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

Consolidated Financial Statements of Bank Pekao S.A. Group for the year ended on 31 December 2016

Warsaw, February 2017

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Consolidated income statement

(In PLN thousand)

	NOTE	2016	2015
Interest income	10	5 448 490	5 456 369
Interest expense	10	(1 066 485)	(1 289 799)
Net interest income		**4 382 005**	**4 166 570**
Fee and commission income	11	2 252 085	2 388 523
Fee and commission expense	11	(293 121)	(382 997)
Net fee and commission income		**1 958 964**	**2 005 526**
Dividend income	12	**16 798**	**13 635**
Result on financial assets and liabilities held for trading	13	**485 409**	**428 048**
Result on fair value hedge accounting	30	**1 313**	**5 547**
Gains (losses) on disposal of:	14	**435 903**	**229 601**
loans and other financial receivables		159 493	534
available for sale financial assets and held to maturity investments		276 493	229 551
financial liabilities		(83)	(484)
Operating income		**7 280 392**	**6 848 927**
Net impairment losses on financial assets and off-balance sheet commitments:	18	**(500 629)**	**(517 558)**
loans and other financial receivables		(401 409)	(500 355)
off-balance sheet commitments		(99 220)	(17 203)
Net result on financial activity		**6 779 763**	**6 331 369**
Administrative expenses	15	**(3 602 324)**	**(3 426 592)**
personnel expenses		(1 896 836)	(1 908 519)
other administrative expenses		(1 705 488)	(1 518 073)
Depreciation and amortization	16	**(340 866)**	**(331 465)**
Net result on other provisions		**(14 475)**	**(28 766)**
Net other operating income and expenses	17	**30 528**	**160 996**
Operating costs		**(3 927 137)**	**(3 625 827)**
Gains (losses) on subsidiaries and associates	19	**38 561**	**113 203**
Gains (losses) on disposal of property, plant and equipment and intangible assets	20	**5 359**	**12 373**
Profit before income tax		**2 896 546**	**2 831 118**
Income tax expense	21	**(616 782)**	**(537 640)**
Net profit for the period		**2 279 764**	**2 293 478**
1. Attributable to equity holders of the Bank		2 279 275	2 292 459
2. Attributable to non-controlling interests	51	489	1 019
Earnings per share (in PLN per share)			
basic for the period	22	8.68	8.73
diluted for the period	22	8.68	8.73

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

Consolidated statement of comprehensive income

(In PLN thousand)

	NOTE	2016	2015
Net profit		**2 279 764**	**2 293 478**
1. Attributable to equity holders of the Bank		2 279 275	2 292 459
2. Attributable to non-controlling interests	51	489	1 019
Other comprehensive income			
Item that are or may be reclassified subsequently to profit or loss:			
Foreign currency translation differences		-	(1 169)
Change in fair value of available-for-sale financial assets		(608 819)	(237 124)
Change in fair value of cash flow hedges	30	(5 557)	(93 341)
Tax on items that are or may be reclassified subsequently to profit or loss	21	116 731	62 789
Items that will never be reclassified to profit or loss:			
Remeasurements of the defined benefit liabilities	45	(11 560)	12 900
Share in remeasurements of the defined benefit liabilities of associates		18	18
Tax on items that will never be reclassified to profit or loss	21	2 196	(2 451)
Other comprehensive income (net of tax)		**(506 991)**	**(258 378)**
Total comprehensive income		**1 772 773**	**2 035 100**
1. Attributable to equity holders of the Bank		1 772 284	2 034 081
2. Attributable to non-controlling interests	51	489	1 019

Notes to the financial statements presented on pages 10 – 151 constitute an integral part of the consolidated financial statements.

Consolidated statement of financial position

(In PLN thousand)

	NOTE	31.12.2016	31.12.2015
ASSETS			
Cash and due from Central Bank	24	5 872 911	7 881 607
Bill of exchange eligible for rediscounting at Central Bank		-	70
Loans and advances to banks	25	3 257 829	7 314 724
Financial assets held for trading	26	732 469	1 126 792
Derivative financial instruments (held for trading)	27	1 913 429	3 206 447
Loans and advances to customers	28	118 689 267	118 555 199
Receivables from finance leases	29	3 974 643	3 503 979
Hedging instruments	30	289 752	421 640
Investments (placement) securities	31	35 120 619	21 181 723
1. Available for sale		32 101 634	17 813 299
2. Held to maturity		3 018 985	3 368 424
Assets held for sale	33	48 277	45 302
Investments in associates	34	136 221	148 965
Intangible assets	35	596 181	636 717
Property, plant and equipment	36	1 422 930	1 460 652
Investment properties	37	24 874	30 221
Income tax assets		1 104 343	991 804
1. Current tax assets		100 992	76 600
2. Deferred tax assets	21	1 003 351	915 204
Other assets	38	1 031 198	2 279 725
TOTAL ASSETS		**174 214 943**	**168 785 567**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to Central Bank	24	6 091	914
Amounts due to other banks	40	4 823 440	5 958 449
Financial liabilities held for trading	26	673 165	611 442
Derivative financial instruments (held for trading)	27	1 952 674	3 204 328
Amounts due to customers	41	137 815 926	128 867 691
Hedging instruments	30	1 638 718	1 702 759
Debt securities issued	42	1 522 963	2 903 233
Income tax liabilities		11 579	6 649
1. Current tax liabilities		6 694	1 713
2. Deferred tax liabilities	21	4 885	4 936
Provisions	43	560 392	425 374
Other liabilities	44	2 298 052	1 680 535
TOTAL LIABILITIES		**151 303 000**	**145 361 374**
Equity			
Share capital	49	262 470	262 470
Other capital and reserves	50	20 375 527	20 869 976
Retained earnings and profit for the period	50	2 259 022	2 275 783
Total equity attributable to equity holders of the Bank		**22 897 019**	**23 408 229**
Non - controlling interests	51	14 924	15 964
TOTAL EQUITY		**22 911 943**	**23 424 193**
TOTAL LIABILITIES AND EQUITY		**174 214 943**	**168 785 567**

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

(In PLN thousand)

	EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK											
		OTHER CAPITAL AND RESERVES										
	SHARE CAPITAL	TOTAL OTHER CAPITAL AND RESERVES	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	FOREIGN CURRENCY TRANSLATION DIFFERENCES	OTHER	RETAINED EARNINGS AND PROFIT FOR THE PERIOD	TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK	NON - CONTROLLING INTERESTS	TOTAL EQUITY
Note	49	50							50		51	
Equity as at 1.01.2016	**262 470**	**20 869 976**	**9 137 221**	**1 975 415**	**9 092 740**	**283 597**	**-**	**381 003**	**2 275 783**	**23 408 229**	**15 964**	**23 424 193**
Management options	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options exercised (share issue)	-	-	-	-	-	-	-	-	-	-	-	-
Revaluation of management share options	-	-	-	-	-	-	-	-	-	-	-	-
Comprehensive income	**-**	**(506 991)**	**-**	**-**	**-**	**(506 991)**	**-**	**-**	**2 279 275**	**1 772 284**	**489**	**1 772 773**
Remeasurements of the defined benefit liabilities (net of tax)	-	(9 346)	-	-	-	(9 346)	-	-	-	(9 346)	-	(9 346)
Revaluation of available-for-sale investments (net of tax)	-	(493 144)	-	-	-	(493 144)	-	-	-	(493 144)	-	(493 144)
Revaluation of hedging financial instruments (net of tax)	-	(4 501)	-	-	-	(4 501)	-	-	-	(4 501)	-	(4 501)
Foreign currency translation differences	-	-	-	-	-	-	-	-	-	-	-	-
Net profit for the period	-	-	-	-	-	-	-	-	2 279 275	2 279 275	489	2 279 764
Appropriation of retained earnings	**-**	**12 547**	**-**	**6 909**	**-**	**-**	**-**	**5 638**	**(2 296 036)**	**(2 283 489)**	**(1 529)**	**(2 285 018)**
Dividend paid	-	-	-	-	-	-	-	-	(2 283 489)	(2 283 489)	(1 529)	(2 285 018)
Profit appropriation to other reserves including consolidation adjustments	-	12 547	-	6 909	-	-	-	5 638	(12 547)	-	-	-
Other	**-**	**(5)**	**-**	**-**	**(5)**	**-**	**-**	**-**	**-**	**(5)**	**-**	**(5)**
Other	-	(5)	-	-	(5)	-	-	-	-	(5)	-	(5)
Equity as at 31.12.2016	**262 470**	**20 375 527**	**9 137 221**	**1 982 324**	**9 092 735**	**(223 394)**	**-**	**386 641**	**2 259 022**	**22 897 019**	**14 924**	**22 911 943**

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

Consolidated statement of changes in equity (cont.)

(In PLN thousand)

	EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK											
		OTHER CAPITAL AND RESERVES										
	SHARE CAPITAL	TOTAL OTHER CAPITAL AND RESERVES	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	FOREIGN CURRENCY TRANSLATION DIFFERENCES	OTHER	RETAINED EARNINGS AND PROFIT FOR THE PERIOD	TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK	NON - CONTROLLING INTERESTS	TOTAL EQUITY
Note	49	50							50		51	
Equity as at 1.01.2015	**262 470**	**20 990 344**	**9 137 221**	**1 937 850**	**9 002 629**	**540 806**	**1 169**	**370 669**	**2 764 875**	**24 017 689**	**28 043**	**24 045 732**
Management options	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options exercised (share issue)	-	-	-	-	-	-	-	-	-	-	-	-
Revaluation of management share options	-	-	-	-	-	-	-	-	-	-	-	-
Comprehensive income	**-**	**(258 378)**	**-**	**-**	**-**	**(257 209)**	**(1 169)**	**-**	**2 292 459**	**2 034 081**	**1 019**	**2 035 100**
Remeasurements of the defined benefit liabilities (net of tax)	-	10 467	-	-	-	10 467	-	-	-	10 467	-	10 467
Revaluation of available-for-sale investments (net of tax)	-	(192 070)	-	-	-	(192 070)	-	-	-	(192 070)	-	(192 070)
Revaluation of hedging financial instruments (net of tax)	-	(75 606)	-	-	-	(75 606)	-	-	-	(75 606)	-	(75 606)
Foreign currency translation differences	-	(1 169)	-	-	-	-	(1 169)	-	-	(1 169)	-	(1 169)
Net profit for the period	-	-	-	-	-	-	-	-	2 292 459	2 292 459	1 019	2 293 478
Appropriation of retained earnings	**-**	**161 860**	**-**	**37 565**	**113 961**	**-**	**-**	**10 334**	**(2 781 551)**	**(2 619 691)**	**(13 098)**	**(2 632 789)**
Dividend paid	-	-	-	-	-	-	-	-	(2 624 701)	(2 624 701)	(8 088)	(2 632 789)
Profit appropriation to other reserves including consolidation adjustments	-	161 860	-	37 565	113 961	-	-	10 334	(156 850)	5 010	(5 010)	-
Other	**-**	**(23 850)**	**-**	**-**	**(23 850)**	**-**	**-**	**-**	**-**	**(23 850)**	**-**	**(23 850)**
Acquisition of Pekao Investment Banking S.A.	-	(23 850)	-	-	(23 850)	-	-	-	-	(23 850)	-	(23 850)
Equity as at 31.12.2015	**262 470**	**20 869 976**	**9 137 221**	**1 975 415**	**9 092 740**	**283 597**	**-**	**381 003**	**2 275 783**	**23 408 229**	**15 964**	**23 424 193**

Notes to the financial statements presented on pages 10 – 151 constitute an integral part of the consolidated financial statements.

Consolidated cash flow statement

(In PLN thousand)

	NOTE	2016	2015
Cash flow from operating activities – indirect method			
Net profit for the period		**2 279 275**	**2 292 459**
Adjustments for:		**9 051 905**	**(3 592 611)**
Depreciation and amortization	16	340 866	331 465
Share of profit (loss) of associates		(38 561)	(52 146)
(Gains) losses on investing activities		(280 761)	(241 559)
Net interest income	10	(4 382 005)	(4 166 570)
Dividend income	12	(16 798)	(13 635)
Interests received		5 347 032	5 228 593
Interests paid		(1 104 545)	(1 266 247)
Income tax		800 763	550 623
Income tax paid		(613 243)	(607 365)
Change in loans and advances to banks		214 246	174 433
Change in financial assets held for trading		393 623	(677 498)
Change in derivative financial instruments (assets)		1 293 018	1 241 528
Change in loans and advances to customers and bill of exchange eligible for rediscounting at Central Bank		(42 858)	(6 507 423)
Change in receivables from finance leases		(470 664)	(391 931)
Change in investment (placement) securities		(928 421)	(830 115)
Change in other assets		1 228 207	819 733
Change in amounts due to banks		(1 128 745)	615 159
Change in financial liabilities held for trading		61 723	20 131
Change in derivative financial instruments (liabilities)		(1 251 654)	(1 213 378)
Change in amounts due to customers		8 969 426	3 229 320
Change in debt securities issued		11 832	91 981
Change in provisions		135 018	(17 082)
Change in other liabilities		514 406	89 372
Net cash flows from operating activities		**11 331 180**	**(1 300 152)**
Cash flow from investing activities			
Investing activity inflows		**83 089 908**	**269 003 982**
Sale of shares in associates		-	75 000
Sale of investment securities		82 248 380	268 281 039
Sale of intangible assets and property, plant and equipment		14 190	17 120
Dividend received	12	16 798	13 635
Other investing inflows		810 540	617 188
Investing activity outflows		**(96 608 585)**	**(265 080 477)**
Acquisition of shares in subsidiary, net of cash acquired		-	(274 329)
Acquisition of investment securities		(96 335 321)	(264 510 542)
Acquisition of intangible assets and property, plant and equipment	35, 36	(273 264)	(295 606)
Net cash flows from investing activities		**(13 518 677)**	**3 923 505**

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

Consolidated cash flow statement (cont.)

(In PLN thousand)

	NOTE	2016	2015
Cash flows from financing activities			
Financing activity inflows		**1 129 733**	**3 966 098**
Issue of debt securities	42	1 129 733	3 966 098
Financing activity outflows		**(4 789 541)**	**(7 632 240)**
Redemption of debt securities	42	(2 506 052)	(5 007 539)
Dividends and other payments to shareholders		(2 283 489)	(2 624 701)
Net cash flows from financing activities		**(3 659 808)**	**(3 666 142)**
Total net cash flows		**(5 847 305)**	**(1 042 789)**
including: effect of exchange rate fluctuations on cash and cash equivalents held		96 157	151 702
Net change in cash and cash equivalents		**(5 847 305)**	**(1 042 789)**
Cash and cash equivalents at the beginning of the period		**14 513 395**	**15 556 184**
Cash and cash equivalents at the end of the period	52	**8 666 090**	**14 513 395**

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

Notes to the financial statements (cont.)

(In PLN thousand)

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

1. General information

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

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

The Bank’s statistical REGON number is 000010205.

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

Bank Pekao S.A. Capital Group (‘Group’ or ‘Bank Pekao S.A. Group’) is part of the UniCredit S.p.A. Group with its seat in Roma, Italy.

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

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

Changes in share ownership structure of the Bank
In the current report No. 17/2016, the Management Board of Bank Pekao S.A. informed that on 18 July 2016 it received the notification from UniCredit S.p.A. according to which, UniCredit S.p.A. sold 26 247 003 shares of the Bank as a result of the execution on 13 July 2016 of the block trades concluded as a result of the accelerated book-building process. The transactions were settled on 15 July 2016.

In the current report No. 30/2016, the Management Board of Bank Pekao S.A. informed that on 8 December 2016 UniCredit S.p.A. announced it has entered into an agreement for the disposal of a 32.8% stake in Bank Pekao S.A. to Powszechny Zakład Ubezpieczeń S.A. (‘PZU’) and Polish Development Fund S.A. (‘PFR’).

The Transaction is subject to the customary regulatory and antitrust approvals and is expected to be completed around mid-2017.

Moreover in the current report No. 31/2016 on 8 December 2016 the Bank informed that it had received communication from UniCredit S.p.A. concerning announcement on sale offer of 1 916 of certificates exchangeable for the Bank shares of total reference value of approx. EUR 500 million, compulsorily settled in the Bank common shares no later than on 15 December 2019. Those certificates shall be used to sell the remaining 7.3% of the Bank shares belonging to UniCredit S.p.A. (after the conclusion of sale agreement mentioned above).

(In PLN thousand)

2. Group structure

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

NAME OF ENTITY	LOCATION	CORE ACTIVITY	PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING	
			31.12.2016	31.12.2015
Pekao Bank Hipoteczny S.A.	Warsaw	Banking	100.00	100.00
Centralny Dom Maklerski Pekao S.A.	Warsaw	Brokerage	100.00	100.00
Pekao Leasing Sp. z o.o.	Warsaw	Leasing services	100.00	36.49
Pekao Investment Banking S.A.	Warsaw	Brokerage	100.00	100.00
Pekao Leasing Holding S.A. (in liquidation), including:	Warsaw	Deleted from the registry	-	100.00
Pekao Leasing Sp. z o.o.	*Warsaw*	*Leasing services*	-	*63.51*
Pekao Faktoring Sp. z o.o.	Lublin	Factoring services	100.00	100.00
Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A.	Warsaw	Pension fund management	65.00	65.00
Centrum Kart S.A.	Warsaw	Financial support	100.00	100.00
Pekao Financial Services Sp. z o.o.	Warsaw	Transferable agent	100.00	100.00
Centrum Bankowości Bezpośredniej Sp. z o.o.	Cracow	Call-center services	100.00	100.00
Pekao Property S.A., including:	Warsaw	Real estate development	100.00	100.00
FPB - Media Sp. z o.o.	*Warsaw*	*Real estate development*	*100.00*	*100.00*
Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation)	Warsaw	Business consulting	100.00	100.00

As at 31 December 2016, all of the subsidiaries have been consolidated.

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

NAME OF ENTITY	LOCATION	CORE ACTIVITY	PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING	
			31.12.2016	31.12.2015
Dom Inwestycyjny Xelion Sp. z o.o. (*)	Warsaw	Financial intermediary	50.00	50.00
Pioneer Pekao Investment Management S.A.	Warsaw	Asset management	49.00	49.00
Pioneer Pekao TFI S.A.	*Warsaw*	*Asset management*	*49.00*	*49.00*
CPF Management	Tortola, British Virgin Islands	Financial brokerage – not operating	40.00	40.00
Polish Banking System S.A. (in liquidation)	Warsaw	Deleted from the registry	-	48.90
PPU Budpress Sp. z o.o. (in liquidation)	Żyrardów	Deleted from the registry	-	36.20

(*)The Group has no control over the entity due to provisions in the Company's Articles of Association.

As at 31 December 2016, the Group held no shares in entities under joint control.

Notes to financial statements (cont.)

(In PLN thousand)

Changes in Group structure

The deletion of Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) from the Registry
On 1 January 2016 Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) were deleted from the Registry.

The deletion of Pekao Leasing Holding S.A. (in liquidation) from the Registry
On 20 September 2016 Pekao Leasing Holding S.A. (in liquidation) was deleted from the Registry. In the course of the liquidation process of the Company, the transfer of ownership of 69 746 shares in Pekao Leasing Sp. z o.o. to Bank Pekao S.A. has been made. The Bank now holds 100% shares in the share capital and in the votes in the General Meeting of Pekao Leasing Sp. z o.o.

3. Business combination

In the year of 2016 there were no business combinations in the Group. In 2015 the Bank acquired 100% of the share capital of UniCredit CAIB Poland S.A. (presently Pekao Investment Banking S.A.). The transaction was detailed in the consolidated financial statements of Bank Pekao S.A. Group for the period ended on 31 December 2015.

4. Statement of compliance

The annual consolidated financial statements ('financial statements') of the Bank Pekao S.A. Group have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union, and in respect to matters that are not regulated by the above standards, in accordance with the requirements of the Accounting Act dated 29 September 1994 (Official Journal from 2016, item 1047 with further amendments) and respective operating regulations, and in accordance with the requirements for issuers of securities admitted or sought to be admitted to trading on an official stock exchange listing market.

These Consolidated Financial Statements were approved for publication by the Bank's Management Board on 9 February 2017.

5. Significant accounting policies

5.1 Basis of preparation of Consolidated Financial Statements

General information
These Consolidated Financial Statements of the Group, which have been prepared for the period from 1 January to 31 December 2016, contain the financial results of the Bank and of its subsidiaries, comprising the 'Group', as well as the results of associated entities, measured using the equity method.

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

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

Notes to financial statements (cont.)

(In PLN thousand)

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

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

The consolidated financial statements include the requirements of all the International Financial Reporting Standards and International Accounting Standards approved by the European Union and related interpretations. Changes in published standards and interpretations, which became effective on or after 1 January 2016, had no material impact on the Group's financial statements (Note 5.10).

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

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

IFRS 9 'Financial Instruments'
In November 2016 the European Commission has adopted International Financial Reporting Standard no. 9 'Financial Instruments' that will replace IAS 39 'Financial Instruments: Recognition and Measurement'.

IFRS 9 will be mandatorily effective for annual periods beginning on or after 1 January 2018.

The new standard will introduce a revised model for classification and measurement of financial asserts, an impairment model for credit allowances based on 'expected loss' and a reformed approach to hedge accounting.

Classification and measurement
According to IFRS 9, classification of financial assets at initial recognition will be based upon:
- the entity's business model for managing the financial assets,
- the contractual cash flow characteristics of the financial asset (i.e. whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding, hereinafter 'SPPI').

Depending on the entity's business model, financial assets may be classified as:
- 'held to collect' contractual cash flows (measured at amortized cost, if SPPI criteria are met, and subject to the expected loss impairment),
- 'held to collect or sale' (measured at fair value through other comprehensive income, if SPPI criteria are met, and subject to the expected loss impairment), or
- 'held for trading' or other (measured at fair value through profit or loss).

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

IFRS 9 allows an entity at initial recognition to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading. Dividends from such an investment shall be recognized in profit or loss.

Notes to financial statements (cont.)

(In PLN thousand)

The Bank has performed an analysis of business models used for managing the particular categories of financial assets as well as characteristics of the cash flows and concluded that:

- loans and advances to banks, loans and advances to customers and debt securities which, in accordance with IAS 39 are classified as loans and receivables and are held to collect contractual cash flows will be mostly measured at amortized cost under IFRS 9,
- debt securities, which according to IAS 39 are classified as held to maturity, are held to collect contractual cash flows and will be measured at amortized cost under IFRS 9,
- the majority of the debt securities which in accordance with IAS 39 are classified as available for sale, are held to collect contractual cash flows or for sale and will be still measured at fair value through other comprehensive income in accordance with IFRS 9,
- financial assets and liabilities held for trading, including assets and liabilities arising from derivative financial instruments, will continue to be measured at fair value through profit or loss,
- investments in equity instruments classified as available for sale according to IAS 39, will be measured at fair value through profit or loss in accordance with IFRS 9. The Bank has not yet made a final decision regarding the possibility of making an irrevocable election regarding recognition of changes in fair value of the equity instrument in other comprehensive income.

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

Impairment of financial assets

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with a forward-looking ‘expected credit loss’ (ECL) model. Because of the aforementioned change the Bank will be obliged to calculate loss allowances based on the expected credit loss, taking into consideration forecasts of future economic conditions with regard to the measurement of the credit risk of an exposure, which is unacceptable under IAS 39.

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

Replacing the concept of ‘incurred loss’ with the concept of ‘expected credit loss’ will influence significantly the way of modelling credit risk parameters and the final amount of loss allowances. The currently applied loss identification period will not be used anymore, therefore the IBNR (incurred but not reported) category of loss allowance will be eliminated. In accordance with IFRS 9, the loss allowances will be calculated in the following categories (instead of the IBNR loss allowances and the loss allowances for non-performing exposures):

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

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

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

Notes to financial statements (cont.)

(In PLN thousand)

The Bank assumes that the implementation of the new impairment model based on the concept of ECL will have an impact on the level of the Bank's loss allowances, particularly with regard to exposures allocated to Stage 2. Contrary to IAS 39, IFRS 9 does not require the entities to identify the impairment triggers in order to estimate lifetime credit losses in Stage 2. Instead, the Bank is obliged to constantly estimate the level of credit losses since the initial recognition of a given asset until its derecognition. In the event of significant increase in credit risk since the initial recognition of the asset, the Bank will be obliged to calculate lifetime expected credit losses – Stage 2. Such an approach will result in the earlier recognition of credit losses which will cause an increase in loss allowances and therefore it will also affect profit or loss.

Within the scope of the IFRS 9 implementation project, the Bank is working on implementing a new methodology of loss allowances calculation as well as on implementing appropriate modifications in IT systems and processes used by the Bank, in particular on the foundations of the impairment model, acquiring appropriate data as well as designing the processes and tools and performing a detailed estimation of the impact of IFRS 9 on the level of loss allowances. Methodological tasks are focused on both development of currently applied solutions as well as implementation of the brand new solutions. In terms of the development of existing solutions, the Bank is currently adjusting PD, RR, EAD and CCF models so that they may be used to estimate expected credit losses.

The development of credit risk models is focused on estimating the life time credit risk parameters adjusted to take into account forward looking information in respect of Bank's expectations regarding future macroeconomic outlook. Modelling of the future exposure on the date of default will leverage on available payment schedules as well as information regarding prepayments. For the exposures without defined payment schedules the Bank is developing methodology aimed at modelling limit utilization at the date of default. In respect of transfer between Stage 1 and Stage 2 the Bank develops statistical transfer logic models utilizing probability of default parameter and other characteristics of the exposure such as product type, rating class or time to maturity, supplemented by additional qualitative transfer triggers.

In terms of new solutions, the works mainly include the development of criteria for the transfer between the stages, as well as taking into account the economic forecasts in the estimation of expected credit losses.

In the Bank's opinion, the implementation of the new Standard requires the application of more complex credit risk models of greater predictive abilities which require a significantly broader set of source data than the currently applied models.

Hedge accounting

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

Therefore, in the case of hedge accounting, the entry into force of IFRS 9 will have no impact on the financial position of the Bank.

Disclosures and comparatives

The Bank expects that new requirements of IFRS 9 will significantly change the presentation and extent of the disclosures on financial instruments, particularly in the year of the adoption of the new standard.

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

Implementation schedule

The Bank has launched a dedicated project of IFRS 9 implementation in 2015. The project is organized into two main streams: (1) C&M (classification and measurement including hedge accounting) and (2) LLP (impairment) which are managed by the key management persons of Finance and Risk Division respectively. Additionally the Bank has appointed the Steering Committee responsible for supervision over the project. The key members of Steering Committee are CFO, CRO and COO. Main objectives of Steering Committee are setting and monitoring key milestones and budget and taking major decisions concerning methodology and the operating model. The project involves also employees of Finance Division, Risk Division, as well as the main Business functions, Organization and Information Technology departments.

Currently, the Bank is in the process of designing and building the necessary solutions for particular requirements based on the results of the analysis gaps and defined methodological assumptions. The Bank plans to gradually finish the design work till the end of third quarter of 2017.

In parallel with the work on the methodology, the Bank develops architecture of IT systems in order to allow both the implementation of the new standard in the framework of impairment calculations and determining the risk parameters used.

Potential impact of IFRS 9 on the financial situation and the own funds

Quantitative assessment of the impact of changes on the financial statements upon adoption of the standard is not yet available primarily due to ongoing methodological works regarding adjustments of credit risk models to IFRS 9 requirements which are still in progress as well as from the lack of uniform market practice. From the legislative standpoint, the supervisory and regulatory authorities are working on updating prudential requirements which will be binding for the Bank. However, it needs to be noted that these works are not advanced enough to enable Bank to unambiguously determine the impact of the IFRS 9 on the financial position and capital adequacy indicators.

In the Bank's opinion, disclosing quantitative data that would not reflect the potential impact of all aspects of IFRS 9 on the Bank's financial situation and own funds could have a negative impact on the informative value of the financial statements for its users. Therefore, the Bank has chosen to disclose solely qualitative information on the Bank's approach to the IFRS 9 implementation, which in the Bank's opinion will enable the users of the financial statements to understand the impact of IFRS 9 on the financial situation and capital management of the Bank.

In the Bank's view the implementation of the new standard, and especially the introduction of the new impairment model based on the ECL concept, will increase the value of impairment allowances, especially in terms of exposures to Stage 2. The Bank does not anticipate a significant impact on the level or volatility of P&L/OCI, as expected changes in classification and measurement methods will be limited to a minor part of financial assets. The final result will depend on the structure of assets at the date of initial application of IFRS 9. Any changes in the carrying value of financial instruments due to the adoption of IFRS 9 will be recognized in the Bank's equity as of 1 January 2018.

The most significant impact on the Bank's own funds will have the above-mentioned increase in the value of allowances for credit losses and the change in the classification and valuation of equity securities which in accordance with IAS 39 are classified to available-for-sale portfolio and measured at fair value recognized through other comprehensive income (provided that the Bank does not exercise the OCI option in accordance with IFRS 9).

Moreover, in connection to the changes resulting from implementation of IFRS 9 in the accounting regulations and lack at present of the information on the direction of the changes in the tax regulations, according to Bank's judgment there is a significant uncertainty concerning the future shape of the tax regulations, which will have to be amended to reflect the new standard and which can have an impact on the value of the deferred tax asset of the Bank created on the cost of allowances for credit losses.

5.2 Consolidation

Consolidation principles

The consolidated financial statements of Bank Pekao S.A. Group include the financial data of Bank Pekao S.A. and its subsidiaries as at 31 December 2016. The financial statements of the subsidiaries are prepared at the same reporting date as those of the parent entity, using consistent accounting policies within the Group in all important aspects.

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

Investments in subsidiaries

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5.3 Accounting estimates

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

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

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

31.12.2015	NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS AND OFF-BALANCE SHEET COMMITMENTS	
	10% INCREASE	10% DECREASE
Recovery rates (RR)	110 990	(112 736)
Probability of default (PD)	(43 102)	43 219

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

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

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

Provisions for defined benefit plans
The principal actuarial assumptions applied to estimation of provisions for defined benefit plans, as well as the sensitivity analysis were presented in Note 45.

(In PLN thousand)

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

5.4 Foreign currencies

- Functional and presentation currency
  The financial statements of individual Group entities, including the Bank's Branch in Paris, are presented in their functional currencies, i.e. in the currency of the primary economic environment in which the entity operates. The Consolidated Financial Statements are presented in Polish zloty. Polish zloty is the functional currency and the presentation currency of the Bank. The Group applies as the closing rate the average the National Bank of Poland ('NBP') exchange rate, valid as at the balance sheet date.
- Transactions and balances
  Foreign currency transactions are calculated into the functional currency using the spot exchange rate from the date of the transaction. Gains and losses from foreign currency translation differences resulting from settlements of such transactions and from the statement of financial position valuation of monetary assets and liabilities expressed in foreign currencies are recognized in the income statement.
- Foreign currency translation differences arising from non-monetary items, such as equity instruments classified as financial assets measured at fair value through the profit or loss are recognized together with the changes in the fair value of that item in the income statement.
  Foreign currency translation differences arising from non-monetary items such as equity instruments classified as available for sale financial assets are recognized in the revaluation reserves.
- Companies of the Group
  The consolidation of assets and liabilities of foreign business entities are translated into Polish currency i.e. to the presentation currency as per the closing exchange rate for the balance sheet date. Revenues and expenses are translated at the average exchange rates calculated on the basis of the exchange rates of the reporting period except for situations where exchange rates fluctuate significantly such that the average exchange rate is not an acceptable approximation of the exchange rate from the transaction date. In such situations revenue and expenses are translated on the basis of the exchange rate from the date of the transaction.

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

(In PLN thousand)

5.5 Income statement

Interest income and expense

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

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

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

At the recognition of impairment of financial instruments measured at amortized cost and of available for sale financial assets, the interest income is accrued based on the carrying amount of the receivable (this is the new, lower value reduced by the impairment charge) using the interest rate used when discounting the future cash flows for impairment calculation.

Interest expense of the reporting period related to interest liabilities associated with client accounts and liabilities from the issue of treasury stock are recognized in the income statement using the effective interest rate.

Fee and commission income and expense

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

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

Income and expense from bancassurance

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

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

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

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

In 2016 the Bank recognized upfront 11% of bancassurance revenue associated with cash loans and 16% of bancassurance revenue associated with mortgage loans. The remaining portion of bancassurance revenue is amortized over the life of the associated loans as part of effective interest rate.

Result on financial assets and liabilities held for trading
Result on financial assets and liabilities held for trading include:

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

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

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

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

5.6 Valuation of financial assets and liabilities, derivative financial instruments

Financial assets
Financial assets are classified into the following categories:

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

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

Derivative instruments are recognized or derecognized on transaction dates.

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

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

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

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

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

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

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

- disappearance of active market for given credit exposure resulted from financial difficulties of debtor. This impairment trigger could refer to financial instruments listed on stock exchanges, when due to significant deterioration in financial standing of issuer (eventually bankruptcy), the liquidity of assets trading is so low that reliable price fixing is not possible,
- receivership has been established or debtor has stopped/suspended its activity,
- unknown place of stay and not disclosed assets of the borrower.

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

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

The Group classifies the exposure as past due in case the borrower has failed to make payment on the principal and/or interest in the contractual maturity date. The Group presents the whole amount of exposure as past due, regardless of whether the delay of payment affects the whole exposure, or only part of it (installment). The number of days past due for receivables paid by installments is assumed as the period from the date of maturity of the earliest installment, when the repayment is delayed.

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

Financial assets available for sale

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

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

Off-balance sheet commitments

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

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

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

Repo and reverse-repo agreements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Cash flow hedge accounting principles

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

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

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

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

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

Financial liabilities

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

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

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

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

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

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

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

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

Intangible assets

Goodwill

Goodwill is defined as a surplus of the purchasing price over the fair value of the assets, liabilities and contingent liabilities of the acquired subsidiary, associate or a unit under joint control. Goodwill at initial recognition is carried at purchase price reduced by any accumulated impairment losses. Impairment is determined by estimating the recoverable value of the cash generating unit, to which given goodwill pertains. If the recoverable value of the cash generating unit is lower than the carrying amount an impairment charge is made. Impairment identified in the course of such tests is not subject to subsequent adjustments.

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

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

These assets include:
- computer software licenses,
- copyrights,
- costs of completed development works.

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

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

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

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

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

a) depreciation rates applied for non-current assets

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

b) amortization rates for intangible assets

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

c) depreciation rates for investment properties

Buildings and structures	1.5% – 10.0%

Land, non-current assets under construction and intangible assets under development are not subject to depreciation and amortization.

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Leases

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

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

Operating leases

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

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

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

Finance leases

The Group as lessor

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

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

The Group as lessee

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

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

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

Provisions

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

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

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

Deferred income and accrued expenses (liabilities)

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

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

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

Government grants

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

Equity of the Group

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

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

The Group equity consists of the following:

a) share capital - applies only to the capital of the Bank as the parent entity and is presented at nominal value specified in the Articles of Association and in the entry in the Enterprises Registry,
b) 'issue premium' - surplus generated during share issues over the nominal value of such issues, remaining after the issue costs are covered. Moreover, this item also includes a change in the value of minority shares, ensuing from an increase of the share of the Parent entity in Bank's share capital. This accounting principle is in accordance with the accounting principles applied by UniCredit Group,
c) the general banking risk fund is established at Bank Pekao S.A. in keeping with the Banking Act dated 29 August 1997 from profit after tax,
d) other reserve capital utilized for the purposes defined in the Statute is created from appropriations of profits,
e) revaluation reserve includes the impact of valuation of financial instruments available for sale, effects of valuation of derivative instruments hedging cash flows, remeasurements of the defined benefit liabilities and the value of deferred tax for items classified as temporary differences, recognized as valuation allowance. In the statement of financial position, the valuation allowance is presented as net value,
f) exchange rate differences include differences arising from valuation of net assets in foreign entities and from the recalculation of the result of a foreign branch at the weighted average exchange rate at the balance sheet date in relation to the average NBP exchange rate,
g) other capital:
    - other supplementary capital, established in keeping with provisions under the Articles of Association of companies from profit appropriations,
    - capital components:
        - bonds convertible to shares - includes the fair value of financial instruments issued as part of transactions settled in equity instruments,
        - provision for purchase of parent entity stocks,
    - brokerage activity fund for stock broking operations, carried out by Bank Pekao S.A.,

- retained earnings from prior periods includes undistributed profit and uncovered losses generated/incurred in prior periods by subsidiaries consolidated full method,
- net profit/loss which constitutes profit/loss presented in the income statement for the relevant period. Net profit is after accounting for income tax.

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

Share-based payments
Employee participation programs are established by the Group under which key management staff is granted pre-emptive rights to buy shares of the Bank, including phantom shares, and shares of UniCredit S.p.A. (Note 46).

Bank's Pekao S.A. phantom shares-settled share-based payment transaction
The cost of transactions settled with employees in phantom shares is measured by reference to the fair value of the liability as of the balance sheet date.
The fair value of the liability is estimated based upon the Bank's shares price on the (WSE) as of the balance sheet date and expected number of phantom shares to which full rights will be acquired.
The cost of phantom share-based payments is recognized in personnel expenses together with the accompanying increase in the value of liabilities towards employees presented in 'Provisions'.
The accumulated cost recognized for transactions settled in phantom shares for each balance sheet date until the vesting date reflects the extent of elapse of the vesting period and the number of rights to shares the rights to which – in the opinion of the Bank's Management Board for that date based on best available estimates of the number of phantom shares – will be eventually vested.

Stock options and stock of the UniCredit S.p.A.
The Group entities joined the UniCredit-wide long term incentive program. The aim of the program is to offer to selected key Group's employees share options and shares of UniCredit S.p.A.

The fair value of the instruments granted to the Group employees was established following the UCI Group-wide applied Hull and White model.

The expenses related to the rights granted are recognized in 'Personnel expenses' and respective increase is recognized as liabilities presented in 'Other liabilities'.

The Group is obliged to pay to UniCredit S.p.A. the fair value of the instruments vested at the time the instruments are exercised.

5.8 Income tax

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

5.9 Other

Contingent liabilities and commitments

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

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

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

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

Cash and cash equivalents

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

5.10 New standards, interpretations and amendments to published standards that have been approved and published by the European Union and are effective on or after 1 January 2016

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
Amendments to IFRS 10 'Consolidated Financial Statements', **IFRS 12** 'Disclosure of interests in other entities' and **IAS 28** 'Investments in Associates and Joint Ventures'	The amendments clarify the application of the consolidation exception for investment entities and their subsidiaries. Date of application: the first financial year beginning on or after 1 January 2016.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IFRS 11 (amendment) 'Joint Arrangements'	The amendments add new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business. The amendments specify the appropriate accounting treatment for such acquisitions. Date of application: the first financial year beginning after 1 January 2016.	The Group claims that the standard's amendment will not have a material impact on its financial statements in the period of its first application.
IAS 1 (amendment) 'Presentation of the financial statements'	The amendments clarify that among others an entity should not reduce understandability by aggregating or disaggregating information in a manner that obscures useful information. Date of application: the first financial year beginning after 1 January 2016.	The Group claims that the standard's amendment will not have a material impact on its financial statements in the period of its first application.
IAS 16 (amendment) 'Property, Plant and Equipment' and **IAS 38 (amendment)** 'Intangible Assets'	The IASB has clarified that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The IASB also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain limited circumstances. Date of application: the first financial year beginning after 1 January 2016.	The Group claims that the standards amendments will not have a material impact on its financial statements in the period of its first application.

Notes to the financial statements (cont.)

(In PLN thousand)

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IAS 16 (amendment) 'Property, Plant and Equipment' and **IAS 41 (amendment)** 'Agriculture'	IAS 41 'Agriculture' currently requires all biological assets related to agricultural activity to be measured at fair value less costs to sell. This is based on the principle that the biological transformation that these assets undergo during their lifespan is best reflected by fair value measurement. However, there is a subset of biological assets, known as bearer plants, which are used solely to grow produce over several periods. At the end of their productive lives they are usually scrapped. Once a bearer plant is mature, apart from bearing produce, its biological transformation is no longer significant in generating future economic benefits. The IASB decided that bearer plants should be accounted for in the same way as property, plant and equipment in IAS 16 'Property, Plant and Equipment', because their operation is similar to that of manufacturing. Date of application: the first financial year beginning after 1 January 2016.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 19 (amendment) 'Employee benefits'	The amendment applies to contributions from employees or third parties to defined benefit plans. The aim of the amendments is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of remuneration. Date of application: the first financial year beginning on or after 1 February 2015.	The Group claims that the standard's amendment did not have a material impact on its financial statements in the period of its first application.
IAS 27 (amendment) 'Separate Financial Statements'	The amendments to IAS 27 will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Date of application: the first financial year beginning after 1 January 2016.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
Improvements to IFRS 2010-2012	The annual improvements to IFRS 2010-2012 principally aim to solve inconsistencies and specify vocabulary. Date of application: the first financial year beginning on or after 1 February 2015.	The Group claims that the improvements did not have a material impact on its financial statements in the period of its first application.
Improvements to IFRS 2012-2014	The annual improvements to IFRS 2012-2014 principally aim to solve inconsistencies and specify vocabulary. Date of application: the first financial year beginning after 1 January 2016.	The Group claims that the improvements will not have a material impact on its financial statements in the period of its first application.

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

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 9 'Financial Instruments'	New regulations constitute a part of changes designed to replace IAS 39 'Financial Instruments: Recognition and Measurement'. The main changes, introduced by the new standard, are as follows: • new categorisation of financial assets, • new criteria of assets classification to the group of financial assets measured at amortized cost, • new impairment model – expected credit losses model, • new principles for recognition of changes in fair value measurement of capital investment in financial instruments, • elimination of the necessity to separate embedded derivatives from financial assets. The major part of IAS 39 requirements relating to financial liabilities classification and valuation were transferred to IFRS 9 unchanged. Date of application: the first financial year beginning after 1 January 2018.	The impact assessment of the new standard implementation on Group's financial statements is described in note 5.1 Basis of preparation of Consolidated Financial Statements.
IFRS 15 'Revenue from Contracts with Customers'	The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally. The core principle of the new Standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. In accordance with new IFRS 15, the revenue is recognized when the control over the goods or services is transferred to the customer. Date of application: the first financial year beginning after 1 January 2018.	The Group is currently assessing the impact of the IFRS 15 application on its financial statements.

Notes to the financial statements (cont.)

(In PLN thousand)

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

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 14 'Regulatory deferral accounts'	The aim of this standard is to enhance the comparability of financial reporting by entities that are engaged in rate-regulated activities. Date of application: the first financial year beginning after 1 January 2016. the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard.	The Group claims that the new standard will not have a material impact on its financial statements in the period of its first application.
IFRS 16 'Leases'	Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis. Date of application: annual periods beginning on or after 1 January 2019.	The Group is currently assessing the impact of the IFRS 15 application on its financial statements.
IFRS 10 (amendment) 'Consolidated Financial Statements' and **IAS 28 (amendment)** 'Investments in Associates and Joint Ventures'	The amendments concern the sale or contribution of assets between the investor and the associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. Date of application: the first financial year beginning after 1 January 2016.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 7 (amendment) 'Statement of Cash Flows' - Disclosure Initiative	The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. Date of application: annual periods beginning on or after 1 January 2017.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 12 (amendment) 'Income Taxes'	The amendments to IAS 12 clarify how to account for deferred tax assets related to debt instruments measured at fair value. Date of application: annual periods beginning on or after 1 January 2017.	The Group is currently analyzing the impact of those changes on the financial statements.
IFRS 2 (amendment) 'Share-based Payment'	The amendments provide requirements on the accounting for (a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, (b) share-based payment transactions with a net settlement feature for withholding tax obligations, and (c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. Date of application: annual periods beginning on or after 1 January 2018.	The Group is currently analyzing the impact of those changes on the financial statements.
IFRS 4 (amendment) 'Insurance Contracts'	The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing the replacement standard that the Board is developing for IFRS 4. Date of application: effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 'Financial Instruments' is applied first time.	The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.

Notes to the financial statements (cont.)

(In PLN thousand)

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IAS 40 (amendment) 'Investment Property'	Amendments to IAS 40 'Investment Property' - Transfers of Investment Property state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. Amendments also state that the list of evidence in paragraph 57 was designated as non-exhaustive list of examples instead of the previous exhaustive list. Date of application: annual periods beginning on or after 1 January 2018.	The Group is currently analyzing the impact of those changes on the financial statements.
Improvements to IFRS 2014-2016	Amendments result from the annual improvement project of IFRS. Amendments relate to IFRS 1, IFRS 12 and IAS 28 and were introduced primarily with a view to removing inconsistencies and clarifying wording. Date of application: amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017 and amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018.	The Group is currently analyzing the impact of those changes on the financial statements.
IFRIC 22 'Foreign Currency Transactions and Advance Consideration'	Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. Date of application: annual periods beginning on or after 1 January 2018.	The Group is currently analyzing the impact of those changes on the financial statements.

6. Risk management

The risk management policy of the Group has a goal of optimizing the structure of the statement of financial position and off-balance sheet positions under the consideration of all risks in relation to income and other risk that the Group encounters in conducting its daily activity. Risks are monitored and controlled with reference to profitability and equity coverage and are regularly reported in accordance with rules briefly presented below.

All important risk types, occurring in the course of the Group's operations are described as follows.

6.1 Organizational structure of risk management

Supervisory Board
The Supervisory Board provides supervision over the risk management control system, assessing the adequacy and effectiveness. Moreover, the Supervisory Board also provides supervision of the compliance with Group policy with respect to risk management as it relates to the Group's strategy and financial planning.

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

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

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

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

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

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

6.2 Credit risk

Credit risk is one of the basic risks associated with activities of the Group. The percentage share of credits and loans in the Group's statement of financial position makes the maintenance of this risk at safe level essential to the Group's performance. The process of credit risk management is centralized and managed mainly by Risk Management Division units, situated at the Bank Head Office or in local units. The integration of various risks in the Risk Management Division, where apart from credit risk, market and operational risk are dealt with, facilitates effective management of all credit-related risks. This process covers all credit functions – credit analysis, making credit decisions, monitoring and loan administration, as well as restructuring and collection. These functions are conducted in compliance with the Bank's credit policy, adopted by the Bank's Management Board and the Bank's Supervisory Board for a given year and its related guidelines. The effectiveness and efficiency of credit functions are achieved using diverse credit methods and methodologies, supported by advanced IT tools, integrated into the Bank's general IT system. The Bank's procedures facilitate credit risk mitigation. In particular those related to transaction risk evaluation, establishing collateral, setting authorization limits for granting loans and limiting of exposure to some areas of business activity in line with current client's segmentation scheme in the Bank.

The Bank's lending activity is limited by the restrictions of the Banking Act as well as internal limits in order to increase safety. These restrictions refer in particular to concentration limits for specific sectors of the economy, share of large exposures in the loan portfolio of the Bank and exposure limits for particular foreign countries, foreign banks and domestic financial institutions. Credit granting limits, concentration limits for specific business activities as well as internal and external prudential standards include not only credits, loans and guarantees, but also derivatives transactions and debt securities.

The Bank established the following portfolio limits:

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

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

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

Rating models utilized in the credit risk management process

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

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

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

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

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

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

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

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

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

1) For the private individuals, the Bank uses two separate models applicable for:
   - mortgage loans,
   - consumer loans.
2) For the corporate clients, the Bank uses rating models dividing clients for:
   - clients with income not exceeding EUR 500 million,
   - corporate clients assessed by central model with income exceeding EUR 500 million,
   - specialized lending.

Notes to the financial statements (cont.)

(In PLN thousand)

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

1) retail exposures immaterial in terms of size and perceived risk profile:
   - Eurokonto limits,
   - overdrafts,
   - forced debits,
   - exposures related to credit cards,
   - exposures related to the Building Society (Kasa Mieszkaniowa) unit,
   - other loans.
2) corporate clients immaterial in terms of size and perceived risk profile:
   - exposures to stock exchanges and other financial intermediators,
   - exposures to insurance companies,
   - project financing,
   - purchased receivables,
   - exposures to investment funds,
   - exposures to leasing companies and financial holding companies,
   - other loans.
3) exposures to regional governments and local authorities which are not treated as exposures to central governments, for which the number of significant counterparties is limited.

Rating scale

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

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

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

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

RATING CLASS	RANGE OF PD	31.12.2016		31.12.2015	
		CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.06%	11 544 215	26.2%	10 532 502	25.9%
2	0.06% <= PD < 0.19%	6 794 533	15.4%	5 936 116	14.6%
3	0.19% <= PD < 0.35%	17 482 613	39.7%	16 303 771	40.1%
4	0.35% <= PD < 0.73%	5 463 689	12.4%	5 213 593	12.8%
5	0.73% <= PD < 3.50%	1 435 604	3.3%	1 393 240	3.4%
6	3.50% <= PD < 14.00%	638 891	1.5%	651 234	1.6%
7	14.00% <= PD < 100.00%	671 745	1.5%	652 160	1.6%
Total		**44 031 290**	**100.0%**	**40 682 616**	**100.0%**

Notes to financial statements (cont.)

(In PLN thousand)

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

RATING CLASS	RANGE OF PD	31.12.2016		31.12.2015	
		CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.34%	687 697	7.9%	573 469	7.4%
2	0.34% <= PD < 0.80%	948 701	10.8%	805 937	10.3%
3	0.80% <= PD < 1.34%	1 506 160	17.2%	1 390 763	17.8%
4	1.34% <= PD < 2.40%	2 669 352	30.5%	2 393 959	30.6%
5	2.40% <= PD < 4.75%	1 815 307	20.7%	1 594 636	20.4%
6	4.75% <= PD < 14.50%	756 550	8.7%	673 978	8.6%
7	14.50% <= PD < 31.00%	186 915	2.1%	187 224	2.4%
8	31.00% <= PD < 100.00%	186 336	2.1%	194 052	2.5%
Total		**8 757 018**	**100.0%**	**7 814 018**	**100.0%**

The distribution of rated portfolio for corporate client segment (excluding impaired loans) – clients with income not exceeding EUR 500 million

RATING CLASS	RANGE OF PD	31.12.2016		31.12.2015	
		CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.15%	515 756	3.5%	357 910	2.4%
2	0.15% <= PD < 0.27%	2 188 032	14.8%	1 887 596	12.5%
3	0.27% <= PD < 0.45%	1 984 785	13.5%	2 348 388	15.6%
4	0.45% <= PD < 0.75%	2 105 131	14.3%	2 304 203	15.3%
5	0.75% <= PD < 1.27%	2 131 155	14.5%	3 136 094	20.8%
6	1.27% <= PD < 2.25%	2 269 874	15.4%	1 935 237	12.8%
7	2.25% <= PD < 4.00%	1 266 801	8.6%	1 043 523	6.9%
8	4.00% <= PD < 8.50%	1 948 049	13.2%	1 898 162	12.6%
9	8.50% <= PD < 100.00%	319 268	2.2%	165 709	1.1%
Total		**14 728 851**	**100.0%**	**15 076 822**	**100.0%**

Notes to financial statements (cont.)

(In PLN thousand)

The distribution of rated portfolio for corporate client segment (excluding impaired loans) – clients assessed by central model with income exceeding EUR 500 million

RATING CLASS	RANGE OF PD	31.12.2016		31.12.2015	
		CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
1	0.0000% <= PD < 0.0011%	-	0.0%	-	0.0%
2	0.0011% <= PD < 0.0031%	-	0.0%	-	0.0%
3	0.0031% <= PD < 0.0069%	-	0.0%	-	0.0%
4	0.0069% <= PD < 0.0124%	-	0.0%	-	0.0%
5	0.0124% <= PD < 0.0223%	1	0.0%	-	0.0%
6	0.0223% <= PD < 0.0395%	-	0.0%	-	0.0%
7	0.0395% <= PD < 0.0691%	5	0.0%	1 243 315	24.2%
8	0.0691% <= PD < 0.1208%	430 448	8.0%	645 108	12.6%
9	0.1208% <= PD < 0.2091%	1 029 404	19.1%	629 490	12.3%
10	0.2091% <= PD < 0.3581%	255 864	4.8%	375 435	7.3%
11	0.3581% <= PD < 0.6132%	2 486 615	46.2%	81 377	1.6%
12	0.6132% <= PD < 1.0807%	-	0.0%	93 303	1.8%
13	1.0807% <= PD < 1.9599%	847 569	15.7%	-	0.0%
14	1.9599% <= PD < 3.5545%	331 740	6.2%	2 063 695	40.2
15	3.5545% <= PD < 7.6705%	11	0.0%	-	0.0%
16	7.6705% <= PD < 19.6959%	-	0.0%	16	0.0%
17	19.6959% <= PD < 100.0000%	-	0.0%	-	0.0%
Total		**5 381 657**	**100.0%**	**5 131 739**	**100.0%**

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

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

SUPERVISORY CATHEGORY	31.12.2016		31.12.2015	
	CARRYING AMOUNT	%PORTFOLIO	CARRYING AMOUNT	%PORTFOLIO
High	3 470 755	42.6%	1 647 122	25.0%
Good	3 623 153	44.5%	4 185 156	63.4%
Satisfactory	1 010 603	12.4%	720 513	10.9%
Low	44 728	0.5%	43 078	0.7%
Total	**8 149 239**	**100.0%**	**6 595 869**	**100.0%**

(In PLN thousand)

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

	31.12.2016	31.12.2015
Loans with no impairment:	**120 112 554**	**119 349 516**
Loans to individuals:	**55 863 932**	**51 611 229**
Covered by internal rating model:	52 788 308	48 496 634
Mortgage loans	44 031 290	40 682 616
Consumer loans	8 757 018	7 814 018
Other, not covered by internal rating model	3 075 624	3 114 595
Loans to corporates:	**64 248 622**	**67 738 287**
Covered by internal rating model:	20 110 508	20 208 561
Clients with income not exceeding EUR 500 million	14 728 851	15 076 822
Clients assessed by central model with income exceeding EUR 500 million	5 381 657	5 131 739
Specialized lending exposures	8 149 239	6 595 869
Debt securities, not covered by internal rating model	12 352 160	12 330 221
Repo transactions, not covered by internal rating model	-	4 755 472
Other, not covered by internal rating model	23 636 715	23 848 164
Impaired loans	**2 550 658**	**2 705 410**
Total loans and advances to customers (*)	**122 663 212**	**122 054 926**

(*) Loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

Client/transaction rating and credit risk decision-making level
Decision-making level connected with transaction approval is directly dependent upon the client's rating.

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

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

Validation of rating models
The internal validation of models and risk parameter assessments is focused on the quality assessment of risk models and the accuracy and stability of parameter assessments, applied by the Bank. The validation covers risk models and parameters assessed locally, whereas the validation of central models is carried out within UniCredit Group. Validation is carried out at the level of each risk model, although the Bank may apply several models for each class of exposures.

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

Notes to the financial statements (cont.)

(In PLN thousand)

Group's exposure to credit risk

The maximum credit risk exposure

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

	31.12.2016	31.12.2015
Due from Central Bank	3 233 379	4 930 181
Loans and advances from banks and from customers (*)	121 947 096	125 869 993
Receivables from finance leases	3 974 643	3 503 979
Financial assets held for trading	732 469	1 126 792
Derivative financial instruments (held for trading)	1 913 429	3 206 447
Hedging instruments	289 752	421 640
Investment securities	35 120 619	21 181 723
Other assets (**)	1 020 482	2 300 995
Balance sheet exposure (***)	**168 231 869**	**162 541 750**
Obligations to grant loans	32 126 475	30 825 051
Other contingent liabilities	11 473 757	15 130 027
Off-balance sheet exposure	**43 600 232**	**45 955 078**
Total	**211 832 101**	**208 496 828**

(*) Loans and advances to customers include bills of exchange eligible for rediscounting at Central Bank.
(**) Includes the following items of the statement of financial position: 'Investments in associates' and part of 'Other assets' (Accrued income, Interbank and interbranch settlements, Other debtors and Card settlements).
(***) Balance sheet exposure is equal to the carrying amount presented in the statement of financial position.

Credit risk mitigation methods

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

The financial effect of pledged collaterals for exposure portfolio with recognized impairment defined individually amounts to PLN 1 496 661 thousand as at the 31 December 2016 (1 465 933 thousand as of the 31 December 2015). The level of required impairment allowances for the portfolio would increase by this amount, if the discounted cash flows from collateral were not taken into account during estimation.

Offsetting financial assets and financial liabilities

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

The netting agreements concluded by the Group are:

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

The Group receives and gives collateral in the form of cash and marketable securities in respect of the following transactions:
- derivatives,
- repo and reverse-repo transactions.

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

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

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

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

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

31.12.2015	CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL RECEIVED	
FINANCIAL ASSETS				
Derivatives	3 628 087	(3 012 327)	(295 762)	319 998
TOTAL	**3 628 087**	**(3 012 327)**	**(295 762)**	**319 998**

Notes to the financial statements (cont.)

(In PLN thousand)

31.12.2015	CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL PLEDGED	
FINANCIAL LIABILITIES				
Derivatives	4 907 087	(3 012 327)	(1 339 417)	555 343
Repo transactions	963 829	(962 346)	-	1 483
TOTAL	**5 870 916**	**(3 974 673)**	**(1 339 417)**	**556 826**

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

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

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

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

31.12.2015	NET CARRYING AMOUNT	ITEM IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES	NOTE
FINANCIAL ASSETS					
Derivatives	3 134 367	Derivative financial instruments (held for trading)	3 206 447	72 080	27
	421 640	Hedging instruments	421 640	-	30
FINANCIAL LIABILITIES					
Derivatives	3 106 943	Derivative financial instruments (held for trading)	3 204 328	97 385	27
	1 702 759	Hedging instruments	1 702 759	-	30
Repo transactions	963 829	Amounts due to other banks	5 958 449	4 994 620	40

Notes to the financial statements (cont.)

(In PLN thousand)

Overall characteristics of monitoring process

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

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

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

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

Overall characteristics of provisioning model

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

The quality analysis of the Group's financial assets

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

	LOANS AND ADVANCES TO BANKS (*)		LOANS AND ADVANCES TO CUSTOMERS (*)	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
GROSS CARRYING AMOUNT OF EXPOSURE INDIVIDUALLY IMPAIRED				
- not past due	-	-	642 927	564 430
- up to 1 month	-	-	106 904	37 283
- between 1 month and 3 months	-	-	31 323	22 868
- between 3 months and 1 year	-	-	228 925	158 487
- between 1 year and 5 years	8 192	9 927	2 565 907	3 079 109
- above 5 years	-	-	1 498 788	1 429 845
Total gross carrying amount	**8 192**	**9 927**	**5 074 774**	**5 292 022**
ALLOWANCE FOR IMPAIRMENT				
- not past due	-	-	(292 907)	(238 852)
- up to 1 month	-	-	(30 285)	(7 530)
- between 1 month and 3 months	-	-	(7 077)	(5 206)
- between 3 months and 1 year	-	-	(121 057)	(52 140)
- between 1 year and 5 years	(8 192)	(9 927)	(1 563 402)	(1 738 572)
- above 5 years	-	-	(1 170 559)	(1 198 995)
Total allowance for impairment	**(8 192)**	**(9 927)**	**(3 185 287)**	**(3 241 295)**
Net carrying amount of exposure individually impaired	**-**	**-**	**1 889 487**	**2 050 727**
GROSS CARRYING AMOUNT OF EXPOSURE COLLECTIVELY IMPAIRED				
- not past due	-	-	166 121	120 069
- up to 1 month	-	-	69 664	42 559
- between 1 month and 3 months	-	-	56 545	47 688
- between 3 months and 1 year	-	-	286 856	303 072
- between 1 year and 5 years	-	-	1 297 813	1 359 720
- above 5 years	9 800	9 800	914 748	956 361
Total gross carrying amount	**9 800**	**9 800**	**2 791 747**	**2 829 469**
ALLOWANCE FOR IMPAIRMENT				
- not past due	-	-	(54 371)	(46 047)
- up to 1 month	-	-	(21 678)	(10 980)
- between 1 month and 3 months	-	-	(20 975)	(17 089)
- between 3 months and 1 year	-	-	(152 797)	(156 199)
- between 1 year and 5 years	-	-	(1 038 042)	(1 047 727)
- above 5 years	(9 800)	(9 800)	(842 713)	(896 744)
Total allowance for impairment	**(9 800)**	**(9 800)**	**(2 130 576)**	**(2 174 786)**
Net carrying amount of exposure collectively impaired	**-**	**-**	**661 171**	**654 683**

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

	LOANS AND ADVANCES TO BANKS (*)		LOANS AND ADVANCES TO CUSTOMERS (*)			
			CORPORATE		RETAIL	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
GROSS CARRYING AMOUNT OF EXPOSURE WITH NO IMPAIRMENT						
- not past due	3 258 534	7 319 104	64 156 501	67 677 272	54 316 545	50 112 528
- up to 30 days	-	-	240 713	214 225	1 314 340	1 269 204
- between 30 days and 60 days	-	-	27 468	34 541	177 909	183 623
- above 60 days	-	-	88 700	89 848	184 075	194 520
Total gross carrying amount	**3 258 534**	**7 319 104**	**64 513 382**	**68 015 886**	**55 992 869**	**51 759 875**
IBNR PROVISION						
- not past due	(8)	(58)	(256 869)	(273 574)	(80 772)	(90 586)
- up to 30 days	-	-	(5 106)	(2 652)	(30 818)	(37 046)
- between 30 days and 60 days	-	-	(1 425)	(686)	(9 873)	(11 615)
- above 60 days	-	-	(1 360)	(687)	(7 474)	(9 399)
Total IBNR provision	**(8)**	**(58)**	**(264 760)**	**(277 599)**	**(128 937)**	**(148 646)**
Net carrying amount of exposure with no impairment	**3 258 526**	**7 319 046**	**64 248 622**	**67 738 287**	**55 863 932**	**51 611 229**

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

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

	LOANS AND ADVANCES TO BANKS (*)		LOANS AND ADVANCES TO CUSTOMERS (*)	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
IMPAIRED EXPOSURE				
Gross carrying amount	17 992	19 727	7 866 521	8 121 491
Allowance for impairment	(17 992)	(19 727)	(5 315 863)	(5 416 081)
Total net carrying amount	**-**	**-**	**2 550 658**	**2 705 410**
EXPOSURES WITH IMPAIRMENT TRIGGERS FOR WHICH NO IMPAIRMENT HAS BEEN IDENTIFIED				
Gross carrying amount, in this:	-	-	100 560	78 166
Exposure with collateral value included in expected discounted cash flow, in this	-	-	*100 560*	*78 166*
Past due exposures	-	-	*35 382*	*31 741*
IBNR provision	-	-	(2 610)	(1 362)
Total net carrying amount	**-**	**-**	**97 950**	**76 804**
EXPOSURES WITH NO IMPAIRMENT TRIGGERS				
Gross carrying amount	3 258 534	7 319 104	120 405 691	119 697 595
IBNR provision	(8)	(58)	(391 087)	(424 883)
Total net carrying amount	**3 258 526**	**7 319 046**	**120 014 604**	**119 272 712**

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

(*) Including NBP bills in an amount of PLN 5 978 629 thousand.
(**) Including NBP bills in an amount of PLN 20 606 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2015

RATING	DEBT SECURITIES				
	HELD FOR TRADING	AVAILABLE FOR SALE	HELD TO MATURITY	REPO TRANSACTIONS(***)	TOTAL
A+ to A-	1 003 007	15 954 349	2 497 324	6 520 122	25 974 802
BBB+ to BBB-	7 724	251 367	-	-	259 091
no rating	113 986	1 312 168 (*)	871 100 (**)	-	2 297 254
Total	**1 124 717**	**17 517 884**	**3 368 424**	**6 520 122**	**28 531 147**

(*) Including NBP bills in an amount of PLN 628 454 thousand.
(**) Including NBP bills in an amount of PLN 871 100 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2015

RATING	DERIVATIVES						
	TRADING DERIVATIVES			DERIVATIVE HEDGING INSTRUMENTS			TOTAL
	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	
AAA	90	-	-	-	-	-	90
AA+ to AA-	126 730	-	-	3 032	-	-	129 762
A+ to A-	1 044 437	272 974		64 698	-	749	1 382 858
BBB+ to BBB-	1 003 930	-	503	319 425	-	-	1 323 858
BB+ to BB-	-	-	1 454	-	-	-	1 454
no rating	464 159	52 220	239 950	29 798	3 938	-	790 065
Total	**2 639 346**	**325 194**	**241 907**	**416 953**	**3 938**	**749**	**3 628 087**

Forbearance measures

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

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

Share of forborne exposures in the Group's loan portfolio

	31.12.2016	31.12.2015
LOANS AND ADVANCES TO CUSTOMERS		
Exposures with no impairment, of which:	**120 112 554**	**119 349 516**
forborne exposures	574 117	422 649
Impaired exposures, of which:	**2 550 658**	**2 705 410**
forborne exposures	1 476 521	1 537 735
Total net carrying amount, of which:	**122 663 212**	**122 054 926**
forborne exposures	2 050 638	1 960 384

The quality analysis of forborne exposures

	31.12.2016	31.12.2015
Exposures with no impairment		
Gross carrying amount	587 347	437 459
IBNR provisions	(13 230)	(14 810)
Net carrying amount	**574 117**	**422 649**
Impaired exposures		
Gross carrying amount, of which:	3 152 110	2 957 036
exposures individually impaired	2 816 470	2 745 545
exposures collectively impaired	335 640	211 491
Allowances for impairment, of which:	(1 675 589)	(1 419 301)
exposures individually impaired	(1 524 510)	(1 323 802)
exposures collectively impaired	(151 079)	(95 499)
Net carrying amount	**1 476 521**	**1 537 735**
Total net carrying amount	**2 050 638**	**1 960 384**

The Group holds the collaterals for forborne exposures amounting to PLN 1 023 631 thousand as at 31 December 2016 (PLN 881 711 thousand at 31 December 2015).

Notes to the financial statements (cont.)

(In PLN thousand)

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

	31.12.2016	31.12.2015
Gross carrying amount of exposures with no impairment, of which:	**587 347**	**437 459**
- not past due	483 434	285 368
- up to 30 days	73 519	95 039
- between 30 days and 60 days	19 513	27 860
- above 60 days	10 881	29 192
IBNR provisions for exposures with no impairment, of which:	**(13 230)**	**(14 810)**
- not past due	(8 476)	(5 807)
- up to 30 days	(3 051)	(5 673)
- between 30 days and 60 days	(1 037)	(1 533)
- above 60 days	(666)	(1 797)
Gross carrying amount of impaired exposures, of which:	**3 152 110**	**2 957 036**
- not past due	627 945	571 632
- up to 1 month	150 815	46 871
- between 1 month and 3 months	46 077	32 999
- between 3 months and 1 year	214 022	131 902
- between 1 year and 5 years	2 026 748	2 124 721
- above 5 years	86 503	48 911
Allowances for impairment, of which:	**(1 675 589)**	**(1 419 301)**
- not past due	(270 904)	(198 882)
- up to 1 month	(44 380)	(11 312)
- between 1 month and 3 months	(13 893)	(7 510)
- between 3 months and 1 year	(116 608)	(42 355)
- between 1 year and 5 years	(1 168 335)	(1 120 572)
- above 5 years	(61 469)	(38 670)
Total net carrying amount	**2 050 638**	**1 960 384**

Changes in net carrying amount of forborne exposures

	2016	2015
Net carrying amount at the beginning	**1 960 384**	**2 168 125**
Amount of exposures recognized in the period	569 808	229 336
Amount of exposures derecognized in the period	(218 057)	(152 818)
Changes in impairment allowances	(118 306)	(217 882)
Other changes	(143 191)	(66 377)
Net carrying amount at the end	**2 050 638**	**1 960 384**
Interest income	139 522	168 659

Notes to the financial statements (cont.)

(In PLN thousand)

Forborne exposures by type of forbearance activity

	31.12.2016	31.12.2015
Modification of terms and conditions	3 546 182	3 199 428
Refinancing	193 275	195 067
Total gross carrying amount	**3 739 457**	**3 394 495**
Impairment allowances	(1 688 819)	(1 434 111)
Total net carrying amount	**2 050 638**	**1 960 384**

Forborne exposures by product type

	31.12.2016	31.12.2015
Mortgage loans	1 293 194	979 328
Current accounts	264 371	301 434
Operating loans	966 079	879 129
Investment loans	844 813	935 210
Cash loans	221 506	206 771
Other loans and advances	149 494	92 623
Total gross carrying amount	**3 739 457**	**3 394 495**
Impairment allowances	(1 688 819)	(1 434 111)
Total net carrying amount	**2 050 638**	**1 960 384**

Forborne exposures by industrial sectors

	31.12.2016	31.12.2015
Corporations:	3 122 618	2 818 427
Manufacturing	770 470	718 779
Construction	770 424	604 287
Real estate activities	481 286	468 815
Professional, scientific and technical activities	554 119	523 922
Accommodation and food service activities	230 080	212 819
Wholesale and retail trade	155 655	128 840
Mining and quarrying	58 100	77 734
Transportation and storage	60 215	63 613
Agriculture, forestry and fishing	14 495	2 816
Other sectors	27 774	16 802
Individuals	616 839	576 068
Total gross carrying amount	**3 739 457**	**3 394 495**
Impairment allowances	(1 688 819)	(1 434 111)
Total net carrying amount	**2 050 638**	**1 960 384**

Notes to the financial statements (cont.)

(In PLN thousand)

Forborne exposures by geographical structure

	31.12.2016	31.12.2015
Poland	3 391 584	3 082 046
Ukraine	319 396	292 314
Cyprus	26 874	18 503
Other countries	1 603	1 632
Total gross carrying amount	**3 739 457**	**3 394 495**
Impairment allowances	(1 688 819)	(1 434 111)
Total net carrying amount	**2 050 638**	**1 960 384**

Credit risk concentration

According to the current legislation the total exposure of the Group to the risks associated with the single borrower or a group of borrowers in which entities are related by capital or management may not exceed 25% of the Group's equity. In 2016 the maximum exposure limits were not exceeded.

a) Breakdown by individual entities:

As at 31 December 2016

EXPOSURE TO 10 LARGEST CLIENTS OF THE GROUP	% SHARE OF PORTFOLIO
Client 1	1.5%
Client 2	1.3%
Client 3	1.1%
Client 4	0.9%
Client 5	0.9%
Client 6	0.8%
Client 7	0.7%
Client 8	0.7%
Client 9	0.6%
Client 10	0.5%
Total	**9.0%**

b) Concentration by capital groups:

As at 31 December 2016

EXPOSURE TO 5 LARGEST CAPITAL GROUPS SERVICED BY THE GROUP	% SHARE OF PORTFOLIO
Group 1	1.7%
Group 2	1.4%
Group 3	1.3%
Group 4	1.3%
Group 5	1.2%
Total	**6.9%**

(In PLN thousand)

c) Breakdown by industrial sectors:

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

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

The table below presents the structure of exposures by industrial sectors

SECTOR DESCRIPTION	31.12.2016	31.12.2015
Wholesale and retail trade; repair of motor vehicles	15.4%	15.2%
Real estate activities	12.4%	10.5%
Public administration and defence	10.3%	10.9%
Electricity, gas, steam	7.3%	8.6%
Construction	6.8%	6.3%
Transportation and storage	6.4%	7.2%
Manufacture of metals, metal products and machinery	5.0%	4.0%
Manufacture of coke, rafined petroleum products, chemicals and pharmaceutical products	4.5%	2.9%
Manufacture of beverages and food products	4.4%	3.8%
Financial and insurance activities	4.1%	7.8%
Mining and quarrying	3.2%	4.4%
Other manufacturing	7.6%	7.3%
Other sectors	12.6%	11.1%
Total	**100.0%**	**100.0%**

CHF loans to individuals

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

Gross and net amount of CHF loans to individuals

	31.12.2016	31.12.2015
Gross carrying amount, of which:	**4 492 086**	**4 761 295**
- denominated in CHF	4 461 077	4 719 657
- indexed to CHF	31 009	41 638
Impairment allowances, of which:	**(91 931)**	**(78 963)**
- denominated in CHF	(91 604)	(78 616)
- indexed to CHF	(327)	(347)
Net carrying amount, of which:	**4 400 155**	**4 682 332**
- denominated in CHF	4 369 473	4 641 041
- indexed to CHF	30 682	41 291

Quality of CHF loans to individuals

	31.12.2016	31.12.2015
Gross carrying amount of exposures with no impairment, of which:	**4 302 638**	**4 599 473**
- not past due	3 956 983	4 251 469
- up to 30 days	280 365	277 566
- between 30 days and 60 days	47 308	41 226
- above 60 days	17 982	29 212
IBNR provisions for exposures with no impairment, of which:	**(11 261)**	**(13 479)**
- not past due	(4 183)	(5 144)
- up to 30 days	(4 464)	(4 898)
- between 30 days and 60 days	(1 755)	(1 542)
- above 60 days	(859)	(1 895)
Gross carrying amount of impaired exposures, of which:	**189 448**	**161 822**
- not past due	31 997	25 499
- up to 1 month	18 589	12 076
- between 1 month and 3 months	12 590	9 211
- between 3 months and 1 year	32 948	30 569
- between 1 year and 5 years	55 254	53 721
- above 5 years	38 070	30 746
Allowances for impairment, of which:	**(80 670)**	**(65 484)**
- not past due	(6 020)	(4 356)
- up to 1 month	(2 867)	(1 507)
- between 1 month and 3 months	(2 720)	(1 764)
- between 3 months and 1 year	(9 379)	(6 250)
- between 1 year and 5 years	(31 609)	(27 927)
- above 5 years	(28 075)	(23 680)
Total net carrying amount	**4 400 155**	**4 682 332**

As of 31 December 2016 the average LTV for CHF loans to individuals granted by the Group amounted to 56.3% (56.5% as at 31 December 2015), with an average LTV for the whole portfolio of 66.0% (66.4% as at 31 December 2015).

(In PLN thousand)

Credit exposures towards Ukraine
In 2016 Group exposure towards Ukraine in the form of interbank placements were repaid in full.

As at 31 December 2016, the net balance sheet value of remaining exposures towards Ukraine amounted to PLN 111 million (which constitutes 0.1% of total Group exposures), less by PLN 481 million in comparison to the end of December 2015.

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

	31.12.2016	31.12.2015
Balance sheet exposure		
Loans and advances to banks	-	402 630
Loans and advances to customers	321 048	300 551
Total gross carrying amount	**321 048**	**703 181**
IBNR / Impairment allowances	(209 687)	(110 605)
Total net carrying amount	**111 361**	**592 576**
Off-balance sheet exposure		
Credit lines granted	428	4 049
Total gross carrying amount	**428**	**4 049**
IBNR	-	(27)
Total net carrying amount	**428**	**4 022**

6.3 Market risk

The Group is exposed in its operations to market risk and other types of risk caused by changing market risk parameters.

Market risk is the risk of deteriorating financial result or capital of the Group resulting from market changes. The main factors of market risk are as follows:

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Market risk of the trading book

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

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

The model is subject to continuous, statistical verification by comparing the VaR values to actual and revaluated performance figures. Results of analyses carried out in 2016 and 2015 confirmed the adequacy of the model applied.

The tables below presents the market risk exposure of the trading portfolio of the Group measured by Value at Risk in 2016 and 2015

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

	31.12.2015	MINIMUM VALUE	AVERAGE VALUE	MAXIMUM VALUE
foreign exchange risk	54	15	203	1 674
interest rate risk	1 176	676	1 175	2 103
Trading portfolio	1 282	854	1 179	1 880

Interest rate risk of the banking book

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

The table below presents the sensitivity levels of the contractual interest income (NII) to the interest rate change by 100 b.p. and of economic value of the Group's equity (EVE) to the interest rate change by 200 b.p. for the end of December 2016 and December 2015. Both analyses assume instant change of market rates. Interest rates of banking products change according to contractual notations, nevertheless in case of contractual NII, for retail deposits the drop of interest rates is limited by 0. In case of EVE sensitivity for current deposits in PLN, the deposit model is applied, which adjusts deposits revaluation profile.

SENSITIVITY IN %	31.12.2016	31.12.2015
NII	(8.03)	(5.97)
EVE	(0.76)	(0.77)

Notes to the financial statements (cont.)

(In PLN thousand)

Currency risk

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

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

CURRENCY	31.12.2016	31.12.2015
Currencies total (*)	208	1 538

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

Foreign currency position of the Group

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

31.12.2015	BALANCE SHEET OPERATIONS		OFF-BALANCE SHEET OPERATIONS-DERIVATIVES		NET POSITION
	ASSETS	LIABILITIES	LONG POSITION	SHORT POSITION	
EUR	18 890 563	17 929 313	11 066 799	11 841 800	186 249
USD	6 294 671	8 290 240	7 077 654	5 116 063	(33 978)
CHF	4 700 851	606 176	3 221 543	7 319 753	(3 535)
GBP	318 067	708 529	622 872	232 423	(13)
CZK	37 732	16 591	183 225	204 259	107
Other currencies	273 984	161 448	73 793	183 113	3 216
TOTAL	**30 515 868**	**27 712 297**	**22 245 886**	**24 897 411**	**152 046**

The amount of the net long position in EUR (equivalent of PLN 186 249 thousand) as at 31 December 2015 mainly resulted from the recognition of the fair value valuation of shares in Visa Europe (Note 31) in the amount of EUR 40 866 611 (equivalent of PLN 174 153 thousand). The foreign currency position from the valuation of shares in Visa Europe was closed on January 2016.

6.4 Liquidity risk

The objective of liquidity risk management is to:

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

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

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

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

Scenario-based stress analyses, conducted on a monthly basis, constitute an integral part of the Group's liquidity monitoring process. Within the scope of these analyses the Group's liquidity is assessed under the conditions of crisis which is caused by financial markets or is caused by internal factors, specific to the Group. In 2016 the Bank widened the scope of applied tests without making significant changes in their logic.

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

In order to define the principles of contingency liquidity management, Bank introduced, approved by the Management Board, 'Contingency Liquidity Policy', which defines the contingency procedures in the event of crisis situations. This policy involves daily monitoring of the system and specific early-warning indicators for the Bank and the Group as well as three levels of liquidity risk states depending on the level of early-warning indicators, the Bank's, the Group's and market situation. It also defines the sources for covering the expected outflows from the Group. This document sets the procedures for monitoring the liquidity states, emergency action procedures, task forces dedicated for restoring the Group's liquidity and the Management's responsibilities for taking necessary decisions to restore the required liquidity level. In 2016, the Policy was updated in order to be adjusted to the Recovery Plan that is in force in the Bank.

Below are presented basic quantitative information concerning the Group's liquidity at the end of 2016 year in comparison to the end of 2015. They cover the structure of financial liabilities by contractual maturity, adjusted liquidity gap and financial flows from derivative transactions.

Notes to the financial statements (cont.)

(In PLN thousand)

Structure of financial liabilities by contractual maturities

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

31.12.2015	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
BALANCE SHEET LIABILITIES)						
Amounts due to banks (*)	1 606 000	1 066 155	108 638	1 204 022	2 124 172	6 108 987
Amounts due to customers	96 357 303	12 213 137	17 987 883	2 777 981	55 721	129 392 025
Debt securities issued	336 500	1 034 304	409 535	616 862	661 531	3 058 732
Financial liabilities held for trading	-	-	170 729	382 663	58 050	611 442
Total	**98 299 803**	**14 313 596**	**18 676 785**	**4 981 528**	**2 899 474**	**139 171 186**
OFF-BALANCE SHEET COMMITMENTS (**)						
Financial liabilities granted	30 935 860	-	-	-	-	30 935 860
Guarantees issued	14 072 827	-	-	-	-	14 072 827
Total	**45 008 687**	**-**	**-**	**-**	**-**	**45 008 687**

(*) Including Central Bank.

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

Adjusted liquidity gap

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

Notes to the financial statements (cont.)

(In PLN thousand)

Adjusted liquidity gap

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

31.12.2015	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Balance sheet assets	39 156 141	7 110 676	24 968 630	50 455 851	47 094 269	168 785 567
Balance sheet liabilities	16 049 305	8 827 295	18 770 564	19 999 689	105 138 714	168 785 567
Off-balance sheet assets/liabilities (net)	(6 717 006)	568 926	1 240 893	2 489 137	1 254 323	(1 163 727)
Periodic gap	**16 389 830**	**(1 147 693)**	**7 438 959**	**32 945 299**	**(56 790 122)**	**(1 163 727)**
Cumulated gap	**-**	**15 242 137**	**22 681 096**	**55 626 395**	**(1 163 727)**	**-**

Off-balance derivative transactions

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

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

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

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

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

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

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2016	26 757	51 903	131 715	1 219 802	449 921	**1 880 098**
31.12.2015	70 648	104 854	151 485	2 007 425	889 219	**3 223 631**

(In PLN thousand)

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

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2016						
inflows	20 805 957	6 032 490	7 701 296	8 030 511	2 915 201	**45 485 455**
outflows	20 827 342	6 055 624	7 823 747	8 745 485	3 322 026	**46 774 224**
31.12.2015						
inflows	16 745 976	6 290 357	7 529 685	8 415 940	2 830 603	**41 812 561**
outflows	16 750 719	6 249 486	7 612 854	9 216 680	3 152 969	**42 982 708**

6.5 Operational risk

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

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

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

Operational risk management system is subject to internal validation at least once a year. Validation aims at verification of compliance with regulatory requirements and standards of the UniCredit Group.

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

- internal frauds – losses resulting from acts of intended fraud, misappropriation of property, circumvention of regulations, the laws and internal policies of a company, excluding losses resulting from diversity or discrimination of employees, which concern at least one internal party,
- external frauds – losses being a consequence of acts of defraud, misappropriation of property or circumvention of regulations performed by a third party,
- employment practices and workplace safety – losses due to acts inconsistent with regulations or employment agreements, workplace health and safety agreements, payments from personal injuries claims or losses from discrimination and unequal employee treatment,

(In PLN thousand)

- clients, products and business practices – losses arising from failures of meeting professional obligations towards clients due to unintended or negligent acts (including custody requirements and appropriate behavior) or concerning specific features or a design of a product,
- damages to physical assets – losses due to damage or loss of tangible assets resulting from natural disasters or other events,
- business disruption and system failures – losses stemming from business or system failures,
- execution, delivery and process management – losses resulting from failed transaction settlements or process management and losses from relations with cooperating parties and vendors.

OPERATING EVENTS BY CATEGORIES	2016	2015
Internal frauds	10.62%	20.50%
External frauds	18.08%	4.70%
Employment practices and workplace safety	14.26%	1.12%
Clients, products and business practices	7.35%	59.15%
Damages to physical assets	32.00%	4.70%
Business disruption and system failures	0.40%	0.71%
Execution, delivery and process management	17.29%	9.12%
Total	**100.00%**	**100.00%**

6.6 Capital management

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

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

The Bank Pekao S.A. has put in place a formalized process of capital management and monitoring, established within the scope of ICAAP process. The Finance Division under the Chief Financial Officer is responsible for functioning of the capital management process in the Bank. The ultimate responsibility for capital management is allocated to the Management Board of the Bank, supported by the Assets, Liabilities and Risk Management Committee, which approves the capital management process. The Bank has also implemented the Capital Contingency Policy which establishes rules and obligations in the event of crisis appearance or further development that would significantly reduce capitalization level of the Bank or Group. The policy defines the principles of supervision including split of responsibilities for the purpose of early and consistent management in case of crisis situation development.

The Capital Management Strategy defines the objectives and general rules of the management and monitoring of the Group's capital adequacy, such as the guidelines concerning risk coverage sources, preferred structure of capital for risk coverage, long-term capital targets, capital limits system and sources of additional capital under contingency.

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

Regulatory capital requirements

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

Capital ratios are the basic measures applied for the measurement of capital adequacy. Minimum capital ratios required by law equal 10.0% for TCR and 8.0% for CET1 which are the sum of minimum value defined in Regulation 575/2013 (8.0% for TCR and 6.0% for T1) and the combined buffer requirement defined in Act on macroprudential supervision (total of 2.0% in line with Chapter 2). According to the recommendation of the Polish Financial Supervision Authority (KNF) total capital ratio of the Pekao Group, taking into account of Other Systemically Important Institution buffer of 0.75%, must be not lower than 14.0% and Tier I capital ratio not lower than 11.0%.

As at 31 December 2016 total capital ratio of the Group amounted at 17.64% (as at 31 December 2015 – 17.66%).

	31.12.2016	31.12.2015
CAPITAL REQUIREMENTS		
Credit and counterparty risk including CVA	8 511 165	8 527 666
Market risk	44 022	63 578
Operational risk	493 557	564 787
Total capital requirement	**9 048 744**	**9 156 031**
OWN FUNDS		
Common Equity Tier 1 capital	19 954 579	20 209 595
Own funds for total capital ratio	**19 954 579**	**20 209 595**
OWN FUNDS REQUIREMENTS		
Common Equity Tier 1 capital ratio (%)	**17.64%**	**17.66%**
Total capital ratio (%)	**17.64%**	**17.66%**

Total capital ratio at the end of 2016 compared with the end of 2015 decreased by 0.02 p.p. due to decrease of own funds by 1.3% despite decrease of total capital requirement by 1.2%.

Total capital requirement decreased in 2016 as a result of decrease of capital requirements for all risks.

For the purpose of capital requirement calculation the Group uses:

- Standardised Approach for credit risk capital requirement calculation,
- Financial Collateral Comprehensive Method for credit risk mitigation,
- Mark-to-Market Method for counterparty credit risk capital requirement calculation,
- Standardised Approach for capital requirement calculation of specific risk and duration-based calculation for general risk of debt instruments,
- Standardised Approach for capital requirement calculation of general and specific risk of equity instruments,

(In PLN thousand)

- Standardised Approach for capital requirement calculation for pre-funded contributions to the default fund of a qualifying central counterparty,
- Standardised Approach for foreign-exchange risk capital requirement calculation,
- Simplified approach for commodities risk capital requirement calculation,
- Standardised Approach for capital requirements for credit risk valuation adjustment risk,
- Advanced Measurement Approach for operational risk measurement in case of Bank and Standardised Approach for Bank's subsidiaries.

Own funds

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

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

	31.12.2016	31.12.2015
OWN FUNDS		
Capital	**22 911 943**	**23 424 193**
Different scope of consolidation	**16 361**	**15 826**
Component of the capital not included into own funds, in which:	**(2 279 275)**	**(2 292 459)**
Current year net profit	(2 279 275)	(2 292 459)
Regulatory adjustments, in which:	**(694 450)**	**(937 965)**
Intangible assets	(531 041)	(570 309)
Capital from revaluation	(32 177)	(36 678)
Unrealised loss from debt and capital instruments available for sale	-	-
Unrealised gain from debt and capital instruments available for sale	(51 593)	(267 136)
Deferred tax assets that rely on future profitability	(18 876)	(16 490)
Additional value adjustments due to prudent calculation	(45 839)	(31 388)
Minority interests	(14 924)	(15 964)
Common Equity Tier 1 capital	**19 954 579**	**20 209 595**
Own funds for total capital ratio	**19 954 579**	**20 209 595**

Components of capital not included into own funds:

- Current year net profit – net profit of current reporting period, verified by statutory auditor responsible for auditing of the Group's accounts reduced by all foreseeable charge and dividend, can be included into Common Equity Tier 1 capital only with the permission of KNF. As at 31 of December 2016, current profit of the Group was not included into Common Equity Tier 1 capital.

Regulatory adjustments:

- intangible assets (after deduction of related deferred tax liabilities) decrease Common Equity Tier 1 capital, according to Article 36 of Regulation No 575/2013,
- capital from revaluation reflects fair value of cash flow hedges is not included in any element of own funds, according to Article 33 of Regulation No 575/2013,
- unrealised losses from debt and capital instruments classified as available for sale according to Article 467 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act, decrease Common Equity Tier 1 capital in 100%,
- unrealised gains from debt and capital instruments classified as available for sale according to Article 468 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act are included in 60% to Common Equity Tier 1 capital,

- deferred tax assets based on future profitability decrease Common Equity Tier 1 capital according to Article 36 of Regulation No 575/2013 only in 60% (Article 469 of Regulation No 575/2013 using national options defined in Article 171a Banking Act),
- additional value adjustments due to prudent valuation are created for every asset measured at fair value, according to Article 34 of Regulation No 575/2013,
- minority interests are deducted from Group's capital because requirements laid down in Regulation No 575/2013 are not meet.

Internal capital adequacy assessment

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

The Group takes the following risk types into consideration:

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

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

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

Preferred methods of measuring quantifiable risks and determining the resulting capital requirements are Value at Risk models, based on assumptions derived from the Group's risk appetite. The models are developed in compliance with the best market practices and regulatory requirements and supplemented with stress tests or scenario analyses. In case of risk types for which such methodologies have not been finally developed or implemented, the Group uses modified regulatory models supplemented with stress tests or simplified measurement methods.
Also, a consistent methodology for estimating the buffer for macroeconomic changes and model risks has been developed. The macroeconomic changes risk capital buffer is determined on the basis of the impact of the economic slowdown scenario on economic capital in the forecast horizon.

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

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

(In PLN thousand)

6.7 Fair value of financial assets and liabilities

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

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

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

As of 31 December 2016 and 31 December 2015, the Group classified the financial assets and liabilities measured at fair value into the following hierarchy of three categories based on the valuation method:

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

31.12.2015	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:	**15 929 590**	**6 134 087**	**504 501**	**22 568 178**
Financial assets held for trading	936 763	142 640	47 389	1 126 792
Derivative financial instruments, including:	28	3 205 476	943	3 206 447
- Banks	-	2 639 346	-	2 639 346
- Customers	28	566 130	943	567 101
Hedging instruments, including:	-	421 640	-	421 640
- Banks	-	416 953	-	416 953
- Customers	-	4 687	-	4 687
Securities available for sale	14 992 799	2 364 331	456 169	17 813 299
Liabilities:	**611 443**	**4 907 086**	**-**	**5 518 529**
Financial liabilities held for trading	611 442	-	-	611 442
Derivative financial instruments, including:	1	3 204 327	-	3 204 328
- Banks	-	2 747 772	-	2 747 772
- Customers	1	456 555	-	456 556
Hedging instruments, including:	-	1 702 759	-	1 702 759
- Banks	-	1 702 759	-	1 702 759
- Customers	-	-	-	-

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

2015	FINANCIAL ASSETS HELD FOR TRADING	DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS)	SECURITIES AVAILABLE FOR SALE
Opening balance	**99 784**	**2 967**	**263 815**
Increases, including:	10 663 874	1 942	200 231
Reclassification	-	1 942	313
Acquisition	10 661 018	-	-
Settlement	-	-	-
Gains on financial instruments	2 856	-	199 918
recognized in the income statement	2 856	-	11 077
recognized in revaluation reserves	-	-	188 841
Decreases, including:	(10 716 269)	(3 966)	(7 877)
Reclassification	(55 052)	(2 967)	-
Settlement / redemption	(435 186)	(891)	(7 877)
Sale	(10 225 856)	-	-
Loss on financial instruments	(175)	(108)	-
recognized in the income statement	(175)	(108)	-
Closing balance	**47 389**	**943**	**456 169**
Unrealized income from financial instruments held in portfolio until end of period, recognized in:	**(63)**	**(108)**	**2 674**
Income statement:	108	(108)	268
net interest income	108	-	268
result on financial assets and liabilities held for trading	-	(108)	-
Other components income	(171)	-	2 406

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

In the period from 1 January to 31 December 2016 the following transfers between fair value hierarchy levels were performed:

- Government bonds in foreign currencies were transferred from Level 1 to Level 2 due to a change in the availability of active market quotations.
- Interest rate derivatives and commodity derivatives (concluded within the year) were transferred from Level 3 to Level 2 due to the decrease of impact on the fair value of credit parameters and correlation parameter respectively.

In the period from 1 January to 31 December 2016 there were no other transfers between fair value hierarchy levels.

The impact of estimated parameters on measurement of financial instruments for which the Group applies fair value valuation according to Level 3 as at 31 December 2016 and 31 December 2015 is as follows

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

Notes to the financial statements (cont.)

(In PLN thousand)

FINANCIAL ASSET/LIABILITY	FAIR VALUE AS AT 31.12.2015	VALUATION TECHNIQUE	UNOBSERVABLE FACTOR	ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE)	IMPACT ON FAIR VALUE AS AT 31.12.2015	
					POSITIVE SCENARIO	NEGATIVE SCENARIO
Corporate debt securities	298 756	Discounted cash flow	Credit spread	0.54%-1%	526	(1 427)
Interest rate derivatives	943	Discounted cash flow	PD	2.1%-5.4%	39	(44)
			LGD	40.1%-54.1%	16	(16)

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

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

As of 31 December 2016 and on 31 December 2015, the Group classified the financial assets and liabilities not measured at fair value in the consolidated statement of financial position into the following three categories based on the valuation level:

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

31.12.2015	CARRYING AMOUNT	FAIR VALUE	OF WHICH:		
			LEVEL 1	LEVEL 2	LEVEL 3
Assets					
Cash and due from Central Bank	7 881 607	7 881 607	2 951 414	4 930 193	-
Loans and advance to banks	7 314 724	7 311 058	-	5 301 176	2 009 882
Loans and advances to customers (*)	118 555 269	117 717 427	-	7 140 550	110 576 877
Receivables from financial leases	3 503 979	3 568 200	-	-	3 568 200
Debt securities held to maturity	3 368 424	3 380 400	2 509 227	871 173	-
Total assets	**140 624 003**	**139 858 692**	**5 460 641**	**18 243 092**	**116 154 959**
Liabilities					
Amounts due to Central Bank	914	928	-	-	928
Amounts due to other banks	5 958 449	6 002 687	-	1 182 111	4 820 576
Amounts due to customers	128 867 691	128 479 792	-	4 468 820	124 010 972
Debt securities issued	2 903 233	2 959 349	-	2 959 349	-
Total liabilities	**137 730 287**	**137 442 756**	**-**	**8 610 280**	**128 832 476**

(*) Including bills of exchange eligible for rediscounting at Central Bank.

7. Custody activity

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

As at 31 December 2016 the Bank maintained 12 333 securities accounts (in comparison to 12 077 securities accounts as at 31 December 2015).

8. Brokerage activity

The Group offers a wide range of capital market products and services via specialized Bank's organizational unit – Dom Maklerski Pekao (DM) and by the agency of Centralny Dom Maklerski Pekao S.A. (CDM) and Pekao Investment Banking S.A. (Pekao IB) a subsidiaries of the Bank Pekao S.A.

Dom Maklerski Pekao and Centralny Dom Maklerski Pekao S.A.
Dom Maklerski Pekao is a specialized organizational unit of the Bank designed to sell capital market products. The objective of the entity is to provide the highest quality brokerage services. The comprehensive offer enables investors, especially the individual clients of the Bank to invest in financial instruments traded on the regulated market and on the alternative trading platform organized by the Warsaw Stock Exchange (GPW S.A.) and by the BondSpot S.A. (i.e. shares, treasury and corporate bonds, derivatives - futures and options, ETF, certificates, warrants) as well as the instruments traded on the particular foreign markets using any service channel (mobile application, Internet, mobile service, phone, direct contact in the Brokerage Services Spots) after activation of the service. Dom Maklerski Pekao intermediates also in sales of the Structured Certificates of Deposit issued by Bank Pekao S.A., enables investors to acquire instruments in the IPO's and makes the transactions on the non-public market. The service for the clients is provided in more than 390 Brokerage Services Spots located in the Bank branches throughout Poland and via remote channels of Pekao24Makler (Internet, mobile service, phone, mobile application) fully integrated with the Bank's electronic banking platform Pekao24.

Centralny Dom Maklerski Pekao S.A. (CDM) is the largest and oldest brokerage firm on the Polish capital market. The aim of CDM is to service investment accounts. The offering enables Clients to invest in inter alia shares, Treasury bonds, corporate bonds, certificates, funds' units, ETF, structured products, insurance and pension programs. CDM grants to clients access to invest on derivatives markets, foreign markets and OTC markets. Clients are served in 48 Consumer Service Spots located mainly in Bank branches throughout Poland and additionally in 12 points dedicated to service for strategic clients and through remote service channels of CDM24 (CDMInternet, TeleCDM, CDM Mobile) enabling connection to electronic banking platform Pekao24.

The tight cooperation of Dom Maklerski Pekao and CDM on the realization of the projects conducted on the primary market and in the other areas of market activities of both entities ensures professional and comprehensive brokerage services.

CDM as well as Dom Maklerski Pekao is a member of the Warsaw Stock Exchange (GPW S.A.) and a direct participant in the National Depository of Securities (KDPW).

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

Notes to the financial statements (cont.)

(In PLN thousand)

Pekao Investment Banking S.A.

Pekao Investment Banking S.A. operates as a brokerage house supervised by the Financial Supervision Commission, focusing on the service of institutional and corporate clients. The scope of services provided by Pekao IB comprises in particular acceptance and transfer of orders for purchase or sale of financial instruments, execution of these orders on account of the person or entity placing the order, offering of financial instruments, advisory services for enterprises on capital structure, corporate strategy or other matters related to such structure or strategy as well as advisory services and other services relating to mergers, divisions and acquisitions of companies. Pekao IB also performs the market maker's function both on the capital market and on the derivatives market, being one of the most active market makers.

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

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

	31.12.2016		31.12.2015	
	QUANTITY (pcs)	VALUE	QUANTITY (pcs)	VALUE
CLIENTS' FINANCIAL INSTRUMENTS				
Held on securities accounts	3 556 221 597	24 707 398	4 085 831 592	28 594 389
Equity securities and rights to such financial assets	3 550 120 296	23 236 537	4 075 825 419	27 191 398
Debt instruments and rights to such financial assets	6 101 301	1 470 861	10 006 173	1 402 991
Stored in a form of document	2 623 762 193	6 291 869	3 767 973 072	16 232 127
Equity securities and rights to such financial assets	2 623 762 193	6 291 869	3 763 773 072	16 074 480
Debt instruments and rights to such financial assets	-	-	4 200 000	157 647

Customers' cash on brokerage accounts

	31.12.2016	31.12.2015
Deposited on cash accounts in brokerage house and paid for securities bought in IPO or on the primary market	1 100 623	857 944
Other customers' cash	40 955	45 571
Total	**1 141 578**	**903 515**

Settlements due to unsettled transactions

	31.12.2016	31.12.2015
Receivables from executed transactions	32 061	-
Liabilities from executed transactions	-	13 201

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

	31.12.2016	31.12.2015
Receivables from clearing fund	24 817	18 727
Receivables from margin deposits	32 391	29 866
Other receivables	1 252	231
Total receivables	**58 460**	**48 824**
Amounts due on margin deposits	921	4 421
Other liabilities	317	331
Total liabilities	**1 238**	**4 752**

(In PLN thousand)

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

	31.12.2016	31.12.2015
Receivables from compensation fund	11 432	10 914
Prepaid expenses - system maintenance fees	1 764	1 456
Deferred income – benefits from system	(13 411)	(12 549)
Total net balance sheet items concerning participation in the compensation fund	**(215)**	**(179)**

Settlement with entities running regulated securities markets and commodity exchanges

	31.12.2016	31.12.2015
Amounts due to Warsaw Stock Exchange	527	638
Total liabilities	**527**	**638**

9. Operating segments

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

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

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

Operating segments
The operating segments of the Group are as follows:

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

	RETAIL BANKING	PRIVATE BANKING	CORPORATE AND INVESTMENT BANKING	ASSETS AND LIABILITIES MANAGEMENT AND OTHER	TOTAL
Total net interest income	**2 406 728**	**47 529**	**1 634 037**	**349 089**	**4 437 383**
Non-interest income	**1 523 051**	**30 608**	**925 353**	**430 823**	**2 909 835**
Operating income	**3 929 779**	**78 137**	**2 559 390**	**779 912**	**7 347 218**
Personnel expenses	(1 111 686)	(25 335)	(261 344)	(498 471)	(1 896 836)
Other administrative expenses	(1 250 524)	(25 125)	(336 035)	637 480	(974 204)
Depreciation and amortisation	(177 566)	(1 714)	(22 642)	(138 944)	(340 866)
Operating costs	**(2 539 776)**	**(52 174)**	**(620 021)**	**65**	**(3 211 906)**
Gross operating profit	**1 390 003**	**25 963**	**1 939 369**	**779 977**	**4 135 312**
Net impairment losses on loans and off-balance sheet commitments	(250 042)	(133)	(252 807)	2 353	(500 629)
Net operating profit	**1 139 961**	**25 830**	**1 686 562**	**782 330**	**3 634 683**
Net result on other provisions	(651)	(514)	1 259	(14 569)	(14 475)
Guarantee funds charges	(99 618)	(632)	(154 296)	(24 922)	(279 468)
Tax on certain financial institutions	-	-	-	(449 533)	(449 533)
Net result on investment activities	(170)	-	498	5 011	5 339
Profit before tax	**1 039 522**	**24 684**	**1 534 023**	**298 317**	**2 896 546**
Income tax expense					(616 782)
Net profit for the period					**2 279 764**
Attributable to equity holders of the Bank					**2 279 275**
Attributable to non-controling interests					489
Allocated assets	63 640 992	261 932	105 098 620	(3 929 788)	165 071 756
Unallocated assets					9 143 187
Total assets					**174 214 943**
Allocated liabilities	79 287 145	8 304 002	63 233 403	(5 142 417)	145 682 133
Unallocated liabilities					28 532 810
Total liabilities					**174 214 943**

Notes to the financial statements (cont.)

(In PLN thousand)

Operating segments reporting for the period from 1 January to 31 December 2015

	RETAIL BANKING	PRIVATE BANKING	CORPORATE AND INVESTMENT BANKING	ASSETS AND LIABILITIES MANAGEMENT AND OTHER	TOTAL
Total net interest income	**2 306 368**	**25 162**	**1 603 118**	**297 648**	**4 232 296**
Non-interest income	**1 537 516**	**33 061**	**1 122 692**	**133 017**	**2 826 286**
Operating income	**3 843 884**	**58 223**	**2 725 810**	**430 665**	**7 058 582**
Personnel expenses	(1 132 086)	(23 226)	(261 916)	(491 291)	(1 908 519)
Other administrative expenses	(1 236 547)	(25 573)	(342 781)	625 213	(979 688)
Depreciation and amortisation	(170 218)	(1 571)	(23 181)	(136 495)	(331 465)
Operating costs	**(2 538 851)**	**(50 370)**	**(627 878)**	**(2 573)**	**(3 219 672)**
Gross operating profit	**1 305 033**	**7 853**	**2 097 932**	**428 092**	**3 838 910**
Net impairment losses on loans and off-balance sheet commitments	(185 573)	(1 066)	(352 613)	21 694	(517 558)
Net operating profit	**1 119 460**	**6 787**	**1 745 319**	**449 786**	**3 321 352**
Net result on other provisions	(283)	(388)	15	(28 110)	(28 766)
Guarantee funds charges	(106 880)	(796)	(171 233)	(256 044)	(534 953)
Tax on certain financial institutions	-	-	-	-	-
Net result on investment activities	(122)	-	386	73 221	73 485
Profit before tax	**1 012 175**	**5 603**	**1 574 487**	**238 853**	**2 831 118**
Income tax expense					(537 640)
Net profit for the period					**2 293 478**
Attributable to equity holders of the Bank					**2 292 459**
Attributable to non-controling interests					1 019
Allocated assets	59 276 412	299 794	97 664 414	(283 705)	156 956 915
Unallocated assets					11 828 652
Total assets					**168 785 567**
Allocated liabilities	71 778 919	8 353 642	64 094 425	(4 755 682)	139 471 304
Unallocated liabilities					29 314 263
Total liabilities					**168 785 567**

Reconciliation of operating income for reportable segments

	2016	2015
Total operating income for reportable segments	**7 347 218**	**7 058 582**
Share in gains (losses) from associates	(38 580)	(52 091)
Net other operating income and expenses	(30 528)	(160 996)
Refunding of administrative expenses	2 282	3 432
Operating income	**7 280 392**	**6 848 927**

Geographical segment

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

Notes to the financial statements (cont.)

(In PLN thousand)

10. Interest income and expense

Interest income

	2016	2015
Loans and other receivables from customers	4 431 535	4 410 834
Interbank placements	79 776	103 034
Reverse repo transactions	50 078	77 626
Investment securities	736 789	699 863
Hedging derivatives	138 866	150 934
Financial assets held for trading	11 446	14 078
Total	**5 448 490**	**5 456 369**

Interest income for 2016 includes income from impaired financial assets in the amount of PLN 243 131 thousand (in 2015 PLN 301 340 thousand).

Total amount of interest income for 2016 measured at amortized cost using the effective interest rate method, which applies to financial assets not measured at fair value through profit or loss, amounted to PLN 3 797 006 thousand (in 2015 PLN 3 730 968 thousand).

Interest expense

	2016	2015
Deposits from customers	(941 996)	(1 097 030)
Interbank deposits	(24 257)	(23 156)
Repo transactions	(44 045)	(59 001)
Loans and advances received	(10 817)	(19 940)
Debt securities issued	(45 370)	(90 672)
Total	**(1 066 485)**	**(1 289 799)**

Total amount of interest expense for 2016, measured at amortized cost using the effective interest rate method with reference to financial liabilities, which are not valued at fair value through profit or loss amounted to PLN 868 315 thousand (in 2015 PLN 1 094 924 thousand).

11. Fee and commission income and expense

Fee and commission income

	2016	2015
Accounts maintenance, payment orders and cash transactions	636 652	651 507
Payment cards	598 246	693 067
Loans and advances	460 543	432 269
Investment products sales intermediation	248 716	294 648
Securities operations	91 198	96 794
Custody activity	62 842	69 519
Pension and investment funds service fees	48 920	50 246
Guarantees, letters of credit and similar transactions	54 774	51 050
Other	50 194	49 423
Total	**2 252 085**	**2 388 523**

Notes to the financial statements (cont.)

(In PLN thousand)

Fee and commission expense

	2016	2015
Payment cards	(218 109)	(322 424)
Money orders and transfers	(20 077)	(21 708)
Securities and derivatives operations	(28 578)	(13 840)
Accounts maintenance	(5 236)	(4 275)
Custody activity	(14 378)	(13 388)
Pension funds management charges	(856)	(868)
Acquisition services	(3 968)	(3 404)
Other	(1 919)	(3 090)
Total	**(293 121)**	**(382 997)**

12. Dividend income

	2016	2015
Issuers of securities held for trading	89	530
Issuers of securities available for sale	16 709	13 105
Total	**16 798**	**13 635**

13. Result on financial assets and liabilities held for trading

	2016	2015
Foreign currency exchange result	416 031	367 908
Gains (losses) on derivatives	45 994	64 206
Gains (losses) on securities	23 384	(4 066)
Total	**485 409**	**428 048**

In 2016, the total change in the fair value of financial instruments valued at fair value through profit or loss, determined with the use of valuation techniques (when no published quotations from active markets are available) amounted to PLN 53 902 thousand (in 2015 PLN 64 586 thousand).

14. Gains (losses) on disposal

Realized gains

	2016	2015
Loans and other financial receivables (*)	159 495	534
Available for sale financial assets – debt instruments	14 531	229 592
Available for sale financial assets – equity instruments (**)	262 826	-
Debt securities issued	1	6
Total	**436 853**	**230 132**

(*) In 2016 the Bank sold loans with a total debt of PLN 1 863 million. The realized gross result on the transaction was PLN 149.9 million.
(**) In 2016 the Bank has received information about the closing of the acquisition of Visa Europe Limited by Visa Inc. The details of the transactions are presented in the Note 31.

(In PLN thousand)

Realized losses

	2016	2015
Loans and other financial receivables	(2)	-
Available for sale financial assets – debt instruments	(864)	(41)
Debt securities issued	(84)	(490)
Total	**(950)**	**(531)**

Net realized profit	**435 903**	**229 601**

The change in fair value of financial assets available for sale transferred in 2016 directly to equity amounted to PLN 332 328 thousand (decrease), in 2015 PLN 7 573 thousand (decrease).

The change in fair value of financial assets, transferred in 2016 from equity to financial income amounted to PLN 276 493 thousand (profit), in 2015 PLN 229 551 thousand (profit).

15. Administrative expenses

Personnel expenses

	2016	2015
Wages and salaries	(1 600 420)	(1 609 253)
Insurance and other charges related to employees	(286 844)	(291 849)
Share-based payments expenses	(9 572)	(7 417)
Total	**(1 896 836)**	**(1 908 519)**

Other administrative expenses

	2016	2015
General expenses	(924 479)	(916 571)
Taxes and charges (*)	(40 874)	(74 850)
Bank Guarantee Fund fee (**)	(278 929)	(509 127)
Financial supervision authority fee (KNF)	(11 673)	(17 525)
Tax on certain financial institutions (***)	(449 533)	-
Total	**(1 705 488)**	**(1 518 073)**

Total administrative expenses	**(3 602 324)**	**(3 426 592)**

(*) In 2015 this item includes the amount of PLN 26 469 thousand representing the cost of provision for the contribution to the Borrowers Support Fund.
(**) In 2016 this item includes the amount of PLN 16 604 thousand contributed by the Group to BFG for the purpose of payments of the funds guaranteed to the depositors of Bank Spółdzielczy in Nadarzyn, respectively in 2015 the amount of PLN 234 081 thousand concerns Spółdzielczy Bank Rzemiosła i Rolnictwa in Wołomin.
(***) On 1 February 2016 tax on certain financial institutions was introduced under the Act on tax on certain financial institutions.

16. Depreciation and amortization

	2016	2015
Property, plant and equipment	(168 077)	(180 457)
Investment property	(1 183)	(1 654)
Intangible assets	(171 606)	(149 354)
Total	**(340 866)**	**(331 465)**

(In PLN thousand)

17. Net other operating income and expenses

Other operating income

	2016	2015
Rental income	21 259	22 096
Miscellaneous income	17 608	15 504
Recovery of debt collection costs	13 539	16 369
Revenues from sale of products, goods and services	16 442	5 778
Excess payments, repayments	9 692	9 152
Compensation, penalty fees and fines received (including received compensations from damages in relation to fixed assets)	5 885	116 510
Revenues from leasing activity	2 615	15 559
Refunding of administrative expenses	2 282	3 432
Income from written off liabilities	3 512	4 624
Releases of impairment allowances for litigation and other assets	1 021	3 093
Gains on sale of leasing assets for third person and other assets	883	764
Other	4 967	7 555
Total	**99 705**	**220 436**

Other operating expenses

	2016	2015
Costs related to leasing activity	(2 262)	(2 443)
Credit insurance expenses	(11 163)	(10 101)
Sundry expenses	(15 501)	(14 541)
Reimbursement and deficiencies	(2 877)	(4 021)
Costs from sale of products, goods and services	(13 119)	(2 358)
Customers complaints expenses	(1 734)	(2 311)
Impairment allowance for litigations and other assets	(4 418)	(9 167)
Costs of litigation and claims	(1 394)	(2 130)
Compensation, penalty fees and fines paid	(1 682)	(644)
Losses on disposal of leasing assets for third person and other assets	(466)	(604)
Other	(14 561)	(11 120)
Total	**(69 177)**	**(59 440)**

Net other operating income and expenses	**30 528**	**160 996**

Notes to the financial statements (cont.)

(In PLN thousand)

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

2016	OPENING BALANCE	INCREASES		DECREASES			CLOSING BALANCE	IMPACT ON INCOME STATEMENT(**)
		IMPARIMENT CHARGES	OTHER (*)	WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET	RELEASE OF IMPARIMENT CHARGES	OTHER (*)		
Impairment of financial assets and off-balance sheet commitments								
Loans and advances to banks valued at amortized cost	19 774	590	1 451	-	(2 933)	(889)	17 993	2 343
Loans and advances to customers valued at amortized cost	5 678 633	1 021 762	167 086	(583 975)	(602 645)	(138 242)	5 542 619	(419 117)
Receivables from financial leases	163 704	17 112	3	(86)	(13 244)	(542)	166 947	(3 868)
Financial assets available for sale	122	-	-	-	-	(122)	-	-
Off-balance sheet commitments	120 771	160 561	992	-	(61 341)	-	220 983	(99 220)
Total financial assets and off-balance sheet commitments	**5 983 004**	**1 200 025**	**169 532**	**(584 061)**	**(680 163)**	**(139 795)**	**5 948 542**	**(519 862)**
Impairment of other assets								
Investments in associates	60	-	-	-	-	(60)	-	-
Intangible assets	10 961	-	-	(10 961)	-	-	-	-
Property, plant and equipment	8 451	-	-	(693)	-	-	7 758	-
Investment properties	8 682	-	-	(926)	-	(725)	7 031	-
Other	77 736	4 418	1 369	(2 230)	(1 021)	(6)	80 266	(3 397)
Total impairment of other assets	**105 890**	**4 418**	**1 369**	**(14 810)**	**(1 021)**	**(791)**	**95 055**	**(3 397)**
Total	**6 088 894**	**1 204 443**	**170 901**	**(598 871)**	**(681 184)**	**(140 586)**	**6 043 597**	**(523 259)**

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

Notes to the financial statements (cont.)

(In PLN thousand)

2015	OPENING BALANCE	INCREASES		DECREASES			CLOSING BALANCE	IMPACT ON INCOME STATEMENT(**)
		IMPARIMENT CHARGES	OTHER (*)	WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET	RELEASE OF IMPARIMENT CHARGES	OTHER (*)		
Impairment of financial assets and off-balance sheet commitments								
Loans and advances to banks valued at amortized cost	19 360	684	1 541	-	(870)	(941)	19 774	186
Loans and advances to customers valued at amortized cost	5 582 478	1 156 227	100 138	(445 826)	(646 377)	(68 007)	5 678 633	(509 850)
Receivables from financial leases	187 901	23 834	-	(139)	(19 101)	(28 791)	163 704	(4 733)
Financial assets available for sale	122	-	-	-	-	-	122	-
Off-balance sheet commitments	102 386	71 614	1 182	-	(54 411)	-	120 771	(17 203)
Total financial assets and off-balance sheet commitments	**5 892 247**	**1 252 359**	**102 861**	**(445 965)**	**(720 759)**	**(97 739)**	**5 983 004**	**(531 600)**
Impairment of other assets								
Investments in associates	60	-	-	-	-	-	60	-
Intangible assets	10 961	-	-	-	-	-	10 961	-
Property, plant and equipment	6 667	610	1 569	(152)	-	(243)	8 451	(610)
Investment properties	8 682	-	-	-	-	-	8 682	-
Other	76 532	9 167	626	(3 592)	(3 093)	(1 904)	77 736	(6 074)
Total impairment of other assets	**102 902**	**9 777**	**2 195**	**(3 744)**	**(3 093)**	**(2 147)**	**105 890**	**(6 684)**
Total	**5 995 149**	**1 262 136**	**105 056**	**(449 709)**	**(723 852)**	**(99 886)**	**6 088 894**	**(538 284)**

(*) Including foreign exchange differences and transfers between positions.
(**) 'Impairment of financial assets and off-balance sheet commitments' includes net impairment in the amount of PLN minus 531 600 thousand and proceeds from recovered bad debt in the amount of PLN 14 042 thousand, the total is PLN minus 517 558 thousand.

Notes to the financial statements (cont.)

(In PLN thousand)

19. Gains (losses) on subsidiaries and associates

Share of profit (losses) from associates

	2016	2015
Share in gains (losses) from associates		
Dom Inwestycyjny Xelion Sp. z o.o.	2 179	1 965
Pioneer Pekao Investment Management S.A.	36 401	44 649
Krajowa Izba Rozliczeniowa S.A.	-	5 477
Total share in gains (losses) from associates	**38 580**	**52 091**
Gains (losses) on liquidation of subsidiaries	**(19)**	**55**
Gains (losses) on disposal of associates	**-**	**61 057**
Total gains (losses) from subsidiaries and associates	**38 561**	**113 203**

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

	2016	2015
Gains (losses) on disposal of property, plant and equipment classified as assets held for sale	1 029	-
Gains (losses) on de-recognition of property, plant and equipment and intangible assets other than classified as assets held for sale	4 330	12 373
Total gains (losses) on disposal of property, plant and equipment and intangible assets	**5 359**	**12 373**

21. Income tax

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

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

	2016	2015
Profit before income tax	**2 896 546**	**2 831 118**
Tax charge according to applicable tax rate	**550 344**	**537 912**
Permanent differences:	**66 438**	**(272)**
Non taxable income	(35 001)	(28 950)
Non tax deductible costs	105 720	29 252
Impact of other tax rates applied under a different tax jurisdiction	-	-
Impact of utilized tax losses	-	-
Tax relieves not included in the income statement	80	185
Other	(4 361)	(759)
Effective income tax charge on gross profit	**616 782**	**537 640**

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

	2016	2015
INCOME STATEMENT		
Current tax	**(586 052)**	**(469 589)**
Current tax charge in the income statement	(585 499)	(489 233)
Adjustments related to the current tax from previous years	207	22 393
Other taxes (e.g. withholding tax, income tax relating to foreign branch)	(760)	(2 749)
Deferred tax	**(30 730)**	**(68 051)**
Occurrence and reversal of temporary differences	(30 730)	(68 051)
Tax charge in the consolidated income statement	**(616 782)**	**(537 640)**
EQUITY		
Deferred tax	**118 927**	**60 338**
Income and costs disclosed in other comprehensive income:		
revaluation of financial instruments - cash flows hedges	1 056	17 735
revaluation of available for sale financial assets – debt securities	77 187	84 422
revaluation of available for sale financial assets – equity securities	38 488	(39 368)
Tax on items that are or may be reclassified subsequently to profit or loss	**116 731**	**62 789**
Tax charge on items that will never be reclassified to profit or loss	**2 196**	**(2 451)**
revaluation of the defined benefit liabilities	2 196	(2 451)
Total charge	**(497 855)**	**(477 302)**

Notes to the financial statements (cont.)

(In PLN thousand)

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

Notes to the financial statements (cont.)

(In PLN thousand)

	CHANGES IN TEMPORARY DIFFERENCES IN 2015									
	OPENING BALANCE			CHANGES RECOGNIZED		CHANGES RESULTING FROM CHANGES IN THE SCOPE OF CONSOLIDATION AND OTHER		CLOSING BALANCE		
	TOTAL DEFERRED TAX	RECOGNIZED IN THE INCOME STATEMENT	IN EQUITY	IN THE INCOME STATEMENT	IN EQUITY	RECOGNIZED IN THE INCOME STATEMENT	IN EQUITY	TOTAL DEFERRED TAX	RECOGNIZED IN THE INCOME STATEMENTS	IN EQUITY
DEFFERED TAX LIABILITY										
Accrued income – securities	-	-	-	-	-	-	-	-	-	-
Accrued income – loans	104 485	104 485	-	24 055	-	-	-	128 540	128 540	-
Change in revaluation of financial assets	258 875	113 075	145 800	(93 473)	(62 789)	59	118	102 790	19 661	83 129
Accelerated depreciation	125 491	125 491	-	(2 165)	-	-	-	123 326	123 326	-
Investment relief	6 459	6 459	-	(735)	-	-	-	5 724	5 724	-
Other	90 351	90 351	-	(233)	-	-	-	90 118	90 118	-
Gross deferred tax liability	**585 661**	**439 861**	**145 800**	**(72 551)**	**(62 789)**	**59**	**118**	**450 498**	**367 369**	**83 129**
DEFFERED TAX ASSET										
Accrued expenses – securities	97 700	97 700	-	(74 334)	-	-	-	23 366	23 366	-
Accrued expenses – loans and deposits	40 482	40 482	-	4 857	-	-	-	45 339	45 339	-
Downward revaluation of financial assets	298 354	298 354	-	(44 155)	-	2 759	-	256 958	256 958	-
Income received to be amortized over time from loans and current accounts	156 639	156 639	-	17 458	-	-	-	174 097	174 097	-
Loan provision expenses	524 936	524 936	-	(31 608)	-	-	-	493 328	493 328	-
Personnel related provisions	105 139	86 205	18 934	9 942	(2 451)	2 027	-	114 657	98 174	16 483
Accruals	25 331	25 331	-	(5 814)	-	-	-	19 517	19 517	-
Previous year loss	-	-	-	(1 412)	-	11 445	-	10 033	10 033	-
Other	212 406	212 406	-	(15 536)	-	26 601	-	223 471	223 471	-
Gross deferred tax asset	**1 460 987**	**1 442 053**	**18 934**	**(140 602)**	**(2 451)**	**42 832**	**-**	**1 360 766**	**1 344 283**	**16 483**
Deferred tax expenses	**x**	**x**	**x**	**(68 051)**	**60 338**	**42 773**	**(118)**	**x**	**x**	**x**
Net deferred tax assets	**877 419**	**1 004 285**	**(126 866)**	**x**	**x**	**x**	**x**	**915 204**	**981 850**	**(66 646)**
Net deferred tax provision	**2 093**	**2 093**	**-**	**x**	**x**	**x**	**x**	**4 936**	**4 936**	**-**

(In PLN thousand)

In the opinion of the Group the deferred tax asset in the amount of PLN 1 003 351 thousand reported as at 31 December 2016 is sustainable in total amount. The analysis was performed based on the past results of the Group's companies and assumed results in the future periods. The analysis assumed the five years' time horizon.

As at 31 December 2016 and 31 December 2015, there were temporary differences related to investments in subsidiaries and associates, for which deferred tax liability was not created as a result of meeting the conditions of controlling the terms of temporary differences' reversing and being probable that these differences will not reverse in foreseeable future.

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

EXPIRATION YEAR OF TEMPORARY DIFFERENCES	AMOUNT OF DIFFERENCES AS AT 31.12.2016	AMOUNT OF DIFFERENCES AS AT 31.12.2015
2016	-	20 753
2017	13 242	13 193
2018	14 165	10 150
2019	7 730	8 801
2020	313	888
2021	-	-
No time limits	32 043	26 448
Total	**67 493**	**80 233**

22. Earnings per share

Basic earnings per share

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

	2016	2015
Net profit	2 279 275	2 292 459
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Earnings per share (in PLN per share)	8.68	8.73

Diluted earnings per share

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

As at 31 December 2016 there no diluting instruments in the form of convertible bonds in the Group.

	2016	2015
Net profit	2 279 275	2 292 459
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Weighted average number of ordinary shares for the purpose of calculation of diluted earnings per share	262 470 034	262 470 034
Diluted earnings per share (in PLN per share)	8.68	8.73

Notes to the financial statements (cont.)

(In PLN thousand)

23. Dividend proposal

The Management Board of the Bank has decided to propose to the Ordinary General Meeting of Shareholders a dividend payment for 2016 in the amount of PLN 8.68 per share. Total dividend proposed to be paid amounts to 2 278 240 thousand. The dividend has not been recognized as liabilities and there are no tax consequences for the Bank.

The final decision on the distribution of net profit and its allocating to dividend will be made by the General Meeting of Shareholders.

24. Cash and balances with Central Bank

CASH AND DUE FROM CENTRAL BANK	31.12.2016	31.12.2015
Cash	2 639 532	2 951 414
Current account at Central Bank	1 718 775	4 930 181
Other	1 514 604	12
Total	**5 872 911**	**7 881 607**

AMOUNTS DUE TO CENTRAL BANK	31.12.2016	31.12.2015
Term deposits	6 091	914
Total	**6 091**	**914**

Cash and balances with Central Bank by currencies

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

31.12.2015	ASSETS	LIABILITIES
PLN	6 900 383	914
EUR	513 012	-
USD	247 073	-
CHF	64 635	-
Other currencies	156 504	-
Total	**7 881 607**	**914**

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

As at 31 December 2016 the interest rate of funds held on the mandatory reserve account is at 1.35% (0.9 of NBP reference rate). As at 31 December 2015 the interest rate was at 1.35% (0.9 of rediscount rate for bills of exchange).

Notes to the financial statements (cont.)

(In PLN thousand)

25. Loans and advances to banks

Loans and advances to banks by product type

	31.12.2016	31.12.2015
Current accounts	118 142	89 553
Interbank placements	267 828	3 461 155
Loans and advances	34 517	59 224
Cash collateral	1 771 842	1 675 589
Reverse repo transactions	703 635	1 757 063
Cash in transit	379 858	291 914
Total gross amount	**3 275 822**	**7 334 498**
Impairment allowances	(17 993)	(19 774)
Total net amount	**3 257 829**	**7 314 724**

Loans and advances to banks by quality

	31.12.2016	31.12.2015
Loans and advances to banks, including:		
non impaired (gross)	3 257 830	7 314 771
impaired (gross)	17 992	19 727
individual impairment allowances	(8 192)	(9 927)
collective impairment allowances (*)	(9 801)	(9 847)
Total	**3 257 829**	**7 314 724**

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

Loans and advances to banks by contractual maturities

	31.12.2016	31.12.2015
Loans and advances to banks, including:		
up to 1 month	3 178 259	6 919 511
between 1 and 3 months	345	11 481
between 3 months and 1 year	69 684	21 852
between 1 and 5 years	47	351 334
over 5 years	2	2
past due	27 485	30 318
Total gross amount	**3 275 822**	**7 334 498**
Impairment allowances	(17 993)	(19 774)
Total net amount	**3 257 829**	**7 314 724**

(In PLN thousand)

Loans and advances to banks by currencies

	31.12.2016	31.12.2015
PLN	1 012 264	2 758 456
CHF	19 462	30 586
EUR	2 010 070	1 959 303
USD	68 792	2 214 880
Other currencies	147 241	351 499
Total	**3 257 829**	**7 314 724**

Changes in the level of impairment allowances in 2016 and 2015 are presented in the Note 18.

26. Financial assets and liabilities held for trading

Financial assets and liabilities held for trading by product type

	31.12.2016	31.12.2015
FINANCIAL ASSETS		
Debt securities	730 750	1 124 717
Equity securities	1 719	2 075
Total financial assets	**732 469**	**1 126 792**
FINANCIAL LIABILITIES		
Debt securities	673 165	611 442
Total financial liabilities	**673 165**	**611 442**

Debt securities held for trading

	31.12.2016	31.12.2015
FINANCIAL ASSETS		
Debt securities issued by State Treasury	654 918	1 003 007
T- bills	-	-
T- bonds	654 918	1 003 007
Debt securities issued by banks	9 719	45 590
Debt securities issued by business entities	66 113	76 120
Debt securities issued by local governments	-	-
Total financial assets	**730 750**	**1 124 717**
FINANCIAL LIABILITIES		
Debt securities issued by State Treasury	673 165	611 442
T- bonds	673 165	611 442
Total financial liabilities	**673 165**	**611 442**

Equity securities held for trading

	31.12.2016	31.12.2015
Shares	1 719	2 075
Total	**1 719**	**2 075**

(In PLN thousand)

Debt securities held for trading by maturity

	31.12.2016	31.12.2015
FINANCIAL ASSETS		
Debt securities, including:		
up to 1 month	-	39 222
between 1 and 3 months	239	23 294
between 3 months and 1 year	117 804	358 297
between 1 and 5 years	324 868	163 737
over 5 years	278 120	532 443
unspecified term	9 719	7 724
Total financial assets	**730 750**	**1 124 717**
FINANCIAL LIABILITIES		
Debt securities, including:		
up to 1 month	102 076	-
between 1 and 3 months	-	-
between 3 months and 1 year	131 194	170 729
between 1 and 5 years	263 435	382 663
over 5 years	176 460	58 050
Total financial liabilities	**673 165**	**611 442**

Debt securities held for trading by currency

	31.12.2016	31.12.2015
FINANCIAL ASSETS		
PLN	710 575	1 110 529
EUR	5 629	10 072
USD	14 546	4 116
Total financial assets	**730 750**	**1 124 717**
FINANCIAL LIABILITIES		
PLN	673 165	611 442
Total financial liabilities	**673 165**	**611 442**

27. Derivative financial instruments (held for trading)

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

Barrier option with one barrier is a type of option where exercise of the option depends on the underlying crossing or reaching a given barrier level. A barrier may be reached starting from lower ('UP') or from higher ('DOWN') level of the underlying instrument. 'IN' options start their lives worthless and only become active when a predetermined knock-in barrier price is breached. 'OUT' options start their lives active and become null and void when a certain knock-out barrier price is breached.
Foreign exchange options are priced using the Garman-Kohlhagen valuation model (and in case of barrier and Asian options using the so-called expanded Garman-Kohlhagen model). Parameters of the model based on market quotations of plain-vanilla at-the-money options and market spreads for out-of-the-money and in-the-money options (volatility smile) for standard maturities.

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

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

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

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

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

Risk involved in financial derivatives
Market risk and credit risk are the basic types of risk, associated with derivatives.

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Fair value of trading derivatives

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

31.12.2015	ASSETS	LIABILITIES
Interest rate transactions		
Interest Rate Swaps (IRS)	2 866 458	2 857 159
Forward Rate Agreements (FRA)	960	906
Options	10 129	10 046
Other	3 515	3 278
Foreign currency and gold transactions		
Cross-Currency Interest Rate Swaps (CIRS)	28 626	99 948
Currency Forward Agreements	80 894	76 309
Currency Swaps (FX-Swap)	134 707	70 979
Options for currency and gold	44 658	41 557
Transactions based on equity securities and stock indexes		
Options	8 366	8 366
Other	28	7 725
Transactions based on commodities and precious metals		
Options	12 120	12 182
Other	15 986	15 873
Total	**3 206 447**	**3 204 328**

Notes to the financial statements (cont.)

(In PLN thousand)

Nominal value of trading derivatives

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

Notes to the financial statements (cont.)

(In PLN thousand)

31.12.2015	CONTRACTUAL MATURITY UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Interest rate transactions						
Interest Rate Swaps (IRS)	5 430 113	7 313 716	11 740 420	71 051 076	16 922 760	112 458 085
Forward Rate Agreements (FRA)	2 710 000	1 715 000	2 600 000	-	-	7 025 000
Options	-	-	449 753	4 067 896	-	4 517 649
Other	2 151 319	-	-	-	-	2 151 319
Foreign currency and gold transactions						
Cross-Currency Interest Rate Swaps (CIRS) - currency bought	-	-	190 050	1 767 090	738 117	2 695 257
Cross-Currency Interest Rate Swaps (CIRS) - currency sold	-	-	191 768	1 824 407	738 117	2 754 292
Currency Forward Agreements - currency bought	5 449 992	1 556 316	2 378 828	1 490 042	-	10 875 178
Currency Forward Agreements - currency sold	5 466 131	1 564 270	2 392 129	1 489 816	-	10 912 346
Currency Swaps (FX-Swap) – currency bought	9 712 492	4 346 841	3 556 983	44 767	-	17 661 083
Currency Swaps (FX-Swap) – currency sold	9 724 187	4 295 106	3 510 929	43 527	-	17 573 749
Options bought	449 287	437 335	2 339 376	1 921 686	-	5 147 684
Options sold	448 167	437 504	2 335 255	1 921 686	-	5 142 612
Transactions based on equity securities and stock indexes						
Options	83 326	81 857	-	-	-	165 183
Other	-	941	684	-	21 000	22 625
Transactions based on commodities and precious metals						
Options	55 650	38 465	180 543	23 048	-	297 706
Other	647	3 652	143 299	20 985	-	168 583
Total	**41 681 311**	**21 791 003**	**32 010 017**	**85 666 026**	**18 419 994**	**199 568 351**

(In PLN thousand)

28. Loans and advances to customers

Loans and advances to customers by product type

	31.12.2016	31.12.2015
Mortgage loans	54 713 809	49 231 194
Current accounts	10 599 898	11 230 205
Operating loans	13 897 871	15 070 467
Investment loans	16 810 632	17 071 901
Cash loans	10 211 931	9 087 671
Payment cards receivables	970 673	873 287
Factoring	2 890 930	2 610 926
Other loans and advances	1 595 088	1 855 173
Debt securities	12 451 372	12 376 949
Reverse repo transactions	-	4 755 472
Cash in transit	89 682	70 587
Total gross amount	**124 231 886**	**124 233 832**
Impairment allowances	(5 542 619)	(5 678 633)
Total net amount	**118 689 267**	**118 555 199**

Loans and advances to customers by customer type

	31.12.2016	31.12.2015
Corporate	55 257 059	58 541 698
Individuals	58 379 647	54 155 797
Budget entities	10 595 180	11 536 337
Total gross amount	**124 231 886**	**124 233 832**
Impairment allowances	(5 542 619)	(5 678 633)
Total net amount	**118 689 267**	**118 555 199**

Loans and advances to customers by quality

	31.12.2016	31.12.2015
Loans and advances to customers, including:		
non impaired (gross)	116 571 271	116 339 786
impaired (gross)	7 660 615	7 894 046
individual impairment allowances	(3 189 149)	(3 248 513)
collective impairment allowances (*)	(2 353 470)	(2 430 120)
Total	**118 689 267**	**118 555 199**

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

(In PLN thousand)

Loans and advances to customers by contractual maturities

	31.12.2016	31.12.2015
Loans and advances to customers, including:		
up to 1 month	15 184 650	17 494 117
between 1 and 3 months	3 050 503	4 172 392
between 3 months and 1 year	12 393 167	12 542 056
between 1 and 5 years	37 323 318	37 537 504
over 5 years	50 359 575	46 398 538
past due	5 920 673	6 089 225
Total gross amount	**124 231 886**	**124 233 832**
Impairment allowances	(5 542 619)	(5 678 633)
Total net amount	**118 689 267**	**118 555 199**

Loans and advances to customers by currencies

	31.12.2016	31.12.2015
PLN	96 647 980	98 406 507
CHF	4 640 419	4 975 796
EUR	13 934 872	11 871 781
USD	3 289 584	3 198 687
Other currencies	176 412	102 428
Total	**118 689 267**	**118 555 199**

Changes in impairment allowances in 2016 and 2015 are presented in the Note 18.

29. Receivables from finance leases

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

31.12.2015	GROSS LEASING INVESTMENT	PRESENT VALUE OF MINIMUM LEASING PAYMENTS
Up to 1 year	1 464 287	1 355 346
Between 1 and 5 years	2 156 562	2 037 787
Over 5 years	284 717	274 550
Total	**3 905 566**	**3 667 683**
Unrealized financial income	(237 883)	
Net leasing investment	**3 667 683**	
Unguaranteed residual values accruing to the benefit of the lessor	-	
Present value of minimum lease payments	3 667 683	
Impairment allowances	(163 704)	
Balance sheet value	**3 503 979**	

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

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

Lease financing receivables from banks by quality

	31.12.2016	31.12.2015
Receivables from financial leases from banks, including:		
non impaired (gross)	704	4 334
impaired (gross)	-	-
individual impairment allowances	-	-
collective impairment allowances (*)	(6)	(11)
Total	**698**	**4 323**

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

Lease financing receivables from customers by quality

	31.12.2016	31.12.2015
Receivables from financial leases from customers, including:		
non impaired (gross)	3 934 980	3 435 904
impaired (gross)	205 906	227 445
individual impairment allowances	(30 047)	(31 556)
collective impairment allowances (*)	(136 894)	(132 137)
Total	**3 973 945**	**3 499 656**

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

Receivables from finance leases by currencies

	31.12.2016	31.12.2015
PLN	2 450 665	2 227 320
CHF	1 416	2 390
EUR	1 522 242	1 270 687
USD	320	3 582
Total	**3 974 643**	**3 503 979**

Changes in impairment allowances in 2016 and 2015 are presented in the Note 18.

(In PLN thousand)

30. Hedge accounting

As at 31 December 2016 the Group applies fair value hedge accounting and cash flow hedge accounting.

In the period from 1 January to 31 December 2016 the Group continued to apply the following hedge accounting:

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

In the period from 1 January to 31 December 2016 the Group designated to the hedge accounting the hedging relationship and terminated the relationship – cash flow hedge accounting for highly probable cash flow denominated in EUR (long position in EUR for the Group) hedged with foreign exchange forward transactions (a series of FX-Spot and FX-Swap transactions) - described in point 6 of the table with details of hedging relationships. Termination of the relationship resulted from settlement of transactions included in the hedging relationship. Last cash flows from hedged items occurred on 27 June 2016.

The table below presents the fair values of hedging derivatives

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

31.12.2015	ASSETS	LIABILITIES
Fair value hedge accounting		
Interest rate swaps (IRS)	5 737	269 817
Cross-currency interest rate swaps (CIRS)	-	-
Cash flow hedge accounting		
Interest rate swaps (IRS)	355 731	-
Cross-currency interest rate swaps (CIRS)	56 840	1 431 956
Currency Swaps (FX–Swap)	3 332	986
Total	**421 640**	**1 702 759**

Notes to the financial statements (cont.)

(In PLN thousand)

The table below presents nominal values of hedging derivatives

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

31.12.2015	CONTRACTS ACCORDING TO MATURITIES					TOTAL
	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	
Fair value hedge accounting						
Interest rate swaps (IRS)	-	-	-	1 511 172	1 451 033	2 962 205
Cross-currency interest rate swaps (CIRS)	-	-	-	-	-	-
Cash flow hedge accounting						
Interest rate swaps (IRS)	-	-	215 000	3 775 000	-	3 990 000
Cross-currency interest rate swaps (CIRS)	-	-	2 708 866	10 972 969	4 507 339	18 189 174
Currency Swaps (FX–Swap)	992 573	777 310	212 988	-	-	1 982 871
Total	**992 573**	**777 310**	**3 136 854**	**16 259 141**	**5 958 372**	**27 124 250**

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

	2016	2015
Revaluation reserves (deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge - gross value)	39 724	45 280
Net interest income on hedging derivatives	212 587	208 571
Ineffective portion in changes in fair value of hedging transactions recognized in income statement	(756)	795

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

	2016	2015
Opening balance	**45 280**	**138 621**
Deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge	(5 451)	(93 277)
Amount of the deferral of fair value changes of hedging instruments of the effective hedge removed from revaluation reserves and presented in net profit or loss	(105)	(64)
Closing balance	**39 724**	**45 280**

Notes to the financial statements (cont.)

(In PLN thousand)

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

TYPE OF GAINS/LOSSES	2016	2015
Gains/losses from revaluation of hedging instruments to fair value	26 502	40 167
Gains/losses from revaluation of hedged item associated with hedged risk to fair value	(25 189)	(34 620)
Result on fair value hedge accounting	**1 313**	**5 547**
Net interest income of hedging derivatives	(73 721)	(57 637)

Detailed description of hedging relationships applied by the Group during the period from 1 January to 31 December 2016

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

Notes to the financial statements (cont.)

(In PLN thousand)

DESCRIPTION OF THE HEDGING RELATIONSHIP	HEDGED ITEM	HEDGING DERIVATIVES	FINANCIAL STATEMENTS PRESENTATION	PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR
4. Cash flow hedge of floating-rate currency assets hedged with FX-Swap transactions against the exchange and interest rate risk				
The Group hedges volatility of cash flows constituting floating-rate financial assets (loans in EUR and USD) with FX-Swap transactions. The currency and interest rate risk is hedged.	Loans with variable interest rate risk, denominated in EUR and USD constitute hedged items.	FX-Swap transaction portfolio constitutes the hedging position.	The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. Settled part of the swap points on the hedging instrument is transferred from the revaluation reserve in equity and recognized in interest income. Currency revaluation regarding the first capital exchange on the hedging instrument is transferred from the revaluation reserve in equity and recognized in the foreign currency exchange result.	It is expected that the cash flows related to the hedged items will occur until 18 April 2017.
5. Fair value hedge of fixed-coupon debt securities				
The Group hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions.	The hedged items are fixed coupon debt securities classified as loans and receivables, denominated in PLN.	The hedging derivatives consist of IRS transactions in PLN (short position in fixed-rate) for which the Group receives floating-rate payments, and pays fixed-rate.	The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on bonds is presented in the net interest income. Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 22 December 2026.
6. Cash flow hedge of expected future inflows in foreign currency – relationship completed				
The Group hedged the volatility of cash flows denominated in EUR constituting the projected inflows from expected sales with the designated FX-Forward transactions. The currency risk was being hedged. Discontinuation of the hedge accounting resulted from settlement of transactions included in the hedging relationship.	Projected inflows dependent on EUR and Polish zloty exchange rates were the hedged item	The hedging derivatives consisted of a portfolio of FX-Forward transactions (FX-Spot and series of FX-Swap), in which the Group sold EUR currency in exchange for PLN currency on 27 June 2016 at an agreed exchange rate.	The amount of the settlement of hedging transactions adjusted the settlement of the hedged item.net interest income.	-

31. Investment (placement) securities

	31.12.2016	31.12.2015
Debt securities available for sale (AFS)	31 949 770	17 517 884
Equity securities available for sale (AFS)	151 864	295 415
Debt securities held to maturity (HTM)	3 018 985	3 368 424
Total	**35 120 619**	**21 181 723**

Notes to the financial statements (cont.)

(In PLN thousand)

Debt securities available for sale (AFS)

	31.12.2016	31.12.2015
Securities issued by State Treasury	25 046 710	15 954 349
T-bills	-	-
T-bonds	25 046 710	15 954 349
Securities issued by Central Banks	5 978 629	628 454
Securities issued by business entities	249 912	251 367
Securities issued by local governments	674 519	683 714
Total	**31 949 770**	**17 517 884**
including impairment of assets	-	-

Equity securities available for sale (AFS)

	31.12.2016	31.12.2015
Shares	151 864	295 415
Total	**151 864**	**295 415**
including impairment of assets	-	(122)

In June 2016 the Bank has received information about the closing of the acquisition of Visa Europe Limited by Visa Inc. As a result of the settlement of this transaction the Bank has recognized in the financial statements for 2016:

- the cash received in the amount of EUR 43.6 million, equivalent to PLN 191.4 million at the average NBP exchange rate as of 21 June 2016,
- 15 818 preferred shares of Visa Inc. Series C, whose value has been estimated by the Bank at EUR 12.7 million, which is equivalent to PLN 55.8 million according to the average NBP exchange rate as of 21 June 2016. The shares have been classified to the available for sale portfolio of securities. Preferred shares of Visa Inc. Series C will be converted into ordinary shares of Visa Inc. Conversion of all preferred shares will take place no later than 2028. Until then, the transfer of shares by the Bank is subject to restrictions. The current conversion of preferred shares into ordinary shares may be decreased until 2028, which depends on the compensation paid by Visa during this period,
- receivables from deferred payments in cash in the amount of EUR 3.8 million (ie. 16.5 million at the average NBP exchange rate as of 21 June 2016). This amount will be paid on the third anniversary of the closing date, ie. in the second quarter of 2019.

On the same time the Bank derecognised the share in Visa Europe, together with its valuation. The carrying value of the share amounted to EUR 40.9 million (PLN 179.5 million as of 21 June 2016).

As a result of the settlement, the Bank has recognized the gain of PLN 263.7 million (before tax) in the Income Statement.

Debt securities held to maturity (HTM)

	31.12.2016	31.12.2015
Securities issued by State Treasury	2 998 379	2 497 324
T- bills	-	-
T- bonds	2 998 379	2 497 324
Securities issued by Central Banks	20 606	871 100
Total	**3 018 985**	**3 368 424**
including impairment of assets	-	-

(In PLN thousand)

Investment debt securities according to contractual maturities

	31.12.2016	31.12.2015
Debt securities, including:		
up to 1 month	7 424 354	1 499 554
between 1 and 3 months	573 661	443 644
between 3 months and 1 year	6 072 130	2 696 342
between 1 and 5 years	12 109 707	10 646 471
over 5 years	8 788 903	5 600 297
Total	**34 968 755**	**20 886 308**

Investment debt securities according to currencies

	31.12.2016	31.12.2015
PLN	30 844 812	17 835 368
EUR	2 790 183	2 635 034
USD	1 333 760	415 906
Total	**34 968 755**	**20 886 308**

Changes in investment (placement) securities

	2016	2015
SECURITIES AVAILABLE FOR SALE (AFS)		
Opening balance	**17 813 299**	**23 111 208**
Increases (purchase)	89 733 305	217 273 604
Decreases (sale and redemption)	(75 816 126)	(222 978 862)
Changes in fair value	(460 735)	(257 139)
Exchange rate differences	170 926	179 036
Accrued interest	705 443	618 156
Other changes	(44 478)	(132 704)
Closing balance	**32 101 634**	**17 813 299**
DEBT SECURITIES HELD UNTIL MATURITY (HTM)		
Opening balance	**3 368 424**	**1 601 568**
Increases (purchase)	6 660 966	47 236 297
Decreases (sale and redemption)	(7 069 725)	(45 530 013)
Accrued interest	28 096	21 238
Other changes	31 224	39 334
Closing balance	**3 018 985**	**3 368 424**
Net total investment (placement) securities	**35 120 619**	**21 181 723**

32. Reclassification of securities

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

In 2016 and 2015, the Group did not reclassify any financial instruments into other categories.

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

Notes to the financial statements (cont.)

(In PLN thousand)

The tables below present the information on the reclassified financial assets

	AMOUNT OF RECLASSIFICATION	31.12.2016		31.12.2015	
		CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Financial assets reclassified from Available for Sale assets to Loans and advances to customers	1 331 580	64 381	61 109	68 974	65 191
Financial assets reclassified from Held for Trading assets to Held to Maturity assets	602 507	217 365	219 258	666 725	673 607
Total	**1 934 087**	**281 746**	**280 367**	**735 699**	**738 798**

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

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

31.12.2015	NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	REVALUATION RESERVE
Financial assets reclassified from Available for Sale assets to Loans and advances to customers	-	127
Financial assets reclassified from Held for Trading assets to Held to Maturity assets	(6 713)	-
Total	**(6 713)**	**127**

Net interest income on reclassified financial assets

	2016	2015
Financial assets reclassified from Available for Sale assets to Loans and advances to customers	1 580	1 998
Financial assets reclassified from Held for Trading assets to Held to Maturity assets	10 625	12 770
Total	**12 205**	**14 768**

33. Assets and liabilities held for sale

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

As at 31 December 2016, non-current assets classified as held for sale are as follows:

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

(In PLN thousand)

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

	31.12.2016	31.12.2015
ASSETS HELD FOR SALE		
Property, plant and equipment	25 703	22 787
Other assets	22 574	22 515
Total assets	**48 277**	**45 302**

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

ASSETS HELD FOR SALE	2016	2015
Opening balance	**45 302**	**37 102**
Increases including:	11 541	51 929
transfer from property, plant and equipment	3 113	27 008
transfer from investment properties	8 295	-
transfer from investments in associates	-	24 119
other changes	133	802
Decreases including:	(8 566)	(43 729)
transfer from property, plant and equipment	(1 250)	(13 460)
transfer from investment properties	(4 466)	-
sale of shares in associate	-	(24 119)
disposal	(2 820)	(5 879)
other changes	(30)	(271)
Stan na koniec okresu	**48 277**	**45 302**

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

	2016	2015
Sales revenues	3 849	5 150
Net carrying amount of disposed assets (including costs to sell)	(2 820)	(5 150)
Profit/loss on sale before income tax	**1 029**	**-**

34. Investments in associates

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

NAME OF ASSOCIATE	COUNTRY OF INCORPORATION AND PLACE OF BUSINESS	PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING		MEASUREMENT METHOD	NATURE OF THE RELATIONSHIP
		31.12.2016	31.12.2015		
Dom Inwestycyjny Xelion Sp. z o.o.	Poland	50.00	50.00	Equity method	The strategic Entity providing affluent customers with services of assets management.
Pioneer Pekao Investment Management S.A.	Poland	49.00	49.00	Equity method	The Entity deals with management of investment funds assets and is of strategic importance for the Group that distributes and supporting such products.

Notes to the financial statements (cont.)

(In PLN thousand)

The summarized financial information of the associates are presented below. The information derives from the financial statements, which are in the process of auditing by the entities authorizing to audit financial statements. The audit opinions on those financial statements will be expressed after the release date of the consolidated financial statements of Bank Pekao S.A. Group.

	DOM INWESTYCYJNY XELION SP. Z O.O.		PIONEER PEKAO INVESTMENT MANAGEMENT S.A.	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Current assets	53 997	48 090	281 275	313 553
Non-current assets	2 175	3 269	8 605	9 295
TOTAL ASSETS	**56 172**	**51 359**	**289 880**	**322 848**
Current liabilities	26 380	26 361	33 299	35 284
Non-current liabilities	4 348	3 913	4 541	5 070
TOTAL LIABILITIES	**30 728**	**30 274**	**37 840**	**40 354**
NET ASSETS	**25 444**	**21 085**	**252 040**	**282 494**

	DOM INWESTYCYJNY XELION SP. Z O.O.		PIONEER PEKAO INVESTMENT MANAGEMENT S.A.	
	2016	2015	2016	2015
Revenue	57 129	56 331	324 839	383 019
Net profit (loss) for the period from continuing operations	4 359	3 930	74 437	91 284
Other comprehensive income	-	-	37	36
Total comprehensive income	**4 359**	**3 930**	**74 474**	**91 320**

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

	DOM INWESTYCYJNY XELION SP. Z O.O.		PIONEER PEKAO INVESTMENT MANAGEMENT S.A.		RAZEM	
	2016	2015	2016	2015	2016	2015
Group's interest in net assets at beginning of the year	10 542	8 577	138 423	141 985	148 965	150 562
Group's interest in net profit (loss) for the period (*)	2 179	1 965	36 401	44 649	38 580	46 614
Group's interest in other comprehensive income	-	-	18	18	18	18
Dividend received from associates	-	-	(51 342)	(48 229)	(51 342)	(48 229)
Group's interest in net assets at beginning of the year	12 721	10 542	123 500	138 423	136 221	148 965
Carrying amount of the interests	**12 721**	**10 542**	**123 500**	**138 423**	**136 221**	**148 965**

(*) Group's interest includes the changes in net profit (loss) for the previous period, that arose after the release date of financial statements of Bank Pekao S.A. Group and before the approval date of financial statements of particular associates.

Notes to the financial statements (cont.)

(In PLN thousand)

35. Intangible assets

	31.12.2016	31.12.2015
Intangible assets, including:	540 661	581 197
research and development expenditures	3 024	7 948
licenses and patents	455 647	446 987
other	7 688	11 183
assets under construction	74 302	115 079
Goodwill	55 520	55 520
Total	**596 181**	**636 717**

The goodwill was transferred to Bank Pekao S.A. on integration with Bank BPH S.A. It represents the goodwill recognized upon acquisition of Pierwszy Komercyjny Bank S.A. in Lublin (‘PKBL’) by Bank BPH S.A. and relates to those branches of the PKBL which were transferred to Bank Pekao S.A. as a result of integration with Bank BPH S.A. It is determined the smallest identifiable cash-generating units (‘CGU’), to which the goodwill has been allocated in the amount of PLN 51 675 thousand.

Moreover in the line ‘Goodwill’ are presented:

- goodwill recognized upon acquisition of Spółdzielcza Kasa Oszczędnościowo – Kredytowa im. Mikołaja Kopernika by Bank Pekao S.A. It is determined the smallest identifiable cash-generating units (‘CGU’), to which the goodwill has been allocated in the amount of PLN 960 thousand,
- goodwill recognized upon acquisition of Pekao Leasing i Finanse S.A. (formerly BPH Leasing S.A.) by Pekao Leasing Holding S.A. (ex. BPH PBK Leasing S.A.). It is determined the smallest identifiable cash-generating units (‘CGU’), to which the goodwill has been allocated in the amount of PLN 2 885 thousand.

In respect to the goodwill, the impairment test is performed annually, irrespective of whether there is any indication that it may be impaired.

The impairment test is performed by comparing the carrying amount of the CGU, including the goodwill, with the recoverable amount of the CGU. The recoverable amount is estimated on the basis of value in use of the CGU. The value in use is the present, estimated value of the future cash flows for the period of 5 years, taking into account the residual value of the CGU. The residual value of the CGU is calculated based on an extrapolation of cash flows projections beyond the forecast period using the growth rate of 2.5%. The forecasts of the future cash flows are based on the assumptions included the Bank’s budget for 2017 and financial plan for 2018-2021. To discount the future cash flows, it is applied the discount rate of 8.38%, which includes the risk-free rate and the risk premium.

The impairment test performed as at 31 December 2016 showed the surplus of the recoverable amount over the carrying amount of the CGU, and therefore no CGU impairment was recognized.

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Intangibles assets' in the course of the reporting period

2016	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	TOTAL
GROSS VALUE					
Opening balance	**90 174**	**2 279 571**	**51 326**	**115 079**	**2 536 150**
Increases including:	-	171 830	312	125 093	297 235
acquisitions	-	5 089	-	125 093	130 182
other	-	183	-	-	183
transfer from investments outlays	-	166 558	312	-	166 870
Decreases, including:	-	(20 889)	(16 445)	(165 870)	(203 204)
liquidation	-	(20 621)	(16 445)	-	(37 066)
other	-	(268)	-	-	(268)
transfer from investments outlays	-	-	-	(165 870)	(165 870)
Closing balance	**90 174**	**2 430 512**	**35 193**	**74 302**	**2 630 181**
ACCUMULATED AMORTIZATION					
Opening balance	**82 226**	**1 832 584**	**29 182**	**-**	**1 943 992**
Amortization	4 924	163 345	3 337	-	171 606
Liquidation	-	(21 064)	(5 014)	-	(26 078)
Other	-	-	-	-	-
Closing balance	**87 150**	**1 974 865**	**27 505**	**-**	**2 089 520**
IMPAIRMENT					
Opening balance	**-**	**-**	**10 961**	**-**	**10 961**
Increases	-	-	-	-	-
Decreases	-	-	(10 961)	-	(10 961)
Closing balance	**-**	**-**	**-**	**-**	**-**
NET VALUE					
Opening balance	**7 948**	**446 987**	**11 183**	**115 079**	**581 197**
Closing balance	**3 024**	**455 647**	**7 688**	**74 302**	**540 661**

Notes to the financial statements (cont.)

(In PLN thousand)

2015	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	TOTAL
GROSS VALUE					
Opening balance	**89 362**	**2 132 059**	**49 663**	**113 316**	**2 384 400**
Increases including:	812	157 708	1 677	154 937	315 134
acquisitions	-	2 826	-	154 937	157 763
other	-	36 741	-	-	36 741
transfer from investments outlays	812	118 141	1 677	-	120 630
Decreases, including:	-	(10 196)	(14)	(153 174)	(163 384)
liquidation	-	(7 319)	-	-	(7 319)
other	-	(2 877)	(14)	(32 544)	(35 435)
transfer from investments outlays	-	-	-	(120 630)	(120 630)
Closing balance	**90 174**	**2 279 571**	**51 326**	**115 079**	**2 536 150**
ACCUMULATED AMORTIZATION					
Opening balance	**78 950**	**1 695 120**	**27 857**	**-**	**1 801 927**
Amortization	3 276	144 738	1 340	-	149 354
Liquidation	-	(7 228)	(15)	-	(7 243)
Other	-	(46)	-	-	(46)
Closing balance	**82 226**	**1 832 584**	**29 182**	**-**	**1 943 992**
IMPAIRMENT					
Opening balance	**-**	**-**	**10 961**	**-**	**10 961**
Closing balance	**-**	**-**	**10 961**	**-**	**10 961**
NET VALUE					
Opening balance	**10 412**	**436 939**	**10 845**	**113 316**	**571 512**
Closing balance	**7 948**	**446 987**	**11 183**	**115 079**	**581 197**

In the period from 1 January to 31 December 2016, the Group acquired intangible assets in the amount of PLN 130 182 thousand (in 2015 - PLN 157 763 thousand).

In the period from 1 January to 31 December 2016 and in 2015 there have been no intangible assets whose title is restricted and pledged as security for liabilities.

Contractual commitments

As at 31 December 2016 the contractual commitments for the acquisition of intangible assets amounted to PLN 43 930 thousand, whereas as at 31 December 2015 - PLN 49 487 thousand.

36. Property, plant and equipment

	31.12.2016	31.12.2015
Non-current assets, including:	1 308 234	1 376 409
land and buildings	1 000 882	1 055 147
machinery and equipment	245 479	245 717
transport vehicles	24 026	34 170
other	37 847	41 375
Non-current assets under construction and prepayments	114 696	84 243
Total	**1 422 930**	**1 460 652**

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Property, plant and equipment' in the course of the reporting period

2016	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	**2 278 125**	**1 452 658**	**83 169**	**326 314**	**84 826**	**4 225 092**
Increases, including:	21 640	81 249	4 882	4 996	133 837	246 604
acquisitions	1 969	5 233	1 412	630	133 837	143 081
other	2	610	3 470	48	-	4 130
transfer from non-current assets under construction	19 669	75 406	-	4 318	-	99 393
Decreases, including:	(35 556)	(64 734)	(7 291)	(10 486)	(103 967)	(222 034)
liquidation and sale	(32 398)	(64 257)	(7 291)	(8 837)	-	(112 783)
transfer to non-current assets held for sale	(2 886)	(149)	-	(78)	-	(3 113)
other	(272)	(328)	-	(1 571)	(4 574)	(6 745)
transfer from non-current assets under construction	-	-	-	-	(99 393)	(99 393)
Closing balance	**2 264 209**	**1 469 173**	**80 760**	**320 824**	**114 696**	**4 249 662**
ACCUMULATED DEPRECIATION						
Opening balance	**1 219 079**	**1 203 090**	**48 999**	**284 821**	**-**	**2 755 989**
Increases, including:	66 805	80 631	12 575	8 371	-	168 382
depreciation	66 805	80 326	12 575	8 371	-	168 077
other	-	305	-	-	-	305
Decreases, including: a\\	(26 410)	(63 814)	(4 840)	(10 333)	-	(105 397)
liquidation and sale	(25 385)	(63 376)	(4 783)	(10 255)	-	(103 799)
transfer to non-current assets held for sale	(1 025)	(147)	-	(78)	-	(1 250)
other	-	(291)	(57)	-	-	(348)
Closing balance	**1 259 474**	**1 219 907**	**56 734**	**282 859**	**-**	**2 818 974**
IMPAIRMENT						
Opening balance	**3 899**	**3 851**	**-**	**118**	**583**	**8 451**
Increases	-	-	-	-	-	-
Decreases	(46)	(64)	-	-	(583)	(693)
Closing balance	**3 853**	**3 787**	**-**	**118**	**-**	**7 758**
NET VALUE						
Opening balance	**1 055 147**	**245 717**	**34 170**	**41 375**	**84 243**	**1 460 652**
Closing balance	**1 000 882**	**245 479**	**24 026**	**37 847**	**114 696**	**1 422 930**

Notes to the financial statements (cont.)

(In PLN thousand)

2015	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	**2 303 114**	**1 495 518**	**94 510**	**344 297**	**86 054**	**4 323 493**
Increases, including:	49 589	79 072	7 718	7 385	110 597	254 361
acquisitions	9 541	12 235	4 324	1 611	110 132	137 843
other	2 228	1 053	3 360	77	465	7 183
transfer from non-current assets under construction	37 820	65 784	34	5 697	-	109 335
Decreases, including:	(74 578)	(121 932)	(19 059)	(25 368)	(111 825)	(352 762)
liquidation and sale	(29 005)	(121 719)	(11 692)	(25 335)	(53)	(187 804)
transfer to non-current assets held for sale	(26 956)	(52)	-	-	-	(27 008)
other	(18 617)	(161)	(7 367)	(33)	(2 437)	(28 615)
transfer from non-current assets under construction	-	-	-	-	(109 335)	(109 335)
Closing balance	**2 278 125**	**1 452 658**	**83 169**	**326 314**	**84 826**	**4 225 092**
ACCUMULATED DEPRECIATION						
Opening balance	**1 196 576**	**1 230 481**	**47 209**	**298 421**	**-**	**2 772 687**
Increases, including:	76 894	93 557	15 331	11 297	-	197 079
depreciation	69 957	84 941	14 923	10 026	-	179 847
other	6 937	8 616	408	1 271	-	17 232
Decreases, including: a\\	(54 391)	(120 948)	(13 541)	(24 897)	-	(213 777)
liquidation and sale	(33 002)	(120 742)	(13 533)	(24 883)	-	(192 160)
transfer to non-current assets held for sale	(13 414)	(47)	-	-	-	(13 461)
other	(7 975)	(159)	(8)	(14)	-	(8 156)
Closing balance	**1 219 079**	**1 203 090**	**48 999**	**284 821**	**-**	**2 755 989**
IMPAIRMENT						
Opening balance	**2 565**	**3 961**	**-**	**141**	**-**	**6 667**
Increases	1 560	35	-	1	583	2 179
Decreases	(226)	(145)	-	(24)	-	(395)
Closing balance	**3 899**	**3 851**	**-**	**118**	**583**	**8 451**
NET VALUE						
Opening balance	**1 103 973**	**261 076**	**47 301**	**45 735**	**86 054**	**1 544 139**
Closing balance	**1 055 147**	**245 717**	**34 170**	**41 375**	**84 243**	**1 460 652**

In the period from 1 January to 31 December 2016 the Group acquired property, plant and equipment in the amount of PLN 143 081thousand (in 2015 - PLN 137 843 thousand), while the value of property, plant and equipment sold amounted to PLN 8 150 thousand (in 2015 - PLN 7 717 thousand).

The amount of compensations received from third parties for impairment of loss of property, plant and equipment items recognized in the income statement for 2016 stood at PLN 3 551 thousand (in 2015 - PLN 1 995 thousand).

In 2016 and 2015 there have been no restrictions to legal titles to property, plant and equipment, nor pledges in place as security for liabilities.

Contractual commitments

As at 31 December 2016 the contractual commitments for the acquisition of property, plant and equipment amounted to PLN 17 525 thousand, whereas as at 31 December 2015 - PLN 57 012 thousand.

Notes to the financial statements (cont.)

(In PLN thousand)

37. Investment property

The Group values investment property using the historical cost model.

The rights to sell the investment property and the rights to transfer related revenues and profits are not a subject to limitations.

Changes in 'Investment property' in the course of the reporting period

	2016	2015
GROSS VALUE		
Opening balance	**66 253**	**71 461**
Increases, including:	431	10 341
acquisitions	431	324
transfer from property plant and equipment	-	10 017
transfer from non-current assets held for sale	-	-
Decreases, including:	(11 120)	(15 549)
sale of real estate	(2 777)	(15 437)
transfer to non-current assets held for sale	(8 295)	-
other	(48)	(112)
Closing balance	**55 564**	**66 253**
ACCUMULATED DEPRECIATION		
Opening balance	**27 350**	**27 484**
Increases, including:	1 183	9 628
depreciation for the period	1 183	1 654
transfer from property plant and equipment	-	7 974
other	-	-
Decreases, including:	(4 874)	(9 762)
sale of real estate	(1 133)	(9 650)
transfer from non-current assets held for sale	(3 741)	-
other	-	(112)
Closing balance	**23 659**	**27 350**
IMPAIRMENT		
Opening balance	**8 682**	**8 682**
Increases, including:	-	-
impairment charges	-	-
Decreases, including:	(1 651)	-
sale of real estate	(926)	-
transfer from non-current assets held for sale	(725)	-
Closing balance	**7 031**	**8 682**
NET VALUE		
Opening balance	**30 221**	**35 295**
Closing balance	**24 874**	**30 221**

(In PLN thousand)

The fair value of investment property as at 31 December 2016 stood at PLN 14 599 thousand (PLN 43 889 thousand as at 31 December 2015). The fair value of investment property are categorized in Level 3 of the fair value hierarchy. The fair value was measured based on valuations of the property appraisers, having appropriate professional qualifications and recent experience in the location of the properties being valued. The valuations of investment property are based on investment method or profits method, taking into account such unobservable input data as expected rental growth rate, void periods, occupancy rate, discount rate.

The following amounts of revenues and costs associated with investment properties have been recognized in the income statement

	2016	2015
Rental revenues from investment properties	4 069	4 319
Direct operating expenses associated with investment properties (including repair and maintenance costs) which generated rental revenues during the reporting period	(1 568)	(1 485)
Direct operating expenses associated with investment properties (including repair and maintenance costs) which did not generate rental revenues during the reporting period	-	(371)

38. Other assets

	31.12.2016	31.12.2015
Prepaid expenses	132 063	112 514
Perpetual usufruct rights	14 876	15 181
Accrued income	78 756	52 595
Interbank and interbranch settlements	156	1 770
Other debtors	325 351	289 515
Card settlements	479 996	1 808 150
Total	**1 031 198**	**2 279 725**

Prepaid expenses represent expenditures, which will be amortized against income statement in the forthcoming reporting periods.

The item ‘Other debtors’ includes assets for sale in the amount of PLN 90 thousand as at 31 December 2016 (PLN 90 thousand as at 31 December 2015). Assets for sale represent assets taken over for debts. They are presented in a debt value reduced by impairment charge, calculated as a difference between the amount of debt and fair value of taken over assets (if lower than the amount of debt). In case of surplus between the fair value of taken over asset and the amount of debt, the difference is recognized as a liability to debtor.

The Group disposes of the assets for sale taken over for debts. The period in which the assets should be disposed is 5 years for real estate and 3 years for other assets for sale (the period starts from the date of assets’ taken over). When the period expires, the Group reclassifies the carrying value of unsold assets for sales into appropriate category of property, plant and equipment used by the Group.

(In PLN thousand)

39. Assets pledged as collateral

As at 31 December 2016 the Group held the following financial assets pledged as security for liabilities

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transaction	bonds	1 774 747	1 678 677	1 775 808
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	750 701	720 200	-
Lombard and technical loan	bonds	4 808 629	4 515 159	-
Other loans	bonds	357 614	353 900	297 497
Issue of mortgage bonds	receivables backed by mortgage, bonds	1 678 258	1 679 057	1 222 018
Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	bonds, cash deposit	51 155	50 890	-
Derivatives	bonds	60 792	65 302	31 987

As at 31 December 2015 the Group held the following financial assets pledged as security for liabilities

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transaction	bonds	3 394 183	3 152 162	3 388 421
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	703 818	680 200	-
Lombard and technical loan	bonds	4 750 392	4 504 675	-
Other loans	bonds	490 285	481 200	328 076
Issue of mortgage bonds	receivables backed by mortgage, bonds	1 679 460	1 683 864	1 234 528
Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	bonds, cash deposit	39 296	38 802	-
Derivatives	bonds	45 708	47 163	24 771

The freeze on securities is a consequence of:

- in case of Repo and Sell-buy-back transactions – binding money market standards for such transactions,
- in case of freeze to the benefit of BFG – binding provisions of the Law on Banking Guaranty Fund BFG,
- in case of lombard and technical loans – policy and standards, applied by the National Bank of Poland NBP,
- in case of other loans, deposits and derivatives – terms and conditions of the agreement, entered between Bank Pekao S.A. and its clients,
- in case of issue of mortgage bonds – binding provisions of the Law on Mortgage Bonds and Mortgage Banks,
- in case of freeze to the benefit of KDPW – with the status of the clearing member for brokerage transactions.

(In PLN thousand)

40. Amounts due to other banks

Amounts due to other banks by product type

	31.12.2016	31.12.2015
Current accounts	902 856	1 121 885
Interbank deposits and other liabilities	309 837	581 301
Loans and advances received	3 249 417	3 263 303
Repo transactions	339 568	963 830
Cash in transit	21 762	28 130
Total	**4 823 440**	**5 958 449**

Amounts due to other banks by currencies

	31.12.2016	31.12.2015
PLN	1 442 611	1 379 402
CHF	731 657	744 746
EUR	2 592 591	3 774 189
USD	48 467	50 277
Other currencies	8 114	9 835
Total	**4 823 440**	**5 958 449**

41. Amounts due to customers

Amounts due to customers by product type

	31.12.2016	31.12.2015
Amounts due to corporate, including:	57 989 927	55 167 425
current accounts	33 946 882	29 048 523
term deposits and other liabilities	24 043 045	26 118 902
Amounts due to budget entities, including:	7 809 235	5 610 623
current accounts	5 461 224	4 689 452
term deposits and other liabilities	2 348 011	921 171
Amounts due to individuals, including:	70 347 039	63 434 250
current accounts	39 682 587	33 827 209
term deposits and other liabilities	30 664 452	29 607 041
Repo transactions	1 436 241	4 468 820
Cash in transit	233 484	186 573
Total	**137 815 926**	**128 867 691**

Amounts due to customers by currencies

	31.12.2016	31.12.2015
PLN	115 090 198	106 548 096
CHF	315 787	234 011
EUR	13 400 735	13 215 198
USD	7 476 067	8 013 651
Other currencies	1 533 139	856 735
Total	**137 815 926**	**128 867 691**

Notes to the financial statements (cont.)

(In PLN thousand)

42. Debt securities issued

Debt securities issued by type

	31.12.2016	31.12.2015
Certificates of deposit	300 945	1 668 706
Mortgage bonds	1 222 018	1 234 527
Total	**1 522 963**	**2 903 233**

The Group redeems its own debt securities issued on a timely basis.

Debt securities issued by currencies

	31.12.2016	31.12.2015
PLN	1 200 548	2 592 848
EUR	322 415	310 385
USD	-	-
Total	**1 522 963**	**2 903 233**

Changes in debt securities issued

	2016	2015
Opening balance	**2 903 233**	**3 857 043**
Increase (issuance)	1 129 733	3 966 098
Decrease (redemption)	(2 467 807)	(4 999 636)
Decrease (partial redemption)	(38 245)	(7 903)
Foreign currency exchange differences	11 885	(1 053)
Purchase	-	(33)
Sale	-	90 989
Other	(15 836)	(2 272)
Closing balance	**1 522 963**	**2 903 233**

43. Provisions

Change in provisions in the reporting period

2016	PROVISIONS FOR LITIGATION AND CLAIMS	PROVISIONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	**10 608**	**268 858**	**120 771**	**25 137**	**425 374**
Provision charges/revaluation	4 092	26 635	160 561	23 386	214 674
Provision utilization	(3 405)	(13 020)	-	(11 207)	(27 632)
Provision releases	(3 202)	(19)	(61 341)	(442)	(65 004)
Foreign currency exchange differences	-	-	992	-	992
Other changes	458	11 560	-	(30)	11 988
Closing balance	**8 551**	**294 014**	**220 983**	**36 844**	**560 392**
Short term	3 214	47 435	67 159	14 201	132 009
Long term	5 337	246 579	153 824	22 643	428 383

Notes to the financial statements (cont.)

(In PLN thousand)

Change in provisions in the reporting period

2015	PROVISIONS FOR LITIGATION AND CLAIMS	PROVISIONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	**37 873**	**267 991**	**102 386**	**34 206**	**442 456**
Provision charges/revaluation	31 147	23 655	71 614	5 814	132 230
Provision utilization	(56 417)	(10 246)	-	(14 435)	(81 098)
Provision releases	(2 310)	(84)	(54 411)	(76)	(56 881)
Foreign currency exchange differences	-	-	1 182	-	1 182
Other changes	315	(12 458)	-	(372)	(12 515)
Closing balance	**10 608**	**268 858**	**120 771**	**25 137**	**425 374**
Short term	4 113	21 180	67 527	145	92 965
Long term	6 495	247 678	53 244	24 992	332 409

Provisions for litigation and claims
Provisions for litigation and claims include court, administrative and other legal proceedings. The provisions were estimated in the amount of expected outflow of resources embodying econimic benefits.

Provisions for defined benefit plans
Detailed information in respect to provisions for defined benefit plans were presented in Note 45.

Other provisions
Other provisions include in particular provisions for other employee benefits.

44. Other liabilities

	31.12.2016	31.12.2015
Deferred income	115 137	120 308
Provisions for holiday leave	56 924	56 983
Provisions for other employee-related liabilities	251 582	255 274
Provisions for administrative costs	90 461	103 348
Other costs to be paid (*)	111 239	162 048
Other creditors	338 335	274 565
Interbank and interbranch settlements	1 029 899	515 533
Card settlements	304 475	192 476
Total	**2 298 052**	**1 680 535**

(*) in this as at 31 December 2016 is PLN 95 346 thousand of provision for future refunds of the part of the remuneration for sale of insurance products linked to loans (PLN 104 122 as at 31 December 2015).

Notes to the financial statements (cont.)

(In PLN thousand)

45. Defined benefit plans

Based on internal regulations in respect to remuneration, the employees of the Group or their families are entitled to defined benefits other than remuneration:
a) retirement benefits,
b) death-in-service benefits.

The present value of such obligations is measured by an independent actuary using the projected unit credit method.
The amount of the retirement benefits and death-in-service benefits is dependent on length of service and amount of remuneration. The expected amount of the benefits is discounted actuarially, taking into account the financial discount rate and the probability of an individual get to the retirement age or die while working respectively. The financial discount rate is determined by reference to market yields at the end of reporting period on government bonds. The probability of an individual get to the retirement age or die while working is determined using the multiple decrement model, taking into consideration the following risks: possibility of dismissal from service, risk of total disability to work and risk of death.

These defined benefit plans expose the Group to actuarial risk, such as:
- interest rate risk – the decrease in market yields on government bonds would increase the defined benefit plans obligations,
- remuneration risk – the increase in remuneration of the Group's employees would increase the defined benefit plans obligations,
- longevity risk – the increase in life expectancy of the Group's employees would increase the defined benefit plans obligations.

The principal actuarial assumptions as at 31 December 2016 are as follows:
- the discount rate at the level of 3.50% (2.90 % as at 31 December 2015),
- the future salary growth rate at the level of 2.50% (2.50 % as at 31 December 2015),
- the probable number of leaving employees calculated on the basis of historical data concerning personnel rotation in the Group,
- the mortality adopted in accordance with Life Expectancy Tables for men and women, published the Central Statistical Office, adequately adjusted on the basis of historical data of the Group.

Reconciliation of the present value of defined benefit plans obligations
The following table presents a reconciliation from the opening balances to closing balances for the present value of defined benefit plans obligations.

	2016	2015
Opening balance	**268 858**	**267 991**
Current service cost	18 845	16 594
Interest expense	7 771	6 978
Remeasurements of the defined benefit obligations:	11 560	(12 900)
actuarial gains and losses arising from changes in demographic assumptions	33 812	(134)
actuarial gains and losses arising from changes in financial assumptions	(16 128)	(9 611)
actuarial gains and losses arising from experience adjustments	(6 124)	(3 155)
Contributions paid by the employer	(13 020)	(10 247)
Business combination	-	442
Closing balance	**294 014**	**268 858**

(In PLN thousand)

Sensitivity analysis
The following table presents how the impact on the defined benefits obligations would have increased (decreased) as a result of a change in the respective actuarial assumptions by one percent.

31.12.2016	DEFINED BENEFIT PLANS OBLIGATIONS	
	1 PERCENT INCREASE	1 PERCENT DECREASE
Discount rate	(23 580)	27 509
Future salary growth rate	26 278	(23 033)

31.12.2015	DEFINED BENEFIT PLANS OBLIGATIONS	
	1 PERCENT INCREASE	1 PERCENT DECREASE
Discount rate	(28 208)	34 057
Future salary growth rate	34 158	(28 801)

Maturity of defined benefit plans obligations
The following table presents the maturity profile of the defined benefit plans obligations

	31.12.2016	31.12.2015
The weighted average duration of the defined benefit plans obligations (in years)	8.8	11.7

46. Share-based payments

The UniCredit Group incentive program
In the current and comparative reporting periods the following incentive programs granted to employees of the Bank Pekao Group by the UniCredit Group existed:

- The long-term UniCredit Group Incentive Program 2007 in respect to share options. The rights to exercise the option were acquired in 2011. Strike price is EUR 7.094. The option will expire in 2017,
- The long-term UniCredit Group Incentive Program 2008 in respect to share options. The rights to exercise the option were acquired in 2012. Strike price is EUR 4.185. The option will expire in 2018,
- Employee Share Ownership Plan that offers to eligible UniCredit Group employees the possibility to buy UniCredit ordinary shares with the following advantages: obtaining Free Shares ('Free Shares') granted free of charge based on the number of the Investment shares purchased by each participant. The granting of free ordinary shares depends on the vesting conditions stated in the rules of the Plan.

The above mentioned share-based payments are recognized as cash-settled transactions.

The fair value of share options and shares of UniCredit S.p.A. was established based on the Hull and White model.

The tables below present changes in the number of stock options and performance shares of UniCredit S.p.A., as well as the weighted average exercise prices

2016	STOCK OPTIONS		PERFORMANCE SHARES	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE (*)	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE
Opening balance	2 289 715	17.83/30.23	-	-
Granted during the year	-	-	-	-
Redeemed during the year	(24 167)	-	-	-
Exercised during the year	-	-	-	-
Terminated during the year	-	-	-	-
Existing at the period-end	2 265 548	17.83/30.23	-	-
Executable at the period-end	2 265 548	17.83/30.23	-	-

(*)The value of PLN 17.83 relates to the stock options program 2008, whereas the value of PLN 30.23 relates to the stock options program 2007.

Notes to the financial statements (cont.)

(In PLN thousand)

The tables below present changes in the number of stock options and performance shares of UniCredit S.p.A., as well as the weighted average exercise prices

2015	STOCK OPTIONS		PERFORMANCE SHARES	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE (*)	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE
Opening balance	2 345 563	17.84/30.24	-	-
Granted during the year	-	-	-	-
Redeemed during the year	(55 848)	-	-	-
Exercised during the year	-	-	-	-
Terminated during the year	-	-	-	-
Existing at the period-end	2 289 715	17.83/30.23	-	-
Executable at the period-end	2 289 715	17.83/30.23	-	-

(*)The value of PLN 17.83 relates to the stock options program 2008, whereas the value of PLN 30.23 relates to the stock options program 2007.

The table below presents the conditions of Employee Share Ownership Plan in 2016

	FREE SHARES
Date of Free Shares delivery to Group employees	29 July 2016
Vesting Period Start-Date	29 July 2016
Vesting Period End-Date	31 July 2017
‘Free Shares’ Fair Value (per unit in EUR)	2.058

The table below presents the conditions of Employee Share Ownership Plan in 2015

	FREE SHARES 1ST ELECTION WINDOW	FREE SHARES 2ND ELECTION WINDOW
Date of Free Shares delivery to Group employees	30 January 2015	31 July 2015
Vesting Period Start-Date	30 January 2015	31 July 2015
Vesting Period End-Date	31 January 2016	31 July 2016
‘Free Shares’ Fair Value (per unit in EUR)	5.280	6.078

The fair value of granted rights to shares under Employee Share Ownership Plan until 31 December 2016 amounted to PLN 1 675 thousand as at 31 December 2016 (PLN 2 415 as at 31 December 2015).

The remuneration expenses for 2016 relating to the incentive programs granted to the emloyees of the Bank by UniCredit Group amounted to PLN 383 thousand (in 2015 - PLN 1 608 thousand).

System of Variable Remuneration for the Management Team

The system of variable remuneration is addressed to Employees defined in the Bank as persons in managerial positions, who are key employees for the fulfillment of the Bank’s strategy, risk management and long-term increase of the Bank’s income. The aim of the system is to support the execution of the Bank’s operational strategy, its risk management and to limit conflict of interests.

Under the system the participant can receive the variable compensation, which is paid out based on a bonus pool approach providing for a comprehensive performance measurement at individual level, level of his/her organizational unit and results of the entire Bank as well as verification of the Participant’s compliant behaviour with respect to law provisions and standards adopted by the Bank.

The compensation consists of cash payment and cash-settled share based payment realized in the form of phantom shares as cash equivalent amounting to the value of granted phantom shares.

Notes to the financial statements (cont.)

(In PLN thousand)

During the reporting period ending on 31 December 2016 the Bank had the following share-based payments transactions

	SYSTEM 2012	SYSTEM 2013	SYSTEM 2014	SYSTEM 2015	SYSTEM 2016
Transaction type	Cash-settled share based payments				
Start date of the assessment period	1 January 2012	1 January 2013	1 January 2014	1 January 2015	1 January 2016
Program announcement date	April 2012	April 2013	June 2014	July 2015	June 2016
Program granting date	12 June 2013	12 June 2014	30 April 2015	16 June 2016	Date of General Shareholders Meeting
Number of instruments granted (pcs)	80 003	76 013	68 040	93 359	Will be defined on granting date
Maturity date	31 July 2017	31 July 2018	31 July 2020	31July 2021	31 July 2022
Vesting date for Management Board Members and Executive Vice President	• 40% after 2 years from program granting date • 40% after 3 years from program granting date • 20% after 4 years from program granting date	• 40% in the year of program granting (settlement after 2 years retention period) • 40% after 2 years from program granting date (settlement after 1 year retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 3 years retention period) • 30% after 3 years from program granting date (settlement after 1 year retention period) • 30% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)
Vesting date for remaining participants	• 20% after 1 year from program granting date • 40% after 2 years from program granting date • 40% after 3 years from program granting date	• 20% after 1 year from program granting date • 40% after 2 years from program granting date • 40% after 3 years from program granting date	• 60% in the year of program granting (settlement after 3 years retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period) • 20% after 4 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 3 years retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period) • 20% after 4 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 2 years retention period) • 20% after 2 years from program granting date (settlement after 1 year retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period)
Vesting conditions	Compliance assessment, Continuous employment, Reaching the aim based on financial results of the Bank for a given period				
Program settlement	On the vesting date, the participant will receive a cash payment amounting to the number the possessed phantom shares times the arithmetic mean of the Bank's share prices at the Warsaw Stock Exchange: • in case of the settlement made at the dates of instalment after the mandatory retention period, for a month preceding the day of General Meeting approving the financial statements for a given year, • in case of settlement made in the voluntary retention period, for 10 working days following the day of release of the financial report in a given quarter, and benefits from acquired phantom shares in the amount equivalent to dividend paid to shareholders in the retention period for shares acquired by the participant				

(In PLN thousand)

For the System 2012, 2013, 2014 and 2015 the fair value of the program was estimated based upon the Bank's shares price on the WSE as of the balance sheet date and expected number of phantom shares to which the rights will be acquired.

For the System 2016, as of 31 December 2016 the Bank prepared the program valuation, presuming that the phantom shares were granted on 31 December 2016. This value will be changed at the actual date of granting the program.

The system of variable remuneration realized in the form of phantom shares is a program settled in cash, and therefore its fair value is adjusted on each balance sheet date until the the program settlement, which in case of this program coincides with the vesting date.

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 22 532 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 24 534 thousand).

The total intrinsic value of liabilities for vested rights to phantom shares amounted to PLN 26 446 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 27 417 thousand).

The remuneration expenses for 2016 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 9 189 thousand (in 2015 - PLN 6 312 thousand).

The table below presents changes in the number of Bank's phantom shares

	2016	2015
Opening balance	191 060	199 452
Granted during the year	93 359	68 040
Redeemed during the year	-	-
Exercised during the year	74 196	76 432
Terminated during the year	-	-
Existing at the period-end	210 223	191 060

The table above does not present the number of shares granted in respect of System 2016. This number will be determined in 2017 after approval of the financial statements for 2016 by the General Shareholder's Meeting. The hypothetical number of shares determined on the basis of the base value of the granted bonus to each of the program participants and arithmetic mean of the Bank's share price on the WSE in December 2016 amounts to 126 547.

System of Variable Remuneration for the Management Team of the subsidiaries
In order to meet requirements concerning rules of establishing policy of variable remuneration's component for individuals in managerial positions (Resolution No. 258/2011 of the Polish Financial Supervision Authority issued on 4 October 2011 and the Minister of Finance Regulation dated 2 December 2011, Official Journal from 2011, No. 263, item 1569), the followinf subsidiaries: Centralny Dom Maklerski Pekao S.A., Pekao Bank Hipoteczny S.A., Pekao Leasing Sp. z o.o., Pekao Investment Banking S.A. and Pekao Financial Services Sp. z o.o. have implemented System of Variable Remuneration for the Management Team.

Within the system participant can receive the bonus depending on the performance and results of work of the participant, of the business unit and the company's results in the area of responsibility of the person, taking into account the results of the whole company, as well as verification of the compliance of Participant's behaviour with respect to law provisions and standards adopted by the company.

At least 40 % components of variable renumerations is settled and paid in the time-period of 3 to 5 years since the granting date.

The companies measure the future employees benefits at fair value of accepted liabilities, in accordance with IAS 19 'Employee benefits'. Results of liabilities meassurement at fair value are presented in income statement as personnel expenses.

(In PLN thousand)

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 4 026 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 4 030 thousand).

The remuneration expenses for 2016 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 1 545 thousand (in 2015 - PLN 127 thousand).

47. Operating lease

The Group as a Lessor
In operating lease of buildings classified as investment properties the Group acts as a lessor.

The amount of future minimum lease payments expected to be received under non-cancellable operating lease can be summarized as follows

	31.12.2016	31.12.2015
Up to 1 year	8 016	7 334
Between 1years and 5 years	3 436	2 869
Over 5 years	929	498
Total	**12 381**	**10 701**

The amount of the minimum operating lease payments classified as income in 2016 amounted to PLN 18 757 thousand (in 2015 - PLN 19 262 thousand in 2015).

The Group as Lessee
The Group is a lessee of buildings' lease contracts classified as operating lease.

The amount of future minimum lease payments expected to be paid under non-cancellable operating lease can be summarized as follows

	31.12.2016	31.12.2015
Up to 1 year	98 387	111 591
Between 1years and 5 years	212 397	243 264
Over 5 years	62 118	105 814
Total	**372 902**	**460 669**

The amount of the minimum operating lease payments recognized as an expense in 2016 amounted to PLN 172 411 thousand (expense in 2015 amounted to PLN 186 023 thousand).

The lease agreements are usually entered into for an indefinite period. In case of lease agreements concluded for an indefinite term, the minimum lease payments are determined based upon notice of termination periods ensuing from relevant contracts. The notice period is usually fixed at 3 or 6 months. Lease agreements are denominated in PLN as well as in foreign currencies. Payments are made in PLN, regardless of the contract currency.

48. Contingent commitments

Litigation
In the entire year of 2016 the total value of the litigation subject in the ongoing court proceedings against the Group was PLN 1 091 638 thousand (in 2015 it was PLN 1 142 702 thousand).

In 2016 there were no proceedings before the court or state administration bodies related to the receivables or payables of the Bank and its subsidiaries in which the pursued claim value (amount to be paid) is at least 10% of the Group's equity.

Notes to the financial statements (cont.)

(In PLN thousand)

In 2016 still going on was the court litigation against the Group entities, Bank Pekao SA and Pekao SA Central Brokerage House, brought by private individuals for the payment of damage arising from the purchase of stocks and the financial compensation for the injury resulting from the execution process, in which the value of the litigation subject, as at 31 December 2016, was PLN 206 422 thousand (previously PLN 306 622 thousand). In the first half of 2015 the sentence dismissing the plaint against defendants was adjudicated. The sentence is not legally binding. The plaintiffs lodged an appeal against the sentence, i.e. its part related to the amount of PLN 206 422 thousand. In the third quarter of 2016 was issued a judgment dismissing the appeal. The plaintiffs are entitled to a cassation appeal.

Moreover against the Group currently are pending the following essential litigations, in which the Bank – in the current factual and legal circumstances – assess the risk of outflow as possible :

- proceedings instigated in the first quarter of 2014 as a result of the plaint brought by guarantee beneficiaries for the payment of PLN 32 750 thousand as the bank guarantee drawing,
- proceedings instigated in the second quarter of 2014 as a result of the plaint brought by a guarantee beneficiary for the payment of PLN 55 996 thousand as the bank guarantee drawing,
- proceedings instigated in the first quarter of 2015 as a result of the plaint brought by guarantee beneficiary for the payment of PLN 29 205 thousand as the bank guarantee drawing,
- proceeding instigated in the fourth quarter of 2016 as a result plaint brought by private individual for the payment of PLN 38 916 thousand taken by the Bank way of settlement of term financial transactions.

The Group created provisions for litigations against the Group entities which, according to the legal opinion, are connected with a risk of the funds outflow resulting from the fulfillment of the obligation. The value of the provisions as at 31 December 2016 is PLN 8 551 thousand (PLN 10 608 thousand as at 31 December 2015).

Financial off–balance commitments granted
Financial commitments granted by entities

	31.12.2016	31.12.2015
Financial commitments to:		
financial entities	734 503	700 755
non - financial entities	31 088 328	29 386 749
budget entities	481 482	848 356
Total	**32 304 313**	**30 935 860**

Off–balance guarantees issued
Guarantees issued by entities

	31.12.2016	31.12.2015
Issued to financial entities, including:	991 115	1 311 490
guarantees	991 115	1 308 840
confirmed export letters of credit	-	2 650
Issued to non-financial entities, including:	9 999 478	12 393 161
guarantees	6 505 040	7 510 192
securities' underwriting guarantees	3 455 429	4 806 284
sureties	39 009	76 685
Issued to budget entities, including:	269 239	368 176
guarantees	11 279	28 176
securities' underwriting guarantees	257 960	340 000
Total	**11 259 832**	**14 072 827**

(In PLN thousand)

Securities underwriting

As at 31 December 2016, the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 1	bonds	1 385 000	23.07.10 - 30.06.20
Client 2	bonds	265 000	21.06.12 - 31.12.17
Client 3	bonds	484 880	22.10.13 - 31.05.22
Client 4	bonds	35 000	27.01.14 - 28.04.17
Client 5	bonds	110 510	30.06.14 - 31.03.17
Client 6	bonds	2 200	15.09.14 - 31.03.18
Client 7	bonds	20 000	15.09.14 - 31.03.18
Client 8	bonds	150 000	24.05.16 - 31.03.18
Client 9	bonds	49 000	22.12.14 - 30.06.17
Client 10	bonds	230 000	23.02.15 - 30.06.17
Client 11	bonds	100 000	23.02.15 - 30 11.22
Client 12	bonds	84 000	27.01.15 - 31.12.17
Client 13	bonds	30 000	14.10.15 - 31.12.17
Client 14	bonds	7 500	14.10.15 - 31.12.17
Client 15	bonds	119 985	18.12.15 - 28.04.17
Client 16	bonds	20 270	28.12.15 - 31.12.17
Client 17	bonds	19 504	09.03.16 - 30.06.17
Client 18	bonds	22 810	09.03.16 - 30.06.17
Client 19	bonds	53 500	21.05.16 - 21.06.19
Client 20	bonds	3 500	21.05.16 - 21.06.19
Client 21	bonds	8 000	06.07.16 - 31.12.18
Client 22	bonds	67 200	06.07.16 - 31.12.18
Client 23	bonds	8 680	06.07.16 - 31.12.18
Client 24	bonds	8 000	06.07.16 - 31.12.18
Client 25	bonds	310 600	31.08.16 - 30.12.19
Client 26	bonds	13 000	31.08.16 - 30.12.19
Client 27	bonds	6 000	08.11.16 - 31.12.17
Client 28	bonds	4 300	23.12.16 - 31.12.18
Client 29	bonds	1 000	22.12.16 - 30.12.16
Client 30	bonds	6 650	23.12.16 - 31.12.18
Client 31	bonds	66 000	20.12.16 - 31.12.20
Client 32	bonds	15 000	28.12.16 - 31.08.17
Client 33	bonds	6 300	29.12.16 - 31.08.17

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

Notes to the financial statements (cont.)

(In PLN thousand)

As at 31 December 2015, the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 1	bonds	1 385 000	23.07.10 - 30.06.20
Client 2	bonds	458 000	21.06.12 - 31.12.17
Client 3	bonds	99 220	06.12.12 - 31.03.16
Client 4	bonds	52 400	28.12.12 - 30.03.16
Client 5	bonds	76 900	28.12.12 - 30.03.16
Client 6	bonds	164 700	01.07.11 - 20.12.17
Client 7	bonds	11 430	20.05.13 - 24.02.16
Client 8	bonds	17 200	14.04.15 - 10.06.16
Client 9	bonds	78 000	14.04.15 - 10.06.16
Client 10	bonds	484 880	22.10.13 - 14.12.16
Client 11	bonds	50 000	22.10.13 - 14.12.16
Client 12	bonds	16 250	27.01.14 - 30.09.16
Client 13	bonds	6 500	15.05.14 - 31.12.16
Client 14	bonds	700	31.05.14 - 31.12.16
Client 15	bonds	157 510	30.06.14 - 31.03.17
Client 16	bonds	61 710	22.07.14 - 31.07.16
Client 17	bonds	6 530	22.07.14 - 31.07.16
Client 18	bonds	100 000	30.07.14 - 30.06.19
Client 19	bonds	830	29.07.14 - 30.06.16
Client 20	bonds	20 450	29.07.14 - 30.09.16
Client 21	bonds	25 000	25.08.14 - 31.08.16
Client 22	bonds	45 770	29.05.14 - 30.04.16
Client 23	bonds	29 050	15.09.14 - 31.12.16
Client 24	bonds	20 000	15.09.14 - 31.12.16
Client 25	bonds	5 600	15.09.14 - 31.12.16
Client 26	bonds	33 790	31.10.14 - 31.03.16
Client 27	bonds	50 000	22.12.14 - 30.06.17
Client 28	bonds	52 135	30.12.14 - 30.06.16
Client 29	bonds	1 378	30.12.14 - 31.03.16
Client 30	bonds	198 780	30.12.14 - 09.03.16
Client 31	bonds	20 500	30.12.14 - 31.12.16
Client 32	bonds	230 000	23.02.15 - 30.06.17
Client 33	bonds	100 000	23.02.15 - 30.11.22
Client 34	bonds	350 000	20.02.15 - 30.04.16
Client 35	bonds	16 000	27.01.15 - 31.12.16
Client 36	bonds	74 000	31.12.15 - 31.12.16
Client 37	bonds	39 000	14.10.15 - 31.12.17
Client 38	bonds	12 500	14.10.15 - 31.12.17
Client 39	bonds	154 955	18.12.15 - 30.09.16
Client 40	bonds	30 000	28.12.15 - 31.12.17
Client 41	bonds	409 616	25.08.14 - 31.12.16

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

Off-balance commitments received
Commitments received by entities

	31.12.2016	31.12.2015
Financial commitments from:	209 107	285 084
financial entities	209 107	285 084
non - financial entities	-	-
budget entities	-	-
Guarantees from:	10 818 912	11 674 503
financial entities	1 552 730	1 161 416
non - financial entities	8 344 980	9 759 234
budget entities	921 202	753 853
Total	**11 028 019**	**11 959 587**

Moreover, the Group can to obtain financing from the National Bank of Poland pledged on securities.

49. Share capital

Shareholding structure

CLASS/ISSUE	TYPE OF SHARES	NUMBER OF SHARES	NOMINAL VALUE OF CLASS/ISSUE	EQUITY COVERAGE	REGISTRATION DATE	DIVIDEND RIGHTS (FROM DATE)
A	Common bearer stock	137 650 000	137 650	fully paid-up	21.12.1997	01.01.1998
B	Common bearer stock	7 690 000	7 690	fully paid-up	06.10.1998	01.01.1998
C	Common bearer stock	10 630 632	10 631	fully paid-up	12.12.2000	01.01.2000
D	Common bearer stock	9 777 571	9 777	fully paid-up	12.12.2000	01.01.2000
E	Common bearer stock	373 644	374	fully paid-up	29.08.2003	01.01.2003
F	Common bearer stock	621 411	621	fully paid-up	29.08.2003	19.05.2006 16.05.2007
G	Common bearer stock	603 377	603	fully paid-up	29.08.2003	15.05.2008
H	Common bearer stock	359 840	360	fully paid-up	12.08.2004	01.01.2004
I	Common bearer stock	94 763 559	94 764	fully paid-up	29.11.2007	01.01.2008
Total number of Shares (pcs)		**262 470 034**				
Total share capital in PLN thousand			**262 470**			
Nominal value per share = PLN 1.00						

Change in the number of shares (pcs)

2016	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

2015	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

(In PLN thousand)

50. Other capital and reserves, retained earnings and profit for the period

The table below presents the structure of the Group's equity attributable to equity holders of the Bank

	31.12.2016	31.12.2015
Reserve capital, including:	9 480 043	9 474 405
issue of shares above face value	9 137 221	9 137 221
other	342 822	337 184
Revaluation reserve, including:	(223 394)	283 597
remeasurements of the defined benefit liabilities	(98 315)	(86 777)
deferred tax	18 680	16 488
revaluation of financial assets portfolio available for sale	(217 204)	391 616
deferred tax	41 269	(74 407)
revaluation of financial hedging instruments portfolio	39 724	45 280
deferred tax	(7 548)	(8 603)
Foreign currency translation differences, including:	-	-
foreign currency translation differences	-	-
deferred tax	-	-
General Banking Risk Fund	1 982 324	1 975 415
Other reserve capital	9 092 735	9 092 740
Bonds convertible into shares- equity component	28 819	28 819
Funds for brokerage activities	15 000	15 000
Total other capital	**20 375 527**	**20 869 976**
Profit (loss) from previous periods, allocated to Bank's shareholders	(20 253)	(16 676)
Net profit for the period, allocated to Bank's shareholders	2 279 275	2 292 459
Total retained earnings and profit for the period	**2 259 022**	**2 275 783**
Total	**22 634 549**	**23 145 759**

The net profit of the Bank for 2015 in the amount of PLN 2 290 398 thousand was distributed in the following way: PLN 2 283 489 thousand – to dividend, PLN 6 909 thousand – to General Banking Risk Fund.

From 1982 to 1984 and from 1988 to 1996, the Group operated in a hyperinflationary economic environment.

IAS 29 (Financial Reporting in Hyperinflationary Economies) requires restatement of each component of owners' equity (except for retained earnings and revaluation surplus) by applying a general price index for the period of hyperinflation. This retrospective application would have resulted in an increase in share capital and other reserves and a decrease in retained earnings in equivalent amounts. This restatement would not have any effect on the total amount of the Group's equity.

(In PLN thousand)

51. Non - controlling interests

The below table presents the information for each of the subsidiaries that have non-controlling interests that are material to the Group

NAME OF THE SUBSIDIARY	COUNTRY OF INCORPORATION AND PLACE OF BUSINESS	PERCENTAGE SHARE OF NON-CONTROLLING INTERESTS IN SHARE CAPITAL / VOTING RIGHTS		NET PROFIT FOR THE PERIOD ATTRIBUTABLE TO NON-CONTROLLING INTERESTS		ACCUMULATED NON-CONTROLLING INTERESTS	
		31.12.2016	31.12.2015	2016	2015	31.12.2016	31.12.2015
Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A.	Poland	35.00	35.00	489	1 019	14 924	15 964
TOTAL				**489**	**1 019**	**14 924**	**15 964**

The summarized financial information of each of the subsidiaries that are material to the Group are presented below

	PEKAO PIONEER POWSZECHNE TOWARZYSTWO EMERYTALNE S.A.	
	2016	2015
Loans and advances to banks	15 256	44 995
Investments (placement) securities	27 214	-
Other items of assets	2 385	2 830
TOTAL ASSETS	**44 855**	**47 825**
Other items of liabilities	2 217	2 458
TOTAL LIABILITIES	**2 217**	**2 458**

	PEKAO PIONEER POWSZECHNE TOWARZYSTWO EMERYTALNE S.A.	
	2016	2015
Revenue	13 996	14 714
Net profit for the period	1 397	2 913
Total comprehensive income	**1 397**	**2 913**
Dividends paid to non-controlling interests	1 529	8 088
Cash flows from operating activities	1 911	3 662
Cash flows from investing activities	(27 280)	(925)
Cash flows from financing activities	(4 369)	(23 108)
Net change in cash and cash equivalents	(29 738)	(20 371)
Cash and cash equivalents at the beginning of the period	44 995	65 366
Cash and cash equivalents at the end of the period	15 257	44 995

Notes to the financial statements (cont.)

(In PLN thousand)

52. Additional information to the consolidated cash flow statement

Cash and cash equivalents

	31.12.2016	31.12.2015
Cash and amounts due from Central Bank	5 872 911	7 881 607
Loans and receivables from banks with maturity up to 3 months	2 793 179	6 631 788
Cash and Cash equivalents presented in the cash flow statement	**8 666 090**	**14 513 395**

Restricted availability cash and cash equivalents as at 31 December 2016 amounted to PLN 4 605 707 thousand (PLN 4 338 995 thousand as at 31 December 2015).

53. Related party transactions

Transactions between the Bank and related parties are typical transactions arising from current operating activities conducted by the Bank. Such transactions mainly include loans, deposits, foreign currency transactions and guarantees.

The credit granting process applicable to the Bank's management and entities related to the Bank
According to the Banking Act, credit transactions with Members of the Bank Management Board and Supervisory Board, persons holding managerial positions at the Bank, with the entities related financially or organizationally therewith, shall be effected according to Regulation adopted by the Supervisory Board of the Bank.

The Regulation provides detailed decision-making procedures, applicable to transactions with such persons and entities, also defining the decision-making levels, authorized to take decisions. In particular, transactions with Members of the Bank's Management Board or Supervisory Board or with an entity related therewith financially or organizationally, are subject to decisions taken by the Bank's Management Board and Supervisory Board.

Members of the Bank's Management Board and entities related therewith financially or organizationally may take advantage of credit products offered by the Bank on standard terms and conditions of the Bank. In particular, the Bank may not offer more advantageous credit interest rates to such persons or entities.

Credit risk assessment is performed using the methodology applied by the Bank, tailored to the client's segment and type of transaction.

In case of entities related to the Bank, the standard credit procedures are applied, with transaction-related decisions taken exclusively at level of the Bank's Head Office.

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions

Related party transactions as at 31 December 2016

NAME OF ENTITY	RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
UniCredit S.p.A. – the Bank's parent entity	187 357	-	-	443	9 261	-	1 674
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	682 836	9 719	32 072	1 306	614 127	620 819	2 972
Associates of Bank Pekao S.A Group							
Dom Inwestycyjny Xelion Sp. z o.o.	-	-	-	48	28 682	-	-
Pioneer Pekao Investment Management S.A.	-	-	-	-	137 850	-	-
Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary)	-	-	-	15 199	112 949	-	-
Total Associates of Bank Pekao S.A. Group	**-**	**-**	**-**	**15 247**	**279 481**	**-**	**-**
Key management personnel of the Bank and UniCredit S.p.A.	7 948	-	-	-	28 457	-	-
Total	**878 141**	**9 719**	**32 072**	**16 996**	**931 326**	**620 819**	**4 646**

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

31.12.2016	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	12 342	175 015	-	-	-	-	187 357
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	597 829	85 007	-	-	-	-	682 836
Associates of Bank Pekao S.A Group	-	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	5 506	-	-	202	2 240	7 948
Total	**610 171**	**265 528**	**-**	**-**	**202**	**2 240**	**878 141**

(*) Current receivables includude Nostro accounts and cash collaterals.

Liabilities due to loans and deposits by contractual maturity

31.12.2016	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	9 261	-	-	-	-	-	9 261
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	65 821	126 115	315	1 451	420 425	-	614 127
Associates of Bank Pekao S.A Group	17 348	91 256	170 877	-	-	-	279 481
Key management personnel of the Bank and UniCredit S.p.A.	8 501	3 226	15 748	982	-	-	28 457
Total	**100 931**	**220 597**	**186 940**	**2 433**	**420 425**	**-**	**931 326**

(*) Current liabilities include Loro accounts and cash collaterals.

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	2 160	10 180	-	175 017	-	187 357
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	561 564	113	7	99 082	22 070	682 836
Associates of Bank Pekao S.A Group	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	7 948	-	7 948
Total	**563 724**	**10 293**	**7**	**282 047**	**22 070**	**878 141**

Liabilities due to loans and deposits by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	543	-	-	8 718	-	9 261
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	52 131	-	391 206	167 723	3 067	614 127
Associates of Bank Pekao S.A Group	-	-	-	279 481	-	279 481
Key management personnel of the Bank and UniCredit S.p.A.	6 818	295	-	21 333	11	28 457
Total	**59 492**	**295**	**391 206**	**477 255**	**3 078**	**931 326**

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions as at 31 December 2015

NAME OF ENTITY	RECEIVABLES FROMLOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
UniCredit S.p.A. – the Bank's parent entity	605 703	-	-	605	1 209	-	2 415
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	1 114 848	7 724	55 861	4 843	1 507 266	653 064	966
Associates of Bank Pekao S.A Group							
Dom Inwestycyjny Xelion Sp. z o.o.	-	-	-	3	25 262	-	29
Pioneer Pekao Investment Management S.A.	-	-	-	35	162 752	-	23
Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary)	-	-	-	16 323	115 116	-	21
Total Associates of Bank Pekao S.A. Group	**-**	**-**	**-**	**16 361**	**303 130**	**-**	**73**
Key management personnel of the Bank and UniCredit S.p.A.	8 568	-	-	-	22 180	-	-
Total	**1 729 119**	**7 724**	**55 861**	**21 809**	**1 833 785**	**653 064**	**3 454**

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

31.12.2015	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	8 497	597 206	-	-	-	-	605 703
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	616 160	94 797	482	779	402 630	-	1 114 848
Associates of Bank Pekao S.A Group	-	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	5 999	-	37	186	2 346	8 568
Total	**624 657**	**698 002**	**482**	**816**	**402 816**	**2 346**	**1 729 119**

(*) Current receivables include Nostro accounts and cash collaterals.

Liabilities due to loans and deposits by contractual maturity

31.12.2015	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	1 209	-	-	-	-	-	1 209
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	160 673	8 458	963 829	-	374 306	-	1 507 266
Associates of Bank Pekao S.A Group	16 224	92 203	194 703	-	-	-	303 130
Key management personnel of the Bank and UniCredit S.p.A.	4 474	4 007	9 841	3 808	50	-	22 180
Total	**182 580**	**104 668**	**1 168 373**	**3 808**	**374 356**	**-**	**1 833 785**

(*) Current liabilities include Loro accounts and cash collaterals.

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2015	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	243 767	350 936	-	11 000	-	605 703
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	598 100	403 900	7	67 079	45 762	1 114 848
Associates of Bank Pekao S.A Group	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	8 568	-	8 568
Total	**841 867**	**754 836**	**7**	**86 647**	**45 762**	**1 729 119**

Liabilities due to loans and deposits by currency

31.12.2015	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	-	-	-	1 209	-	1 209
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	1 010 843	261	374 306	121 856	-	1 507 266
Associates of Bank Pekao S.A Group	-	-	-	303 130	-	303 130
Key management personnel of the Bank and UniCredit S.p.A.	7 129	920	-	14 128	3	22 180
Total	**1 017 972**	**1 181**	**374 306**	**440 323**	**3**	**1 833 785**

Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2016 to 31 December 2016

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSION EXPENSE	POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME	NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES
UniCredit S.p.A. – the Bank's parent entity	(137)	(375)	1 239	(2 723)	3 158	(13 368)
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	13 416	(4 448)	9 282	(246)	18 580	(55 879)
Associates of Bank Pekao S.A Group						
Pioneer Pekao Investment Management S.A.	-	(1 862)	197	-	14	-
Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary)	-	(1 370)	189 607	-	4	-
Dom Inwestycyjny Xelion Sp.z o.o.	-	(323)	45	(171)	318	-
Total Associates of Bank Pekao S.A. Group	**-**	**(3 555)**	**189 849**	**(171)**	**336**	**-**
Key management personnel of the Bank and UniCredit S.p.A.	237	(318)	17	-	-	-
Total	**13 516**	**(8 696)**	**200 387**	**(3 140)**	**22 074**	**(69 247)**

Income and expenses from transactions with related parties for the period from 1 January 2015 to 31 December 2015

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSION EXPENSE	POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME	NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES
UniCredit S.p.A. – the Bank's parent entity	216	(246)	1 689	(3 070)	811	(15 664)
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	42 043	(4 242)	9 388	(1 329)	41 577	(6 896)
Associates of Bank Pekao S.A Group						
Pioneer Pekao Investment Management S.A.	-	(2 761)	357	-	26	-
Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary)	-	(1 973)	226 313	-	-	-
Dom Inwestycyjny Xelion Sp.z o.o.	-	(361)	64	(117)	314	(1)
Krajowa Izba Rozliczeniowa S.A. (*)	-	(135)	57	-	-	(4 303)
Total Associates of Bank Pekao S.A. Group	**-**	**(5 230)**	**226 791**	**(117)**	**340**	**(4 304)**
Key management personnel of the Bank and UniCredit S.p.A.	253	(419)	17	-	-	-
Total	**42 512**	**(10 137)**	**237 885**	**(4 516)**	**42 728**	**(26 864)**

(*) until sale's date 3 125 shares.

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial liabilities and guarantees as at 31 December 2016

NAME OF ENTITY	GRANTED		RECEIVED	
	FINANCIAL	GUARANTEES	FINANCIAL	GUARANTEE
UniCredit S.p.A. – the Bank's parent entity	50 162	246 519	-	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	202 191	599 604	5 192	192 481
Associates of Bank Pekao S.A Group				
Pioneer Pekao Investment Management S.A.	15	-	-	-
Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary)	96	-	-	-
Total Associates of Bank Pekao S.A. Group	**111**	**-**	**-**	**-**
Key management personnel of the Bank and UniCredit S.p.A.	217	-	-	-
Total	**252 681**	**846 123**	**5 192**	**246 444**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by contractual maturity

31.12.2016	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
FINANCIAL COMMITMENTS GRANTED							
UniCredit S.p.A. – the Bank's parent entity	-	-	-	-	-	50 162	50 162
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	-	-	-	202 191	202 191
Associates of Bank Pekao S.A Group	-	-		-	111	-	111
Key management personnel of the Bank and UniCredit S.p.A.	30	-	5	-	182	-	217
Total	**30**	**-**	**5**	**-**	**293**	**252 353**	**252 681**
GUARANTEES ISSUED							
UniCredit S.p.A. – the Bank's parent entity	-	2 624	-	50 190	81 659	112 046	246 519
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	9 343	24 475	113 978	293 599	158 209	599 604
Total	**-**	**11 967**	**24 475**	**164 168**	**375 258**	**270 255**	**846 123**
FINANCIAL COMMITMENTS RECEIVED							
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	5 192	-	-	-	-	5 192
Total	**-**	**5 192**	**-**	**-**	**-**	**-**	**5 192**
GUARANTEES RECEIVED							
UniCredit S.p.A. – the Bank's parent entity	-	4 645	752	33 619	13 399	1 548	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	3 322	75 122	11 062	102 975	192 481
Total	**-**	**4 645**	**4 074**	**108 741**	**24 461**	**104 523**	**246 444**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
FINANCIAL COMMITMENTS GRANTED						
UniCredit S.p.A. – the Bank's parent entity	30 164	-	-	19 998	-	50 162
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	98 535	41 716	-	61 580	360	202 191
Associates of Bank Pekao S.A Group	-	-	-	111	-	111
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	217	-	217
Total	**128 699**	**41 716**	**-**	**81 906**	**360**	**252 681**
GUARANTEES ISSUED						
UniCredit S.p.A. – the Bank's parent entity	12 167	-	-	234 352	-	246 519
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	53 077	-	-	546 527	-	599 604
Total	**65 244**	**-**	**-**	**780 879**	**-**	**846 123**
FINANCIAL COMMITMENTS RECEIVED						
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	-	-	5 192	5 192
Total	**-**	**-**	**-**	**-**	**5 192**	**5 192**
GUARANTEES RECEIVED						
UniCredit S.p.A. – the Bank's parent entity	29 130	-	-	24 833	-	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	109 606	-	-	82 090	785	192 481
Total	**138 736**	**-**	**-**	**106 923**	**785**	**246 444**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees as at 31 December 2015

NAME OF ENTITY	GRANTED		RECEIVED
	FINANCIAL	GUARANTEES	GUARANTEE
UniCredit S.p.A. – the Bank's parent entity	48 223	236 659	14 588
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	179 072	890 343	34 490
Associates of Bank Pekao S.A Group			
Dom Inwestycyjny Xelion Sp. z o.o.	2 000	-	-
Pioneer Pekao Investment Management S.A.	15	-	-
Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary)	52	-	-
Total Associates of Bank Pekao S.A. Group	**2 067**	**-**	**-**
Key management personnel of the Bank and UniCredit S.p.A.	697	-	-
Total	**230 059**	**1 127 002**	**49 078**

As at 31 December 2015, the Group did not have off-balance sheet financial commitments received from related parties.

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by contractual maturity

31.12.2015	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
FINANCIAL COMMITMENTS GRANTED							
UniCredit S.p.A. – the Bank's parent entity	-	-	-	28 223	-	20 000	48 223
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	-	179 072	-	-	179 072
Associates of Bank Pekao S.A Group	-	-	-	2 007	60	-	2 067
Key management personnel of the Bank and UniCredit S.p.A.	30	515	5	18	129	-	697
Total	**30**	**515**	**5**	**209 320**	**189**	**20 000**	**230 059**
GUARANTEES ISSUED							
UniCredit S.p.A. – the Bank's parent entity	-	2 631	17 719	66 440	83 818	66 051	236 659
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	16 189	98 861	90 053	322 855	362 385	890 343
Total	**-**	**18 820**	**116 580**	**156 493**	**406 673**	**428 436**	**1 127 002**
GUARANTEES RECEIVED							
UniCredit S.p.A. – the Bank's parent entity	-	-	-	11 300	3 288	-	14 588
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	553	30 406	3 531	-	34 490
Total	**-**	**-**	**553**	**41 706**	**6 819**	**-**	**49 078**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by currency

31.12.2015	EUR	USD	CHF	PLN	OTHER	TOTAL
FINANCIAL COMMITMENTS GRANTED						
UniCredit S.p.A. – the Bank's parent entity	28 223	-	-	20 000	-	48 223
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	77 772	-	-	101 300	-	179 072
Associates of Bank Pekao S.A Group	-	-	-	2 067	-	2 067
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	697	-	697
Total	**105 995**	**-**	**-**	**124 064**	**-**	**230 059**
GUARANTEES ISSUED						
UniCredit S.p.A. – the Bank's parent entity	10 497	-	-	226 162	-	236 659
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	60 778	-	-	829 565	-	890 343
Total	**71 275**	**-**	**-**	**1 055 727**	**-**	**1 127 002**
GUARANTEES RECEIVED						
UniCredit S.p.A. – the Bank's parent entity	3 288	-	-	11 300	-	14 588
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	8 147	-	-	26 343	-	34 490
Total	**11 435**	**-**	**-**	**37 643**	**-**	**49 078**

(In PLN thousand)

Remuneration of Bank's Management Board and Supervisory Board Members
Short-term employee benefits related to the Management Board of the Bank in of 2016 amounted to PLN 19 120 thousand, compared to PLN 17 144 thousand in 2015. Short-term employee benefits included: base salary, bonuses and other benefits due in next 12 months from the balance sheet date.

Long-term benefits related to the Management Board of the Bank amounted to PLN 2 083 thousand in 2016, compared to PLN 2 453 thousand in 2015 and comprised of provisions for deferred bonus payments.

The expenses in 2016 included PLN 5 393 thousand in respect of share-based payments, compared to PLN 3 473 thousand in 2015. The value of share-based payments is a part of Personnel Expenses, recognized according to IFRS 2 during the reporting period in the income statement, representing the settlement of fair value of phantom shares, granted to the Members of the Bank's Management Board.

Remuneration expenses of Supervisory Board of the Bank, comprising short-term employee benefits, amounted to PLN 1 069 thousand in 2016, compared to PLN 978 thousand in 2015.

The Bank's Management Board and Supervisory Board Members did have not received any remuneration from subsidiaries and associates in 2016 and 2015.

Remuneration of Supervisory Boards and Management Boards of subsidiaries
Remuneration expenses of Management Boards of Group's subsidiaries, comprising short-term employee benefits, amounted to PLN 14 810 thousand in 2016, compared to PLN 14 427 thousand in 2015.

Remuneration expenses of Supervisory Boards of Group's subsidiaries, comprising short-term employee benefits, amounted to PLN 343 thousand in 2016, compared to PLN 183 thousand in 2015.

54. Repo and reverse repo transactions

The Group increases its funds by sales transactions with the repurchase promise granted (repo and sell-buy back) at the same price increased by interest.

Securities composing the balance sheet portfolio of the Group as well as securities with obligation of resale (reverse repo and buy-sell back transactions) may be a subject to repo and sell-buy back transactions.

Securities composing the balance sheet portfolio of the Group and treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Group holds all the benefits and the risk deriving from these assets.

	31.12.2016		31.12.2015	
	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RESPECTIVE LIABILITIES	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RESPECTIVE LIABILITIES
Financial assets available for sale				
up to 1 month	1 599 015	1 599 789	2 359 798	2 357 096
from 1 to 3 months	-	-	1 032 882	1 029 821
from 3 months to 1 year	-	-	1 503	1 504
Total financial assets available for sale	**1 599 015**	**1 599 789**	**3 394 183**	**3 388 421**
Financial assets held for trading				
up to 1 month	175 732	176 019	-	-
Total financial assets held for trading	**175 732**	**176 019**	**-**	**-**
Financial assets purchased under reverse-repo and buy-sell back				
up to 1 month	-	-	2 050 199	2 044 228
Total financial assets purchased under reverse-repo and buy-sell back	**-**	**-**	**2 050 199**	**2 044 228**
Total	**1 774 747**	**1 775 808**	**5 444 382**	**5 432 649**

(In PLN thousand)

The Group purchases financial instruments with the obligations of repurchase or resale (reverse-repo and buy-sell back) at the same price increased by interest.

Securities treated as reverse-repo and buy-sell back transactions are not disclosed at the statement of financial position due to the fact that the Group do not holds all the advantages of risks and awareness deriving from these assets.

	31.12.2016		31.12.2015	
	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGE ASSETS	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGE ASSETS
Loans and advances from banks				
up to 1 month	703 635	700 960	1 757 063	1 757 459
Total loans and advances from bank	**703 635**	**700 960**	**1 757 063**	**1 757 459**
Loans and advances from customers				
up to 1 month	-	-	4 755 472	4 762 663
Total loans and advances from customers	**-**	**-**	**4 755 472**	**4 762 663**
Total	**703 635**	**700 960**	**6 512 535**	**6 520 122**

Financial assets subject to reverse repo and buy-sell back transactions constitute collateral accepted by the Group, which the Group has the right to sell or pledge.

	31.12.2016	31.12.2015
Fair value of assets pledged as collaterals, in this:	700 960	6 520 122
Short sale	673 165	611 442
Reverse repo transactions/ buy-sell back	-	2 050 199

55. Company Social Benefits Fund ('ZFŚS')

The Social Benefits Fund Act of 4 March 1994 with subsequent amendments introduced the requirement to create a Company's Social Benefits Fund by all employers employing over 20 employees. The Bank and Group companies employing at least 20 staff have created the ZFŚS Fund and are making periodic charges to the ZFŚS Fund in amounts required by the Act. The basic aim of the ZFŚS Fund is to subsidize social assistance in benefit of the employees, former employees (pensioners and the retired) and entitled members of their families.

The liabilities of the ZFŚS Fund represent the accumulated value of charges made by the Company towards the ZFŚS Fund decreased by the amount of non-returnable expenditures of the ZFŚS Fund.

In the consolidated statement of financial position, the Group netted the ZFŚS Fund assets against the ZFŚS Funds value, due to the fact that the assets of the ZFŚS Fund do not represent the assets of the Group. For this reason the amount pertaining to the ZFŚS Fund in the consolidated statement of financial position as at 31 December 2016 and 31 December 2015 was zero.

Notes to the financial statements (cont.)

(In PLN thousand)

The table below presents the assets according to type and book value, the balance of the Fund and costs related to ZFŚS:

	31.12.2016	31.12.2015
Loans granted to employees	39 022	44 030
Cash at ZFŚS account	3 760	8 576
ZFŚS assets	**42 782**	**52 606**
ZFŚS value	**42 782**	**52 606**
	2016	**2015**
Deductions made to ZFŚS during fiscal period	25 104	25 888

56. Subsequent events

There have been no significant subsequent events.

Signatures of all Management Board Members

Date	Name/Surname	Position/Function	Signature
09.02.2017	Luigi Lovaglio	President of the Management Board, CEO	
09.02.2017	Diego Biondo	Vice President of the Management Board	
09.02.2017	Andrzej Kopyrski	Vice President of the Management Board	
09.02.2017	Adam Niewiński	Vice President of the Management Board	
09.02.2017	Grzegorz Piwowar	Vice President of the Management Board	
09.02.2017	Stefano Santini	Vice President of the Management Board	
09.02.2017	Marian Ważyński	Vice President of the Management Board	

Glossary

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IFRS – International Financial Reporting Standards – the standards, interpretations and their structure adopted by the International Accounting Standards Board (IASB.)

IAS – International Accounting Standards – previous name of the standards forming part of the current IFRS.

IFRIC – International Financial Reporting Interpretations Committee – the committee operating under the International Accounting Standards Board publishing interpretations of IFRS.

CIRS – Currency Interest Rate Swap – the transaction exchange of principal amounts and interest payments in different currencies between two counterparties.

IRS – Interest Rate Swap – the agreement between two counterparties, under which the counterparties pay each other (at specified intervals during the contract life) interest on contractual principal of the contract, charged at a different interest rate.

FRA – Forward Rate Agreement – the contract under which two counterparties fix the interest rate that will apply in the future for a specified amount expressed in currency of the transaction for a predetermined period.

CAP – the financial agreement, which limits the risk borne by lender on a variable interest rate, exposed to the potential loss as a result of increase in interest rates. Cap option is a series of call options on interest rates, in which the issuer guarantees the buyer the compensation of the additional interest costs, that the buyer must pay if the interest rate on loan increases above the fixed interest rate.

FLOOR –the financial agreement, which limits the risk of incurring losses resulting from decrease in interest rates by the lender providing the loan at a variable interest rate. Floor option is a series of put options on interest rates, in which the issuer guarantees the interest to be paid on the loan if the interest rate on the loan decreases below the fixed interest rate.

IBNR – Incurred But Not Reported losses.

PD – Probability Default – the parameter used in Internal Ratings-Based Approach which determines the likelihood that the debtor will be unable to meet its obligation. PD is a financial term describing the likelihood of a default over an one year time horizon.

LGD – Loss Given Default – the percentage of loss over the total exposure when bank's counterparty goes to default.

EAD – Exposure At Default.

EL – Expected Loss.

CCF – Credit Conversion Factor.

A-IRB – Advanced Internal Ratings-Based Approach – advanced method where all parameters of risk (PD, LGD, EAD) are estimated by the bank using its own quantitative model for calculating the risk weighted assets (RWA).

VaR – Value at Risk – the risk measure by which the market value of an asset or portfolio may be reduced for a given assumptions, probability and time horizon.

EaR – Earnings at Risk – the maximum decrease of earnings, relative to specific goal, which might occur due to impact of market risk on specific risk factors for the given time horizon and confidence level.

ICAAP – Internal Capital Adequacy Assessment Process – the process of assessing internal capital adequacy.