	**258 907**

EXPOSURE TO CREDIT RISK - OFF-BALANCE SHEET ITEMS	31.12.2017	31.12.2016
Irrevocable liabilities granted	33 607	31 078
Guarantees granted	8 609	7 931
Letters of credit issued	1 430	1 600
Underwriting of securities	4 651	5 120
Total	**48 297**	**45 729**

PAST DUE FINANCIAL ASSETS

FINANCIAL ASSETS PAST DUE BUT NOT IMPAIRED, GROSS	31.12.2017			
	up to 1 month	1 - 3 months	after 3 months	Total
Loans and advances to customers	2 166	489	208	**2 863**
Other assets - other financial assets	1	-	9	**10**
Total	**2 167**	**489**	**217**	**2 873**

(IN PLN MILLION)

FINANCIAL ASSETS PAST DUE BUT NOT IMPAIRED, GROSS	31.12.2016			
	up to 1 month	1 - 3 months	after 3 months	Total
Loans and advances to customers	2 317	609	167	3 093
Other assets - other financial assets	-	-	11	11
Total	**2 317**	**609**	**178**	**3 104**

The receivables disclosed above are secured with the following types of collateral: mortgages, registered pledges, transfer of title, freezing of a deposit account, insurance of credit exposures and guarantees and sureties.

As part of an assessment performed, it has been concluded that the expected cash flows from the collateral fully cover the carrying amounts of these financial assets.

FINANCIAL ASSETS ASSESSED ON AN INDIVIDUAL BASIS WITH A RECOGNIZED IMPAIRMENT TRIGGER

FINANCIAL ASSETS ASSESSED ON AN INDIVIDUAL BASIS WITH A RECOGNIZED IMPAIRMENT TRIGGER, AT GROSS CARRYING AMOUNT	31.12.2017	31.12.2016
Loans and advances to customers	3 757	4 420
housing loans	470	739
consumer loans	197	218
business loans	3 090	3 389
debt securities	-	74
Debt investment securities available-for-sale	819	1 293
Total	**4 576**	**5 713**

Loans and advances to customers were secured by the following collateral established for PKO Bank Polski SA: mortgages, registered pledges, debtor's promissory notes and transfers of receivables.
The financial effect of the collateral held in the amount which is the best reflection of the maximum exposure to credit risk as at 31 December 2017 amounted to PLN 2 104 million (PLN 2 558 million as at 31 December 2016).

INTERNAL RATINGS

Exposures to corporate customers which are not individually impaired are classified according to customer rating as part of the internal rating classes, from A to G (in respect of financial institutions from A to F).

The following portfolios are covered by the rating system:

- corporate market customers;
- small- and medium-sized enterprises (excluding certain product groups assessed in a simplified manner).

Loans and advances which are not individually impaired and are not rated, are characterized with a satisfactory level of the credit risk. This applies in particular to retail loans (including housing loans) which do not have individually significant exposures and thus do not create significant credit risk.

(IN PLN MILLION)

FINANCIAL ASSETS NOT IMPAIRED, NOT PAST DUE INTERNAL RATINGS	31.12.2017	31.12.2016
Loans and advances to customers	**180 325**	**181 852**
corporate loans	63 165	54 203
A (first rate)	875	949
B (very good)	18 162	2 065
C (good)	9 575	6 665
D (satisfactory)	9 236	7 205
E (average)	11 205	19 363
F (acceptable)	10 576	14 287
G (poor)	3 536	3 669
consumer and housing loans	103 869	113 273
A (first rate)	90 236	91 882
B (very good)	8 728	8 834
C (good)	3 010	5 469
D (average)	1 210	4 651
E (acceptable)	685	2 437
without an internal rating - financial, non-financial and public sector customers (consumer, housing and other loans)'	13 291	14 376
Securities available for sale	**5 147**	**5 088**
A (first rate)	55	12
B (very good)	409	353
C (good)	1 061	712
D (satisfactory)	1 589	1 376
E (average)	1 131	1 462
F (acceptable)	795	1 070
G (poor)	74	63
G 3 (low)	33	40
Total	**185 472**	**186 940**

External ratings

The structure of debt securities and amounts due from banks which are neither past due nor impaired by external rating classes is presented below:

31.12.2017	AAA	AA- to AA+	A- to A+	BBB- to BBB+	BB- to BB+	B- to B+	CCC- to CCC+	Total
Amounts due from banks	7	918	2 182	447	21	3	-	3 578
Debt securities	132	62	40 983	2 412	620	50	-	44 259
NBP money market bills	-	-	4 199	-	-	-	-	4 199
Treasury bonds	-	-	36 033	-	-	-	-	36 033
municipal bonds	-	-	183	68	42	-	-	293
corporate bonds	132	62	568	2 344	578	50	-	3 734
TOTAL	139	980	43 165	2 859	641	53	-	47 837

(IN PLN MILLION)

31.12.2016	AAA	AA- to AA+	A- to A+	BBB- to BBB+	BB- to BB+	B- to B+	CCC- to CCC+	Total
Amounts due from banks	**24**	**1 496**	**2 209**	**378**	**14**	**5**	**192**	**4 318**
Debt securities	**154**	**1 426**	**37 572**	**1 936**	**38**	**49**	**-**	**41 175**
NBP money market bills	-	-	8 999	-	-		-	8 999
Treasury bonds	-	-	28 460	-	-		-	28 460
municipal bonds	-	15	113	105	38		-	271
corporate bonds	154	1 411	-	1 831	-	49	-	3 445
TOTAL	**178**	**2 922**	**39 781**	**2 314**	**52**	**54**	**192**	**45 493**

55. CONCENTRATION OF CREDIT RISK AT THE BANK

PKO Bank Polski SA defines credit concentration risk as the risk arising from a considerable exposure to single entities or groups of entities whose repayment capacity depends on a common risk factor. PKO Bank Polski SA analyses concentration risk with respect to: the largest entities, the largest groups, industries, geographical regions, currencies and mortgage-secured exposures.

CONCENTRATION BY THE LARGEST ENTITIES

The concentration risk of exposures to individual customers and groups of related customers is monitored in accordance with Article 395 clause 1 of Regulation of the European Parliament and the Council (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms (CRR), according to which the Bank shall not assume an exposure to a customer or a group of related customers whose value exceeds 25% of the value of its recognized capital.

As at 31 December 2017 and 31 December 2016, concentration limits were not exceeded. As at 31 December 2017, the Bank's concentration risk relating to the largest exposure to a single customer amounted to 49.0% of the Bank's eligible capital (37.3% as at 31 December 2016).

(IN PLN MILLION)

The Bank's exposure to the 20 largest non-banking customers:

31.12.2017			31.12.2016		
	CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[2]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES		CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[2]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES
1 [1]	16 784	6,32%	1 [1]	11 599	4,29%
2	2 936	1,11%	2 [1]	4 204	1,55%
3	2 828	1,07%	3	3 200	1,18%
4	2 450	0,92%	4	2 856	1,06%
5	2 332	0,88%	5	2 450	0,91%
6	1 895	0,71%	6	2 371	0,88%
7	1 747	0,66%	7	2 064	0,76%
8	1 602	0,60%	8	1 571	0,58%
9	1 566	0,59%	9	1 583	0,59%
10	1 322	0,50%	10	1 482	0,55%
11 [1]	1 150	0,43%	11	1 325	0,49%
12	1 101	0,41%	12 [1]	1 150	0,43%
13	796	0,30%	13	1 081	0,40%
14	755	0,28%	14	992	0,37%
15	746	0,28%	15	956	0,35%
16	724	0,27%	16	883	0,33%
17	702	0,26%	17	872	0,32%
18	682	0,26%	18	828	0,31%
19	653	0,25%	19	761	0,28%
20	650	0,24%	20	706	0,26%
Total	**43 421**	**16,36%**	**Total**	**42 934**	**15,89%**

[1] exposure excluded from exposure concentration limit.
[2] off-balance sheet exposure includes the liability arising from derivative transaction in the amount equal to their balance sheet equivalent.

CONCENTRATION BY THE LARGEST GROUPS

As at 31 December 2017, the largest concentration of PKO Bank Polski SA's exposures to a group of borrowers amounted to 6.80%* of the Bank's loan portfolio (6.35% as at 31 December 2016). As at 31 December 2017, the largest concentration of PKO Bank Polski's exposures to a group amounted to 52.7% of the Bank's recognized capital (55.2% as at 31 December 2016).

(IN PLN MILLION)

The Bank's exposure to 5 largest groups:

31.12.2017			31.12.2016		
No.	CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[2]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES	No.	CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[2]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES
1 [1]	18 063	6,80%	1 [1]	17 181	6,35%
2	3 094	1,17%	2	3 129	1,16%
3	3 063	1,15%	3	2 468	0,91%
4	2 336	0,88%	4	2 397	0,89%
5	2 169	0,82%	5	2 113	0,78%
Total	**28 725**	**10,82%**	**Total**	**27 288**	**10,09%**

[1] exposure excluded from exposure concentration limit.
[2] off-balance sheet exposure includes the liability arising from derivative transaction in the amount equal to their balance sheet equivalent.

CONCENTRATION BY INDUSTRY

The Bank applies limits intended to reduce the level of risk associated with financing institutional customers operating in certain industries characterized by a high level of credit risk, and to avoid excessive concentration in individual industry sectors.

An increase in the Bank's exposure to business entities is observed. The structure of the Bank's exposure to industry sectors is dominated by entities operating in the Financial and insurance activity section.

The structure of exposure to industry sectors as at 31 December 2017 and 31 December 2016 is presented in the table below:

Section s	Section name	31.12.2017		31.12.2016	
		Exposure	No. of entities	Exposure	No. of entities
K	Financial and insurance activities	17,36%	1,90%	16,62%	1,94%
C	Industrial processing	13,78%	10,59%	13,84%	10,42%
L	Real estate administration	11,76%	22,76%	13,88%	23,09%
G	Wholesale and retail trade, repair of motor vehicles	11,66%	23,65%	11,55%	23,88%
O	Public administration and national defence, obligatory social security	14,65%	0,45%	15,28%	0,50%
Other exposures		30,79%	40,65%	28,83%	40,17%
Total		**100,00%**	**100,00%**	**100,00%**	**100,00%**

The structure by industry presented above excludes the exposure arising from debt securities reclassified from 'available-for-sale' to 'loans and advances to customers'.

(IN PLN MILLION)

CONCENTRATION BY GEOGRAPHICAL REGIONS

The Bank's loan portfolio is diversified in terms of geographical concentration.

The structure of the loan portfolio by geographical regions is identified by the Bank depending on a customer type – it is different for the Retail Market Area (ORD) and for the Corporate and Investment Banking Area (OKI). As at 31 December 2017 and 31 December 2016, the largest concentration of the ORD loan portfolio was in the Warsaw region (warszawski) and Katowice region (katowicki) (these two regions account for approx. 25% of the total ORD portfolio).

CONCENTRATION OF CREDIT RISK BY GEOGRAPHICAL REGION FOR RETAIL CUSTOMERS	31.12.2017	31.12.2016
warszawski	14,20%	14,46%
katowicki	11,03%	10,91%
poznański	9,99%	9,93%
krakowski	9,07%	9,14%
łódzki	8,84%	8,83%
wrocławski	9,29%	9,23%
gdański	8,66%	8,71%
bydgoski	7,52%	7,49%
lubelski	6,91%	6,92%
białostocki	6,57%	6,48%
szczeciński	6,16%	6,22%
Head Office	0,91%	0,84%
other	0,85%	0,84%
Total	**100,00%**	**100,00%**

As at 31 December 2017, the largest concentration of the OKI loan portfolio was in the central macroregion which accounted for 49% of the OKI portfolio (43% as at 31 December 2016).

CONCENTRATION OF CREDIT RISK BY GEOGRAPHICAL REGION FOR CORPORATE CUSTOMERS	31.12.2017	31.12.2016
central macroregion	48,58%	42,82%
northern macroregion	10,60%	12,45%
western macroregion	8,70%	11,36%
southern macroregion	9,46%	11,60%
north-eastern macroregion	4,76%	5,34%
south-western macroregion	6,45%	7,60%
south-eastern macroregion	10,40%	8,31%
Head Office	0,35%	0,42%
foreign countries	0,70%	0,10%
other	0,00%	0,00%
Total	**100,00%**	**100,00%**

CONCENTRATION OF CREDIT RISK BY CURRENCY

As at 31 December 2017, the share of exposure in convertible currencies other than PLN in the entire Bank's portfolio amounted to 19.8%, which represents a decrease of circa 4.7 p.p. compared with 31 December 2016. Exposures in CHF represent the largest part of the Bank's foreign currency exposures with the share in the entire foreign currency portfolio of the Bank of 64% as at 31 December 2017 (65% as at 31 December 2016).

(IN PLN MILLION)

CONCENTRATION OF CREDIT RISK BY CURRENCY	31.12.2017	31.12.2016
PLN	80,19%	75,46%
CHF	12,75%	15,98%
EUR	6,14%	7,34%
USD	0,81%	1,05%
GBP	0,05%	0,05%
other	0,06%	0,12%
Total	**100,00%**	**100,00%**

OTHER TYPES OF CONCENTRATION

The Bank analyses the structure of its housing loan portfolio by LTV levels. Both in 2017 and in 2016, the largest concentration was in the LTV range of 61%–80%.

HOUSING LOAN PORTFOLIO STRUCTURE BY LTV	31.12.2017	31.12.2016
0% - 40%	19,69%	16,47%
41%-60%	21,66%	17,97%
61% - 80%	31,96%	26,03%
81% - 90%	16,96%	18,14%
91% - 100%	4,76%	9,91%
powyżej 100%	4,96%	11,47%
Total	**100,00%**	**100,00%**

The average LTV of the portfolio of housing loans amounted to 62.95% as at 31 December 2017 and 70.58% as at 31 December 2016.

56. FORBEARANCE PRACTICES

Forbearance is defined by the Bank as actions aimed at amending the contractual terms agreed with a debtor or an issuer, forced by the debtor's or issuer's difficult financial situation (restructuring activities introducing concessions that otherwise would not have been granted). The aim of forbearance activities is to restore a debtor's or an issuer's ability to settle their liabilities towards the Bank and to maximize the efficiency of managing non-performing loans management, i.e. obtaining the highest possible recoveries while minimizing the costs incurred.

Forbearance consists in amending repayment terms which are agreed individually for each agreement. Such changes may consist in:

- dividing the debt due into instalments;
- changing the repayment scheme (fixed payments, degressive) payments);
- extending of the loan period;
- changing interest rate;
- change the margin;
- reducing the debt.

As a result of signing and repaying the amounts due under the forbearance agreement on a timely basis, a non-performing loan becomes performing. The forbearance process also involves evaluating the debtor's capacity to meet the terms of the settlement agreement on a timely basis (repayment of the debt at agreed dates). Forbearance agreements are monitored on an on-going basis. If impairment is recognized in relation to the related credit exposures, impairment allowances are recognized to reflect the impairment loss identified.

(IN PLN MILLION)

Forborne exposures classified as non-performing are included in the portfolio of performing exposures when the following conditions are met simultaneously:

- a receivable does not meet the condition of an individual impairment trigger and there is no impairment recognized;
- at least 12 months have passed from the conclusion of the restructuring agreement;
- the entire debt is covered by the restructuring agreement;
- the debtor demonstrated the capacity to fulfil the terms of the restructuring agreement.

Exposures cease to meet the criteria of a forborne exposure when all of the following conditions are met:

- at least 24 months have passed from the date of including the forborne exposure in the portfolio of performing exposures (conditional period;
- as at the end of the conditional period referred to above, the customer has no debt towards the Bank overdue for more than 30 days;
- at least 12 instalments have been repaid on a timely basis and in the amounts agreed.

LOANS AND ADVANCES TO CUSTOMERS

EXPOSURES SUBJECT TO FORBEARANCE IN THE LOAN PORTFOLIO	31.12.2017	31.12.2016
Loans and advances to customers, gross, of which:	**194 063**	**196 387**
subject to forbearance	3 881	3 852
Impairment allowances on loans and advances to customers, of which:	(7 170)	(7 320)
subject to forbearance	(978)	(899)
Loans and advances to customers, net, of which:	**186 893**	**189 067**
subject to forbearance	**2 903**	**2 953**

LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE BY PRODUCT TYPE	31.12.2017	31.12.2016
Loans and advances to customers subject to forbearance, gross	**3 881**	**3 852**
housing loans	1 405	1 546
corporate loans	2 187	1 999
consumer loans	289	307
Impairment allowances on loans and advances to customers subject to forbearance	**(978)**	**(899)**
Loans and advances to customers subject to forbearance, net	**2 903**	**2 953**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE, GROSS BY GEOGRAPHICAL REGION	31.12.2017	31.12.2016
mazowiecki	1 013	659
śląsko-opolski	436	482
wielkopolski	266	363
zachodnio-pomorski	256	336
łódzki	296	285
dolnośląski	290	300
podlaski	194	275
małopolsko-świętokrzyski	255	286
pomorski	261	272
kujawsko-pomorski	382	372
lubelsko-podkarpacki	225	199
warmińsko-mazurski	7	23
Total	**3 881**	**3 852**

LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE - THE BANK'S EXPOSURE TO CREDIT RISK	Exposure by carrying amount, gross	
	31.12.2017	31.12.2016
Loans and advances impaired	2 028	2 072
Loans and advances not impaired, of which:	1 853	1 780
not past due	1 570	1 454
past due	283	326
Total, gross	**3 881**	**3 852**

CHANGE IN CARRYING AMOUNTS OF LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE AT THE BEGINNING AND END OF THE PERIOD	2017	2016
Net carrying amount as at the beginning of the period	2 953	4 390
Impairment allowance (change during the period)	(79)	12
Gross book value of loans and advances which ceased to meet the forbearance criteria during the period	(605)	(1 947)
New loans and advances recognized in the period, gross	1 261	975
Other changes/repayment	(627)	(477)
Net carrying amount as at the end of the period	**2 903**	**2 953**

LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE BY TYPE OF CHANGES IN TERMS OF REPAYMENT	carrying amount, gross	
	31.12.2017	31.12.2016
Dividing the debt due into instalments	2 334	2 715
Change in the repayment scheme (fixed payments, degressive)	1 577	1 702
Extension of the loan period	1 684	1 431
Change in interest rate	764	583
Change in margin	896	536
Debt reduction	150	114

More than one change in the terms and condition of repayment may be applied to a forborne exposure.

The amount of recognized interest income on forborne loans and advances to customers for the period ended 31 December 2017 amounted to PLN 132 million (PLN 153 million for the period ended 31 December 2016).

(IN PLN MILLION)

AVAILABLE-FOR-SALE INVESTMENT SECURITIES SUBJECT TO FORBEARANCE

EXPOSURES SUBJECT TO FORBEARANCE IN THE PORTFOLIO OF AVAILABLE-FOR-SALE INVESTMENT SECURITIES	31.12.2017	31.12.2016
Available-for-sale debt securities, gross, of which	41 806	35 588
subject to forbearance	1 050	1 293
Impairment allowances on available-for-sale investment securities, of which:	(246)	(274)
subject to forbearance	(246)	(274)
Available-for-sale investment securities, net, of which:	**41 560**	**35 314**
subject to forbearance	**804**	**1 019**

AVAILABLE-FOR-SALE INVESTMENT SECURITIES SUBJECT TO FORBEARANCE – THE BANK'S EXPOSURE TO CREDIT RISK	Exposure by carrying amount, gross	
	31.12.2017	31.12.2016
Available-for-sale investment securities, impaired	819	1 293
Available-for-sale investment securities, not impaired	231	-
Total, gross	**1 050**	**1 293**

CHANGE IN CARRYING AMOUNTS OF AVAILABLE-FOR-SALE INVESTMENT SECURITIES SUBJECT TO FORBEARANCE AT THE BEGINNING AND END OF THE PERIOD	2 017	2 016
Net carrying amount as at the beginning of the period	1 019	341
Impairment allowance (change during the period)	28	(221)
New available-for-sale investment securities recognized in the period, gross	-	899
Other changes/repayment	(243)	-
Net carrying amount as at the end of the period	**804**	**1 019**

INVESTMENT SECURITIES SUBJECT TO FORBEARANCE, GROSS, BY TYPE OF CHANGES IN REPAYMENT TERMS	Carrying amount, gross	
	31.12.2017	31.12.2016
Dividing the debt due into instalments	1 050	1 204
Change in the repayment scheme	1 050	716
Extension of the loan period;	1 050	716
Change in interest rate	819	716
Change in margin	819	716
Debt reduction	133	129

(IN PLN MILLION)

57. EXPOSURE TO THE COUNTERPARTY CREDIT RISK

CREDIT RISK OF FINANCIAL INSTITUTIONS ON THE WHOLESALE MARKET

CONCENTRATION OF CREDIT RISK – INTERBANK MARKET – EXPOSURE TO INTERBANK MARKET AS AT 31.12.2017[1]

Counterparty	Country	Rating	Type of instrument Deposit	Derivatives (market value, excluding collateral if positive)	Securities (nominal value)	Total
Counterparty 1	Belgium	BBB	692	(6)	-	692
Counterparty 2	Germany	AA	592	-	-	592
Counterparty 3	Belgium	A	480	-	-	480
Counterparty 4	Poland	A	-	-	400	400
Counterparty 5	Austria	BBB	396	-	-	396
Counterparty 6	China	A	332	-	-	332
Counterparty 7	Supranational institution	AAA	170	16	130	316
Counterparty 8	Sweden	AA	190	84	-	274
Counterparty 9	Poland	BBB	-	217	62	279
Counterparty 10	Austria	A	209	-	-	209
Counterparty 11	France	A	-	171	-	171
Counterparty 12	Poland	A	-	-	150	150
Counterparty 13	UK	AA	-	120	-	120
Counterparty 14	US	A	115	-	-	115
Counterparty 15	US	AA	-	103	-	103
Counterparty 16	France	A	-	88	-	88
Counterparty 17	Ukraine	NONE	80	-	-	80
Counterparty 18	Poland	BBB	10	44	-	54
Counterparty 19	Denmark	A	50	(3)	-	50
Counterparty 20	Poland	A	-	47	-	47

[1] Excluding exposure to the State Treasury and the National Bank of Poland.

(IN PLN MILLION)

CONCENTRATION OF CREDIT RISK – INTERBANK MARKET – EXPOSURE TO INTERBANK MARKET AS AT 31.12.2016[1]						
Counterparty	Country	Rating	Type of instrument			Total
			Deposit	Derivatives (market value, excluding collateral if positive)	Securities (nominal value)	
Counterparty 4	Poland	A	-	-	900	900
Counterparty 79	Switzerland	AA	494	-	-	494
Counterparty 1	Belgium	BBB	398	7	-	405
Counterparty 80	Switzerland	AA	397	-	-	397
Counterparty 6	Luxembourg	A	323	-	-	323
Counterparty 5	Austria	BBB	288	-	-	288
Counterparty 81	Norway	A	167	-	-	167
Counterparty 7	Luxembourg	AAA	-	(19)	155	155
Counterparty 15	US	AA	-	132	-	132
Counterparty 82	UK	A	-	110	-	110
Counterparty 20	Poland	A	100	(36)	-	100
Counterparty 17	Ukraine	CCC	92	-	-	92
Counterparty 18	Poland	BBB	-	65	-	65
Counterparty 24	Germany	A	-	45	-	45
Counterparty 46	UK	A	-	40	-	40
Counterparty 27	France	A	-	38	-	38
Counterparty 83	Poland	BB	-	34	-	34
Counterparty 25	Poland	unrated	20	1	-	21
Counterparty 63	Poland	BB	-	12	-	12
Counterparty 56	UK	AAA	-	10	-	10

[1] Excluding exposure to the State Treasury and the National Bank of Poland.

As at 31 December 2017 and 31 December 2016, the Bank had access to two clearing houses (as an indirect participant in one, and as a direct participant in the other) through which the Bank settled interest rate derivatives referred to in the EMIR Regulation (Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, including the related delegated and executive regulations) with selected domestic and foreign counterparties. In nominal terms, the share of transactions cleared centrally was 70% of the entire IRS/OIS portfolio, and in the case of FRA, all transactions were submitted for clearing to clearing houses.

As at 31 December 2017, the Bank had framework agreements under the ISDA/ZBP standard signed with 22 domestic banks and 66 foreign banks and credit institutions, and CSA/ZBP collateral agreements with 21 domestic banks and 64 foreign banks and credit institutions. In addition, the Bank was a party to 22 repo agreements (under the GMRA/ZBP standard). As at 31 December 2016, the Bank had framework agreements under the ISDA/ZBP standard signed with 23 domestic banks and 62 foreign banks and credit institutions, and CSA/ZBP collateral agreements with 21 domestic banks and 52 foreign banks and credit institutions. In addition, the Bank was a party to 22 repo agreements (under the GMRA/ZBP standard).

The structure of exposures by ratings assigned to counterparties is presented in the table below. When determining a rating, external rating assigned by Moody's, Standard&Poor's and Fitch were used as a basis (if a rating was assigned by two agencies, the lower one was adopted, and in the case of three ratings - the middle one).

(IN PLN MILLION)

CREDIT RISK OF FINANCIAL INSTITUTIONS ON THE NON-WHOLESALE MARKET

In addition to the interbank market exposure, as at 31 December 2017 and 31 December 2016, the Bank had an exposure to financial institutions on the non-wholesale market (e.g. loans granted, bonds purchased outside interbank market).

The structure of exposures exceeding PLN 10 million is presented in the table below:

2017	Nominal exposure		Country of the counterparty's registered office
	balance sheet	off-balance sheet	
Counterparty 9	1 473	2 927	Poland
Counterparty 21	50	-	Poland
Counterparty 22	44	-	Poland
Counterparty 8	27	25	Sweden
Counterparty 17	-	104	Ukraine
Counterparty 15	-	60	US

For comparison, the structure of exposure over PLN 10 million as at 31 December 2016 is presented in the table below:

2016	Nominal exposure		Country of the counterparty's registered office
	balance sheet	off-balance sheet	
Counterparty 4	500	-	Poland
Counterparty 17	17	109	Ukraine
Counterparty 22	89	-	Poland
Counterparty 21	50	-	Poland
Counterparty 8	-	21	Sweden
Counterparty 15	-	60	US
Counterparty 9	-	1 400	Poland

58. RISK MANAGEMENT OF FOREIGN CURRENCY RISK ASSOCIATED WITH MORTGAGE LOANS FOR HOUSEHOLDS

The Bank analyses its portfolio of foreign currency mortgage loans to households in a specific manner. The Bank monitors the quality of the portfolio on an on-going basis and reviews the risk of deterioration in the quality of the portfolio. Currently, the quality of the portfolio is at an acceptable level. The Bank takes into consideration the risk of foreign currency mortgage loans for households in the capital adequacy and own fund management.

The tables below present an analysis of the quality of loans denominated in CHF.

LOANS AND ADVANCES TO CUSTOMERS IN CHF BY METHOD OF CALCULATING IMPAIRMENT ALLOWANCES (translated into PLN at the exchange rate of 1 CHF = 3.5672)	31.12.2017			
	Financial institutions	Corporates	Households	Total
Assessed on an individual basis, of which:	-	92	102	194
impaired	-	83	90	173
Assessed on a portfolio basis, impaired	-	15	1 041	1 056
Assessed on a group basis (IBNR)	2	257	23 277	23 536
Loans and advances to customers, gross	**2**	**364**	**24 420**	**24 786**
Impairment allowances on exposures assessed on an individual basis, of which:	-	(36)	(42)	(78)
impaired	-	(36)	(42)	(78)
Impairment allowances on exposures assessed on a portfolio basis	-	(12)	(749)	(761)
Impairment allowances on exposures assessed on a group basis (IBNR)	-	(3)	(49)	(52)
Total impairment allowances	**-**	**(51)**	**(840)**	**(891)**
Loans and advances to customers, net	**2**	**313**	**23 580**	**23 895**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS IN CHF BY METHOD OF CALCULATING IMPAIRMENT ALLOWANCES (translated into PLN at the exchange rate of 1 CHF = 4.1173)	31.12.2016			
	Financial institutions	Corporates	Households	Total
Assessed on an individual basis, of which:	-	155	166	321
impaired	-	128	137	265
Assessed on a portfolio basis, impaired	-	23	1 184	1 207
Assessed on a group basis (IBNR)	5	346	29 361	29 712
Loans and advances to customers, gross	**5**	**524**	**30 711**	**31 240**
Impairment allowances on exposures assessed on an individual basis, of which:	-	(55)	(64)	(119)
impaired	-	(54)	(64)	(118)
Impairment allowances on exposures assessed on a portfolio basis	-	(16)	(793)	(809)
Impairment allowances on exposures assessed on a group basis (IBNR)	-	(2)	(70)	(72)
Total impairment allowances	-	**(73)**	**(927)**	**(1 000)**
Loans and advances to customers, net	**5**	**451**	**29 784**	**30 240**

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR)	31.12.2017		
	PLN	CHF	Other currencies
Loans and advances to customers, gross	145 696	23 536	12 920
past due	1 953	512	133
not past due	143 743	23 024	12 787
Impairment allowances on exposures assessed on a group basis (IBNR)	(467)	(52)	(106)
past due	(117)	(27)	(5)
not past due	(350)	(25)	(101)
Loans and advances to customers, net	**145 229**	**23 484**	**12 814**

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR)	31.12.2016		
	PLN	CHF	Other currencies
Loans and advances to customers, gross	138 160	29 712	15 779
past due	2 056	658	168
not past due	136 104	29 054	15 611
Impairment allowances on exposures assessed on a group basis (IBNR)	(388)	(72)	(45)
past due	(119)	(35)	(4)
not past due	(269)	(37)	(41)
Loans and advances to customers, net	**137 772**	**29 640**	**15 734**

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR) SUBJECT TO FORBEARANCE, BY CURRENCY	31.12.2017		
	PLN	CHF	Other currencies
Loans and advances to customers, gross	1 031	397	172
Impairment allowances on exposures assessed on a group basis (IBNR)	(54)	(14)	(2)
Loans and advances to customers subject to forbearance, net	**977**	**383**	**170**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR) SUBJECT TO FORBEARANCE, BY CURRENCY	31.12.2016		
	PLN	CHF	Other currencies
Loans and advances to customers, gross	899	557	89
Impairment allowances on exposures assessed on a group basis (IBNR)	(33)	(21)	(1)
Loans and advances to customers subject to forbearance, net	**866**	**536**	**88**

As at 31 December 2017, the average LTV for the portfolio of CHF-denominated loans amounted to 67.00% (82.7% as at 31 December 2016) compared with the average LTV for the entire loan portfolio of 62.95% (70.6% as at 31 December 2016).

59. Interest rate risk management

Interest rate risk management
Financial information:
Repricing gap
Sensitivity measures

Interest rate risk management

Definition

Interest rate risk is a risk of losses being incurred on the Bank's balance sheet and off-balance sheet items sensitive to interest rate fluctuations, as a result of changes in the market interest rates.

Risk management objective

To reduce the potential losses resulting from market interest rate fluctuations to an acceptable level by properly shaping the structure of balance sheet and off-balance sheet items.

Risk identification and measurement

The Bank uses the following measures of interest rate risk: interest income sensitivity, economic value sensitivity, value at risk (VaR), stress tests and repricing gaps.

Risk control

Control over interest rate risk consists in determining interest rate risk limits and thresholds tailored to the scale and complexity of the Bank's operations, in particular the strategic limit of tolerance to interest rate risk.

Risk forecasting and monitoring

The following are monitored by the Bank on a regular basis:

- the levels of interest rate risk measures;
- utilization of the strategic limit of tolerance to interest risk;
- utilization of internal limits and thresholds of interest rate risk.

Reporting

Reports on interest rate risk are prepared on a daily, weekly, monthly and quarterly basis.

Management activities

The main tools for interest rate risk management used by the Bank are: interest rate risk management procedures, interest rate risk limits and thresholds.

The Bank established limits and thresholds for interest rate risk comprising, among other things, the following: interest income sensitivity, sensitivity of the economic value and losses.

FINANCIAL INFORMATION

REPRICING GAP

The repricing gap shows the difference between the present value of assets and liabilities exposed to interest rate risk which are repriced in a given time range, with the items recognized on the transaction date.

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
PLN (in PLN million)								31.12.2017
Periodic gap	49 532	38 793	(11 527)	(15 058)	(14 735)	(28 139)	4 130	22 996
Cumulative gap	49 532	88 325	76 798	61 740	47 005	18 866	22 996	
PLN (in PLN million)								31.12.2016
Periodic gap	55 318	18 246	(16 392)	(7 802)	(12 408)	(26 075)	5 816	16 703
Cumulative gap	55 318	73 564	57 172	49 370	36 962	10 887	16 703	

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
USD (in USD million)								31.12.2017
Periodic gap	924	(376)	(429)	(85)	(8)	(119)	-	(93)
Cumulative gap	924	548	119	34	26	(93)	(93)	-
USD (in USD million)								31.12.2016
Periodic gap	801	(831)	(142)	92	108	3	(126)	(95)
Cumulative gap	801	(30)	(172)	(80)	28	31	(95)	-

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
EUR (in EUR million)								31.12.2017
Periodic gap	3 658	(1 607)	(736)	(551)	(900)	135	18	17
Cumulative gap	3 658	2 051	1 315	764	(136)	(1)	17	-
EUR (in EUR million)								31.12.2016
Periodic gap	2 331	(1 186)	(614)	(118)	(138)	(843)	70	(498)
Cumulative gap	2 331	1 145	531	413	275	(568)	(498)	-

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
CHF (in CHF million)								31.12.2017
Periodic gap	284	874	75	(83)	(217)	(2)	(590)	341
Cumulative gap	284	1 158	1 233	1 150	933	931	341	-
CHF (in CHF million)								31.12.2016
Periodic gap	116	2 962	159	(1 839)	2	(325)	(677)	398
Cumulative gap	116	3 078	3 237	1 398	1 400	1 075	398	-

As at the end of 2017 and 2016, PKO Bank Polski SA had a positive cumulative gap in PLN in all the time horizons.

SENSITIVITY MEASURES

POK Bank Polski SA's exposure to interest rate risk remained within the adopted limits as at 31 December 2017 and 31 December 2016. The Bank was mainly exposed to PLN interest rate risk. Among all the stress tests performed by the Bank involving a parallel shift of interest rate curves, the most unfavourable for the Bank was the scenario of a parallel shift of interest rate curves in PLN.

The Bank's VaR and a stress-test analysis of the Bank's exposure to interest rate risk are presented in the table below:

SENSITIVITY MEASURE	31.12.2017	31.12.2016
VaR for a 10-day time horizon at a confidence level of 99% (in PLN million)	301	269
Parallel movement of interest rate curves by 200 b.p. (in PLN million) (stress-test)[1]	2 097	2 131

[1] The table presents the value of the most adverse stress-test scenario: a movement of interest rate curves in particular currencies by 200 b.p. upwards and by 200 b.p. downwards.

As at 31 December 2017, the Bank's interest rate VaR for the 10-day time horizon (10-day VaR) amounted to PLN 301 million, and as at 31 December 2016, the Bank's VaR amounted to PLN 269 million.

60. Currency risk management

Currency risk management

Definition

Currency risk is the risk of incurring losses due to unfavourable fluctuations in the exchange rate. The risk is generated by maintaining open currency positions in various foreign currencies.

Risk management objective

To reduce the potential losses resulting from exchange rate fluctuations to an acceptable level by properly shaping the currency structure of balance sheet and off-balance sheet items.

Risk identification and measurement

The Bank uses the following measures of the currency risk: value-at-risk (VaR) and stress tests.

Risk control

Control over currency risk consists in determining currency risk limits and thresholds tailored to the scale and complexity of the Bank's operations, in particular the strategic limit of tolerance to currency risk.

Risk forecasting and monitoring

The following are monitored by the Bank on a regular basis:

- the level of currency risk measures;
- utilization of the strategic limit of tolerance to currency risk;
- utilization of internal limits and thresholds of currency risk.

Reporting

Reports on currency risk are prepared on a daily, weekly, monthly and quarterly basis.

Management activities

The main tools for currency risk management used by the Bank are:

- currency risk management procedures;
- currency risk limits and thresholds;
- defining allowable types of foreign currency transactions and the exchange rates used in such transactions.

The Bank has set limits and thresholds for currency risk for, among other things: currency positions, Value at Risk calculated for a 10-day time horizon and daily loss from transactions on the currency market.

FINANCIAL INFORMATION

SENSITIVITY MEASURES

The Bank's VaR and a stress-test analysis of the Bank's exposure to currency risk, presented cumulatively for all currencies, are presented in the table below:

SENSITIVITY MEASURE	31.12.2017	31.12.2016
VaR for a 10-day time horizon at a confidence level of 99% (in PLN million)	3	9
Change in CUR/PLN by 20% (in PLN million) (stress-test)[1]	184	78

[1]The table presents the value of the most adverse stress-test scenario: PLN appreciation by 20% and PLN depreciation by 20%.

As at 31 December 2017 and 31 December 2016, the currency risk was low.

FOREIGN CURRENCY POSITION

FOREIGN CURRENCY POSITION	31.12.2017	31.12.2016
EUR	63	108
USD	14	69
CHF	8	(38)
GBP	11	9
Other (Global, Net)	22	39

Currency positions (in addition to volatility of foreign exchange rates) are a key factor determining the level of currency risk to which the Bank is exposed. The level of currency positions is determined by all foreign currency transactions concluded by the Bank, both those reported in the statement of financial position (e.g. loans) and off-balance sheet (e.g. derivative transactions, especially CIRS). In accordance with the currency risk management policy, a currency position opened by the Bank as part of its banking operations (e.g. repayment of foreign-currency loan by the customer in PLN, currency conversion of a loan) must be closed on the same day, including by using derivatives. This means that the Bank's foreign currency position as at the end of the day may consist solely of an unclosed position in banking operations generated on that date and the currency position generated in trading operations, which is maintained within the adopted limits.

(IN PLN MILLION)

CURRENCY STRUCTURE

	Foreign currencies translated into PLN as at 31.12.2017				
	PLN	EUR	CHF	Other	Total
Cash and cash balances with the Central Bank	16 484	726	78	477	17 765
Amounts due from banks	4 821	2 190	16	1 742	8 769
Financial assets held for trading, excluding derivative financial instruments	333	137	-	2	472
Derivative financial instruments	2 648	117	3	37	2 805
Financial instruments designated at fair value through profit or loss upon initial recognition	5 439	77	893	-	6 409
Loans and advances to customers	149 521	11 833	23 895	1 643	186 892
Available-for-sale investment securities	41 153	583	-	273	42 009
Investment securities held to maturity	1 622	-	-	-	1 622
Investments in subsidiaries, joint ventures and associates	3 011	-	-	-	3 011
Non-current assets held for sale	359	-	-	-	359
Intangible assets	2 622	-	-	-	2 622
Property, plant and equipment	2 170	-	-	-	2 170
Deferred income tax asset	957	-	-	-	957
Other assets	1 782	108	1	31	1 922
Total assets	**232 922**	**15 771**	**24 886**	**4 205**	**277 784**
Amounts due to the Central Bank	6	-	-	-	6
Amounts due to banks	933	2 251	1 100	15	4 299
Derivative financial instruments	2 493	185	3	60	2 741
Amounts due to customers	190 625	17 115	1 889	12 895	222 524
Debt securities issued	645	3 132	1 427	-	5 204
Subordinated liabilities	1 720	-	-	-	1 720
Other liabilities	3 982	464	4	142	4 592
Current income tax liabilities	501	-	-	-	501
Provisions	187	20	1	2	210
Equity	35 987	-	-	-	35 987
Total liabilities and equity	**237 079**	**23 167**	**4 424**	**13 114**	**277 784**
Off-balance sheet liabilities granted	50 782	7 390	185	2 512	60 869

(IN PLN MILLION)

	Foreign currencies translated into PLN as at 31.12.2016				
	PLN	EUR	CHF	Other	Total
Cash and cash balances with the Central Bank	11 907	714	79	577	13 277
Amounts due from banks	5 125	2 093	503	750	8 471
Financial assets held for trading, excluding derivative financial instruments	350	8	-	-	358
Derivative financial instruments	2 682	152	2	59	2 895
Financial instruments designated at fair value through profit or loss upon initial recognition	10 542	171	1 031	-	11 744
Loans and advances to customers	142 467	14 244	30 240	2 116	189 067
Available-for-sale investment securities	34 347	1 099	-	327	35 773
Investment securities held to maturity	157	-	-	-	157
Investments in subsidiaries, joint ventures and associates	2 535	-	-	-	2 535
Non-current assets held for sale	361	-	-	-	361
Intangible assets	2 817	-	-	-	2 817
Property, plant and equipment	2 325	-	-	-	2 325
Deferred income tax asset	1 034	-	-	-	1 034
Other assets	2 051	70	-	22	2 143
Total assets	**218 700**	**18 551**	**31 855**	**3 851**	**272 957**
Amounts due to the Central Bank	4	-	-	-	4
Amounts due to banks	791	2 647	15 239	40	18 717
Derivative financial instruments	3 944	206	-	79	4 229
Amounts due to customers	179 833	15 612	2 524	11 402	209 371
Debt securities issued	809	884	-	-	1 693
Subordinated liabilities	1 617	-	922	-	2 539
Other liabilities	3 015	221	3	101	3 340
Current income tax liabilities	251	-	-	-	251
Provisions	211	5	1	6	223
Equity	32 590	-	-	-	32 590
Total liabilities and equity	**223 065**	**19 575**	**18 689**	**11 628**	**272 957**
Off-balance sheet liabilities granted	53 984	6 031	221	3 777	64 013

61. LIQUIDITY RISK MANAGEMENT

LIQUIDITY RISK MANAGEMENT

DEFINITION

Liquidity risk is the risk of the inability to settle liabilities as they become due because of an absence of liquid assets. The lack of liquidity may be due to the inappropriate structure of the statement of financial position, a mismatch of cash flows, customers' failing to settle their liabilities, a sudden withdrawal of funds by the customers or other market developments.

The Bank also management the financing risk which takes into account the risk of losing the existing sources of financing and the inability of renewing the required means of financing or a loss of access to new sources of financing.

RISK MANAGEMENT OBJECTIVE

To ensure the necessary level of funds needed to settle current and future liabilities (also potential ones) as they become due, taking into account the nature of the activities conducted and the needs which may arise due to changes in the market environment, by appropriately shaping the structure of the statement of financial position and off-balance sheet liabilities.

RISK IDENTIFICATION AND MEASUREMENT

The Bank uses the following measures of the liquidity risk:

- contractual and adjusted liquidity gap;
- liquidity reserve;
- liquidity surplus;
- the ratio of stable funds to illiquid assets;
- liquidity coverage ratio (LCR)
- domestic supervisory liquidity measures (M1-M4)
- measures of stability of the deposit and loan portfolios
- liquidity stress tests.

RISK CONTROL

Control over the liquidity risk consists in determining liquidity risk limits and thresholds tailored to the scale and complexity of the Bank's operations, in particular the strategic limit of tolerance to liquidity risk.

RISK FORECASTING AND MONITORING

The Bank regularly monitors:

- utilization of the strategic limit of tolerance to liquidity risk;
- utilization of regulatory liquidity standards;
- utilization of internal limits and thresholds of liquidity risk;
- concentration of the sources of financing;
- early warning indicators – monitored in order for the early detection of unfavourable developments which may have a negative impact on the Bank's or the financial sector's liquidity position (when exceeded, early warning indicators trigger liquidity contingency plans).

The Bank also makes regular liquidity forecasts which take into account the current developments in the Bank's operations. Liquidity forecasts include primarily the levels of selected liquidity risk measures envisaged in the forecasts of the Bank's statement of financial position and in selected stress test scenarios.

REPORTING

Liquidity reports are developed on a daily, weekly, monthly and quarterly basis and once a year, an in-depth long-term liquidity analysis is performed.

MANAGEMENT ACTIONS / RISK MANAGEMENT TOOLS

The main tools for liquidity risk management used by the Bank are:

- procedures for liquidity risk management, in particular contingency plans;
- limits and thresholds to mitigate short-term, medium-term and long-term liquidity risk;
- national and European supervisory liquidity standards;

- deposit, investment and securities transactions and well as derivatives, including structural currency transactions and transactions for sale or purchase of securities;
- transactions ensuring long-term financing of the lending activities.

The Bank's policy concerning liquidity is based on keeping a portfolio of appropriate level of liquidity surplus through an increase in the portfolio of liquid securities, and stable sources of financing (a stable deposit base, in particular). In liquidity risk management, money market instruments, including NBP open market operations, are also used.

FINANCIAL INFORMATION

LIQUIDITY GAP

The liquidity gaps presented below include, among other things, the Bank's adjusted balance sheet items in respect of core deposits from non-financial entities and their maturities, core overdrafts of non-financial entities and their maturities, and liquid securities and their maturities.

	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	more than 60 months
31.12.2017								
Adjusted periodic gap	15 256	22 934	(1 927)	1 912	12 096	10 242	34 258	(94 771)
Adjusted cumulative periodic gap	15 256	38 190	36 263	38 175	50 271	60 513	94 771	-
31.12.2016								
Adjusted periodic gap	12 018	20 185	641	(223)	8 593	9 101	23 850	(74 165)
Adjusted cumulative periodic gap	12 018	32 203	32 844	32 621	41 214	50 315	74 165	-

LIQUIDITY RESERVE AND LIQUIDITY SURPLUS

LIQUIDITY RISK MEASURE	31.12.2017	31.12.2016
Liquidity reserve up to 1 month[1] (in PLN billion)	37	31
Liquidity surplus in a horizon of up to 30 days[2] (in PLN billion)	14	13

[1] Liquidity reserve is the difference between the most liquid assets and the expected and potential liabilities which will mature in a given time horizon.

[2] Liquidity surplus – determines the Bank's ability to meet the liquidity needs in a given survival horizon if the scenarios defined in stress tests materialize.

SUPERVISORY LIQUIDITY MEASURES

SUPERVISORY LIQUIDITY MEASURES	31.12.2017	31.12.2016
M1 - short-term liquidity gap	22 446	24 464
M2 - short-term liquidity ratio	1,66	1,89
M3 - coverage ratio of non-liquid assets to own funds	13,92	11,63
M4 - coverage ratio of non-liquid assets and liquidity-restricted assets with own funds and stable external funds	1,19	1,19
NSFR - net stable funding ratio	114,6%	115,9%
LCR - liquidity coverage ratio	160,7%	134,2%

In the periods ended 31 December 2017 and 31 December 2016, liquidity measures remained above their respective supervisory limits.

CORE DEPOSIT BASE

As at 31 December 2017, the core deposit base constituted approx. 93.6% of all deposits placed with the Bank (excluding the interbank market), which represents a decrease of approx. 0.2 p.p. compared with the end of 2016.

(IN PLN MILLION)

STRUCTURE OF THE SOURCES OF FINANCING

STRUCTURE OF THE BANK'S SOURCES OF FINANCING	31.12.2017	31.12.2016
Total deposits (excluding interbank market)	80,40%	76,50%
Interbank market deposits	0,50%	0,30%
Equity	13,30%	12,40%
Market financing	5,80%	10,80%
Total	**100,00%**	**100,00%**

CONTRACTUAL CASH FLOWS FROM THE BANK'S LIABILITIES, EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS

The tables below show the contractual maturity analysis presenting the outstanding contractual maturity dates by individual categories of the statement of financial position and off-balance sheet liabilities, excluding derivative financial instruments.

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2017 and as at 31 December 2016. The amounts disclosed comprise non-discounted future cash flows, both in respect of principal and interest (if applicable), in accordance with the contract, for the entire period to the date of the liability's maturity. Where the party to whom the Bank has a liability is able to select the settlement deadline, it has been assumed that the earliest date on which the Bank is obliged to settle the liability will be taken into account. Where the Bank is obliged to settle the liabilities in instalments, each instalment is allocated to the earliest period in which the Bank might be obligated to settle. In the case of liabilities where instalment amounts are not fixed, the terms binding as at the reporting date have been adopted.

The Bank's contractual cash flows by maturity

BANK'S LIABILITIES AS AT 31 DECEMBER 2017, BY MATURITY	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Contractual amount	Carrying amount
Liabilities:							
Amounts due to the Central Bank	6					6	6
Amounts due to banks	1 592	-	20	2 656	-	4 268	4 299
Amounts due to customers	157 600	16 577	29 526	13 637	7 752	225 092	222 524
Debt securities issued	-	-	657	4 576	-	5 232	5 204
Subordinated liabilities	-	29	59	289	2 080	2 456	1 720
Other liabilities	3 943	10	287	168	184	4 592	4 592
Off-balance sheet liabilities:							
- financing, granted	7 547	2 672	13 253	14 915	7 792	46 179	-
- guarantees, granted	751	506	3 232	8 010	2 191	14 690	-

BANK'S LIABILITIES AS AT 31 DECEMBER 2016, BY MATURITY	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Contractual amount	Carrying amount
Liabilities:							
Amounts due to the Central Bank	4	-	-	-	-	4	4
Amounts due to banks	971	2	78	17 450	-	18 501	18 717
Amounts due to customers	134 861	18 969	34 764	15 100	10 673	214 367	209 371
Debt securities issued	-	-	1 699	-	-	1 699	1 693
Subordinated liabilities	-	33	46	351	2 604	3 034	2 539
Other liabilities	2 776	9	232	152	171	3 340	3 340
Off-balance sheet liabilities:						-	
- financing, granted	12 669	5 749	13 408	11 104	6 432	49 362	-
- guarantees, granted	263	569	3 700	8 582	1 536	14 650	-

(IN PLN MILLION)

CONTRACTUAL CASH FLOWS FROM LIABILITIES IN RESPECT OF DERIVATIVE FINANCIAL INSTRUMENTS

DERIVATIVE FINANCIAL INSTRUMENTS SETTLED ON A NET BASIS

Derivative financial instruments settled by the Bank on a net basis include:

- interest rate swaps (IRS);
- Forward Rate Agreements (FRA);
- Non Deliverable Forwards (NDF);
- options.

The tables below show the contractual maturity analysis presenting the outstanding contractual maturity dates by individual categories of derivative financial instruments in respect of which the valuation as at the balance sheet date was negative (a liability), as at 31 December 2017 and 31 December 2016.

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2017 and as at 31 December 2016. In the case of IRS transactions, non-discounted future net cash flows in respect of interest have been presented and in the case of the remaining derivative instruments settled on a net basis, the amount of the valuation as at 31 December 2017 and as at 31 December 2016 respectively was adopted as the cash flow amount.

As at 31 December 2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Contractual amount
Derivative financial instruments - liabilities:						
- Interest rate swap (IRS)	(22)	(0)	94	(676)	(100)	(705)
- other derivatives (options, FRA, NDF)	(143)	(304)	(927)	(1 400)	(0)	(2 775)

As at 31 December 2016	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Contractual amount
Derivative financial instruments - liabilities:						
- Interest rate swap (IRS)	(22)	(16)	(325)	(770)	(180)	(1 313)
- other derivatives (options, FRA, NDF)	(110)	(73)	(625)	(524)	-	(1 332)

DERIVATIVE FINANCIAL INSTRUMENTS SETTLED ON A GROSS BASIS

Derivative financial instruments settled by the Bank on a gross basis include:

- foreign currency swaps;
- foreign currency forwards;
- Cross Currency IRS (CIRS).

The tables below show the contractual maturity analysis, presenting the outstanding contractual maturity dates by individual categories of derivative financial instruments (inflows and outflows) in respect of which valuation the balance sheet date was negative (a liability).

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2017 and as at 31 December 2016. The amounts disclosed comprise non-discounted future cash flows, both in respect of principal and interest (if applicable).

As at 31 December 2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Contractual amount
- outflows	(7 347)	(2 196)	(4 812)	(2 946)	(238)	(17 539)
- inflows	7 238	2 072	5 008	6 745	250	21 313

As at 31 December 2016	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Contractual amount
- outflows	(7 030)	(2 243)	(4 700)	(3 089)	(41)	(17 103)
- inflows	8 058	2 593	4 944	9 908	142	25 645

(IN PLN MILLION)

CURRENT AND NON-CURRENT ASSETS AND LIABILITIES

The Bank classifies an asset as current when:

- it expects to realize the asset or intends to sell or consume it in the course of the normal operating cycle;
- it holds the asset primarily for the purpose of trading;
- it expects that the asset will be realized within twelve months after the reporting period, or
- the asset is cash or a cash equivalent (as defined in IAS 7) unless it is restricted from being exchanged or used to settle a liability for at least twelve months from the end of reporting period.

All other assets are classified as non-current.

The Bank classifies a liability as current when:

- it expect that the liability will be settled in the normal operating cycle;
- it holds the liability primarily for the purpose of trading;
- the liability matures within twelve months of the end of the reporting period, or
- the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

All other liabilities are classified as non-current.

31.12.2017	Current	Non-current	Impairment	Total carrying amount
Cash and cash balances with the Central Bank	17 765	-	-	17 765
Amounts due from banks	7 292	1 477	-	8 769
Financial assets held for trading	472	-	-	472
Derivative financial instruments	743	2 062	-	2 805
Financial instruments designated at fair value through profit or loss upon initial recognition	5 370	1 039	-	6 409
Loans and advances to customers	40 304	153 758	(7 170)	186 892
Available-for-sale investment securities	4 649	37 658	(298)	42 009
Investment securities held to maturity	-	1 622	-	1 622
Other assets	3 981	8 422	(1 362)	11 041
Total assets	**80 576**	**206 038**	**(8 830)**	**277 784**
Amounts due to the Central Bank	6	-	-	6
Amounts due to banks	1 709	2 590	-	4 299
Derivative financial instruments	1 465	1 276	-	2 741
Amounts due to customers	202 961	19 563	-	222 524
Debt securities issued	646	4 558	-	5 204
Subordinated liabilities	-	1 720	-	1 720
Other liabilities	4 888	415	-	5 303
Total liabilities	**211 675**	**30 122**	-	**241 797**
Equity	-	35 987	-	35 987
Total liabilities and equity	**211 675**	**66 109**	-	**277 784**

(IN PLN MILLION)

31.12.2016	Current	Non-current	Impairment	Total carrying amount
Cash and cash balances with the Central Bank	13 277	-	-	13 277
Amounts due from banks	8 458	13	-	8 471
Financial assets held for trading	358	-	-	358
Derivative financial instruments	1 002	1 893	-	2 895
Financial instruments designated at fair value through profit or loss upon initial recognition	8 999	2 745	-	11 744
Loans and advances to customers	46 288	150 099	(7 320)	189 067
Available-for-sale investment securities	1 769	34 279	(275)	35 773
Investment securities held to maturity	-	157	-	157
Other assets	4 431	8 138	(1 354)	11 215
Total assets	**84 582**	**197 324**	**(8 949)**	**272 957**
Amounts due to the Central Bank	4	-	-	4
Amounts due to banks	1 631	17 086	-	18 717
Derivative financial instruments	1 632	2 597	-	4 229
Amounts due to customers	185 625	23 746	-	209 371
Debt securities issued	1 693	-	-	1 693
Subordinated liabilities	-	2 539	-	2 539
Other liabilities	3 437	377	-	3 814
Total liabilities	**194 022**	**46 345**	-	**240 367**
Equity	-	32 590	-	32 590
Total liabilities and equity	**194 022**	**78 935**	-	**272 957**

62. OTHER MARKET RISKS

COMMODITY PRICE RISK MANAGEMENT

DEFINITION – Commodity price risk is the risk of incurring a loss due to changes in commodity prices, generated by maintaining open positions on particular types of goods.

MANAGEMENT OBJECTIVE – The objective of commodity price risk management is to reduce potential losses resulting from changes in commodity prices to the acceptable level by shaping the appropriate structure of these items.

RISK IDENTIFICATION AND MEASUREMENT – In respect of the measurement of the prices of commodities, information on the positions taken by the Bank in particular commodities is utilized, and stress-test analyses are performed.

CONTROL – Control of commodity prices risk covers determining the respective limits and threshold tailored to the scale and complexity of the Bank's operations.

FORECASTING AND MONITORING – In respect of the commodity price risk, the Bank regularly monitors, in particular: open commodity positions, the outcome of stress-tests and utilization of internal risk limits.

REPORTING - Reports on commodity price risks are developed on a daily, weekly, monthly and quarterly basis.

MANAGEMENT ACTIONS – Commodity price risk is managed by imposing limits on instruments generating the commodity price risk, monitoring their use and reporting the risk level. The effect of commodity price risk on the Bank's financial position is immaterial.

MANAGEMENT OF THE EQUITY PRICE RISK

DEFINITION - The risk of equity securities price is the risk of losses being incurred as a result of changes in the prices of equity securities on the public market, or stock exchange indices, generated by maintaining open positions in instruments sensitive to changes in these market parameters. The risk results from operations conducted as part of trading activities of the Brokerage House of the Bank, investing activities and from other operations as part of banking activities which generate positions in equity securities.

MANAGEMENT OBJECTIVE - Managing the risk of equity securities prices is aimed at limiting potential losses resulting to changes in the prices of equity securities on the public market or stock exchange indices to an acceptable level, by optimizing the positions taken in instruments sensitive to changes in these market parameters.

Risk identification and measurement – For the purpose of equity securities price risk management the Bank utilizes:

- analyses of stress tests, taking into account the changes in market prices of the underlying instruments and changes in their volatility;
- information on the utilization of limits adopted for positions taken in the equity securities portfolio.

Control – Control over equity securities price risk consists in determining equity securities risk limits and thresholds tailored to the scale and complexity of the Bank's operations.

Forecasting and monitoring – The Bank regularly monitors the level of equity securities price risk and the utilization of the limits on positions taken in the equity securities portfolio.

Reporting – Reports on the risk of equity securities prices are prepared on a monthly and quarterly basis.

Management actions – The risk is managed by imposing limits on the activities of the Brokerage House of PKO Bank Polski SA and by monitoring the utilization thereof. The effect of the equity securities prices risk on the financial position of the Bank was assessed as immaterial. The positions taken in equity securities and index instruments are being limited, and are not expected to increase significantly.

Other price risks

Taking into consideration other price risks, as at the end of 2017 and 2016, the Bank was exposed to the price risk of participation units in collective investment funds. The impact of this risk to the Bank's financial situation is immaterial.

63. Derivative instruments risk management

Definition

Derivative instrument risk is the risk resulting from the Bank taking up a position in derivative financial instruments.

Risk management objective

To limit potential losses in respect of changes in factors specific for derivatives (other than foreign exchange rates or interest rates) to acceptable levels by appropriately shaping the structure of positions taken in those instruments.

Risk identification and measurement

For the purpose of managing derivatives risk, the Bank uses:

- the Value at Risk (VaR) model;
- analyses of stress tests, taking into account the changes in market prices of the underlying instruments, in their volatility, and in interest rates;
- sensitivity ratios for options.

Risk control

Control over derivatives risk consists in determining derivatives risk limits and thresholds tailored to the complexity of the Bank's operations.

Risk forecasting and monitoring

Monitoring the risk of derivative instruments takes place as part of monitoring of other types of financial and credit risk. The Bank places particular emphasis on monitoring the financial risk related to the maintenance of the currency options portfolio and the customer credit risk resulting from amounts due to the Bank in respect of derivative instruments.

Reporting

The reports on derivative risk are developed on a daily, weekly, monthly and quarterly basis.

MANAGEMENT ACTIONS

The main tools used in derivative risk management are as follows:

- procedures for derivative risk management;
- limits and threshold values for the risk of derivatives;
- master agreements defining, e.g. settlement mechanisms;
- collateral agreements, under which selected customers are required to establish a collateral on exposures arising from derivative instruments.

The risk is managed by imposing limits on the derivative transactions, monitoring these limits and reporting the level of risk.

The derivative risk management process in the Bank is integrated with the management of the following types of risk: interest rate, currency, liquidity and credit risk. However, due to the specific nature of derivative instruments, it is subject to specific controls specified in the internal regulations of the Bank.

64. OPERATIONAL RISK MANAGEMENT

DEFINITION

Operational risk is defined as the risk of losses being incurred due to a failure or the unreliability of the internal processes, people and systems or due to external events. Operational risk includes legal risk and excludes reputation risk and business risk.

RISK MANAGEMENT OBJECTIVE

The objective of operational risk management is to enhance the safety of the operational activities conducted by the Bank by improving the efficiency – tailored to the profile and the scale of operations – of the mechanisms for identifying, assessing and measuring, controlling, monitoring, mitigating and reporting operational risk.

RISK IDENTIFICATION AND MEASUREMENT

Operational risk management comprises the identification of operational risk in particular through collecting data about the operational risk and the self-assessment of operational risk.

In order to manage the operational risk, the Bank gathers internal and external data about operational events and the causes and consequences of their occurrence, data on the factors of the business environment, results of operational risk self-assessment, data on KRI and data related to the quality of internal functional controls.

The operational risk self-assessment comprises the identification and assessment of the operational risk for the Bank's products, processes and applications as well as organizational changes and it is conducted cyclically and before the introduction of new or changed Bank products, processes and applications.

The measurement of operational risk comprises:

- calculating Key Risk Indicators (KRI);
- calculating the requirement for own funds to cover operational risk under the AMA approach (the Bank) and BIA approach (the German and Czech Branches);
- stress-tests;
- calculating the Bank's internal capital.

RISK CONTROL

Control of operational risk includes setting up risk controls tailored to the scale and complexity of the Bank's activities, in the form of limits on operational risk, in particular the strategic limits of tolerance to operational risk, loss limits, KRIs with thresholds and critical values.

Risk forecasting and monitoring

The Bank regularly monitors:

- utilization of the strategic tolerance and operational risk losses limits for the Bank;
- operational events and their consequences;
- results of the operational risk self-assessment;
- the requirement in respect of own funds to cover operational risk, in accordance with the BIA approach in the case of the German and Czech Branches and in accordance with the AMA approach in the case of the remaining activity of the Bank;
- the results of stress tests;
- Key Risk Indicators (KRI) in relation to threshold and critical values;
- the risk level for the Bank, and for the operational risk management areas and tools within the Bank;
- the effectiveness and timeliness of actions undertaken to reduce or transfer operational risk;
- management actions relating to the presence of elevated or high levels of operational risk and their effectiveness in reducing the level of operational risk.

Reporting

Reporting of information concerning operational risk is performed for the needs of the senior management staff, the ORC, the RC, the Management Board and the Supervisory Board. Each month, information about operational risk is prepared and forwarded to the ORC, senior management staff, the organizational units of the Head Office and specialist organizational units responsible for system-based operational risk management. The scope of the information is diversified and tailored to the scope of responsibilities of the individual recipients of the information.

Management actions

Management actions are taken in the following cases:

- on an initiative of ORC or the Management Board
- on the initiative of organizational units and cells of the Bank managing operational risk;
- when operational risk has exceeded the levels determined by the Management Board or ORC.

In particular when the risk level is elevated or high, the Bank uses the following approach and instruments to manage the operational risk:

- risk reduction – mitigating the impact of risk factors or the consequences of its materialization by introducing or strengthening various types of instruments for managing operational risk such as: control instruments, human resources management instruments, determination or verification of thresholds and critical KRIs, determination or verification of operational risk levels, and contingency plans;
- risk transfer – transfer of responsibility for covering potential losses to a third-party: insurance and outsourcing;
- risk avoidance – resignation from the risk-generating activity or elimination of the probability of materialization.

65. OTHER RISKS

COMPLIANCE AND CONDUCT RISK MANAGEMENT

DEFINITION

Compliance risk is the risk of legal sanctions, incurring financial losses or loss of reputation as a result of non-compliance with the law, internal regulations and the market standards adopted by the Bank on the part of the Bank, the Bank's employees or entities operating on the Bank's behalf.

Conduct risk is the risk of damages arising on the part of: 1) the customer, 2) the Bank, including its credibility, 3) financial markets, with regard to their credibility, as a result of inappropriate action (also unintentional) or omission by the Bank, its staff or related entities, with regard to offering and providing financial services.

RISK MANAGEMENT OBJECTIVE

The objectives of the compliance and conduct risks management are as follows:

- strengthening the image of the Bank as an institution acting in accordance with the law and the accepted market standard, trustworthy, reliable and fair, among the Bank's shareholders, customers, employees, business partners and other market participants;
- preventing financial losses, legal penalties or loss or reputation which may result from breaching the law, the Bank's internal regulations and the market standards adopted by the Bank.
- preventing losses on the part of the Bank's customers which may result from improper conduct (including unintentional) or omission of the Bank, its employees or related entities, as regards acquiring and providing financial services.

RISK IDENTIFICATION AND MEASUREMENT

To identify and assess the compliance and conduct risks, information on compliance incidents and their reasons is used, including information resulting from internal audits, internal controls and external inspections.

Identification and assessment of compliance and conduct risks is based mainly on the following:

1) estimating the potential impact of non-compliance;
2) the results of operational risk self-assessment;
3) the results of a review and assessment of the adequacy and effectiveness of control mechanisms;
4) information on irregularities identified during internal controls;
5) an evaluation of the existence of additional risk of non-compliance with the law.

During the assessment, the nature and the potential scale of the losses is identified and the possible ways of mitigating or eliminating the compliance risk. The assessment is conducted in the form of workshops.

MONITORING

Monitoring the compliance and conduct risk is performed using information provided by the Bank's organizational units and consists of:

- analysing compliance incidents occurring in the Bank and in the banking sector, their reasons and effects;
- evaluating changes in the key legal regulations affecting the operations of the Bank;
- evaluating actions undertaken by the Bank as part of compliance risk management;
- evaluating the effectiveness and adequacy of the controls relating to mitigation of the compliance risk;
- analysing information on the status of the major projects conducted within the Bank to

	adjust to the universally applicable provisions of the law, market standards adopted by the Bank and communication from external regulatory and control bodies; • analysing information on operational events, security incidents, disputes (including court cases) against the Bank, complaints and irregularities relating to conduct risk.
REPORTING	The reporting of compliance risk and conduct risk takes the form of quarterly reports addressed to the Risk Committee, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board, and information submitted for the purposes of external regulatory and inspection bodies.
MANAGEMENT ACTIONS	Compliance risk management covers, in particular, the following issues: • preventing the Bank from engaging in illegal activities; • promoting ethical standards and monitoring their operation; • managing conflicts of interests; • preventing situations where Bank's employees could be perceived as pursuing their own interest in the professional context; • professional, fair and transparent formulation of the product offer, advertising and marketing communication; • ensuring data protection; • prompt, fair and professional consideration of the customers' complaints, suggestions and claims; • preventing situations when a product which does not meet a customer's needs is offered; • determining an adequate manner and form of offering a product, depending on the product's character; • monitoring sales and the fair execution of the agreements concluded with customers. In 2017 and 2016, the principle of 'zero tolerance' to compliance risk was upheld in the Bank. This means that the Bank focuses its activities in preventing the materialization of the said risk.

BUSINESS (STRATEGIC) RISK MANAGEMENT)

DEFINITION	Business risk is the risk of failing to achieve the adopted financial targets, including incurring losses, due to adverse changes in the business environment, taking bad decisions, incorrectly implementing the decisions made, or not taking appropriate actions in response to changes in the business environment.
RISK MANAGEMENT OBJECTIVE	Maintaining, on an acceptable level, the potential negative financial consequences resulting from adverse changes in the business environment, making adverse decisions, improper implementation of adopted decisions or lack of appropriate actions, which would be a response to changes in the business environment.
RISK IDENTIFICATION AND MEASUREMENT	Risk identification consist in determining both existing and potential factors arising from the current and planned activities of the Bank which may significantly affect the Bank's financial position and the level of the Bank's income and expenses. Business risk identification is performed by identifying and analysing the factors which contributed to significant deviations in the actual income and costs from their budgeted values. The measurement of business risk is aimed at defining the scale of threats related to the existence of business risk using the adopted risk measures. The measurement of business risk includes: calculating internal capital, conducting stress-tests and backtesting.
RISK CONTROL	Control of business risk is aimed at maintaining it at an acceptable level. It involves setting and periodic review of the risk controls in the form of tolerance limits on business risk along with its thresholds and critical values, adequate to the scale and complexity of the Bank.

RISK FORECASTING AND MONITORING	Forecasting of the business risk is intended to determine the anticipated extent of achievement of the planned results by the Bank. Forecasts are prepared on a quarterly basis with a 1-year horizon and include a forecast of internal capital. Business risk forecasts are verified on a quarterly basis (backtesting). Business risk is monitored to identify areas which require management action. Business risk monitoring includes: • strategic limits of business risk tolerance; • the results of stress tests; • results of backtesting; • internal capital level; • deviations in business risk materialization from the forecast; • results of a qualitative assessment of the business risk.
REPORTING	Reporting is performed on a quarterly basis. The reports on the business risk level are addressed to the ALCO, the RC, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board.
MANAGEMENT ACTIONS	Management actions involve, in particular: • verifying and updating quarterly financial forecasts, including actions aimed at lowering the business risk level in accordance with the limits; • monitoring the level of the strategic limit of tolerance to business risk.

REPUTATION RISK MANAGEMENT

DEFINITION	The reputation risk is understood as the risk of a deterioration in reputation among customers, counterparties, investors, supervisory and inspection authorities, and the general public, as a result of business decisions adopted by the Bank, operating events, instances of non-compliance or other events.
RISK MANAGEMENT OBJECTIVE	The objective of managing reputation risk is to protect the Bank's reputation by preventing reputation losses and mitigating the negative effect of image-related events on the Bank's reputation.
IDENTIFICATION	Identifying reputation risks covers the developments observed in the Bank's internal processes and in its external environment, including in particular: image-related events and factors related to the business environment, i.e. quantitative and qualitative information, including especially the data which describes the Bank and its external environment, which suggest the existence of reputation risk.
ASSESSMENT	An assessment of the reputation risk involves evaluating the impact of image-related events on the Bank's reputation, and in particular, quantifying and determining the severity of reputation losses. The evaluation of a reputation loss includes the impact, credibility and the opinion-forming potential of the disclosure of an image-related event to the public.
RISK CONTROL	Control over reputation risk includes setting up reputation risk controls tailored to the scale and complexity of the Bank's activities, in the form of reputation risk limits and thresholds.
MONITORING	Monitoring reputation risk consists of regularly assessing the reputation risk measures compared to the adopted thresholds. The level of reputation risk is determined based on the reputation risk measures.

REPORTING	Information on the reputation risk is reported in the form of: 1) a semi-annual management report addressed to the Risk Committee, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board. 2) ad-hoc information on current events having a material impact on the Bank's reputation, addressed to the President of the Management Board and to his Office. 3) information included in the Bank's and the Group's financial statements and provided at the request of the external supervisory and inspection bodies.
MANAGEMENT ACTIONS	Based on the specific level of reputation risk, management actions are taken. These may involve: 1) analysing the reasons behind a specific level of risk; 2) evaluating the effects of such a level of risk occurring; 3) developing suggestions of the management actions to be taken in order to reduce the level of reputation risk or a justification for refraining from taking such action if not needed, e.g. in the event of incidental extraordinary events occurring.

MODEL RISK MANAGEMENT

DEFINITION	Model risk is the risk of incurring losses as a result of making incorrect business decisions based on the existing models.
RISK MANAGEMENT OBJECTIVE	The objective of model risk management is to mitigate the level of risk of incurring losses as a result of making incorrect business decisions on the basis of existing models in the Bank through a well-defined and implemented process of models management. One of the elements of the model management process is to regularly perform independent validation of all significant models in the Bank.
RISK IDENTIFICATION, MEASUREMENT AND ASSESSMENT	Identification of the model risk consists of, in particular, collecting information about the existing models and models planned to be implemented as well as determining the materiality of the models on a periodical basis. Model risk evaluation is aimed at determining the scale of the threats associated with the occurrence of the model risk. The evaluation is made at the level of each model as well as on an aggregate basis at the level of the Bank.
RISK CONTROL	Control of the model risk is aimed at maintaining an aggregate evaluation of the model risk at a level which is acceptable to the Bank. Control of the model risk consists in determining the mechanisms used to diagnose the model risk level and tools for reducing the level of this risk. The tools used to diagnose the model risk include, in particular, a strategic limit of tolerance to the model risk and the thresholds for the model risk.
MONITORING	Periodical monitoring of the model risk is aimed at diagnosing areas requiring management actions and includes, in particular: • updating the model risk level; • evaluating the utilization of the strategic limit of tolerance to the model risk and the thresholds of the model risk; • verifying the stage of implementation and evaluating the effectiveness of the implementation of actions intended to mitigate the model risk.
REPORTING	The results of model risk monitoring risk are presented periodically in reports addressed to the RC, the Management Board, and the Supervisory Board.
MANAGEMENT ACTIONS	The purpose of management actions is to shape the model risk management process and to affect the level of this risk, in particular by determining acceptable risk levels and making decisions about the use of tools supporting model risk management.

MACROECONOMIC RISK MANAGEMENT

DEFINITION	Macroeconomic risk is the risk of a deterioration in the Bank's financial position as a result of and the adverse impact of changes in macroeconomic conditions.
RISK MANAGEMENT OBJECTIVE	The objective of macroeconomic risk management is to identify macroeconomic factors having a significant impact on the Bank's activities and taking actions to reduce the adverse impact of the potential changes in the macroeconomic situation on the financial position of the Bank.
RISK IDENTIFICATION, MEASUREMENT AND ASSESSMENT	Identification of the risk of macroeconomic changes consists in determining scenarios of the potential macroeconomic changes and determining those risk factors which have the greatest impact on the financial position of the Bank. Macroeconomic risk arises due to the impact of both factors which depend on the Bank's activities (in particular, the structure of the statement of financial position and response plans prepared for the purposes of stress test scenarios) and those which are independent of it (macroeconomic factors). The Bank identifies factors which contribute to the level of macroeconomic risk when conducting comprehensive stress tests. The risk of macroeconomic changes is measured in order to determine the scale of threats associated with the occurrence of macroeconomic changes. Macroeconomic risk measurement includes: • calculating the profit or loss and its components, and the risk measures, as part of the comprehensive stress tests; • backtesting; • calculating the internal capital level; The risk of macroeconomic changes is assessed on a yearly basis, based on the results of periodical comprehensive stress tests. The level of macroeconomic risk is described as moderate, elevated or high.
RISK CONTROL	Control of the risk of macroeconomic changes is intended to mitigate the adverse effect of the potential changes in the macroeconomic developments on the financial position of the Bank. Macroeconomic risk control consists of determining the acceptable level of the risk, tailored to the scale of the Bank's operations, and the impact of the risk of the Bank's operations and financial position. An acceptable level of the risk of macroeconomic changes means a situation where stress test results do not signal a need to take any corrective measures, or the corrective measures which need to be taken will be sufficient to improve the financial position of the Bank.
RISK FORECASTING AND MONITORING	Forecasting the macroeconomic risk is intended to determine the anticipated impact of the future materialization of an adverse scenario on the Bank's results, including its capital. The forecast includes a forecast of the internal capital and is prepared on a quarterly basis with a 1-year horizon based on the results of comprehensive stress tests. Monitoring the macroeconomic risk consists in analysing macroeconomic developments, the macroeconomic factors to which the Bank is sensitive, the level of the risk and the results of comprehensive stress tests.
REPORTING	Reports on the macroeconomic risk are prepared on a quarterly basis. The reports are addressed to the ALCO, the RC, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board.
MANAGEMENT ACTIONS	Management actions involve, in particular: • determining acceptable levels of risk; • proposals of actions aimed at reducing the level of risk in the event of an elevated or high risk of macroeconomic changes.

MANAGING CAPITAL RISK

DEFINITION	Capital risk is the risk of failing to ensure an appropriate level and structure of own funds, with respect to the scale of the Bank's operations and risk exposure and, consequently, insufficient for the absorption of unexpected losses, taking into account development plans and extreme situations.
RISK MANAGEMENT OBJECTIVE	The objective of managing the capital risk is to ensure an appropriate level and structure of own funds, with respect to the scale of the operations and risk exposure of the Group and the Bank, taking into account the assumptions of the Bank's dividend policy as well as supervisory instructions and recommendations concerning capital adequacy.
RISK MEASUREMENT	The capital risk level for the Bank is determined based on the thresholds and strategic tolerance limits, including, among other things, the total capital ratio and basic capital (Tier 1) ratio. In addition, threshold and maximum values are determined for capital adequacy measures, as an excess over the minimum values constituting strategic tolerance limits for the capital adequacy measures. The capital risk level is determined as follows: 1) low level – when all capital adequacy measures exceed the thresholds; 2) elevated level – when at least one adequacy measure is lower than the respective threshold and no capital adequacy measure is lower than the strategic tolerance limit; 3) high level – when at least one capital adequacy measure is lower than the strategic tolerance limit.
MONITORING	The Bank regularly monitors the level of capital adequacy measures in order to determine the degree of compliance with the supervisory standards, internal strategic limits, and to identify instances which require taking capital contingency actions. Should a high level of capital risk be identified, the Bank takes measures to bring capital adequacy measures to a lower level, taking into account the assumptions of the dividend policy as well as the supervisory instructions and recommendations concerning capital adequacy.

MANAGEMENT OF THE RISK OF EXCESSIVE LEVERAGE

DEFINITION	The risk of excessive financial leverage is the risk resulting from vulnerability to threats resulting from financial leverage or conditional financial leverage which may require taking unintended action to adjust business plans, including an emergency sale of assets which could result in losses or the need to adjust the valuation of other assets.
RISK MANAGEMENT OBJECTIVE	The objective of managing the risk of excessive leverage is to ensure an appropriate objective relationship between the amount of the core capital (Tier 1) and the total of balance sheet assets and off-balance sheet liabilities granted by the Bank.
IDENTIFICATION, ASSESSMENT AND MEASUREMENT	Risk identification consists in recognizing the existing and potential sources of risk and estimating the significance of their potential impact on the Bank's operations. For the purpose of measuring the risk of excessive financial leverage, a leverage ratio is calculated by the Bank as a measure of Tier 1 capital divided by the measure of total exposure and is expressed as a percentage rate. The Bank calculated the leverage ratio as at the reporting date. As at 31 December 2017, the leverage ratio is calculated both with reference to Tier 1 capital and in accordance with the transitional definition of Tier 1 capital. When assessing the risk of excessive leverage, the mismatch of assets and liabilities ratio is also used.

RISK CONTROL	The objective of the control over the risk of excessive leverage is to maintain the Bank's risk at an acceptable level. To maintain the risk of excessive leverage at an acceptable level, a tolerance limit and a threshold for the ratio are determined.
MONITORING AND FORECASTING	The risk of excessive leverage is monitored on a quarterly basis by verifying: • the current level of the leverage ratio, by comparing it with the strategic tolerance limits and threshold; • deviation of the leverage ratio from forecasts. Leverage ratio forecasts are prepared on a quarterly basis. The level of the excessive leverage ratio is described as low – when the leverage ratio is equal to or lower than the threshold, elevated – when the leverage ratio is lower than the threshold and equal to or higher than the strategic tolerance limit, or high – when the leverage ratio is below the strategic tolerance limit.
REPORTING	Reporting is performed on a quarterly basis. Reports on the excessive leverage risk include the current and forecast levels of the leverage ratio in relation to the strategic tolerance limits and the threshold. Information on the level of risk of excessive leverage is presented in the "Report on Capital Adequacy of PKO Bank Polski SA". The reports on the level of the risk of excessive leverage are addressed to ALCO, the RC, the Management Board, the Risk Committee of the Supervisory Board, and the Supervisory Board.
MANAGEMENT ACTIONS	In the event of a high or elevated risk level, proposals for management actions are developed, taking into account the current macroeconomic situation and the costs of the actions proposed. The impact of the recommended management actions on the level of risk of excessive leverage is identified. As part of updating quarterly financial forecasts and developing the financial plan, management actions intended to reduce the level of risk of excessive leverage to an acceptable level are taken into account,

66. COMPREHENSIVE STRESS-TESTS

Comprehensive stress-tests are an integral part of the Bank's risk management and are complementary to stress-tests specific to particular types of risks. They cover the risks which, on an aggregate basis, are considered material by the Bank. They include an analysis of the impact of changes in the environment and the functioning of the Bank on the Bank's financial position, in particular: the income statement, statement of financial position, own funds, capital adequacy and selected liquidity measures.

Comprehensive stress tests include periodical tests and supervisory tests. Periodical stress tests are conducted once a year, with a 3-yearly horizon. Supervisory tests are carried out at the request of the supervisory authorities in accordance with the assumptions provided by the supervisory authorities. Periodical and thematic comprehensive stress tests are conducted taking into account the changes in amounts and structure of the balance sheet and the income statement.

67. CAPITAL ADEQUACY

Capital adequacy Own funds for capital adequacy purposes Requirements as regard own funds (Pillar I) Internal capital (Pillar II) Disclosures (Pillar III)

CAPITAL ADEQUACY

Capital adequacy management is a process intended to ensure that the level of risk which the Bank assumes in relation to the development of its business activities may be covered with its capital, taking into account a specific risk tolerance level and time horizon. The process of managing capital adequacy comprises, in particular, compliance with the applicable regulations of the supervisory and control authorities, as well as the risk tolerance level determined within the Bank and the capital planning process, including the policy concerning the sources of acquisition of capital.

The objective of capital adequacy management is to maintain own funds at a level which is adequate to the scale and profile of the risk relating to the Bank's activities at all times.

The process of managing the Bank's capital adequacy comprises:

- specifying and pursuing the Bank's capital targets;
- identifying and monitoring significant types of risk;
- measuring or estimating internal capital to cover individual risk types of risk and total internal capital;
- determining strategic tolerance limits and thresholds of capital adequacy measures;
- forecasting, monitoring and reporting the level and structure of equity and capital adequacy,
- managing the structure of the balance sheet to optimize the quality of the Bank's own funds,
- emergency measures with regard to capital;
- stress-tests;
- planning and allocating own funds and internal capital to business areas and customer segments in the Bank;
- assessing the profitability of the individual business areas and customer segments.

Capital adequacy measures include:

- total capital ratio;
- the ratio of own funds to internal capital;
- Tier 1 core capital ratio;
- Tier 1 capital ratio;
- leverage ratio.

The objective of monitoring the level of capital adequacy measures is to determine the degree of compliance with supervisory standards and to identify cases which require that emergency measures be implemented.

Major regulations applicable in the capital adequacy assessment process include:

- the CRR Regulation
- the Polish Banking Law;
- the Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system (hereinafter referred to as 'the Act on macroprudential supervision').

In accordance with Article 92 of the CRR Regulation, the minimum levels of the capital ratios to be maintained by the Bank are as follows:

- total capital ratio (TCR) – 8.0%;
- Tier 1 capital ratio (T1) – 6.0%;
- Tier 1 core capital ratio (CET1) – 4.5%.

In accordance with the CRR Regulation and the Act on macroprudential supervision, the Bank is obliged to maintain a combined buffer representing the sum of the applicable buffers, namely:

- a capital buffer which applies to all banks. Every year, the capital buffer will be increased to the target level of 2.5% (in 2019). As at 31 December 2017, the systemic risk buffer amounted to 1.25%, and will amount to 1.875% after 1 January 2018.
- the countercyclical buffer imposed to mitigate the systemic risk arising from the credit cycle. The Bank calculates the countercyclical buffer at the level specified by the relevant authority of the country where the Bank has exposures. Starting from 1 January 2017, the countercyclical buffer is equal to 0% for credit exposures in the Republic of Poland.

- a systemic risk buffer – intended to prevent and mitigate long-term non-cyclical risk or prudential risk which may cause strong negative consequences for the financial system and the economy of a given country. As at 31 December 2017, the systemic risk buffer was equal to 0%. Starting from 1 January 2018, the systemic risk buffer amounts to 3%.
- the buffer relating to the fact that the Bank has been identified as a systemically important institution ('O-SII') – on 24 November 2017, on the basis of an assessment of the Bank's systemic importance in accordance with the Act on macroprudential supervision, the Bank received an individual decision of the Polish Financial Supervision Authority imposing a buffer on the Bank of 0.75% of its total risk exposure calculated in accordance with the CRR Regulation.

In addition, the Bank is obliged to maintain own funds to cover an additional capital requirement in order to hedge the risk resulting from mortgage-secured loans and advances to households denominated in foreign currencies ("a discretionary capital requirement"). On 16 November 2017, the Bank received a letter from the Polish Financial Supervision Authority concerning an individual recommendation to meet an additional capital requirement (a discretionary capital requirement) for stand-alone capital ratios: the total capital ratio: 0.66 p.p.; Tier 1 capital ratio: 0.50 p.p.; and Tier 1 core capital ratio: 0.37 p.p.

The total value of buffers and additional discretionary capital requirements which the Bank was obliged to meet as at 31 December 2017 was 2.66% of the total exposure to risk calculated in accordance with the CRR Regulation. The same values as at 31 December 2016 amounted to 2.83%.

In 2017 and in 2016, PKO Bank Polski SA maintained a safe capital base in excess of the supervisory and regulatory limits.

OWN FUNDS FOR CAPITAL ADEQUACY PURPOSES

An increase in Tier 1 capital before regulatory adjustments and reductions between 31 December 2017 and 31 December 2016 resulted from:

- a decision adopted on 22 June 2017 by the Ordinary General Shareholders' Meeting on the appropriation of the Bank's net profit for 2016 by transferring it to supplementary and reserve capital, without distributing any amounts as dividend. The resulting increase in own funds amounted to PLN 1 299 million, and the remaining part of the net profit for 2016 (PLN 1 589 million) had already been included in own funds as at 31 December 2016 since the Bank had received the required permission from the PFSA to include the net profit earned for the three quarters of 2016, less the anticipated charges, in Tier 1 core capital;
- a permission from the PFSA received by the Bank on 21 September 2017 to include the net profit of PKO Bank Polski SA for the first half of 2017, less the anticipated charges (of PLN 1 118 million) in Tier 1 core capital;
- a permission from the PFSA received by the Bank on 15 December 2017 to include the net profit of PKO Bank Polski SA for the third quarter of 2017, less the anticipated charges (of PLN 704 million) in Tier 1 core capital.

Changes in Tier 2 capital between 31 December 2017 and 31 December 2016 resulted from the following:

- having obtained the necessary permissions from the PFSA, the Bank exercised a call option for subordinated bonds of PLN 1 600 million and made an early repayment of a subordinated loan of CHF 224 million (the equivalent of PLN 884 million). As at 31 December 2016, both these instruments were classified as Tier 2 capital. Since the receipt of the said permission, they have no longer been included in the Bank's own funds.
- the Bank obtained permission from the PFSA to include a new issue of the Bank's subordinated bonds amounting to PLN 1 700 million in own funds.

REQUIREMENTS RELATING TO OWN FUNDS (PILLAR I)

The Bank calculates own funds requirements for the following types of risk:

CREDIT RISK	under the standard approach, using the following formulas with regard to: STATEMENT OF FINANCIAL POSITION ITEMS – a product of a carrying amount (considering value of adjustments for specific credit risk), a risk weight of the exposure calculated according to the standardized method of credit risk requirement as regards own funds and 8% (considering recognized collateral); OFF-BALANCE SHEET LIABILITIES GRANTED – a product of value of liability (considering value of adjustments for specific credit risk), a risk weight of the product, a risk weight of off-balance sheet exposure calculated according to the standardized method of credit risk requirement for own funds and 8% (considering recognized collateral); OFF-BALANCE SHEET TRANSACTIONS (DERIVATIVE INSTRUMENTS) – a product of risk weight of the off-balance sheet transaction calculated according to the standardized method of credit risk requirement for own funds, equivalent in the statement of financial position of off-balance sheet transaction and 8% (the value of the equivalent in the statement of financial position is calculated in accordance with the mark-to-market method).
OPERATIONAL RISK	• in accordance with the AMA approach – with respect to the Bank's activities, excluding the Bank's branches in Germany and the Czech Republic; • in accordance with the AMA approach – with respect to the Bank's activities, excluding the Bank's branches in Germany and the Czech Republic;
MARKET RISK	• currency risk – calculated under the core approach; • commodity risk – calculated under the simplified approach; • equity instruments risk – calculated under the simplified approach; • specific risk of debt instruments – calculated under the core approach; • general risk of debt instruments – calculated under the duration-based approach, • other types of risk, other than delta risk (non-delta risk) calculated under the scenario approach in the case of options for which the Bank uses its own valuation models and under the delta plus approach for other options.
OTHER RISKS	• settlement risk and delivery risk – calculated under the approach specified in Title V, "Own funds requirements for settlement risk" of the CRR Regulation; • counterparty credit risk – calculated under the approach set out in Chapter 6, "Counterparty credit risk" of Title II, "Capital requirements for credit risk" of the CRR Regulation; • credit valuation adjustment risk – calculated under the approach specified in Title VI, "Own funds requirements for credit valuation adjustment risk" of the CRR Regulation; • exceeding the large exposures limit – calculated under the approach set out in Articles 395-401 of the CRR Regulation; • for exposures to a central counterparty, a requirement for transactions and contributions made to the default fund of a qualifying central counterparty is calculated.

(IN PLN MILLION)

	31.12.2017	31.12.2016
Total own funds	**34 297**	**31 129**
Tier 1 capital	**32 597**	**28 673**
Tier 1 capital before regulatory adjustments and reductions, of which:	34 854	31 733
Share capital	1 250	1 250
Other reserves	30 712	27 824
General banking risk fund for unidentified risk of banking activities	1 070	1 070
Retained earnings	1 822	1 589
(-) Goodwill	(871)	(871)
(-) Other intangible assets	(1 509)	(1 694)
Accumulated other comprehensive income	182	(442)
Adjustments in Tier 1 basic capital due to prudential filters	12	11
Other transitional period adjustments to Tier 1 basic capital	(71)	(64)
Tier 2 capital	**1 700**	**2 456**
Equity instruments and subordinated loans eligible as Tier 2 capital	1 700	2 523
(-) Equity exposures deducted from own funds	-	(67)
Requirements for own funds	**14 008**	**14 489**
Credit risk	13 017	13 299
Operational risk	455	482
Market risk	495	661
Credit valuation adjustment risk	41	47
Total capital adequacy ratio	**19,59%**	**17,19%**
Tier 1 capital ratio	**18,62%**	**15,83%**

The leverage ratio calculated in accordance with the transitional definition amounted to 11.38% as at 31 December 2017, and 10.02% as at 31 December 2016.

INTERNAL CAPITAL (PILLAR II)

In 2017, PKO Bank Polski SA calculated internal capital in accordance with external regulations:

- the CRR Regulation;
- the Polish Banking Law;
- the Regulation of the Minister of Finance and Development of 6 March 2017 on the risk management and internal control systems, remuneration policy and the detailed procedure for estimating the internal capital in banks;
- the Act on Macro-prudential supervision;

and the Bank's internal regulations.

Internal capital is the amount of capital estimated by the Bank that is necessary to cover all of the identified significant risks characteristic of the Bank's activities and the effect of changes in the business environment, taking account of the anticipated risk level.

The estimation of internal capital is aimed at determining the minimum level of own funds which ensures the safety of operations, taking into account changes in the profile and scale of the operations as well as adverse stress conditions.

The internal capital for covering the individual risk types is determined using the methods specified in the internal regulations. In the event of performing internal capital estimates based on statistical models, the annual forecast horizon is adopted and a 99.9% confidence level. The total internal capital of each entity of the Bank is the sum of internal capital amount necessary to cover all of the risks significant for the Bank.

The correlation coefficient for different types of risk used in the internal capital calculation is equal to 1. In 2017 and 2016, the relation of the Bank's own funds to its internal capital remained on a level exceeding both the threshold set by the law and the Bank's internal limits.

DISCLOSURES (PILLAR III)

The Bank annually announces information, in particular, about risk management and capital adequacy in accordance with: the CRR regulation and the implementing acts thereto, Recommendation H, the Polish Banking Law, the Act on Macro-Prudential Supervision, Recommendation M relating to operational risk management in banks and Recommendation P relating to liquidity risk, issued by the Polish Financial Supervision Authority.

Details of the scope of information disclosed, the method of its verification and publication are presented in PKO Bank Polski SA Capital Adequacy Information Policies and other information to be published, which are available on the Bank's website (www.pkobp.pl).www.pkobp.pl).

68. SALE OF RECEIVABLE PORTFOLIOS

In 2017, the Bank effected a sale of impaired loan portfolios (balance sheet and off-balance sheet receivables) of more than 17.8 thousand individual receivables from retail and business customers amounting to approximately PLN 1.5 billion. The total carrying amount of the provision for potential claims on sale of impaired loan portfolios as at 31 December 2017 amounted to PLN 2 million (as at 31 December 2016 it was PLN 3 million). As a result of the sale, all risks and rewards were transferred, hence the Bank derecognized these assets.

The Bank did not receive any securities on account of the above-mentioned transactions.

SUBSEQUENT EVENTS

69. SUBSEQUENT EVENTS

1. On 30 January 2018, the Bank adopted a resolution consenting to an issue of subordinated bonds in the 10NC5 format, i.e. with 10-year maturity and the Bank's right to early redemption, subject to permission from the PFSA, all bonds after 5 years of the issuance date (the call option). The total nominal value of the bonds in this issue will amount to no more than PLN 1 billion. Bonds will be issued based on the Bonds Act, and the funds obtained from the issue will be used, subject to permission from the PFSA, to increase the Bank's Tier 2 capital. The nominal value of one bond will amount to PLN 500 000. Bonds will bear interest at a market level, with a half-yearly interest period, and the interest on the bonds will increase their nominal value.

(IN PLN MILLION)

2. On 8 February 2018, the Bank made full and final early repayment of a credit line granted by Nordea Bank AB (publ) based on an agreement dated 1 April 2014. Initially, the credit line was granted for a period of 7 years, which means that the Bank repaid it 3 years before its original maturity.

Signatures of all Members of the Bank's Management Board

27.02.2018	Zbigniew Jagiełło	President of the Management Board	.... (signature)
27.02.2018	Rafał Antczak	Vice-President of the Management Board	.... (signature)
27.02.2018	Rafał Kozłowski	Vice-President of the Management Board	.... (signature)
27.02.2018	Maks Kraczkowski	Vice-President of the Management Board	.... (signature)
27.02.2018	Mieczysław Król	Vice-President of the Management Board	.... (signature)
27.02.2018	Adam Marciniak	Vice-President of the Management Board	.... (signature)
27.02.2018	Piotr Mazur	Vice-President of the Management Board	.... (signature)
27.02.2018	Jakub Papierski	Vice-President of the Management Board	.... (signature)
27.02.2018	Jan Emeryk Rościszewski	Vice-President of the Management Board	.... (signature)

Signature of the person responsible for maintaining the books of account
27.02.2018
Danuta Szymańska
Director of the Accounting Division

....
(signature)