Bank Polski

Consolidated financial statements of the PKO Bank Polski SA Group for the year ended 31 December 2017

Report publication date:
12 March 2018

Bank Polski

SELECTED FINANCIAL DATA DERIVED FROM THE FINANCIAL STATEMENTS

SELECTED CONSOLIDATED FINANCIAL DATA	PLN million		EUR million	
	period from 01.01.2017 to 31.12.2017	period from 01.01.2016 to 31.12.2016	period from 01.01.2017 to 31.12.2017	period from 01.01.2016 to 31.12.2016
Net interest income	8 606	7 755	2 027	1 772
Net fee and commission income/(expense)	2 969	2 693	699	615
Operating profit/(loss)	4 227	3 748	996	857
Profit before income tax	**4 249**	**3 783**	**1 001**	**865**
Net profit (including non-controlling shareholders)	**3 109**	**2 876**	**732**	**657**
Net profit attributable to equity holders of the parent company	**3 104**	**2 874**	**731**	**657**
Earnings per share for the period - basic (in PLN/EUR)	**2,48**	**2,30**	**0,59**	**0,53**
Earnings per share for the period - diluted (in PLN/EUR)	**2,48**	**2,30**	**0,59**	**0,53**
Total net comprehensive income	3 687	2 304	869	527
Net cash flows from operating activities	17 749	7 096	4 181	1 622
Net cash flows from investing activities	(6 894)	(8 956)	(1 624)	(2 047)
Cash flows from /used in financing activities	(5 821)	2 562	(1 371)	586
Total net cash flows	5 034	702	1 186	160

SELECTED CONSOLIDATED FINANCIAL DATA	PLN million		EUR million	
	As at 31.12.2017	As at 31.12.2016	As at 31.12.2017	As at 31.12.2016
Total assets	296 912	285 573	71 187	64 551
Total equity	36 256	32 569	8 693	7 362
Capital and reserves attributable to equity holders of the parent company	36 267	32 585	8 695	7 366
Share capital	1 250	1 250	300	283
Number of shares (in million)	1 250	1 250	1 250	1 250
Book value per share (in PLN/EUR)	29,00	26,05	6,95	5,89
Diluted number of shares (in million)	1 250	1 250	1 250	1 250
Diluted book value per share (in PLN/EUR)	29,00	26,05	6,95	5,89
Capital adequacy ratio	17,37%	15,81%	17,37%	15,81%
Tier 1	32 326	28 350	7 750	6 408
Tier 2	1 700	2 523	408	570

SELECTED CONSOLIDATED FINANCIAL STATEMENT ITEMS HAVE BEEN TRANSLATED INTO EUR AT THE FOLLOWING RATES	31.12.2017	31.12.2016
average NBP exchange rates as at the last day of each month of the period	4,2447	4,3757
mid NBP exchange rates as at the last day of the period	4,1709	4,4240

TABLE OF CONTENTS

Bank Polski

CONSOLIDATED INCOME STATEMENT

	Note	2017	2016
Interest and similar income	7	10 919	9 965
Interest expenses and similar charges	7	(2 313)	(2 210)
Net interest income		**8 606**	**7 755**
Fee and commission income	8	3 918	3 579
Fee and commission expense	8	(949)	(886)
Net fee and commission income/(expense)		**2 969**	**2 693**
Dividend income	9	12	10
Net gain/(loss) on financial instruments measured at fair value	10	8	4
Gain/(loss) on investment securities	11	46	506
Net foreign exchange gains/(losses)	12	452	503
Other operating income	13	710	649
Other operating expenses	13	(240)	(330)
Net other operating income and expenses		**470**	**319**
Net impairment allowances and provisions	14	(1 620)	(1 623)
Administrative expenses	15	(5 784)	(5 590)
Tax on certain financial institutions	16	(932)	(829)
Operating profit/(loss)		**4 227**	**3 748**
Participation in profits/ (losses) of associates		22	35
Profit before income tax		**4 249**	**3 783**
Income tax expense	17	(1 140)	(907)
Net profit (including non-controlling shareholders)		3 109	2 876
Profit (loss) attributable to non-controlling shareholders		5	2
Net profit attributable to the equity holders of the parent company		**3 104**	**2 874**
Earnings per share	18		
– basic earnings per share for the period (PLN)		2,48	2,30
– diluted earnings per share for the period (PLN)		2,48	2,30
Weighted average number of ordinary shares during the period (in million)		1 250	1 250
Weighted average diluted number of ordinary shares during the period (in million)		1 250	1 250

(IN PLN MILLION)

Bank Polski

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Note	2017	2016
Net profit (including non-controlling shareholders)		**3 109**	**2 876**
Other comprehensive income		**578**	**(572)**
Items which may be reclassified to profit or loss		**577**	**(574)**
Cash flow hedges (gross)	23	(8)	(63)
Deferred tax on cash flow hedges	17, 23	1	12
Cash flow hedges (net)	23	(7)	(51)
Remeasurement of available-for-sale financial assets (gross)		761	(636)
Deferred tax on available-for-sale financial assets	17	(142)	118
Unrealized net gains on available-for-sale financial assets (net)		619	(518)
Foreign exchange differences on translation of foreign branches		(36)	(4)
Share in other comprehensive income of associates and joint ventures		1	(1)
Items which cannot be reclassified to profit or loss		1	2
Actuarial gains and losses (gross)		1	2
Actuarial gains and losses (net)		1	2
Total net comprehensive income		**3 687**	**2 304**
Total net comprehensive income, of which attributable to:		3 687	2 304
equity holders of PKO Bank Polski SA		3 682	2 302
non-controlling shareholders		5	2

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Note	31.12.2017	31.12.2016
ASSETS			
Cash and cash balances with the Central Bank	19	17 810	13 325
Amounts due from banks	20	5 233	5 345
Financial assets held for trading, excluding derivative financial instruments	21	431	326
Derivative financial instruments	22	2 598	2 901
Financial instruments designated at fair value through profit or loss upon initial recognition	24	8 157	13 937
Loans and advances to customers	25	205 628	200 606
Available-for-sale investment securities	26	43 675	36 676
Investment securities held to maturity	27	1 812	466
Investments in associates and joint ventures	41	393	386
Non-current assets held for sale	28	138	14
Inventories	29	186	260
Intangible assets	30	3 242	3 422
Property, plant and equipment	30	2 915	3 086
Current income tax receivable		2	10
Deferred income tax asset	17	1 767	1 779
Other assets	31	2 925	3 034
TOTAL ASSETS		**296 912**	**285 573**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to the Central Bank		6	4
Amounts due to banks	32	4 558	19 208
Derivative financial instruments	22	2 740	4 198
Amounts due to customers	33	218 800	205 066
Liabilities in respect of insurance activities	34	2 999	2 944
Debt securities in issue	35	23 932	14 493
Subordinated liabilities	36	1 720	2 539
Other liabilities	37	5 062	3 987
Current income tax liabilities		588	305
Deferred income tax provision	17	36	31
Provisions	38	215	229
TOTAL LIABILITIES		**260 656**	**253 004**
Equity			
Share capital	39	1 250	1 250
Other capital	39	32 236	28 701
Foreign exchange differences on translation of foreign branches	39	(257)	(221)
Retained earnings	39	(66)	(19)
Net profit or loss for the year	39	3 104	2 874
Capital and reserves attributable to equity holders of the parent company	39	36 267	32 585
Non-controlling interests	39	(11)	(16)
TOTAL EQUITY		**36 256**	**32 569**
TOTAL LIABILITIES AND EQUITY		**296 912**	**285 573**
Capital adequacy ratio	71	17,37%	15,81%
Book value (in PLN million)		36 256	32 569
Number of shares (in million)		1 250	1 250
Book value per share (in PLN)		29,00	26,05
Diluted number of shares (in million)		1 250	1 250
Diluted book value per share (in PLN)		29,00	26,05

The notes on pages 11 to 196 are an integral part of these consolidated financial statements

(IN PLN MILLION)

STATEMENT OF CHANGES IN CONSOLIDATED EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2017	Share capital	Other capital								Exchange differences on translating foreign operations	Retained earnings	Net profit or loss for the year	Capital and reserves attributable to equity holders of the parent company	Non-controlling interests	Total equity
		Reserves			Other comprehensive income										
		Supplementary capital	General banking risk fund	Other reserves	Share in other comprehensive income of associates and joint ventures	Available-for-sale financial assets	Cash flow hedges	Actuarial gains and losses	Total other capital and reserves						
As at 1 January 2017	1 250	24 491	1 070	3 607	(1)	(347)	(109)	(10)	28 701	(221)	(19)	2 874	32 585	(16)	32 569
Transfer from retained earnings	-	-	-	-	-	-	-	-	-	-	2 874	(2 874)	-	-	-
Total comprehensive income, of which:	-	-	-	-	1	619	(7)	1	614	(36)	-	3 104	3 682	5	3 687
Net profit	-	-	-	-	-	-	-	-	-	-	-	3 104	3 104	5	3 109
Other comprehensive income	-	-	-	-	1	619	(7)	1	614	(36)	-	-	578	-	578
Transfer from retained earnings to reserves	-	2 883	-	38	-	-	-	-	2 921	-	(2 921)	-	-	-	-
As at 31 December 2017	1 250	27 374	1 070	3 645	-	272	(116)	(9)	32 236	(257)	(66)	3 104	36 267	(11)	36 256

FOR THE YEAR ENDED 31 DECEMBER 2016	Share capital	Other capital								Exchange differences on translating foreign operations	Retained earnings	Net profit or loss for the year	Capital and reserves attributable to equity holders of the parent company	Non-controlling interests	Total equity
		Reserves			Other comprehensive income										
		Supplementary capital	General banking risk fund	Other reserves	Share in other comprehensive income of associates and joint ventures	Available-for-sale financial assets	Cash flow hedges	Actuarial gains and losses	Total other capital and reserves						
As at 1 January 2016	1 250	20 711	1 070	3 536	-	171	(58)	(12)	25 418	(217)	1 222	2 610	30 283	(18)	30 265
Transfer from retained earnings	-	-	-	-	-	-	-	-	-	-	2 610	(2 610)	-	-	-
Total comprehensive income, of which:	-	-	-	-	(1)	(518)	(51)	2	(568)	(4)	-	2 874	2 302	2	2 304
Net profit	-	-	-	-	-	-	-	-	-	-	-	2 874	2 874	2	2 876
Other comprehensive income	-	-	-	-	(1)	(518)	(51)	2	(568)	(4)	-	-	(572)	-	(572)
Transfer from retained earnings to reserves	-	3 780	-	71	-	-	-	-	3 851	-	(3 851)	-	-	-	-
As at 31 December 2016	1 250	24 491	1 070	3 607	(1)	(347)	(109)	(10)	28 701	(221)	(19)	2 874	32 585	(16)	32 569

(IN PLN MILLION)

CONSOLIDATED STATEMENT OF CASH FLOWS

	Note	2017	2016
Cash flows from operating activities			
Profit before income tax		**4 249**	**3 783**
Adjustments:		**13 500**	**3 313**
Amortization and depreciation		844	801
(Gains)/losses on investing activities	47	(117)	(186)
Interest and dividends	47	(465)	(236)
Change in:			
amounts due from banks	47	700	325
financial instruments designated at fair value through profit or loss upon initial recognition and financial assets held for trading		5 675	1 674
derivative financial instruments		(1 155)	1 020
loans and advances to customers	47	(4 844)	(3 822)
other assets, inventories and non-current assets held for sale	47	45	(1 311)
amounts due to banks	47	(1 202)	(3 042)
amounts due to customers	47	15 337	8 592
debt securities in issue	47	(1 119)	443
provisions and impairment allowances	47	(172)	(291)
other liabilities and liabilities in respect of insurance activities	47	1 124	1 101
Income tax paid		(972)	(918)
Other adjustments	47	(179)	(837)
Net cash from/used in operating activities		**17 749**	**7 096**
Cash flows from investing activities			
Inflows from investing activities		**96 663**	**50 580**
Proceeds from sale and interest on investment securities		96 415	50 294
Proceeds from sale of subsidiaries		-	134
Proceeds from sale of intangible assets, property, plant and equipment and assets held for sale		224	131
Other inflows from investing activities (dividends)		24	21
Outflows from investing activities		**(103 557)**	**(59 536)**
Purchase of a subsidiary, net of cash acquired		(47)	(571)
Increase in equity of an associate		(23)	(1)
Purchase of investment securities		(102 862)	(58 208)
Purchase of intangible assets and property, plant and equipment		(625)	(756)
Net cash from/used in investing activities		**(6 894)**	**(8 956)**
Cash flows from financing activities			
Proceeds from debt securities in issue	35	17 836	7 807
Proceeds from issue of subordinated bonds	36	1 700	-
Redemption of debt securities	35	(7 278)	(4 747)
Repayment of a subordinated loan	36	(880)	-
Repayment of liabilities arising from subordinated bonds	36	(1 656)	-
Taking up loans and advances		311	460
Repayment of loans and advances	32;33	(15 360)	(485)
Repayment of interest on long-term borrowings		(494)	(473)
Net cash from financing activities		**(5 821)**	**2 562**
Total net cash flows		**5 034**	**702**
of which foreign exchange differences on cash and cash equivalents		(366)	135
Cash equivalents at the beginning of reporting period		17 966	17 264
Cash equivalents at the end of reporting period	47	23 000	17 966

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. General information about the Group and the Bank

Business activities of the Group and the Bank

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

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

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

The Powszechna Kasa Oszczędnościowa Bank Polski Spółka Akcyjna Group ("the PKO Bank Polski SA Group", "the Bank's Group", "the Group") conducts its operations within the territory of the Republic of Poland and through subsidiaries in Ukraine, Sweden and Ireland; it also has branches in the Federal Republic of Germany ("the German Branch") and in the Czech Republic ("the Czech Branch").

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

Through its subsidiaries, the Group offers mortgage loans, provides financial services related to leases, factoring, investment funds, pension funds, insurance and debt collection services, transfer agent services, IT outsourcing and business outsourcing services, conducts development and real estate management operations.

The composition of the Group and scope of operations of its entities are presented in the note "Structure of the PKO Bank Polski SA Group and scope of activities of the Group entities".

(IN PLN MILLION)

Information on members of the Supervisory Board and Management Board of the Bank

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

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

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

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

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

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

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

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The Group's consolidated financial statements have been prepared for the year ended 31 December 2017 and comprise the comparative data for the year ended 31 December 2016. The financial data is presented in Polish zloty (PLN) in millions, unless indicated otherwise.

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

2.1. STATEMENT OF COMPLIANCE

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

(IN PLN MILLION)

2.2. Going concern

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

2.3. Basis of preparation of the financial statements

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

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

Estimates and assumptions made by the Group are reviewed on an ongoing basis. Changes to estimates are recognized in the period to which they relate.

2.4. Approval of the financial statements

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

3. Summary of significant accounting policies

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

CONSOLIDATED INCOME STATEMENT	Note	Accounting policy[1]
Interest income and expense	7	Y
Commission and fee income and expense	8	Y
Dividend income	9	Y
Net gain/(loss) on financial instruments measured at fair value	10	Y
Gain/(loss) on investment securities	11	Y
Net foreign exchange gains/(losses)	12	Y
Other operating income and expenses	13	Y
Net impairment allowances and provisions	14	Y
Administrative expenses	15	Y
Income tax expense	17	Y

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

(IN PLN MILLION)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION	Note	Accounting policy[1]	Major estimates and judgments[1]
Cash and cash balances with the Central Bank	19	Y	
Amounts due from banks	20	Y	
Financial assets held for trading, excluding derivative financial instruments	21	Y	
Derivative financial instruments	22	Y	Y
Derivatives hedging derivatives	23	Y	
Financial instruments designated at fair value through profit or loss upon initial recognition	24	Y	
Loans and advances to customers	25	Y	Y
Available-for-sale investment securities	26	Y	Y
Investment securities held to maturity	27	Y	
Investments in associates and joint ventures	41	Y	
Non-current assets held for sale	28	Y	
Inventories	29	Y	
Intangible assets	30	Y	Y
Property, plant and equipment	30	Y	Y
Deferred income tax asset	17		
Other assets	31	Y	
Amounts due to banks	32	Y	
Amounts due to customers	33	Y	
Liabilities in respect of insurance activities	34	Y	
Debt securities issued	35	Y	
Subordinated liabilities	36	Y	
Other liabilities	37	Y	
Provisions	38	Y	Y
Equity and shareholders of the Bank	39	Y	

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

3.1. Foreign currencies

Functional and presentation currency

Items included in the financial statements of the individual Group companies operating outside the territory of Poland are measured in the functional currency, i.e. the currency of the primary economic environment in which a given entity operates. The functional currency of the parent company and other entities included in these financial statements, except for the German Branch, the Czech Branch and entities conducting their activities outside of the Republic of Poland, is the Polish zloty. The functional currency of the entities operating in Ukraine is the Ukrainian hryvnia, the functional currency of the German Branch and the entities operating in Sweden is euro, and the functional currency of the Czech Branch is the Czech koruna.

Transactions and balances in foreign currencies

Transactions expressed in foreign currencies are translated into the functional currency using the exchange rates prevailing at the date of the transaction. At each balance sheet date items are translated by the Group using the following principles:

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

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

(IN PLN MILLION)

UAH	2017	2016
Foreign exchange rates as at the end of the period	0,1236	0,1542
Arithmetic mean of exchange rates as at the last day of each month in the period	0,1402	0,1542
The highest exchange rate during the period	0,1499	0,1632
The lowest exchange rate during the period	0,1236	0,1436

EUR	2017	2016
Foreign exchange rates as at the end of the period	4,1709	4,424
Arithmetic mean of exchange rates as at the last day of each month in the period	4,2447	4,3757
The highest exchange rate during the period	4,3308	4,4405
The lowest exchange rate during the period	4,1709	4,2684

CZK	2017	2016
Foreign exchange rates as at the end of the period	0,1632	0,1670
Arithmetic mean of exchange rates as at the last day of each month in the period	0,1614	0,1621
The highest exchange rate during the period	0,1657	0,1670
The lowest exchange rate during the period	0,1559	0,1578

3.2. BASIS OF CONSOLIDATION

SUBSIDIARIES

Subsidiaries are entities controlled by the parent company, which means that the parent company has a direct or indirect impact on the financial and operating policy of the given entity in order to gain economic benefits from its operations.

ACQUISITION ACCOUNTING METHOD

All entities of the PKO Bank Polski SA Group are consolidated using the acquisition accounting method.

The process of consolidation of financial statements of subsidiaries by the acquisition accounting method involves adding up the individual items of the income statements and statements of financial position of the parent company and the subsidiaries in the full amounts, and making appropriate consolidation adjustments and eliminations. The carrying amount of the Bank's investments in subsidiaries and the equity of these entities at the date of their acquisition are eliminated at consolidation. The following items are eliminated in full at consolidation:

1) intercompany receivables and payables and other settlements between consolidated entities of a similar nature;
2) revenues and costs resulting from business transactions between consolidated entities;
3) profits or losses resulting from business transactions between consolidated entities contained in the value of the consolidated entities" assets, except for impairment losses;
4) dividends accrued or paid by subsidiaries to the parent company and other consolidated entities;
5) inter-company cash flows in the statement of cash flows.

The consolidated statement of cash flows has been prepared on the basis of the consolidated statement of financial position, consolidated income statement and additional notes and explanations.

Financial statements of subsidiaries are prepared for the same reporting periods as the financial statements of the parent company. Consolidation adjustments are made in order to eliminate any differences in the accounting policies applied by the Bank and its subsidiaries.

ACQUISITION METHOD

The acquisition of subsidiaries by the Group is accounted for under the acquisition method.

In respect of mergers of the Group companies, i.e. the so-called transactions under common control, the predecessor accounting method is applied, i.e. the acquired subsidiary is recognized at the carrying amount of its assets and liabilities recognized in the Group's consolidated financial statements in respect of the given subsidiary, including the goodwill arising from the acquisition of that subsidiary.

ASSOCIATES AND JOINT VENTURES

Associates are entities on which the Group exerts significant influence but which it does not control, which usually accompanies having from 20% to 50% of the total number of votes in the decision-making bodies of the entities.

Joint ventures are commercial companies or other entities, which are jointly controlled by the Bank on the basis of the Memorandum or Articles of Association or an agreement concluded for a period longer than one year.

Investments in these entities are accounted for in accordance with the equity method and are initially stated at purchase cost. The investment includes goodwill determined as at the acquisition date, net of any accumulated impairment allowances.

The Group's share in the results of associates and joint ventures from the acquisition date is recorded in the income statement and its share in changes in the balance of other comprehensive income from the acquisition date is recorded in other comprehensive income. The carrying amount of investments is adjusted by the total movements in the individual equity items from the acquisition date. When the Group's share in the losses of these entities becomes equal or higher than the Group's interest in such entities, including unsecured receivables (if any), the Group discontinues recognizing further losses, unless it has assumed the obligation or made payments on behalf of the particular entity.

Unrealized gains on transactions between the Group and such entities are eliminated pro rata to the Group's interest in those entities. Unrealized losses are also eliminated, unless there is evidence of impairment of the asset transferred.

At each balance sheet date, the Group makes an assessment of whether there is any objective evidence of impairment in investments in associates and joint ventures. If any such evidence exists, the Group estimates the recoverable amount, i.e. the value in use of the investment or the fair value of the investment less costs to sell, whichever of these values is higher. If the carrying amount of an asset exceeds its recoverable amount, the Group recognizes an impairment allowance in the income statement.

3.3. ACCOUNTING FOR TRANSACTIONS

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

3.4. DERECOGNITION OF FINANCIAL INSTRUMENTS FROM THE STATEMENT OF FINANCIAL POSITION

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

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

When the Group transfers a financial asset, it evaluates the extent to which it retains the risks and rewards of ownership of the financial asset. In such case:

- if the Group transfers substantially all risks and benefits associated with holding a given financial asset, the financial asset is eliminated from the statement of financial position;

- if the Group retains substantially all risks and benefits associated with holding a given financial asset, the financial asset continues to be recognized in the statement of financial position;
- if substantially all risks and benefits associated with holding a given financial asset are neither transferred nor retained, the Group determines whether it has maintained control of that financial asset.

If the Group has retained control, it continues to recognize the financial asset in the statement of financial position to the extent of its continuing involvement in the financial asset; if control has not been retained, then the financial asset is derecognized from the statement of financial position.

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

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

4. CHANGES IN ACCOUNTING POLICIES

4.1 AMENDMENTS TO PUBLISHED STANDARDS AND INTERPRETATIONS THAT ARE EFFECTIVE AS OF 1 JANUARY 2017

IAS 7 STATEMENT OF CASH FLOWS

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

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

4.2 NEW STANDARDS AND INTERPRETATIONS AND AMENDMENTS THERETO THAT HAVE BEEN PUBLISHED AND ADOPTED BY THE EU, BUT HAVE NOT COME INTO FORCE YET AND ARE NOT APPLIED BY THE GROUP

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

(IN PLN MILLION)

4.2.1. IFRS 9 Financial Instruments

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

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

	31.12.2017 (classification under IAS 39)	Classification and measurement: reclassification	Classification and measurement: remeasure-ment	Impairment	01.01.2018 (classification under IFRS 9)
FINANCIAL ASSETS					
Cash and cash balances with the Central Bank	17 810	-	-	-	17 810
Amounts due from banks	5 233	-	-	-	5 233
Derivative instruments	2 598	(12)	-	-	2 586
Securities	**54 075**	**4 380**	**64**	**4**	**58 523**
- held for trading	431	-	-	-	431
- financial instruments designated at fair value through profit or loss upon initial recognition	8 157	(8 157)	-	-	-
- available-for-sale investment securities	43 675	(43 675)	-	-	-
- investment securities held to maturity	1 812	(1 812)	-	-	-
- not held for trading, mandatorily measured at fair value through profit or loss		4 578	62	25	4 665
- at fair value through OCI		47 266	2	(20)	47 248
- at at amortized cost		6 180	-	(1)	6 179
Loans and advances to customers	205 628	(4 368)	-	(763)	200 497
- not held for trading, mandatorily measured at fair value through profit or loss		1 055	-	13	1 068
- at fair value through OCI		-	-	-	-
- at at amortized cost	205 628	(5 423)	-	(776)	199 429
Other assets (other financial assets)	2 377	-	-	-	2 377
			-	-	
TOTAL FINANCIAL ASSETS	**287 721**	**-**	**64**	**(759)**	**287 026**
Deferred income tax asset	1 767	-	(12)	207	1 962

	31.12.2017 (classification under IAS 39)	Classification and measurement: reclassification	Classification and measurement: remeasure-ment	Impairment	01.01.2018 (classification under IFRS 9)
Amounts due to the Central Bank	6			-	6
Amounts due to banks	4 558			-	4 558
Derivative financial instruments	2 740			-	2 740
Amounts due to customers	218 800			-	218 800
Debt securities issued	23 932			-	23 932
Subordinated liabilities	1 720			-	1 720
Other liabilities (other financial liabilities)	4 129			-	4 129
Deferred income tax provision	36			(3)	33
Provisions for liabilities and guarantees granted	215	-	-	73	288
Current income tax liabilities	588	-	-	52	640
TOTAL FINANCIAL LIABILITIES, PROVISION FOR LIABILITIES AND GUARANTEES GRANTED AND DEFERRED TAX PROVISION	**256 724**	**-**	**-**	**122**	**256 846**

(IN PLN MILLION)

IFRS 9 impact as at 1 January 2018:	31.12.2017 (classification under IAS 39)	Classification and measurement: reclassification	Classification and measurement: remeasure-ment	Impairment	01.01.2018 (classification under IFRS 9)
Other comprehensive income	147	-	(78)	-	69
Retained earnings	(66)	-	130	(674)	(610)
		-	-	-	-
Total impact on equity	**81**	**-**	**52**	**(674)**	**(541)**

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

4.2.1.1 Implementation schedule

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

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

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

2) impairment.

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

Since the beginning of 2017, the second stage of the project has been carried out, aimed at implementing the changes resulting from IFRS 9. As in the first stage, which covered the gap analysis, the project was divided into two cooperating areas:

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

2) impairment.

The second stage of the project comprised:

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

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

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

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

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

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

4.2.1.2 CLASSIFICATION AND MEASUREMENT

a) THE PRINCIPLES FOR CLASSIFICATION OF FINANCIAL INSTRUMENTS

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

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

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

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

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

BUSINESS MODEL

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

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

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

ASSESSMENT OF CONTRACTUAL CASH FLOW CHARACTERISTICS

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

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

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

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

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

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

FINANCIAL ASSETS MEASURED AT AMORTIZED COST

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

EQUITY INSTRUMENTS

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

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

b) RECLASSIFICATION OF FINANCIAL ASSETS

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

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

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

No financial liabilities are reclassified.

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

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

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

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

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

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

c) CHANGES IN THE ESTIMATED CONTRACTUAL CASH FLOWS – MODIFICATIONS

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

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

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

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

The following QUALITATIVE CRITERIA have been adopted:

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

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

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

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

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

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

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

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

e) Measurement of off-balance sheet instruments

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

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

f) Interest income

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

1) purchased or originated credit-impaired financial assets (see item d). With respect to such financial assets, the Group applies the effective interest rate adjusted for credit risk to the amount of amortized cost of the financial asset (net carrying amount) from the date of initial recognition (POCI assets);

2) financial assets other than purchased or originated credit-impaired financial assets, which subsequently became credit-impaired financial assets. With respect to such financial assets, the Group applies the original effective interest rate (as at the date of recognition of an indication of impairment) to the amount of amortized cost of the financial asset (the net carrying amount) in the subsequent reporting periods.

g) Assessment of impact – classification and measurement

Change in the classification and measurement of financial assets concerns:

- NBP bills, which were measured at fair value through profit or loss on a portfolio basis in accordance with IAS 39. In accordance with IFRS 9, a portfolio of bills is measured at the fair value through other comprehensive income due to the fact that the “held to collect cash flows and to sell” model is applied;
- due to the occurrence of the leverage component (an interest formula based on a multiple that is higher than 1) in the interest rate formula for selected loan portfolios, the SPPI test has not been passed: ARiMR (the Agency for Restructuring and Modernization of Agriculture) investment loans, selected working capital loans, student loans, preferential housing loans with BGK financing, housing loans (Alicja), selected loans granted to local government units. If the SPPI test has not been passed despite the application of the “held to collect cash flows” model, it is necessary to change the measurement category for such loan portfolios from amortized cost to fair value through profit or loss;
- due to the SPPI test not being met, despite the application of the “held to collect cash flows” model, the fair value measurement through profit or loss will be applied to selected tranches of corporate bonds acquired by the Group (one entity). The classification of corporate bonds (which were previously recognized in investment securities available for sale) with an embedded option of conversion for shares (presented in derivatives) was also changed. In accordance with IFRS 9, they are collectively measured at the fair value through profit or loss.

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

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

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

The Group has estimated that, in connection with the IFRS 9 implementation on 1 January 2018, the total effect of adjustments arising from changes in the measurement and classification on equity (retained earnings or other comprehensive income) as at 1 January 2018 will amount to PLN 64 million (PLN 52 million after tax).

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

As the main POCI category, the Group recognized impaired exposures acquired as a result of mergers and business combinations as at the date of the merger/business combination (the mergers with Nordea Bank Polska and SKOK "Wesoła" in Mysłowice) and exposures to corporate entities and lease receivables that satisfy the POCI criteria in the net carrying amount of PLN 603 million.

4.2.1.3 IMPAIRMENT

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

IFRS 9 has introduced new concepts concerning impairment:

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

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

- debt financial instruments comprising credit exposures and securities;
- lease receivables;

- off-balance sheet financial and guarantee liabilities.

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

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

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

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

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

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

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

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

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

IMPACT ASSESSMENT – IMPAIRMENT

The Group estimates that the implementation of IFRS 9 will result in a decrease in the net asset value of PLN 832 million (PLN 674 million after tax).

4.2.1.4 HEDGE ACCOUNTING

IFRS 9 increases the range of items that can be designated as hedged items, as well as allows designating as a hedging instrument financial assets or liabilities measured at fair value through profit or loss. The obligation of retrospective measurement of hedge effectiveness together with the previously applicable threshold of 80%-125% were eliminated (the condition to the application of hedge accounting is the economic relationship between the hedging instrument and the hedged item). In addition, the scope of required disclosures regarding risk management strategies, cash flows arising from hedging transactions and the impact of hedge accounting on the financial statements were extended.

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

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

4.2.1.5 Disclosures and comparative data

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

4.2.1.6 The impact of IFRS 9 on own funds and capital adequacy measures

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

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

The impact of the provisions of IFRS 9 concerning changes in the impairment model on own funds and capital adequacy measures is regulated by Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State. In accordance with this regulation, banks may apply transitional provisions with respect to own funds and increase Tier 1 capital associated with the implementation of a new impairment model in the period of 5 consecutive years from 1 January 2018. The scaling factor shall decrease from one period to another.

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

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

As a result of adjusting the calculations of regulatory capital requirements that take into account the transitional solutions aimed at easing the impact of the IFRS 9 implementation as at 1 January 2018, the Group's own funds calculated for capital adequacy purposes increased by approx. PLN 86 million; at the same time, due to impairment adjustments resulting from the implementation of IFRS 9, own funds decreased by approx. PLN 33 million, and due to adjustments relating to changes in measurement methods it increased by approx. PLN 46 million. At the same time, the Group's own funds increased by approx. PLN 72 million due to the fact that the transitional period provided for in the CRR for removing a specific percentage of unrealized gains on securities measured at fair value from own funds ended (as at 31.12.2017, 20% of such gains was removed).

Had the transitional solutions not been applied, the Group's own funds would be PLN 555 million lower. This decrease would comprise a decrease of PLN 674 million resulting from impairment adjustments, an increase of PLN 46 million resulting from changes in measurement methods, and a simultaneous increase of PLN 72 million resulting from the end of the transitional period provided for in the CRR.

As a result, the total capital ratio of the Group will decrease by 3 base points. If the transitional solutions relating to IFRS 9 were not applied and the total impact of the implementation of IFRS 9 was recognized, the total capital ratio would decrease by 30 base points.

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

4.2.2 IFRS 15 Revenue from Contracts with Customers

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

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

The scope of the standard does not include financial instruments (IAS 39), insurance contracts (IFRS 4) and leases (IAS 17). The current accounting treatment of sales is consistent with the presentation provided in IFRS 15; therefore, in the Group's opinion, the new standard will not affect the recognition of revenues from contracts with customers in the consolidated financial statements of the Group.

4.2.3 IFRS 16 Leases

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

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

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

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

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

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

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

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

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

6. INFORMATION ON BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS

SEGMENT REPORTING

The PKO Bank Polski SA Group conducts business activities within segments offering specific products and services addressed to specific groups of customers. The manner in which the business segments are divided ensures consistency with the sales management model and offers customers a comprehensive product mix comprising both traditional banking products and more complex investment products, as well as services provided by the PKO Bank Polski SA Group entities. The segment note presented below is included in the internal reporting system, i.e. information presented to the Management Board of PKO Bank Polski SA, used to assess the achieved results and allocate resources. The segment report presented below reflects the internal organizational structure of the PKO Bank Polski SA Group.

The PKO Bank Polski SA Group comprises three basic segments: retail, corporate and investment, and transfer & other activities centre:

1. The retail segment offers a full range of services to individuals as part of retail, private and mortgage banking. It also comprises transactions concluded with legal persons, i.e. small- and medium-sized enterprises. The products and services offered to the customers in this segment comprise: current and savings accounts, term deposits, private banking services, combined investment and insurance products, credit and debit cards, electronic banking services. With regard to financing, this segment offers consumer loans, mortgage loans, including those offered by PKO Bank Hipoteczny SA, as well as business loans for small- and medium-sized enterprises, developers, cooperatives and property managers, and leases and factoring offered by the PKO Leasing SA Group. In addition, the results of the retail segment comprise the results of the following companies: PKO TFI SA, PKO BP Bankowy PTE SA, PKO Życie Towarzystwo Ubezpieczeń SA, PKO Towarzystwo Ubezpieczeń SA, PKO BP Finat Sp. z o.o. and ZenCard Sp. z o.o.
2. The corporate and investment segment includes transactions concluded with large corporate clients and financial institutions. This segment offers the following products and services: maintaining current accounts and term deposits, safekeeping of securities, currency products and derivatives, business loans, leasing and factoring offered by the PKO Leasing SA Group. In this segment, PKO Bank Polski SA also concludes, on its own or as part of syndicates with other banks, agreements for the financing of large projects in the form of loans and issues of non-treasury securities. Moreover, the segment comprises own operations, i.e. investing activities, brokerage activities, interbank transactions, transactions in derivatives and debt securities. The results of the corporate and investment segments also comprise the results of the companies operating in Ukraine, mainly KREDOBANK SA and the companies which conduct real estate development and real estate management activities.
3. The transfer and other activities centre comprises the result on internal settlements related to funds transfer pricing, the result on long-term sources of financing and the result on positions classified for hedge accounting, as well as the results not allocated to any other segment. Internal funds transfer is based on arm's length transfer pricing. Transactions between the operating segments are conducted on an arm's length basis. Long-term external financing includes issuing securities, including covered bonds, subordinated liabilities and loans received from financial institutions. As part of this segment, the results of PKO Finance AB are presented.

The PKO BP SA Group usually accounts for transactions between the segments as if they were transactions between unrelated entities – using internal settlements rates. Transactions between the segments are conducted on an arm's length basis.

Accounting policies applied in the segment report are consistent with the accounting policies described in Note 3 to these financial statements.

Disclosed assets and liabilities are operating assets and liabilities used by the segment in its operating activities. The values of assets, liabilities, income and expenses of the particular segments are based on internal management information. Assets and liabilities as well as income and costs related to these assets and liabilities are assigned to particular segments.

The income tax expense in respect of the presentation of the financial result, and deferred income tax assets, current income tax receivables, current income tax liabilities and deferred income tax provision in respect of the presentation of the statement of financial position were recognized at Group level.

(IN PLN MILLION)

The following tables present data on revenues and results of individual operating segments of the PKO Bank Polski SA Group for the 12-month period ended 31 December 2017 and 31 December 2016, as well as assets and liabilities as at 31 December 2017 and as at 31 December 2016.

FOR THE YEAR ENDED 31 DECEMBER 2017	Continuing operations			
	Retail segment	Corporate and investment segment	Transfer centre and other	Total activity of the PKO Bank Polski SA Group
Net interest income	6 975	1 403	228	8 606
Net fee and commission income	2 373	602	(6)	2 969
Other net income	449	448	91	988
Gains/(losses) on financial transaction	5	46	3	54
Net foreign exchange gains/(losses)	213	197	42	452
Dividend income	-	12	-	12
Net other operating income and expense	205	219	46	470
Income/(expenses) relating to internal customers	26	(26)	-	-
Net impairment allowances and provisions	(1 085)	(535)	-	(1 620)
Administrative expenses, of which:	(4 767)	(881)	(136)	(5 784)
Amortization and depreciation	(727)	(117)	-	(844)
Tax on certain financial institutions	(710)	(251)	29	(932)
Shares in profits (losses) of associates and jointly controlled entities	-	-	-	22
Segment profit/(loss) before tax	3 235	786	206	4 249
Income tax expense (tax burden)	-	-	-	(1 140)
Profit (loss) attributable to non-controlling shareholders	-	-	-	5
Net profit attributable to the equity holders of the parent company	**3 235**	**786**	**206**	**3 104**

AS AT 31 DECEMBER 2017	Continuing operations			
	Retail segment	Corporate and investment segment	Transfer centre and other	Total activity of the PKO Bank Polski SA Group
Assets	161 380	128 151	5 612	295 143
Unallocated assets	-	-	-	1 769
Total assets	161 380	128 151	5 612	296 912
Liabilities	172 240	59 181	28 611	260 032
Unallocated liabilities	-	-	-	624
Total liabilities	172 240	59 181	28 611	260 656

(IN PLN MILLION)

FOR THE YEAR ENDED 31 December 2016	Continuing operations			
	Retail segment	Corporate and investment segment	Transfer centre and other	Total activity of the PKO Bank Polski SA Group
Net interest income	6 585	1 203	(33)	7 755
Net fee and commission income	2 141	555	(3)	2 693
Other net income	357	524	461	1 342
Gains/(losses) on financial transaction	10	102	398	510
Net foreign exchange gains/(losses)	266	175	62	503
Dividend income	-	10	-	10
Net other operating income and expenses	55	263	1	319
Income/(expenses) relating to internal customers	26	(26)	-	-
Net impairment allowances and provisions	(1 088)	(535)	-	(1 623)
Administrative expenses, of which:	(4 685)	(905)	-	(5 590)
Amortization and depreciation	(706)	(95)	-	(801)
Tax on certain financial institutions	(606)	(228)	5	(829)
Shares in profits (losses) of associates and jointly controlled entities	-	-	-	35
Segment profit/(loss) before tax	2 704	614	430	3 783
Income tax expense (tax burden)	-	-	-	(907)
Profit (loss) attributable to non-controlling shareholders	-	-	-	2
Net profit attributable to the equity holders of the parent company	**2 704**	**614**	**430**	**2 874**

AS AT 31 DECEMBER 2016	Continuing operations			
	Retail segment	Corporate and investment segment	Transfer centre and other	Total activity of the PKO Bank Polski SA Group
Assets	157 417	122 296	4 071	283 784
Unallocated assets	-	-	-	1 789
Total assets	157 417	122 296	4 071	285 573
Liabilities	168 476	48 899	35 293	252 668
Unallocated liabilities	-	-	-	336
Total liabilities	168 476	48 899	35 293	253 004

INFORMATION ON GEOGRAPHICAL AREAS

Additionally, the PKO Bank Polski SA Group divides its operations into geographical areas. The Group conducts activities in the Republic of Poland and in Ukraine through the KREDOBANK SA Group, "Inter-Risk Ukraina" Sp. z o.o. and Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o., in Sweden through subsidiaries: PKO Finance AB and PKO Leasing Sverige AB, in Ireland through the subsidiary: ROOF Poland Leasing 2014 DAC, as well as through a corporate branch of PKO Bank Polski SA (PKO Bank Polski Niederlassung Deutschland) in the Federal Republic of Germany and through a corporate branch in the Czech Republic. For presentation purposes, the results of companies operating in Sweden and the results of the branches operating in Germany and the Czech Republic, which from the point of view of the scale of operations of the PKO Bank Polski SA Group are not significant, are included in the segment of Poland.

(IN PLN MILLION)

FOR THE PERIOD ENDED 31 DECEMBER 2017	Poland	Ukraine	Total
Net interest income	8 453	153	8 606
Fee and commission income	2 915	54	2 969
Other net income	975	13	988
Administrative expenses	(5 660)	(124)	(5 784)
Net impairment allowances and provisions	(1 595)	(25)	(1 620)
Tax on certain financial institutions	(932)	-	(932)
Shares in profits (losses) of associates and jointly controlled entities	-	-	22
Profit before income tax	4 156	71	4 249
Income tax expense (tax burden)	-	-	(1 140)
Profit (loss) attributable to non-controlling shareholders	-	-	5
Net profit attributable to equity holders of the parent company	**4 156**	**71**	**3 104**

AS AT 31 DECEMBER 2017	Poland	Ukraine	Total
Assets, of which:	295 133	1 779	296 912
non financial non-current assets	6 249	94	6 343
deferred income tax assets and current income tax receivable	1 764	5	1 769
Liabilities	259 048	1 608	260 656

FOR THE PERIOD ENDED 31 DECEMBER 2016	Poland	Ukraine	Total
Net interest income	7 618	137	7 755
Net fee and commission income	2 649	44	2 693
Other net income	1 340	2	1 342
Administrative expenses	(5 481)	(109)	(5 590)
Net impairment allowances and provisions	(1 589)	(34)	(1 623)
Tax on certain financial institutions	(829)	-	(829)
Shares in profits (losses) of associates and jointly controlled entities	-	-	35
Profit before income tax	3 708	40	3 783
Income tax expense	-	-	(907)
Profit (loss) attributable to non-controlling shareholders	-	-	2
Net profit attributable to equity holders of the parent company	**3 708**	**40**	**2 874**

AS AT 31 DECEMBER 2016	Poland	Ukraine	Total
Assets, of which:	283 861	1 712	285 573
non financial non-current assets	6 685	83	6 768
deferred income tax assets and current income tax receivable	1 780	9	1 789
Liabilities	251 444	1 560	253 004

NOTES TO THE CONSOLIDATED INCOME STATEMENT

7. INTEREST INCOME AND EXPENSES

Accounting policies
- Interest and expenses resulting from sales of insurance products linked to loans and advances.

Financial information:
- Interest income
- Interest expenses

ACCOUNTING POLICIES

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

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

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

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

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

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

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

Remuneration is divided into the commission portion and the interest portion based on the proportion of the fair value of the financial instrument and the fair value of the intermediation service to the sum of these two values, in accordance with the relative fair value model comprising a range of different parameters, including the average effective interest rate on the financial instrument, the average contractual and economic (actual) lending or lease period, the average insurance premium amount, the term of the insurance policy, the independent insurance agent's commission. Measurement of the fair value of a financial instrument is based on the income-based approach, involving the conversion of future cash flows to their present value using a discount rate consisting of a risk-free rate determined in relation to the average yield on 5-year and 10-year bonds in the past year, the risk premium determined in relation to the annual costs of credit risk and exceeding the credit risk premium, which reflects all other factors that the market participants would take into account in the fair value measurement under the current circumstances.

(IN PLN MILLION)

On the other hand, the fair value of the insurance intermediation service is measured in accordance with the market approach, which is based on prices and other information generated by identical or comparable market transactions.

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

The Group makes periodical estimations of the remuneration amount that will be recoverable in the future due to the early termination of the insurance contract based on historical data on premiums collected and refunds made. The provision for future refunds is allocated to the financial instrument and insurance service in accordance with the relative fair value model.

The Group verifies the correctness of the parameters used in the relative fair value model and the ratio of the provision for refunds each time it learns about significant changes in this respect, not less frequently, however, than once a year.

FINANCIAL INFORMATION

INTEREST INCOME ON:	2017	2016
loans to and other receivables from banks	136	122
loans and advances to customers, of which:	9 182	8 363
on impaired loans	270	278
investment securities	1 045	840
hedging derivatives	322	340
financial assets designated at fair value through profit or loss upon initial recognition	191	226
financial assets held for trading, excluding derivative financial instruments	42	69
other	1	5
Total	**10 919**	**9 965**

INTEREST EXPENSE ON:	2017	2016
amounts due to banks	(136)	(102)
amounts due to customers	(1 623)	(1 577)
debt securities in issue and subordinated liabilities	(464)	(395)
available-for-sale debt securities	(69)	(79)
financial assets held for trading, excluding derivative financial instruments	(11)	(33)
financial assets designated at fair value through profit or loss upon initial recognition	(10)	(24)
Total	**(2 313)**	**(2 210)**

8. FEE AND COMMISSION INCOME AND EXPENSES

ACCOUNTING POLICIES

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

(IN PLN MILLION)

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

FINANCIAL INFORMATION

FEE AND COMMISSION INCOME ON:	2017	2016
payment and credit cards	1 126	1 024
maintenance of bank accounts	858	879
loans and advances granted	616	592
maintenance of investment funds and OFE (including management fees)	590	450
cash transactions	98	103
servicing foreign mass transactions	101	89
brokerage activities and issue arrangement	206	148
offering insurance products	94	31
sale and distribution of court fee stamps	5	12
investment and insurance products	73	105
customer orders	44	44
fiduciary services	6	5
other	101	97
Total	**3 918**	**3 579**

FEE AND COMMISSION EXPENSE ON:	2017	2016
card activities	(624)	(551)
commission paid to external entities for product sales	(61)	(65)
cost of construction investment supervision and property valuation	(41)	(40)
settlement services	(29)	(33)
fee and commissions for operating services provided by banks	(19)	(18)
sending short text messages (SMS)	(21)	(16)
asset management	(15)	(12)
fees incurred by the Brokerage House	(21)	(17)
other[1]	(118)	(134)
Total	**(949)**	**(886)**

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

9. DIVIDEND INCOME

ACCOUNTING POLICIES

Dividend income is recognized at the record date.

FINANCIAL INFORMATION

DIVIDEND INCOME FROM:	2017	2016
Available-for-sale investment securities	11	9
Financial assets held for trading	1	1
Total	**12**	**10**

(IN PLN MILLION)

10. NET GAIN/(LOSS) ON FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

ACCOUNTING POLICIES AND CLASSIFICATION

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

FINANCIAL INFORMATION

NET GAIN/(LOSS) ON FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	2017	2016
Debt instruments	3	(15)
Equity instruments	2	3
Derivative instruments (of which an ineffective portion of cash flow hedges)	4	11
Other, including gains and losses on the hedging instrument and the hedged item relating to the hedged risk (fair value hedges)	(1)	5
Total	**8**	**4**

11. GAIN/(LOSS) ON INVESTMENT SECURITIES

ACCOUNTING POLICIES

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

FINANCIAL INFORMATION

GAIN/(LOSS) ON INVESTMENT SECURITIES	2017	2016
Equity securities[1]	3	418
Debt securities	43	88
Total	**46**	**506**

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

12. NET FOREIGN EXCHANGE GAINS/ (LOSSES)

ACCOUNTING POLICIES AND CLASSIFICATION

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

(IN PLN MILLION)

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

NET FOREIGN EXCHANGE GAINS/(LOSSES)	2017	2016
Net foreign exchange gains/(losses)	452	503
Total	**452**	**503**

13. OTHER OPERATING INCOME AND EXPENSES

ACCOUNTING POLICIES

Other operating income and expenses comprise income and costs not directly related to banking activities. Other operating income mainly includes gains on sale of housing investments, sale or liquidation of non-current assets, intangible assets and foreclosed collateral, sale of shares in a subsidiary, legal damages, fines and penalties, income from lease/rental of properties. Other operating expenses mainly include losses on sale or liquidation of non-current assets, intangible assets and foreclosed collateral, and donations made.

Other operating income and expenses of the Group entities also include income from sale of finished goods, goods for resale and materials, and the corresponding costs of their production.

Income from construction services (real estate development activities) is recognized on a completed contract basis, which involves recognition of all costs related to the housing investments that are incurred during the period of construction as work-in-progress, and payments received on account of purchase of apartments – as deferred income.

FINANCIAL INFORMATION

OTHER OPERATING INCOME	2017	2016
net sales of products goods and services[1]	472	313
proceeds from sale of subsidiaries	-	77
gains on sale or scrapping of property, plant and equipment, intangible assets and assets held for sale	95	86
damages, penalties and fines received	22	80
sundry income	27	26
recovery of receivables expired, forgiven or written off	3	7
other	91	60
Total	**710**	**649**

[1] Including income from the Neptun Park project completed in the second quarter of 2017 in the amount of PLN 36 million and from sale of properties in the amount of PLN 32 million.

(IN PLN MILLION)

OTHER OPERATING EXPENSE	2017	2016
costs of products and services sold[1]	(118)	(150)
losses on sale or scrapping of property, plant and equipment, intangible assets and assets held for sale	(21)	(33)
donations made	(23)	(31)
sundry expenses	(17)	(18)
other	(61)	(98)
Total	**(240)**	**(330)**

[1] Including the costs of the Neptun Park project completed in the second quarter in the amount of PLN 21 million

14. Net impairment allowance and provisions

Accounting policies

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

Financial information

NET IMPAIRMENT ALLOWANCES AND PROVISIONS	Note	2017	2016
Available-for-sale investment securities	26	(24)	(52)
Loans and advances to customers	25	(1 504)	(1 504)
Property, plant and equipment	30	(8)	10
Intangible assets	30	(1)	(4)
Investments in associates and joint ventures	41	(26)	(30)
Inventories		3	(3)
Other receivables (other assets)		(37)	(48)
Provision for legal claims, lending commitments and guarantees granted	38	(21)	9
Provision for future liabilities (other provisions)	38	(2)	(1)
Total		**(1 620)**	**(1 623)**

15. ADMINISTRATIVE EXPENSES

ACCOUNTING POLICIES AND CLASSIFICATION

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

(IN PLN MILLION)

FINANCIAL INFORMATION

ADMINISTRATIVE EXPENSES	2017	2016
Employee benefits	(2 974)	(2 836)
Overheads	(1 409)	(1 422)
Amortization and depreciation	(844)	(801)
Contributions to the Bank Guarantee Fund (BGF)	(401)	(438)
Taxes and other charges	(156)	(69)
Costs of an additional contribution to BGF[1]	-	(24)
Total	**(5 784)**	**(5 590)**

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

The amount of the Group's contribution to the guarantee fund for the year 2017 was PLN 192 million, and the amount of the contribution to the banks' forced restructuring fund was PLN 209 million. The mandatory contribution for 2016 amounted to PLN 298 million, and the prudential fee amounted to PLN 140 million.

EMPLOYEE BENEFITS	2017	2016
Wages and salaries, of which:	(2 497)	(2 373)
costs of contributions to the employee pension plan	(47)	(46)
Social insurance, of which:	(399)	(379)
contributions for disability and retirement benefits	(270)	(310)
Other employee benefits	(78)	(84)
Total	**(2 974)**	**(2 836)**

OPERATING LEASE – THE LESSEE

The costs of operating lease on the part of the lessee are recognized in administrative expenses under overheads.

Rental and lease contracts concluded by the Group as part of its normal operating activities also meet the definition of operating lease. All contracts are concluded on an arm's length basis.

The lease and sub-lease payments recognized in the costs of a current period in 2017 amounted to PLN 249 million (in 2016 they amounted to PLN 263 million).

TOTAL VALUE OF FUTURE LEASE PAYMENTS UNDER IRREVOCABLE OPERATING LEAS	31.12.2017	31.12.2016
For a period:		
up to 1 year	209	243
from 1 to 5 years	383	449
over 5 years	95	140
Total	**687**	**832**

(IN PLN MILLION)

16. TAX ON CERTAIN FINANCIAL INSTITUTIONS

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

	2017	2016
Tax on certain financial institutions, of which:		
PKO Bank Polski SA	(894)	(820)
PKO Życie Towarzystwo Ubezpieczeń SA	(5)	(4)
PKO Bank Hipoteczny SA	(32)	(4)
PKO Towarzystwo Ubezpieczeń SA	(1)	(1)
Total	**(932)**	**(829)**

17. INCOME TAX

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

ACCOUNTING POLICIES

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

CURRENT INCOME TAX

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

DEFERRED INCOME TAX

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

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

(IN PLN MILLION)

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

For deferred income tax calculation the Group uses the 19% tax rate for entities operating in the territory of Poland, 18% tax rate for entities operating in Ukraine and 22% tax rate for entities operating in Sweden.

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

FINANCIAL INFORMATION

INCOME TAX EXPENSE

	2017	2016
Current income tax expense	(1 264)	(1 243)
Deferred income tax on temporary differences	124	336
Income tax expense recognized in the income statement	**(1 140)**	**(907)**
Income tax expense on temporary differences recognized in other comprehensive income	(141)	130
Total	**(1 281)**	**(777)**

The Group companies are corporate income tax payers. The amount of current tax liability of the entities is transferred to the appropriate tax authorities.

The final settlement of the corporate income tax liabilities of the Group entities for the year 2017 will be performed within the statutory deadlines.

RECONCILIATION OF THE EFFECTIVE TAX RATE

	2017	2016
Profit before income tax	4 249	3 783
Tax calculated using the enacted rate in force in Poland (19%)	(807)	(719)
Effect of different tax rates of foreign entities	1	-
Effect of permanent timing differences, of which:	(349)	(238)
Tax on certain financial institutions	(177)	(158)
Contributions to BGF	(76)	(26)
Non-tax-deductible impairment allowances on loans and advances	(61)	(18)
Recognizing a non-tax-deductible impairment allowance on investments in associates and joint ventures	(5)	(5)
Other permanent differences	(30)	(31)
Effect of other timing differences, including new technologies tax relief and donations	15	50
Income tax expense recognized in the income statement	**(1 140)**	**(907)**
Effective tax rate	**26,83%**	**23,98%**

(IN PLN MILLION)

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

DEFERRED TAX ASSETS, NET

DEFERRED TAX PROVISION	31.12.2016	Income statement	Other comprehensive income	31.12.2017
Interest accrued on receivables (loans)	239	(15)	-	224
Capitalized interest on performing housing loans	118	(12)	-	106
Interest on securities	43	19	-	62
Valuation of securities	5	(55)	58	8
Valuation of derivatives	2	6	-	8
Difference between carrying amount and tax value of property, plant and equipment and intangible assets	351	(18)	-	333
Prepayments	70	50	-	120
Foreign exchange gains		18	-	18
Other taxable temporary differences	2	2	-	4
				-
Gross deferred income tax provision	**830**	**(5)**	**58**	883
Deferred tax asset				
Interest accrued on liabilities	110	6	-	116
Valuation of derivatives	184	(29)	1	156
Valuation of securities	135	(51)	(84)	-
Provision for employee benefits	91	3	-	94
Impairment allowances on loan exposures	720	15	-	735
Adjustment of straight-line valuation method and effective interest rate	667	38	-	705
Provision for costs to be incurred	45	(4)	-	41
Tax loss	15	1	-	16
Foreign exchange gains and losses	14	(13)	-	1
Difference between carrying amount and tax value of property, plant and equipment and intangible assets, including leased assets	575	148	-	723
Other deductible temporary differences	22	5	-	27
Gross deferred tax asset	**2 578**	**119**	**(83)**	2 614
Total effect of temporary differences	**1 748**	**124**	**(141)**	1 731
Deferred income tax provision (presented in the statement of financial position)	31			36
Deferred income tax asset (presented in the statement of financial position)	1 779			1 767

18. EARNINGS PER SHARE

EARNINGS PER SHARE	2017	2016
Net profit attributable to equity holders of the parent company	3 104	2 874
Weighted average number of ordinary shares during the period (in million)	1 250	1 250
Earnings per share (in PLN per share)	2,48	2,30

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

(IN PLN MILLION)

NOTES TO THE CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

19. Cash and balances with the Central Bank

Accounting policies

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

FINANCIAL INFORMATION

CASH AND BALANCES WITH THE CENTRAL BANK	31.12.2017	31.12.2016
Current account with the Central Bank	11 172	7 460
Cash in hand	4 673	4 185
Deposits with the Central Bank	1 965	1 680
Total	**17 810**	**13 325**

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

Funds on the obligatory reserve account bear interest of 0.9 of the reference rate.

As at 31 December 2017 and 31 December 2016, this interest rate was 1.35%.

20. Amounts due from banks

Accounting policies

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

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

FINANCIAL INFORMATION

AMOUNTS DUE FROM BANKS	31.12.2017	31.12.2016
Deposits with banks	3 710	3 846
Current accounts	1 470	784
Loans and advances granted	51	50
Receivables in respect of repurchase agreements	-	661
Cash in transit	2	4
Total, gross	**5 233**	**5 345**
Impairment allowance for receivables	-	-
Total, net	**5 233**	**5 345**

(IN PLN MILLION)

AMOUNTS DUE FROM BANKS - THE GROUP'S EXPOSURE TO CREDIT RISK	Exposure	
	31.12.2017	31.12.2016
Amounts due form banks not impaired, not past due	5 233	5 345
Total, gross	**5 233**	**5 345**
Total carrying amount, net	**5 233**	**5 345**

21. FINANCIAL ASSETS HELD FOR TRADING EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS

ACCOUNTING POLICIES

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

FINANCIAL INFORMATION

FINANCIAL ASSETS HELD FOR TRADING, EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS	31.12.2017	31.12.2016
Debt securities	405	312
treasury bonds (in PLN)	151	186
treasury bonds (in foreign currencies)	138	6
municipal bonds (in PLN)	23	42
corporate bonds (in PLN)	92	76
corporate bonds (in foreign currencies)	1	2
Shares in other entities - listed	19	11
Investment certificates, rights to shares, pre-emptive rights	7	3
Total	**431**	**326**

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

DEBT SECURITIES BY MATURITY (AT CARRYING AMOUNTS)	31.12.2017	31.12.2016
up to 1 month	9	20
1 to 3 months	4	-
3 months to 1 year	48	65
1 to 5 years	260	115
over 5 years	84	112
Total	**405**	**312**

(IN PLN MILLION)

22. DERIVATIVE FINANCIAL INSTRUMENTS

ACCOUNTING POLICIES

In the course of its activities, the Group uses derivative financial instruments designated for the purpose of managing the risks associated with its operations. The most frequently used derivative instruments include: IRS, CIRS, FX Swap, options, commodity swap, FRA, Forward and Futures. Derivative financial instruments are recognized at fair value from the transaction date. A derivative instrument is presented under "Derivative financial instruments" as an asset if its fair value is positive, and as a liability if its fair value is negative.

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

EMBEDDED DERIVATIVE INSTRUMENTS

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

ESTIMATES AND JUDGEMENTS

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

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

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

FINANCIAL INFORMATION

DERIVATIVE FINANCIAL INSTRUMENTS	31.12.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
Hedging instruments	887	204	382	1 135
Other derivative instruments	1 711	2 536	2 519	3 063
Total	**2 598**	**2 740**	**2 901**	**4 198**

(IN PLN MILLION)

TYPE OF CONTRACT	31.12.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
IRS	965	1 420	1 387	2 098
CIRS	874	229	570	1 391
FX SWAP	161	380	205	164
Options	254	250	450	341
Commodity swap	129	128	97	96
FRA	1	1	2	2
Forward	206	324	177	106
Futures	7	8	-	-
Other	1	-	13	-
Total	**2 598**	**2 740**	**2 901**	**4 198**

NOMINAL AMOUNTS OF UNDERLYING INSTRUMENTS (BOTH SALE AND PURCHASE) AS AT 31.12.2017 BY MATURITY

	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Interest rate transactions						
Cap Floor Collar Swaption	**-**	**-**	**154**	**442**	**131**	**727**
Purchase	-	-	43	221	65	329
Sale	-	-	111	221	66	398
IRS	**12 302**	**21 058**	**73 654**	**161 954**	**29 028**	**297 996**
Purchase	6 151	10 529	36 827	80 977	14 514	148 998
Sale	6 151	10 529	36 827	80 977	14 514	148 998
FRA	**1 663**	**1 000**	**8 400**	**500**	**-**	**11 563**
Purchase	1 352	-	3 300	250	-	4 902
Sale	311	1 000	5 100	250	-	6 661
Interest rate futures	**-**	**1**	**4**	**2**	**-**	**7**
Purchase	-	1	3	2	-	6
Sale	-	-	1	-	-	1
Transactions in equity securities						
Equity options	**98**	**82**	**185**	**82**	**-**	**447**
Purchase	49	41	93	41	-	224
Sale	49	41	92	41	-	223
FX transactions						
Forward	**5 557**	**5 482**	**9 859**	**6 294**	**4**	**27 196**
Purchase	2 776	2 742	4 904	3 097	3	13 522
Sale	2 781	2 740	4 955	3 197	1	13 674
FX swap	**32 246**	**7 167**	**2 435**	**1 227**	**-**	**43 075**
Purchase	16 102	3 512	1 218	627	-	21 459
Sale	16 144	3 655	1 217	600	-	21 616
CIRS	**-**	**-**	**2 365**	**40 544**	**26 355**	**69 264**
Purchase	-	-	1 178	21 676	15 486	38 340
Sale	-	-	1 187	18 868	10 869	30 924
FX options	**2 100**	**8 579**	**29 007**	**3 620**	**-**	**43 306**
Purchase	973	4 381	15 380	1 839	-	22 573
Sale	1 127	4 198	13 627	1 781	-	20 733
Transactions in precious metals and commodities	**1 138**	**1 332**	**1 403**	**667**	**-**	**4 540**
Purchase	569	666	702	334	-	2 271
Sale	569	666	701	333	-	2 269
Other	**946**	**-**	**-**	**10**	**-**	**956**
Purchase	5	-	-	10	-	15
Sale	941	-	-	-	-	941
Total derivatives	**56 050**	**44 701**	**127 466**	**215 342**	**55 518**	**499 077**

(IN PLN MILLION)

NOMINAL AMOUNTS OF UNDERLYING INSTRUMENTS (BOTH SALE AND PURCHASE) AS AT 31.12.2016 BY MATURITY						
	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Interest rate transactions						
Cap Floor Collar Swaption	-	**259**	-	**916**	**148**	**1 323**
Purchase	-	-	-	458	74	532
Sale	-	259	-	458	74	791
IRS	**5 974**	**18 137**	**121 272**	**164 764**	**37 810**	**347 957**
Purchase	2 987	9 069	60 636	82 382	18 905	173 979
Sale	2 987	9 068	60 636	82 382	18 905	173 978
FRA	-	-	**18 477**	**1 250**	-	**19 727**
Purchase	-	-	7 087	500	-	7 587
Sale	-	-	11 390	750	-	12 140
Interest rate futures	-	**1**	**400**	-	-	**401**
Purchase	-	-	400	-	-	400
Sale	-	1	-	-	-	1
Transactions in equity securities						
Equity futures	15	-	-	-	-	15
Purchase	8	-	-	-	-	8
Sale	7	-	-	-	-	7
Equity options	-	**57**	**202**	**371**	-	**630**
Purchase	-	55	127	133	-	315
Sale	-	2	75	238	-	315
FX transactions						
Forward	**5 921**	**3 678**	**9 113**	**4 651**	**6**	**23 369**
Purchase	2 972	1 832	4 553	2 297	6	11 660
Sale	2 949	1 846	4 560	2 354	-	11 709
FX swap	**23 608**	**5 908**	**8 404**	**1 563**	-	**39 483**
Purchase	11 818	2 962	4 214	795	-	19 789
Sale	11 790	2 946	4 190	768	-	19 694
CIRS	**3 605**	**2 550**	**1 722**	**22 348**	**10 577**	**40 802**
Purchase of foreign currencies	1 734	1 275	861	10 687	6 508	21 065
Sale of foreign currencies	1 871	1 275	861	11 661	4 069	19 737
FX options	**990**	**1 957**	**21 111**	**4 473**	-	**28 531**
Purchase of foreign currencies	613	1 062	10 762	2 506	-	14 943
Sale of foreign currencies	377	895	10 349	1 967	-	13 588
Transactions in precious metals and commodities	**997**	**512**	**1 027**	**863**	-	**3 399**
Purchase	499	256	514	432	-	1 701
Sale	498	256	513	431	-	1 698
Other	**2 079**	-	-	**7**	-	**2 086**
Purchase	-	-	-	7	-	7
Sale	2 079	-	-	-	-	2 079
Total derivatives	43 189	33 059	181 728	201 206	48 541	507 723

Calculation of estimates

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

ESTIMATED CHANGE IN THE VALUATION ASSUMING A PARALLEL SHIFT IN YIELD CURVES:	31.12.2017		31.12.2016	
	scenario +50bp	scenario -50bp	scenario +50bp	scenario -50bp
IRS	(83)	84	(119)	121
CIRS	(117)	120	(88)	91
other insruments	7	(7)	(4)	4
Total	**(193)**	**197**	**(211)**	**216**

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

23. DERIVATIVE HEDGING INSTRUMENTS

ACCOUNTING POLICIES

THE USE OF HEDGE ACCOUNTING

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

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

The Group used fair value hedging as at 31 December 2017, whereas as at 31 December 2016 it did not use such hedging.

DISCONTINUATION OF HEDGE ACCOUNTING:

- A HEDGE INSTRUMENT EXPIRES, IS SOLD, RELEASED OR EXERCISED – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective are recognized in a separate item in other comprehensive income until the planned transaction occurs;

- THE HEDGE CEASES TO MEET THE HEDGE ACCOUNTING CRITERIA – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective are recognized in a separate item in other comprehensive income until the planned transaction occurs;

- THE PLANNED TRANSACTION IS NO LONGER CONSIDERED PROBABLE – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective, are recognized in the income statement;

- THE HEDGING RELATIONSHIP CEASED TO BE VALID – accumulated gains or losses related to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective are recognized in a separate item in other comprehensive income until the planned transaction occurs.

CASH FLOW HEDGE

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

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

The effectiveness tests comprise the valuation of hedging transactions, net of interest accrued and foreign exchange gains (losses) on the nominal value of the hedging transactions (in case of CIRS transactions).

Hedge effectiveness is verified through the use of prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.

FAIR VALUE HEDGES

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

The effectiveness tests comprise the measurement of hedging transactions net of accrued interest.

Hedge effectiveness is verified through the use of prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.

TYPES OF HEDGING STRATEGIES APPLIED BY THE GROUP

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

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

STRATEGY 3	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN CHF, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate CHF loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS transactions where the Group pays coupons based on floating 3M CHF LIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of loans in CHF indexed to the floating 3M CHF LIBOR rate
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – February 2024

STRATEGY 4	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN EUR, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate EUR loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS transactions where the Group pays coupons based on floating 3M EURIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of loans in EUR indexed to the floating 3M EURIBOR rate
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – June 2022

STRATEGY 5	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN FOREIGN CURRENCIES, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND FROM FOREIGN EXCHANGE RATE RISK AND HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FIXED INTEREST RATE FINANCIAL LIABILITY IN A FOREIGN CURRENCY, RESULTING FROM FOREIGN EXCHANGE RATE RISK, USING CIRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of fluctuations in cash flows from floating interest rate loans in foreign currencies, resulting from the risk of fluctuations in interest rates and from foreign exchange rate risk and elimination of the risk of fluctuations in cash flows from fixed interest rate financial liability in a foreign currency, resulting from foreign exchange rate risk, using CIRS transactions in the hedged period
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Group pays coupons based on floating 3M CHF LIBOR rate, and receives coupons based on a fixed USD rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of floating interest rate mortgage loans denominated in CHF and fixed interest rate financial liability denominated in USD
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – September 2022

STRATEGY 6	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN FOREIGN CURRENCIES OTHER THAN CHF AND NEGOTIATED TERM DEPOSITS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING CIRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate loans denominated in foreign currencies other than CHF and negotiated term deposits in PLN, resulting from fluctuations in reference interest rates and changes in foreign exchange rates using CIRS transactions during the hedged period
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Group pays coupons based on 3M EURIBOR rate, and receives coupons based on WIBOR 3M rate on the nominal value for which they were concluded
HEDGED ITEM	the portfolio of floating interest rate mortgage loans in EUR and the portfolio of short-term negotiated deposits, including their future renewals (high probability of occurrence)
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – March 2021

STRATEGY 7	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN FOREIGN CURRENCIES AND REGULAR SAVINGS PRODUCTS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING CIRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate loans denominated in CHF and floating interest rate regular savings products in PLN, resulting from fluctuations in reference interest rates in CHF and PLN, and changes in CHF/PLN foreign exchange rates using CIRS transactions during the hedged period
HEDGED RISK	foreign exchange risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Group pays coupons based on 3M CHF LIBOR, and receives coupons based on 3M WIBOR on the nominal value defined in CHF and PLN respectively
HEDGED ITEM	the portfolio of floating interest rate mortgage loans in CHF and the portfolio of floating interest rate regular savings products in PLN
	The period in which cash flows are expected to occur and affect the financial results: January 2018 – July 2023

STRATEGY 8	HEDGES AGAINST FLUCTUATIONS IN THE FAIR VALUE OF FIXED INTEREST LOANS IN FOREIGN CURRENCIES, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	elimination of the risk of fluctuations in the fair value of fixed interest loans in foreign currencies, resulting from the risk of fluctuations in interest rates, during the hedged period
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS (Interest Rate Swap) transactions in foreign currencies, where the Group pays coupons based on a fixed rate (the market IRS rate) and receives coupons based on a floating reference rate without an additional margin
HEDGED ITEM	a component of the interest rate risk relating to a fixed interest rate loan in a foreign currency, which corresponds to the market IRS rate

In 2017, the Group introduced Strategy 7, which concerns cash flow hedging, and Strategy 8, which concerns fair value hedging. These strategies are described above.

(IN PLN MILLION)

FINANCIAL INFORMATION

CARRYING AMOUNT/FAIR VALUE OF HEDGING INSTRUMENTS	31/12/2017		31/12/2016	
	Assets	Liabilities	Assets	Liabilities
Hedges of interest rate risk	90	35	90	32
IRS	90	35	90	32
Hedges of currency and interest rate risks	797	169	292	1 103
CIRS	797	169	292	1 103
Total	887	204	382	1 135

NOMINAL VALUE OF HEDGING INSTRUMENTS BY MATURITY AS AT 31 DECEMBER 2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Cash flow hedges						
Hedges of interest rate risk						
IRS PLN fixed - float	700	1 610	3 030	3 071	-	8 411
IRS EUR fixed - float (original currency)	-	-	-	499	25	524
IRS CHF fixed - float (original currency)	-	-	-	400	-	400
Hedges of currency and interest rate risks						
CIRS float CHF/float PLN						
float CHF	-	-	95	1 750	150	1 995
float PLN	-	-	325	6 329	573	7 227
CIRS fixed USD/float CHF						
fixed USD	-	-	-	875	-	875
float CHF	-	-	-	818	-	818
CIRS float EUR/float PLN						
float EUR	-	-	-	125	-	125
float PLN	-	-	-	545	-	545
CIRS fixed EUR/float CHF						
fixed EUR	-	-	-	802	999	1 801
float CHF	-	-	-	889	1 112	2 001
Fair value hedges						
Hedges of interest rate risk						
IRS EUR fixed - float (original currency)	-	-	-	46	-	46

NOMINAL VALUE OF HEDGING INSTRUMENTS BY MATURITY AS AT 31 DECEMBER 2016	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Cash flow hedges						
Hedges of interest rate risk						
IRS PLN fixed - float	-	250	9 030	6 846	-	16 126
IRS EUR fixed - float (original currency)	-	-	-	-	499	499
Hedges of currency and interest rate risks						
CIRS float CHF/float PLN						
float CHF	300	-	-	1 720	25	2 045
float PLN	1 099	-	-	6 171	88	7 358
CIRS fixed USD/float CHF						
fixed USD	-	-	-	-	875	875
float CHF	-	-	-	-	815	815
CIRS float EUR/float PLN						
float EUR	-	-	-	125	-	125
float PLN	-	-	-	545	-	545

(IN PLN MILLION)

CHANGE IN OTHER COMPREHENSIVE INCOME RELATING TO CASH FLOW HEDGES AND AN INEFFECTIVE PORTION OF CASH FLOW HEDGES	2017	2016
Other comprehensive income at the beginning of the period, gross	**(134)**	**(71)**
Gains/losses recognized in other comprehensive income during the period	1 821	(51)
Amounts transferred from other comprehensive income to the income statement, of which:	(1 829)	(12)
- interest income	(322)	(340)
- net foreign exchange gains/(losses)	(1 507)	328
Accumulated other comprehensive income at the end of the period, gross	**(142)**	**(134)**
Tax effect	26	25
Accumulated other comprehensive income at the end of the period, net	**(116)**	**(109)**
Impact on other comprehensive income during the period, gross	**(8)**	**(63)**
Tax effect	1	12
Impact on other comprehensive income during the period, net	**(7)**	**(51)**
Ineffective portion of cash flow hedges recognized in the income statements, including in:	**16**	**(10)**
Net foreign exchange gains/(losses)	14	(1)
Net gain/(loss) on financial instruments measured at fair value	2	(9)

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

CALCULATION OF ESTIMATES

ESTIMATED CHANGE IN THE VALUATION ASSUMING A PARALLEL SHIFT IN YIELD CURVES:	31.12.2017		31.12.2016	
	scenario +50bp	scenario -50bp	scenario +50bp	scenario -50bp
IRS	(107)	109	(143)	146
CIRS	(117)	119	(88)	91
Total	**(224)**	**228**	**(231)**	**237**

(IN PLN MILLION)

24. Financial instruments designated upon initial recognition at fair value through profit and loss

Accounting policies

The Group classifies a financial instrument to this category when:

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

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

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

FINANCIAL INFORMATION

FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION	31.12.2017	31.12.2016
Debt securities	6 688	12 204
NBP money market bills	4 199	9 079
Treasury bonds (in PLN)	1 413	1 812
Treasury bonds (in foreign currencies)	893	1 075
municipal bonds (in PLN)	106	111
corporate bonds (in foreign currencies)	77	127
Participation units in ICF (insurance capital funds) related to insurance products belonging to the group of investment products where the risk is borne by the policyholder	1 469	1 733
Total	**8 157**	**13 937**

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

DEBT SECURITIES BY MATURITY (AT CARRYING AMOUNTS)	31.12.2017	31.12.2016
up to 1 month	4 203	9 089
1 to 3 months	106	-
3 months to 1 year	1 222	171
1 to 5 years	1 067	2 837
over 5 years	90	107
Total	**6 688**	**12 204**

25. LOANS AND ADVANCES TO CUSTOMERS

ACCOUNTING POLICIES

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

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

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

Finance lease agreements are recognized as receivables in the amount equal to the current contractual value of the lease payments plus the potential unguaranteed residual value attributed to the lessor, determined as at the date of inception of the lease. Lease payments on finance leases are divided between interest income and a reduction in the balance of receivables in a manner enabling achieving a fixed interest rate on the remaining receivables.

Buy-sell-back securities are recognized under amounts due from customers if the counterparty to the transaction is other than a bank. Receivables due from repurchase agreements are measured at amortized cost. The difference between the purchase price and the repurchase (sale) price is recognized as interest expense and is settled over the term of the contract using the effective interest rate.

Loans and advances to customers also include an adjustment for hedging accounting of fair value for loans disclosed in the hedged item in Strategy 8 "Hedging the fair value volatility of fixed-rate loans in convertible currencies resulting from the risk of changes in interest rates using IRS transactions" (Note "Derivative hedging instruments").

ESTIMATES AND JUDGEMENTS – IMPAIRMENT ALLOWANCES

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

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

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

- identifying impairment triggers and events significant from the perspective of identifying those triggers;
- registering in the Group's IT systems the events that are significant from the perspective of identifying impairment triggers on loan exposures;
- determining the method of measuring impairment;
- measuring impairment and determining an impairment allowance or provision;
- verifying and aggregating the results of the impairment measurement;
- recording the results of impairment measurement.

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

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

The Group categorizes its loans and advances based on the exposure amounts. The Group applies three methods of estimating impairment:

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

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

(IN PLN MILLION)

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

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

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

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

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

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

According to the Group's plans the adopted methodology used for estimating impairment allowances will be developed in line with the further possibilities of gathering information on impairment from the existing and implemented applications and information systems. As a consequence, new data obtained could influence the level of impairment allowances in the future. The methodology and assumptions used in the estimates are reviewed on a regular basis to minimize the differences between the estimated and actual loss amount.

FINANCIAL INFORMATION

LOANS AND ADVANCES TO CUSTOMERS	31.12.2017	31.12.2016
	Net amount	Net amount
Loans and advances to customers (excluding adjustments relating to fair value hedge accounting)	205 629	200 606
Adjustment relating to fair value hedge accounting	(1)	-
Total loans and advances to customers	**205 628**	**200 606**

LOANS AND ADVANCES TO CUSTOMERS BY PRODUCT TYPE (excluding adjustments relating to fair value hedge accounting)	31.12.2017			31.12.2016		
	Gross	Impairment allowances	Net	Gross	Impairment allowances	Net
Loans	**194 936**	**(7 363)**	**187 573**	**189 736**	**(7 478)**	**182 258**
housing	108 163	(1 972)	106 191	108 321	(2 200)	106 121
corporate	60 497	(3 705)	56 792	56 722	(3 807)	52 915
consumer	26 276	(1 686)	24 590	24 693	(1 471)	23 222
Debt securities	**4 378**	**(10)**	**4 368**	**4 948**	**(78)**	**4 870**
debt securities (corporate)	1 859	(4)	1 855	2 352	(69)	2 283
debt securities (municipal)	2 519	(6)	2 513	2 596	(9)	2 587
Receivables in respect of repurchase agreements	**902**	**-**	**902**	**1 339**	**-**	**1 339**
Finance lease receivables	**13 236**	**(450)**	**12 786**	**12 586**	**(447)**	**12 139**
Total	**213 452**	**(7 823)**	**205 629**	**208 609**	**(8 003)**	**200 606**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS BY METHOD OF CALCULATING IMPAIRMENT ALLOWANCES (excluding adjustments relating to fair value hedge accounting)	31.12.2017			31.12.2016		
	Gross	Impairment allowances	Net	Gross	Impairment allowances	Net
individual basis, of which:	5 420	(2 103)	3 317	6 551	(2 608)	3 943
impaired	4 346	(2 097)	2 249	5 049	(2 594)	2 455
not impaired	1 074	(6)	1 068	1 502	(14)	1 488
portfolio basis, of which:	7 354	(5 000)	2 354	7 183	(4 766)	2 417
impaired	7 332	(5 000)	2 332	7 171	(4 766)	2 405
not impaired	22	-	22	12	-	12
group basis (IBNR)	200 678	(720)	199 958	194 875	(629)	194 246
Total	**213 452**	**(7 823)**	**205 629**	**208 609**	**(8 003)**	**200 606**

LOANS AND ADVANCES TO CUSTOMERS – THE GROUP'S EXPOSURE TO CREDIT RISK (excluding adjustments relating to fair value hedge accounting)	31.12.2017			31.12.2016		
	Gross	Impairment	Net	Gross	Impairment	Net
impaired, of which:	11 678	(7 097)	4 581	12 220	(7 360)	4 860
assessed on an individual basis	4 346	(2 097)	2 249	5 049	(2 594)	2 455
not impaired, of which:	201 774	(726)	201 048	196 389	(643)	195 746
with a recognized individual impairment trigger	1 074	(6)	1 068	1 452	(14)	1 438
not past due	763	(4)	759	1 199	(13)	1 186
past due	311	(2)	309	253	(1)	252
without a recognized individual impairment trigger/IBNR	200 700	(720)	199 980	194 937	(629)	194 308
not past due	195 643	(544)	195 099	190 628	(436)	190 192
past due	5 057	(176)	4 881	4 309	(193)	4 116
Total	**213 452**	**(7 823)**	**205 629**	**208 609**	**(8 003)**	**200 606**

LOANS AND ADVANCES TO CUSTOMERS BY CUSTOMER SEGMENT (excluding adjustments relating to fair value hedge accounting)	31.12.2017	31.12.2016
Loans and advances to customers, gross, of which:	**213 452**	**208 609**
mortgage banking	101 544	101 389
corporate (including receivables due from repurchase agreements)	56 056	54 522
retail and private banking	26 288	24 701
small and medium enterprises	29 564	27 997
Impairment allowances on loans and advances	(7 823)	(8 003)
Loans and advances to customers, net	**205 629**	**200 606**

LOAN QUALITY RATIOS (excluding adjustments relating to fair value hedge accounting)	31.12.2017	31.12.2016
Share of impaired loans	5,5%	5,9%
Coverage ratio of impaired loans[1]	67,0%	65,5%
Share of loans overdue for more than 90 days in gross loans and advances to customers	4,2%	4,4%

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

(IN PLN MILLION)

IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES TO CUSTOMERS - RECONCILIATION OF MOVEMENTS IN 2017	As at the beginning of the period	Recognized during the period	Reversed during the period	Derecognition of assets and settlements	Other, of which arising from business combinations	As at the end of the period	Recoveries of exposures written off[*]	Net - impact on the income statement
housing loans	2 200	708	(526)	(268)	(142)	1 972	16	(166)
business loans	3 807	2 217	(1 374)	(770)	(175)	3 705	71	(772)
consumer loans	1 471	1 251	(744)	(226)	(66)	1 686	8	(499)
debt securities (corporate)	69	4	(9)	(60)	-	4	-	5
debt securities (municipal)	9	-	(2)	-	(1)	6	-	2
finance lease receivables	447	245	(171)	(68)	(3)	450	-	(74)
Total	8 003	4 425	(2 826)	(1 392)	(387)	7 823	95	(1 504)

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

IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES TO CUSTOMERS - RECONCILIATION OF MOVEMENTS IN 2016	As at the beginning of the period	Recognized during the period	Reversed during the period	Derecognition of assets and settlements	Other, of which arising from business combinations	As at the end of the period	Recoveries of exposures written off[*]	Net - impact on the income statement
housing loans	2 337	1 240	(883)	(488)	(6)	2 200	11	(346)
business loans	4 107	2 271	(1 428)	(967)	(176)	3 807	56	(787)
consumer loans	1 569	1 143	(793)	(397)	(51)	1 471	5	(345)
debt securities (corporate)	69	-	-	-	-	69	-	-
debt securities (municipal)	3	6	-	-	-	9	-	(6)
finance lease receivables	202	121	(101)	(15)	240	447	-	(20)
Total	8 287	4 781	(3 205)	(1 867)	7	8 003	72	(1 504)

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

RECLASSIFICATION OF SECURITIES

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

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

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

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

(IN PLN MILLION)

CALCULATION OF ESTIMATES – IMPAIRMENT ALLOWANCES

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

ESTIMATED CHANGE IN IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES IN THE SCENARIOS OF IMPROVING OR DETERIORATING RISK PARAMETERS, OF WHICH:[1]	31.12.2017		31.12.2016	
	scenario +10%	scenario -10%	scenario +10%	scenario -10%
Changes in the present value of estimated future cash flows for the Group's portfolio of individually impaired loans and advances assessed on an individual basis	(191)	290	(196)	320
changes in the probability of default	47	(48)	49	(49)
changes in recovery rates	(314)	314	(353)	353

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

FINANCE LEASE AGREEMENTS

The Group conducts lease activities through entities in the PKO Leasing SA Group.

GROSS INVESTMENT IN THE LEASE AND MINIMUM LEASE PAYMENTS RECEIVABLE AS AT 31 DECEMBER 2017	Gross investment in the lease	Present value of minimum lease payments	Unrealized income
Lease receivables, gross			
up to 1 year	5 518	5 054	464
from 1 to 5 years	8 136	7 580	556
over 5 years	652	602	50
Total, gross	14 306	13 236	1 070
Impairment allowances	(450)	(450)	-
Total, net	**13 856**	**12 786**	**1 070**

GROSS INVESTMENT IN THE LEASE AND MINIMUM LEASE PAYMENTS RECEIVABLE AS AT 31 DECEMBER 2016	Gross investment in the lease	Present value of minimum lease payments	Unrealized income
Lease receivables, gross			
up to 1 year	5 120	4 651	469
from 1 to 5 years	7 859	7 287	572
over 5 years	710	648	62
Total, gross	13 689	12 586	1 103
Impairment	(447)	(447)	-
Total carrying amount, net	**13 242**	**12 139**	**1 103**

As at 31 December 2017 and 31 December 2016, there were no unguaranteed residual values attributable to the lessor.

26. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

ACCOUNTING POLICIES

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

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

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

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

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

ESTIMATES AND JUDGEMENTS

IMPAIRMENT ALLOWANCES

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

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

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

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

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

(IN PLN MILLION)

CVA ADJUSTMENTS

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

FINANCIAL INFORMATION

AVAILABLE-FOR-SALE INVESTMENT SECURITIES	31.12.2017	31.12.2016
Debt securities, gross	43 441	36 419
Treasury bonds (in PLN)	33 502	25 744
Treasury bonds (in foreign currencies)	238	678
municipal bonds (in PLN)	4 928	4 552
corporate bonds (in PLN)	4 291	4 800
corporate bonds (in foreign currencies)	482	645
Impairment allowances	(249)	(277)
corporate bonds (in PLN)	(246)	(210)
corporate bonds (in foreign currencies)	(3)	(67)
Total debt securities, net	**43 192**	**36 142**
Available-for-sale equity securities, gross	304	285
not admitted to public trading	150	129
admitted to public trading	154	156
Impairment allowances	(77)	(67)
Total equity securities, net	**227**	**218**
Participation units in investment funds and shares in collective investment undertakings	256	316
Total available-for-sale investment securities, net	**43 675**	**36 676**

In the "PLN State Treasury bonds" item, the State Treasury bonds of the Republic of Poland are recognized. As at 31 December 2017, the item "Foreign currency bonds" comprised State Treasury bonds of the Ukraine.

AVAILABLE-FOR-SALE INVESTMENT DEBT SECURITIES – THE GROUP'S EXPOSURE TO CREDIT RISK	Exposure	
	31.12.2017	31.12.2016
impaired, assessed on an individual basis	822	1 297
not impaired, not past due	42 619	35 122
with an external rating	37 472	30 034
with an internal rating	5 147	5 088
Total, gross	**43 441**	**36 419**
Impairment allowances	(249)	(277)
Total carrying amount, net	**43 192**	**36 142**

(IN PLN MILLION)

AVAILABLE-FOR-SALE DEBT SECURITIES BY MATURITY (AT CARRYING AMOUNTS)	31.12.2017	31.12.2016
up to 1 month	411	28
1 to 3 months	5	36
3 months to 1 year	4 323	1 869
1 to 5 years	23 026	20 177
over 5 years	15 427	14 032
Total	**43 192**	**36 142**

IMPAIRMENT ALLOWANCES – RECONCILIATION OF MOVEMENTS IN 2017	As at the beginning of the period	Recognized during the period	Reversed during the period	Derecognition of assets and settlements	Other	As at the end of the period	Net - impact on the income statement
Debt securities	277	79	(66)	-	(41)	249	(13)
Equity securities	67	51	(40)	-	(1)	77	(11)
Total	**344**	**130**	**(106)**	**-**	**(42)**	**326**	**(24)**

IMPAIRMENT ALLOWANCES – RECONCILIATION OF MOVEMENTS IN 2016	As at the beginning of the period	Recognized during the period	Reversed during the period	Derecognition of assets and settlements	Other	As at the end of the period	Net - impact on the income statement
Debt securities	57	52	-	-	168	277	(52)
Equity securities	76	-	-	(9)	1	67	-
Total	**133**	**52**	**-**	**(9)**	**169**	**344**	**(52)**

SIGNIFICANT TRANSACTION

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

- EUR 71 million in cash paid to the Group's account on 21 June 2016;
- 25 612 preference C-series shares of Visa Inc., the value of which as at the transaction date was estimated at USD 21 million;
- a receivable due to deferred payment in cash equivalent to 0.5435987989% of EUR 1 billion, i.e. the amount attributable to all transaction participants, paid on the 3rd anniversary of the transactions, subject to potential adjustments, in the event of the occurrence of situations described in the transaction terms; the value of the above-mentioned receivable as at 21 June 2016 amounted to EUR 6.1 million.

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

Received preference C-series shares will be converted to ordinary Visa Inc. shares, and the terms of the transaction provide progressive shares conversion. The conversion of all preference shares will occur not later than in 2028. The conversion ratio granted at the moment of the settlement of the transaction and the current ratio as at 31 December 2017 amounts to 13.952 and may be reduced in the period to 2028, which is dependent on potential liabilities in respect of legal claims in that period relating to the acquired company, i.e. Visa Europe Limited.

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

(IN PLN MILLION)

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

27. INVESTMENT SECURITIES HELD TO MATURITY

ACCOUNTING POLICIES

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

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

FINANCIAL INFORMATION

INVESTMENT SECURITIES HELD TO MATURITY	31.12.2017	31.12.2016
Debt securities, of which		
Treasury bonds (in PLN)	1 663	199
Treasury bonds (in foreign currencies)	149	267
Total	**1 812**	**466**

The “PLN Treasury bonds” item includes the Republic of Poland State Treasury Bonds. The item “Foreign currency Treasury bonds” includes State Treasury Bonds of the Ukraine.

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

DEBT SECURITIES IN THE HELD-TO-MATURITY PORTFOLIO AT CARRYING AMOUNT - BY MATURITY	31.12.2017	31.12.2016
up to 1 month	95	3
1 to 3 months	53	5
3 months to 1 year	3	90
1 to 5 years	557	342
over 5 years	1 104	26
Total	**1 812**	**466**

28. NON-CURRENT ASSETS HELD FOR SALE

ACCOUNTING POLICIES

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

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

(IN PLN MILLION)

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

FINANCIAL INFORMATION

NON-CURRENT ASSETS HELD FOR SALE	31.12.2017	31.12.2016
Land and buildings[1]	129	14
Other	9	-
Total	**138**	**14**

[1] The change is related mainly to the Qualia Group, reclassification of hotel items from property, plant and equipment to non-current assets held for sale due to the fact that the criteria for classifying the items in accordance with IFRS 5 were met.

29. INVENTORIES

ACCOUNTING POLICIES

Inventories are measured at purchase price or cost of manufacture not exceeding the recoverable net value as at the date of valuation.

FINANCIAL INFORMATION

INVENTORIES	31.12.2017	31.12.2016
Goods for resale	190	190
Finished goods[1]	10	29
Construction investments for sale[1]	-	55
Materials	7	11
Impairment allowances on inventories	(21)	(25)
Total	**186**	**260**

[1] In 2016, the Qualia Group was in the course of an investment project and all respective costs were capitalized in inventories and presented as “Construction investments for sale”. In April 2017, after obtaining a permit for use, the assets were reclassified to “Finished goods” and will be reduced upon transferring the premises for use.

30. INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

ACCOUNTING POLICIES

INTANGIBLE ASSETS

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

GOODWILL – Goodwill is recognized as the excess of consideration paid over the amount of identifiable assets acquired, liabilities assumed measured at fair value as at the acquisition date. Following the initial recognition, goodwill is measured at the initial value less any cumulative impairment allowances. Goodwill arising on acquisition of subsidiaries is recognized under “Intangible assets” and goodwill arising on acquisition of associates and joint ventures is recognized under “Investments in associates and joint ventures”. The test for goodwill impairment is carried out at least at the end of each year. Impairment is calculated by estimating the recoverable amount of the cash-generating unit to which the given goodwill relates. If the recoverable amount of the cash-generating unit is lower than its carrying amount, an impairment allowance is recognized.

CUSTOMER RELATIONS AND VALUE IN FORCE – As a result of a settlement of the transaction, two components of intangible assets that are recognized separately from goodwill, i.e. customer relations and value in force, representing the present value of future profits from concluded insurance contracts, were identified. These components of intangible assets are amortized using the declining balance method based on the rate of consumption of the economic benefits arising from their use.

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

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

PROPERTY, PLANT AND EQUIPMENT

PROPERTY, PLANT AND EQUIPMENT – are valued according to the purchase price or cost of production, less accumulated depreciation and impairment allowances.

INVESTMENT PROPERTIES – are valued according to accounting principles applied to property, plant and equipment.

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

DEPRECIATION / AMORTIZATION

Depreciation/amortization is charged on all non-current assets, whose value decreases due to the usage or passage of time, using the straight-line method over the estimated useful life of the given asset. The adopted depreciation/amortization method and useful lives are reviewed at least on an annual basis.

Depreciation of property, plant and equipment, investment properties and amortization of intangible assets begins upon commissioning the asset for use, and ends no later than at the time when:

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

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

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

IMPAIRMENT ALLOWANCES ON NON-FINANCIAL NON-CURRENT ASSETS

An impairment allowance is recognized if the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognized in the income statement.

Impairment allowances in respect of cash generating units first and foremost reduce the goodwill relating to those cash generating units (groups of units), and then they reduce proportionally the book value of other assets in the unit (group of units).

An impairment allowance in respect of goodwill cannot be reversed. In respect of other assets, the impairment allowance may be reversed if there was a change in the estimates used to determine the recoverable amount. An impairment allowance may be reversed only to the level at which the book value of an asset does not exceed the book value – less depreciation/amortization – which would be determined should the impairment allowance not have been recorded.

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

OPERATING LEASE – LESSOR

Initial direct costs incurred in the course of negotiating the operating lease agreements are added to the carrying amount of a leased asset and recognized over the period of the lease on the same basis as the rental income. Contingent lease payments are recognized as income in the period in which they become due. Lease payments receivable in respect of operating leases are recognized as revenue in the income statement on a straight-line basis over the period of the lease. The average agreement period is usually 36 months. The lessee bears service and insurance costs.

ESTIMATES AND JUDGEMENTS

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

In estimating the useful economic lives of particular types of property, plant and equipment, intangible assets and investment properties, the following factors are considered:

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

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

Depreciation /amortization periods applied by PKO Bank Polski SA Group:

Property, plant and equipment	**Period**
Buildings, premises, cooperative rights to premises (including investment properties)	from 25 to 60 years
Leasehold improvements (buildings, premises)	from 1 to 20 years (or the period of the lease, if shorter)
Machinery and equipment	from 2 to 15 years
Computer hardware	from 2 to 11 years
Vehicles	from 3 to 8 years
Intangible assets	**Period**
Software	from 2 to 20 years
Other intangible assets	from 1 to 20 years

IMPAIRMENT ALLOWANCES

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

(IN PLN MILLION)

FINANCIAL INFORMATION

INTANGIBLE ASSETS

FOR THE YEAR ENDED 31 December 2017	Software	Goodwill	Future profits on concluded insurance contracts	Customer relationships	Other, including capital expenditure	Total
Carrying amount as at the beginning of the period, gross	4 460	1 426	141	150	447	6 624
Purchase	17	12	-	-	256	285
Transfers from capital expenditure	338	-	-	-	(338)	-
Sale or scrapping	(2)	-	-	-		(2)
Other, including taking up control over subsidiaries	19	-	-	-	(4)	15
Carrying amount as at the end of the period, gross	4 832	1 438	141	150	361	6 922
Accumulated amortization as at the beginning of the period	(2 832)	-	(60)	(52)	(62)	(3 006)
Amortization charge for the period	(441)	-	(15)	(10)	(10)	(476)
Scrapping and sale	1	-	-	-	-	1
Accumulated amortization as at the end of the period	(3 272)	-	(75)	(62)	(72)	(3 481)
Impairment allowances as at the beginning of the period	(16)	(174)	-	-	(6)	(196)
Recognized during the period	-	(1)				(1)
Other, including taking up control over subsidiaries	(2)	-	-	-	-	(2)
Impairment allowances as at the end of the period	(18)	(175)	-	-	(6)	(199)
Net carrying amount as at the beginning of the period	1 612	1 252	81	98	379	3 422
Net carrying amount as at the end of the period	1 542	1 263	66	88	283	3 242

FOR THE YEAR ENDED 31 DECEMBER 2016	Software	Goodwill	Future profits on concluded insurance contracts	Customer relationships	Other, including capital expenditure	Total
Carrying amount as at the beginning of the period, gross	4 068	1 368	141	86	321	5 984
Purchase	14	-	-	-	469	483
Transfers from capital expenditure	327	-	-	-	(327)	-
Sale and disposal	(9)	-	-	-	(1)	(10)
Other, including taking up control over subsidiaries	60	58	-	64	(15)	167
Carrying amount as at the end of the period, gross	4 460	1 426	141	150	447	6 624
Accumulated amortization as at the beginning of the period	(2 380)	-	(42)	(38)	(63)	(2 523)
Depreciation charge for the period	(429)	-	(18)	(14)	(8)	(469)
Other, including taking up control over subsidiaries	(23)	-	-	-	9	(14)
Accumulated amortization as at the end of the period	(2 832)	-	(60)	(52)	(62)	(3 006)
Impairment allowances as at the beginning of the period	(16)	(170)	-	-	(6)	(192)
Recognized during the period	-	(4)				(4)
Write-downs as at the end of the period	(16)	(174)	-	-	(6)	(196)
Net carrying amount as at the beginning of the period	1 672	1 198	99	48	252	3 269
Net carrying amount as at the end of the period	1 612	1 252	81	98	379	3 422

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

(IN PLN MILLION)

GOODWILL

NET GOODWILL	31.12.2017	31.12.2016
Nordea Bank Polska SA	863	863
PKO Życie Towarzystwo Ubezpieczeń SA	91	91
PKO Leasing Pro SA	31	31
Raiffeisen - Leasing Polska SA and its subsidiaries	57	57
PKO Towarzystwo Funduszy Inwestycyjnych SA (investment fund management company)	150	150
PKO BP BANKOWY PTE SA	51	51
Qualia 2 spółka z.o.o. - Nowy Wilanów Sp.k.	-	1
Assets taken over from CFP Sp. z o.o.	8	8
ZenCard Sp. z o.o.	12	-
Total	**1 263**	**1 252**

As at 31 December 2017, the Group performed mandatory impairment tests in respect of goodwill on the acquisition of Nordea Bank Polska SA. The impairment test is conducted by comparing the carrying amounts of Cash Generating Units ('CGUs') with their recoverable amount. Two CGUs were identified to which goodwill on acquisition of Nordea Bank Polska SA was allocated – the retail and corporate CGU.

The recoverable amount is estimated based on the value in use of the CGUs. The value in use is the present estimated value of future cash flows in 10 years, taking into consideration the residual value of the CGUs. The residual value of a CGU has been calculated by extrapolating the cash flow projections beyond the period of the forecast, using the growth rate adopted at a level of 2.7%. Cash flow projections are based on the assumptions included in the financial plan of the Bank for 2018. For the discounting of the future cash flows a discount rate of 8.16% was used, taking into account the risk-free rate and risk premium.

The impairment test performed as at 31 December 2017 showed a surplus of the recoverable amount over the carrying amount of each CGU and therefore no goodwill impairment was recognized.

The impairment test of PKO Życie Towarzystwo Ubezpieczeń SA has been developed on the basis of the present value of expected future cash flows for PKO Bank Polska SA including the residual value. Future cash flows were estimated on the basis prepared by the Company's 10 year financial forecast.

Goodwill arising on the acquisition of PKO Leasing Pro SA by PKO Bank Polski SA was allocated to the entire entity PKO Leasing SA as a direct parent which took over the assets of PKO Leasing Pro SA as a result of the merger. The impairment test was carried out on the basis of the present value of expected future cash flows generated by PKO Leasing SA for 5 years, developed on the basis of the financial projections of the Company, assuming termination of its operations after this period.

Goodwill arising on the acquisition of Raiffeisen-Leasing Polska SA with its subsidiaries was allocated to a group of assets separated in the records of the PKO Leasing SA Group, constituting the assets of the acquired Raiffeisen-Leasing Polska SA Group. The impairment test was carried out using the discounted dividend method, taking into account the residual value, based on an 8-year financial forecast.

The impairment test of goodwill arising from the acquisition of PKO Towarzystwo Funduszy Inwestycyjnych SA was carried out on the basis of the present value of expected future cash flows for PKO Bank Polski SA, prepared by the Company's management on the basis of a three-year financial forecast. The test takes into account the two variants of financial flows: only dividend as well as dividend and distribution fee for the sale of fund units of PKO TFI SA in the network of PKO Bank Polski SA, and in both cases includes the residual value.

The impairment test of the goodwill of PKO BP BANKOWY PTE SA was carried out using the embedded value method according to which the value in use of the Company's shares was established. The impairment test of the goodwill of PKO BP BANKOWY PTE SA was carried out using the embedded value method according to which the value in use of the Company's shares was established. The test takes into account changes connected with the Act on the amendments to the act on pensions from the Social Insurance Fund and certain other acts, passed by the Sejm (the Polish Parliament) on 16 November 2016, which introduced a reduction in the compulsory minimum retirement age, establishing the right to retire at the age of 60 years for women and 65 years for men. The Act came into force as of 1 October 2017.

The goodwill arising from the acquisition of ZenCard Sp. z o.o. was allocated to the entire investment project (i.e. the company's total value). The impairment test was carried out based on the current value of expected future cash flows generated by the company, taking into account the residual value, based on a 3-year financial forecast developed by the company's management.

In the above-mentioned impairment tests concerning the subsidiaries of PKO Bank Polski SA, the future cash flows were discounted using a discount rate of 8.79%, taking into account a risk-free rate equal to the yield on 10-year treasury bonds as of the valuation date as well as the market risk premium and risk ratio determined for projects in PKO Bank Polski SA.

The valuation methods and forecast periods were adapted to the specific features of activities related to the assets or companies being valued.

The above-mentioned tests indicated no need for the recognition of impairment.

At the same time in 2017, consistently as in previous years, an impairment loss was recognized on goodwill resulting from the acquisition of shares in Qualia 2 Spółka z ograniczoną odpowiedzialnością – Nowy Wilanów Sp. k. in the amount of PLN 0.5 million, i.e. in proportion to the sold part of the cash-generating units to which goodwill has been allocated.

(IN PLN MILLION)

PROPERTY, PLANT AND EQUIPMENT

FOR THE YEAR ENDED 31 December 2017	Land and buildings	Machinery and equipment	Assets under construction	Other	Total
Gross carrying amount of property, plant and equipment as at the beginning of the period	2 951	1 611	107	1 182	5 851
Purchase	5	27	203	211	446
Transfers from capital expenditure	45	93	(180)	42	-
Scrapping and sale	(121)	(91)	-	(99)	(311)
Other, including taking up control over subsidiaries	(184)	(10)	(4)	(41)	(239)
Gross carrying amount of property, plant and equipment as at the end of the period	2 696	1 630	126	1 295	5 747
Accumulated depreciation as at the beginning of the period	(1 037)	(1 122)	-	(540)	(2 699)
Depreciation charge for the period	(100)	(165)	-	(103)	(368)
Other, including taking up control over subsidiaries	103	95	-	83	281
Accumulated depreciation as at the end of the period	(1 034)	(1 192)	-	(560)	(2 786)
Impairment allowances as at the beginning of the period	(50)	(1)	(4)	(11)	(66)
Recognized during the period	(7)			(3)	(10)
Reversed during the period	2				2
Other, including taking up control over subsidiaries	22	-	1	5	28
Write-downs as at the end of the period	(33)	(1)	(3)	(9)	(46)
Net carrying amount as at the beginning of the period	1 864	488	103	631	3 086
Net carrying amount as at the end of the period	1 629	437	123	726	2 915

FOR THE YEAR ENDED 31 DECEMBER 2016	Land and buildings	Machinery and equipment	Assets under construction	Other	Total
Gross carrying amount of property, plant and equipment as at the beginning of the period	2 712	1 850	265	906	5 733
Purchase	2	22	214	97	335
Transfers from capital expenditure	122	193	(369)	54	-
Scrapping and sale	(94)	(474)	-	(59)	(627)
Other, including taking up control over subsidiaries	209	20	(3)	184	410
Gross carrying amount of property, plant and equipment as at the end of the period	2 951	1 611	107	1 182	5 851
Accumulated amortization as at the beginning of the period	(1 006)	(1 420)	-	(469)	(2 895)
Depreciation charge for the period	(100)	(158)	-	(74)	(332)
Other, including taking up control over subsidiaries	69	456	-	3	528
Accumulated depreciation as at the end of the period	(1 037)	(1 122)	-	(540)	(2 699)
Impairment allowances as at the beginning of the period	(33)	(3)	(4)	(17)	(57)
Recognized during the period	(12)	-	-	-	(12)
Reversed during the period	16	2		4	22
Other, including taking up control over subsidiaries	(21)	-	-	2	(19)
Write-downs as at the end of the period	(50)	(1)	(4)	(11)	(66)
Net carrying amount as at the beginning of the period	1 673	427	261	420	2 781
Net carrying amount as at the end of the period	1 864	488	103	631	3 086

OPERATING LEASE – LESSOR

TOTAL FUTURE LEASE PAYMENTS UNDER IRREVOCABLE OPERATING LEAS	31.12.2017	31.12.2016
For a period:		
up to 1 year	69	50
from 1 to 5 years	142	106
over 5 years	13	10
Total	**224**	**166**

The average agreement period for operating lease agreements where the Group is a lessor is usually 36 months. The lessee bears service and insurance costs.

As at the balance sheet date the assets in lease under operating lease are as follows:

FOR THE YEAR ENDED 31 DECEMBER 2017	Vehicles provided under operating leases	Properties provided under operating leases	Machinery and equipment provided under operating leases	Total
Gross amount as at the beginning of the period	266	76	8	350
Changes during the period	126	2	1	129
Gross amount as at the end of the period	392	78	9	479
Accumulated depreciation as at the beginning of the period	(54)	(5)	(2)	(61)
Depreciation charge for the period	(41)	(2)	(1)	(44)
Other changes in accumulated depreciation, including foreign exchange differences	20	-	-	20
Accumulated depreciation as at the end of the period	(75)	(7)	(3)	(85)
Impairment allowances as at the beginning of the period	(4)	(1)	-	(5)
Impairment allowances as at the end of the period	(4)	(1)	-	(5)
Net amount	**313**	**70**	**6**	**389**

FOR THE YEAR ENDED 31 DECEMBER 2016	Vehicles provided under operating leases	Properties provided under operating leases	Machinery and equipment provided under operating leases	Total
Gross amount as at the beginning of the period	35	2	1	38
Taking up control over subsidiaries	182	13	8	203
Changes during the period	49	61	(1)	109
Gross amount as at the end of the period	266	76	8	350
Accumulated depreciation as at the beginning of the period	1	-	(1)	-
Taking up control over subsidiaries	(49)	(1)	-	(50)
Depreciation charge for the period	(11)	(1)	-	(12)
Other changes in accumulated depreciation, including foreign exchange differences	5	(3)	(1)	1
Accumulated depreciation as at the end of the period	(54)	(5)	(2)	(61)
Impairment allowances as at the beginning of the period	-	(1)	-	(1)
Taking up control over subsidiaries	(4)	-	-	(4)
Impairment allowances as at the end of the period	(4)	(1)	-	(5)
Net amount	**208**	**70**	**6**	**284**

CALCULATION OF ESTIMATES

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

CHANGE IN ESTIMATED USEFUL LIVES OF DEPRECIABLE ASSETS IN THE "LAND AND BUILDINGS" CATEGORY	31.12.2017		31.12.2016	
	scenario +10 years	scenario -10 years	scenario +10 years	scenario -10 years
Depreciation	(40)	282	(45)	313

(IN PLN MILLION)

31. OTHER ASSETS

ACCOUNTING POLICIES

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

FINANCIAL INFORMATION

OTHER ASSETS	31.12.2017	31.12.2016
Settlements in respect of card transactions	1 136	1 236
Settlements of financial instruments (including unpaid option premium)	284	382
Receivables in respect of cash settlements	158	125
Receivables and settlements in respect of trading in securities	94	80
Receivables relating to selling excess currency	2	26
Assets for sale	107	178
Prepayments and deferred costs	286	291
Trade receivables	209	173
VAT receivable	114	102
Reinsurance receivables	472	377
Other	63	64
Total	**2 925**	**3 034**
of which financial assets	2 377	2 247

OTHER FINANCIAL ASSETS - THE GROUP'S EXPOSURE TO CREDIT RISK	31.12.2017	31.12.2016
impaired	99	107
not impaired, of which:	2 378	2 247
not past due	2 368	2 235
past due	10	12
Total, gross	2 477	2 354
Impairment allowances	(100)	(107)
Total net carrying amount	2 377	2 247

MANAGEMENT OF FORECLOSED COLLATERAL– ITEM ASSETS FOR SALE

Foreclosed collaterals as a result of restructuring or debt collection activities are either designated for sale or used by the Group for internal purposes. Details of the foreclosed assets are analysed in order to determine whether they can be used by the Group for internal purposes.

All of the assets foreclosed as a result of restructuring and debt collection activities in the years ended 31 December 2017 and 31 December 2016, respectively, were designated for sale. Activities undertaken by the Group are aimed at selling assets as soon as possible.

The primary procedure for the sale of assets is an open tender. In justified cases, the sale follows a different procedure depending on the specifics of the sold property.

(IN PLN MILLION)

32. AMOUNTS DUE TO BANKS

ACCOUNTING POLICIES

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

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

FINANCIAL INFORMATION

AMOUNTS DUE TO BANKS	31.12.2017	31.12.2016
Loans and advances received	2 785	17 567
Bank deposits	1 077	800
Amounts due from repurchase agreements	-	206
Current accounts	653	593
Other monetary market deposits	43	42
Total	**4 558**	**19 208**

In 2017, the Group partly repaid loans from:

- Nordea Bank AB (publ), including: CHF 3,339 million (PLN 12,535 million), USD 4 million (PLN 13 million) and EUR 107 million (PLN 456 million).
- domestic banks of PLN 442 million.

In 2016, the Group partly repaid loans from domestic banks of PLN 44 million.

33. AMOUNTS DUE TO CUSTOMERS

ACCOUNTING POLICIES

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

(IN PLN MILLION)

FINANCIAL INFORMATION

AMOUNTS DUE TO CUSTOMERS BY TYPE OF PRODUCT	31.12.2017	31.12.2016
Amounts due to retail customers	151 161	148 000
Current accounts and overnight deposits	86 819	72 365
Term deposits	64 126	75 304
Other liabilities	216	331
Amounts due to corporate entities	56 230	48 657
Current accounts and overnight deposits	40 070	30 987
Term deposits	11 613	11 947
Loans and borrowings received	3 563	4 662
Amounts due from repurchase agreements	48	-
Other liabilities	936	1 061
Amounts due to public entities	11 409	8 409
Current accounts and overnight deposits	9 555	8 163
Term deposits	1 820	187
Other liabilities	34	59
Total	**218 800**	**205 066**

AMOUNTS DUE TO CUSTOMERS BY SEGMENT	31.12.2017	31.12.2016
Amounts due to customers, of which		
retail and private banking	142 484	140 021
corporate	48 570	37 639
small and medium enterprises	24 127	22 734
loans and advances received	3 563	4 662
amounts due from repurchase agreements	48	-
other liabilities	8	10
Total	**218 800**	**205 066**

(IN PLN MILLION)

LOANS AND ADVANCES FROM INTERNATIONAL FINANCIAL INSTITUTIONS

Date of receipt of a loan or advance by the Group	Nominal value	Currency	Maturity	carrying amount at 31.12.2017	carrying amount at 31.12.2016
28/12/2006	5	EUR	30/04/2020	21	22
28/12/2006	97	PLN	30/04/2020	97	97
28/12/2006	7	CHF	30/07/2021	25	29
28/12/2006	57	PLN	18/08/2017	-	57
30/04/2009	76	CHF	30/04/2019	108	187
23/10/2009	45	CHF	23/10/2017	-	187
23/10/2009	182	CHF	23/10/2019	649	748
23/12/2009	50	EUR	23/12/2019	83	132
23/12/2010	75	EUR	23/12/2020	188	265
11/07/2011	22	EUR	31/08/2018	92	97
11/07/2011	16	EUR	07/08/2017	-	71
17/08/2011	15	EUR	20/03/2017	-	66
25/09/2013	75	EUR	25/09/2023	313	332
29/10/2013	105	PLN	01/04/2019	53	88
29/10/2013	25	EUR	28/08/2019	61	101
29/11/2013	185	CHF	29/11/2023	659	762
15/09/2014	100	PLN	15/03/2017	-	100
15/09/2014	261	PLN	15/06/2017	-	262
11/06/2015	170	PLN	31/05/2021	123	158
11/06/2015	40	EUR	31/03/2021	108	150
25/09/2015	40	EUR	30/09/2021	145	177
25/09/2015	50	PLN	30/11/2020	32	43
16/03/2016	170	PLN	01/03/2019	84	152
16/03/2016	85	PLN	30/09/2020	85	-
18/03/2016	66	EUR	15/03/2021	273	289
28/10/2016	40	EUR	31/01/2022	138	88
25/09/2015	100	EUR	30/11/2022	208	-
25/09/2017	100	UAH	10/10/2019	13	-
other loans and advances[1]	5	PLN		5	2
Total				**3 563**	**4 662**

[1]short-term loan and advance agreements with various dates of execution and termination

In 2017, the Group partly repaid loans and advances received from international financial institutions totalling PLN 1,914 million. At the same time, the Group drew loans and advances in the amount of PLN 311 million. In 2016, the Group partly repaid loans and advances received from international financial institutions totalling PLN 441 million, and at the same time it drew loans and advances amounting to PLN 460 million.

(IN PLN MILLION)

34. LIABILITIES IN RESPECT OF INSURANCE ACTIVITIES

ACCOUNTING POLICIES

The Group creates technical reserves to cover current and future claims and costs which may arise from the insurance agreements concluded.
The technical reserves comprise: unearned premium and unexpired risk reserves, outstanding claims and benefits reserve, reserve for bonuses and discounts for the insured, life insurance reserve, and other reserves.

FINANCIAL INFORMATION

LIABILITIES IN RESPECT OF INSURANCE ACTIVITIES	31.12.2017	31.12.2016
Technical reserves	882	543
Liabilities in respect of insurer's investment contracts, broken down by:	2 117	2 401
unit-linked financial insurance products	1 811	2 130
"Safe Capital"	292	268
other	14	3
Total	**2 999**	**2 944**

TYPES OF INSURANCE PROVISIONS AND RESERVES	31.12.2017	31.12.2016
Provisions for life insurance	524	443
Outstanding claims reserve	86	90
Life insurance technical reserve where the investment risk is borne by the policyholder	1 733	2 025
Unearned premium and unexpired risk reserves	656	386
Total	**2 999**	**2 944**

Majority of insurance products refer to investment products where the risk is borne by the policyholder.

35. DEBT SECURITIES IN ISSUE

ACCOUNTING POLICIES

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

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

(IN PLN MILLION)

FINANCIAL INFORMATION

DEBT SECURITIES IN ISSUE	31.12.2017	31.12.2016
Financial instruments measured at amortised cost	23 932	14 493
bonds issued by PKO Finance AB	5 882	6 705
bonds issued by PKO Bank Polski SA	5 204	1 693
bonds issued by the PKO Leasing SA Group[1]	1 593	1 742
bonds issued by PKO Bank Hipoteczny SA	2 406	1 151
covered bonds issued by PKO Bank Hipoteczny SA	8 847	3 202
Total	**23 932**	**14 493**

[1] including the bonds taken up by the PKO Leasing SA Group as part of the acquisition of Raiffeisen Leasing Polska SA.

DEBT SECURITIES IN ISSUE	31.12.2017	31.12.2016
bonds, of which:	15 085	11 291
in PLN	4 644	3 702
in EUR, translated into PLN	5 484	3 365
in USD, translated into PLN	3 530	4 224
in CHF, translated into PLN	1 427	-
Total	**15 085**	**11 291**
covered bonds, of which		
in PLN	2 261	1 000
in EUR, translated into PLN	6 586	2 202
Total	**8 847**	**3 202**

LIABILITIES IN RESPECT OF DEBT SECURITIES IN ISSUE - BY MATURITY	31.12.2017	31.12.2016
up to 1 month	486	376
1 to 3 months	1 414	986
3 months to 1 year	2 167	2 343
1 to 5 years	15 087	4 194
over 5 years	4 778	6 594
Total	**23 932**	**14 493**

INFORMATION ON THE ISSUE, REDEMPTION AND REPAYMENT OF SECURITIES

ADDITIONAL INFORMATION	2017	2016
issuance of debt securities during the period (nominal value)		
in PLN	9 807	5 132
in original currency (EUR)	1 829	700
in original currency (CHF)	400	-
redemption of debt securities during the period (nominal value)		
in PLN	7 279	3 205
in original currency (EUR)	200	200
in original currency (CHF)	-	250

In 2017, there were the following issues, redemptions and repayments of securities in the PKO Bank Polski SA Group:

(IN PLN MILLION)

Relating to the issue of bonds by PKO Bank Polski SA

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

The Bank held two issues of Eurobonds:

- On 18 July 2017, the Bank issued 4-year Eurobonds of EUR 750 million with the 0.75% coupon (Mid Swap+65 b.p.). The bonds are listed on the Luxembourg Securities Exchange and on the Warsaw Securities Exchange. This issue is the first one held under the new EMTN programme launched in May 2017 for a total of EUR 3 billion. The programme provides for the issue of unsecured senior Eurobonds and subordinated bonds in EUR, USD, CHF and PLN.
- On 19 October 2017, the Bank placed its Eurobonds under the EMTN programme amounting to CHF 400 million, with 4-year maturity and 0.300% coupon (Mid Swap + 58 p.b.). The bonds are listed on the Zurich Securities Exchange.. The Bank aims at introducing the bonds to alternative trading on the Warsaw Securities Exchange.

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

Bonds issued by PKO Bank Polski SA

Issuance date	Nominal value	Currency	Maturity	carrying amount at 31.12.2017	carrying amount at 31.12.2016
22/04/2016	200	EUR	21/04/2017	-	884
18/11/2016	815	PLN	18/05/2017	-	809
25/07/2017	750	EUR	25/07/2021	3 132	-
02/11/2017	400	CHF	02/11/2021	1 427	-
17/11/2017	650	PLN	17/05/2018	645	-
Total				**5 204**	**1 693**

Relating to the issue of mortgage-covered bonds by PKO Bank Hipoteczny SA

PKO Bank Hipoteczny SA carried out issues of mortgage-covered bonds, including:

- three domestic issues in PLN addressed to institutional investors, with a total nominal value of PLN 1,265 million; mortgage-covered bonds were purchased by investors at a price equal to their nominal value, and are listed on the Warsaw Securities Exchange;
- two foreign issues in EUR addressed to institutional investors, with a total nominal value of EUR 1,000 million; mortgage-covered bonds were purchased by investors at a price lower than their nominal value, and are listed on the Securities Exchanges in Luxembourg and Warsaw;
- two foreign private placements in EUR addressed to institutional investors, with a total nominal value of EUR 79 million; mortgage-covered bonds were purchased by investors at a price equal to their nominal value, and are listed on the Luxembourg Securities Exchange;

Relating to the issue of bonds by members of the PKO Bank Polski SA Group

- PKO Bank Hipoteczny SA issued 61,888 bonds with a total nominal value of PLN 6,189 million, and redeemed 49,046 bonds with a total nominal value of PLN 4,905 million. Issues of the company's bonds are governed by the Bond Issue Programme Agreement concluded with PKO Bank Polski SA.
- PKO Leasing SA issued 1,040,880 bonds with a total nominal value of PLN 1,041 million, and redeemed 961,591 bonds with a total nominal value of PLN 962 million. Issues of the company's bonds are governed by the Bond Issue Agreement concluded with PKO Bank Polski SA.
- PKO Leasing SA (legal successor of Raiffeisen-Leasing Polska SA) repurchased earlier, at the request of Raiffeisen Bank Polska SA, 2,270 bonds with a total nominal value of PLN 227 million. The payment was financed from the funds received from PKO Bank Polski SA as part of the loan, based on an agreement concluded in December 2016.

(IN PLN MILLION)

- KREDOBANK SA issued 250,000 bonds with a total nominal value of UAH 250 million, and redeemed 245,300 bonds with a total nominal value of UAH 245 million.

Bonds issued by the PKO Leasing SA Group

Issuance date	Nominal value	Currency	Maturity	carrying amount at 31.12.2017	carrying amount at 31.12.2016
01/12/2014[1]	1 254	PLN	02/10/2025	1 262	1 261
01/06/2016	73	PLN	01/06/2019	73	300
08/11/2016	19	PLN	16/01/2017	-	19
10/11/2016	67	PLN	10/02/2017	-	67
14/11/2016	65	PLN	16/01/2017	-	65
06/12/2016	30	PLN	06/03/2017	-	30
09/11/2017	28	PLN	09/05/2018	28	-
10/11/2017	101	PLN	12/02/2018	101	-
05/12/2017	90	PLN	08/03/2018	90	-
20/12/2017	39	PLN	21/03/2018	39	-
Total				**1 593**	**1 742**

[1] the bonds taken up by the PKO Leasing SA Group as part of the acquisition of Raiffeisen Leasing Polska SA. Bonds are secured with securitized lease receivables (see the note Information on securitization of the lease portfolio and portfolio sale of receivables).

Bonds issued by PKO Finance AB

Issuance date	Nominal value	Currency	Maturity	carrying amount at 31.12.2017	carrying amount at 31.12.2016
25/07/2012	50	EUR	25/07/2022	211	222
26/09/2012	1 000	USD	26/09/2022	3 530	4 224
23/01/2014	500	EUR	23/01/2019	2 141	2 259
Total				**5 882**	**6 705**

(IN PLN MILLION)

BONDS ISSUED BY PKO BANK HIPOTECZNY SA

Issuance date	Nominal value	Currency	Maturity	carrying amount at 31.12.2017	carrying amount at 31.12.2016
02/08/2016	30	PLN	02/02/2017	-	30
12/08/2016	278	PLN	27/02/2017	-	277
16/09/2016	150	PLN	27/02/2017	-	150
10/10/2016	17	PLN	16/01/2017	-	17
21/10/2016	31	PLN	20/01/2017	-	31
28/10/2016	30	PLN	16/01/2017	-	30
28/10/2016	13	PLN	16/01/2017	-	13
02/11/2016	28	PLN	20/01/2017	-	28
02/11/2016	25	PLN	28/04/2017	-	25
09/11/2016	23	PLN	02/02/2017	-	22
24/11/2016	37	PLN	20/01/2017	-	36
29/11/2016	28	PLN	20/01/2017	-	28
08/12/2016	123	PLN	31/03/2017	-	123
08/12/2016	210	PLN	26/05/2017	-	208
16/12/2016	134	PLN	31/03/2017	-	133
07/08/2017	41	PLN	23/01/2018	41	-
15/09/2017	642	PLN	15/03/2018	639	-
29/09/2017	50	PLN	05/03/2018	50	-
29/09/2017	24	PLN	23/01/2018	23	-
02/10/2017	100	PLN	05/03/2018	100	-
12/10/2017	30	PLN	16/04/2018	30	-
16/10/2017	515	PLN	16/04/2018	512	-
16/10/2017	15	PLN	16/04/2018	15	-
20/10/2017	88	PLN	05/02/2018	88	-
20/10/2017	160	PLN	23/01/2018	160	-
25/10/2017	50	PLN	05/02/2018	50	-
26/10/2017	4	PLN	26/10/2018	4	-
02/11/2017	50	PLN	15/02/2018	50	-
02/11/2017	20	PLN	30/10/2018	20	-
15/11/2017	187	PLN	15/05/2018	185	-
01/12/2017	118	PLN	23/01/2018	117	-
15/12/2017	25	PLN	25/06/2018	25	-
20/12/2017	37	PLN	05/04/2018	37	-
20/12/2017	30	PLN	20/06/2018	30	-
20/12/2017	60	PLN	25/06/2017	59	-
27/12/2017	100	PLN	27/06/2018	99	-
29/12/2017	73	PLN	29/03/2018	72	-
Total				**2 406**	**1 151**

(IN PLN MILLION)

MORTGAGE-COVERED BONDS ISSUED BY PKO BANK HIPOTECZNY SA

Issuance date	Nominal value	Currency	Maturity	carrying amount at 31.12.2017	carrying amount at 31.12.2016
11/12/2015	19	PLN	11/12/2020	18	16
27/04/2016	486	PLN	28/04/2021	487	486
17/06/2016	498	PLN	18/06/2021	498	498
24/10/2016	500	EUR	24/06/2022	2 079	2 202
02/02/2017	25	EUR	02/02/2024	105	-
30/03/2017	500	EUR	24/01/2023	2 093	-
28/04/2017	497	PLN	18/05/2022	497	-
22/06/2017	261	PLN	10/09/2021	263	-
27/09/2017	500	EUR	27/08/2024	2 084	-
27/10/2017	499	PLN	27/06/2023	498	-
02/11/2017	54	EUR	03/11/2022	225	-
Total				8 847	3 202

36. SUBORDINATED LIABILITIES

ACCOUNTING POLICIES

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

FINANCIAL INFORMATION

	Nominal value in a foreign currency	Currency	Period	Special terms	Balance in PLN 31.12.2017	Balance in PLN 31.12.2016
Subordinated bonds	1 700	PLN	28/08/2017 - 28/08/2027	right to early redemption within 5 years from the issue date	1 720	-
Subordinated bonds	1 601	PLN	14/09/2012 - 14/09/2022	right to early redemption within 5 years from the issue date	-	1 617
Subordinated loan from Nordea Bank AB (publ)	224	CHF	24/04/2012 - 24/04/2022		-	922
Total					1 720	2 539

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

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

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

(IN PLN MILLION)

On 30 August 2017, the Group obtained the PFSA's approval for exercising its call option in respect of subordinated bonds. On 14 September 2017, the Group repurchased all its subordinated bonds series OP0922, with a total nominal value of PLN 1,601 million, issued on 14 September 2012. The legal basis for early repurchase referred to the terms and conditions of the issue of subordinated bonds series OP0922, which allowed the Group to repurchase all subordinated OP0922 bonds earlier, after the lapse of 5 years from the issue.

37. OTHER LIABILITIES

ACCOUNTING POLICIES

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

FINANCIAL INFORMATION

	31.12.2017	31.12.2016
Expenses to be paid	631	573
Deferred income	391	608
Liability in respect of tax on certain financial institutions	76	77
Interbank settlements	1 313	813
Liabilities arising from investing activities and internal operations	295	324
Amounts due to suppliers	211	206
Liabilities and settlements in respect of trading in securities	534	210
Settlements of financial instruments (including unpaid option premium)	281	355
Liabilities in respect of contribution to the Bank Guarantee Fund[1]	120	-
Liabilities under the public law	165	99
Liabilities in respect of foreign exchange activities	350	217
Liabilities in respect of payment cards	259	111
Liabilities to insurance institutions	59	146
Settlements relating to buying foreign currencies	-	26
Other[2]	377	222
Total	**5 062**	**3 987**
of which financial liabilities	4 129	3 058

[1] The item "Liabilities in respect of contributions to the Bank Guarantee Fund" includes an obligation to pay contributions to BGF (see Note 53 Assets pledged to secure liabilities and financial assets transferred).

[2] The item "Other" includes amounts due to insurance companies and liabilities in respect of interest charges on the interest temporarily repurchased from the State Budget.

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

38. PROVISIONS

ACCOUNTING POLICIES

PROVISIONS FOR LEGAL CLAIMS

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

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

PROVISION FOR RETIREMENT AND DISABILITY BENEFITS

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

PROVISION FOR LOAN COMMITMENTS AND GUARANTEES GRANTED

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

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

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

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

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

OTHER PROVISIONS

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

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

(IN PLN MILLION)

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

ESTIMATES AND JUDGEMENTS

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

FINANCIAL INFORMATION

FOR THE PERIOD ENDED 31 DECEMBER 2017	Provisions for legal claims	Provision for disability and retirement benefits	Provisions for loan commitments and guarantees granted	Other provisions[1]	Total
As at 1 January 2017, of which"	24	46	67	92	229
Short-term provisions	24	7	51	92	174
Long-term provisions	-	39	16	-	55
Increase/reassessment	22	4	256	5	287
Release	(21)	-	(236)	(3)	(260)
Utilization	(4)	(3)	-	(38)	(45)
Other changes and reclassifications	-	(1)	(1)	6	4
As at 31 December 2017, of which:	**21**	**46**	**86**	**62**	**215**
Short-term provisions	21	7	61	62	151
Long-term provisions	-	39	25	-	64

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

FOR THE PERIOD ENDED 31 DECEMBER 2016	Provisions for legal claims	Provision for disability and retirement benefits	Provisions for loan commitments and guarantees granted	Other provisions[1]	Total
As at 01 January 2016, of which"	23	46	83	101	253
Short-term provisions	23	4	64	101	192
Long-term provisions	-	42	19	-	61
Increase/reassessment	31	4	238	23	296
Release	(23)	-	(255)	(13)	(291)
Provisions utilized	(7)	(2)	-	(19)	(28)
Other changes and reclassifications	-	(2)	1	-	(1)
As at 31 December 2016, of which"	**24**	**46**	**67**	**92**	**229**
Short-term provisions	24	7	51	92	174
Long-term provisions	-	39	16	-	55

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

(IN PLN MILLION)

CALCULATION OF ESTIMATES

The Group performed a reassessment of its estimates as at 31 December 2017, on the basis of a calculation conducted by an independent external actuary. The provisions calculated are equal to discounted future payments, taking into account staff turnover, and are related to the period ending on the balance sheet date. An important factor affecting the amount of the provision is the financial discount rate which was adopted by the Bank at the level of 3.25%. As at 31 December 2016 the adopted financial discount rate amounted to 3.50%.

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

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

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

39. EQUITY AND SHAREHOLDING STRUCTURE OF THE BANK

ACCOUNTING POLICIES

Equity constitutes capital and reserves created in accordance with the legal regulations.

The classification to particular components discussed below results from the Polish Commercial Companies Code, the Banking Law and the requirements of IAS 1.7, IAS 1.78.e, IAS 1.54.q-r and IAS 1.79.b.

Equity components of the subsidiaries, other than share capital, in a proportion equal to the interest in the subsidiary held by the parent company, are added to the respective equity components of the parent company. The Group's equity includes only those parts of the equity of the subsidiaries which arose after the acquisition of shares by the parent company. In accordance with the legislation in force in Poland, only the equity of the parent company and the equity of specific subsidiaries, determined on the basis of stand-alone financial statements, are distributable.

Equity components:

- Share capital comprises solely the share capital of the parent company and is stated at nominal value in accordance with the Articles of Association and entry in the Register of Entrepreneurs.
- Supplementary capital is created according to the Articles of Association of Companies in the Group, from the appropriation of profits and from share premium less issue costs and is to cover the potential losses which might result from the Group's activities.
- The general banking risk fund in PKO Bank Polski SA is created from profit after tax in accordance with the Banking Law, and it is to cover unidentified risks of the Bank's operations.
- Other reserves are created from the appropriation of net profit. Other reserves are only intended to cover any potential balance-sheet losses.
- Non-controlling interests represent the part of capital in a subsidiary, which cannot be directly or indirectly assigned to the parent company.

(IN PLN MILLION)

- Other comprehensive income comprises the effects of valuation of available-for-sale financial assets, the effective part of cash flow hedges resulting from hedge accounting as well as actuarial gains and losses. Deferred tax on those items is recognized in other comprehensive income. Moreover, the item includes the share of the parent company in total other comprehensive income of associates and joint ventures and foreign exchange differences on translation to Polish currency of the net result of the foreign operation at a rate constituting the arithmetic mean of foreign exchange rates for the currency as at the day ending each of the months in the financial year published by the National Bank of Poland.

FINANCIAL INFORMATION

EQUITY	31.12.2017	31.12.2016
Share capital	1 250	1 250
Supplementary capital	27 374	24 491
General banking risk fund	1 070	1 070
Other reserves	3 645	3 607
Other comprehensive income	147	(467)
Share in other comprehensive income of associates and joint ventures	-	(1)
Available-for-sale financial assets	272	(347)
Cash flow hedges	(116)	(109)
Actuarial gains and losses;	(9)	(10)
Exchange differences on translating foreign operations	(257)	(221)
Retained earnings	(66)	(19)
Net profit or loss for the year	3 104	2 874
Non-controlling interests	(11)	(16)
Total	**36 256**	**32 569**

SHAREHOLDING STRUCTURE OF THE BANK

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

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

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

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

(IN PLN MILLION)

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

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

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

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

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

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

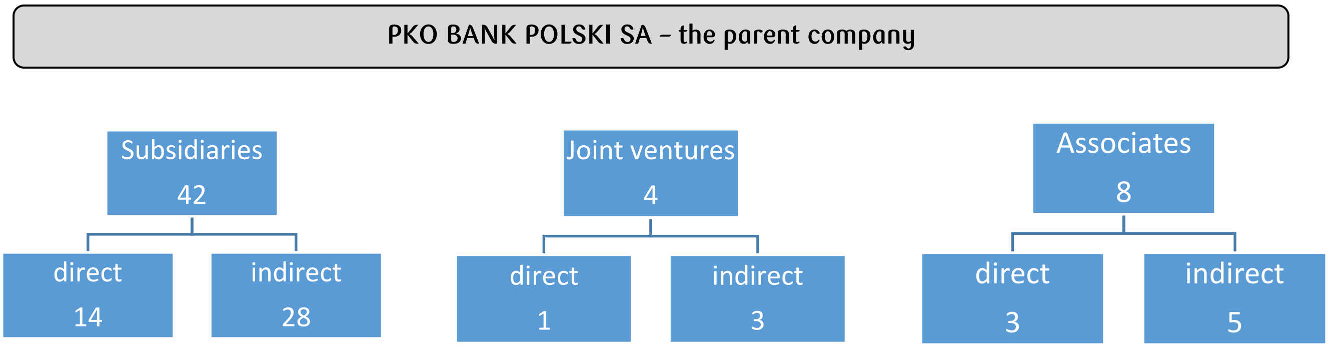
STRUCTURE OF PKO BANK POLSKI SA'S SHARE CAPITAL:

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

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

(IN PLN MILLION)

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



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

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

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

[1] The second shareholder of the entity is “Inter-Risk Ukraina” Additional Liability Company.
[2] The company was acquired on 26 January 2017.
[3] PKO Bank Polski SA has investment certificates of the Fund; the share in the Fund’s investment certificates is presented in the item “Share in equity”.

(IN PLN MILLION)

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

* share in equity of the direct parent

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

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

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

(IN PLN MILLION)

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

41. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

SELECTED INFORMATION ON ASSOCIATES AND JOINT VENTURES

The Group holds the following associates and joint ventures:

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

* share in equity of the direct parent
[1] In July 2017, the Extraordinary Shareholders' Meeting adopted resolution on dissolving the company.
[2] In June 2017, the Shareholders' Meeting adopted a resolution on dissolving the company.

NAME OF JOINT VENTURES AND ASSOCIATES	CORE BUSINESS
CENTRUM ELEKTRONICZNYCH USŁUG PŁATNICZYCH ESERVICE SP. Z O.O.	The company offers services which consist of processing transactions involving payment instruments conducted both through POS terminals in Poland and abroad and online, lease of POS terminals, top-ups of mobile phone cards and servicing of gift cards. PKO Bank Polski SA, together with the company, offer comprehensive services which involve attracting and servicing entities which use POS terminals and settling transactions conducted with payment instruments using such terminals. Both entities jointly participate in tenders, and the cooperation is governed by agreements on, among other things: • servicing cashless transactions concluded using payment instruments for bilateral agreements with merchants; • marketing cooperation in respect of services of fundamental importance to the functioning of the products and services offered both by the Bank and the company; • the provision of services relating to withdrawals of cash in the Bank's agent and branch offices and in post offices using Visa and MasterCard payment cards using POS terminals; • cooperation in providing services associated with attracting retail outlets which accept payment instruments. The company has two direct subsidiaries and exerts full control over these subsidiaries.
"CENTRUM OBSŁUGI BIZNESU" SP. Z O.O.	A joint project of PKO Bank Polski SA, Buildco Poznań SA and the City of Poznań which consists of building a hotel in Poznań. The Bank is a member of a syndicate of banks which granted the company an investment loan for the execution of the said project. The hotel was completed and began operating in 2007. The operating results generated by the company are insufficient to ensure the current, full servicing of the liabilities arising from the loan agreement. At the company's request, as part of the restructuring of the loans, the syndicate modified the repayment schedule of principal and interest instalments. The schedule is valid until June 2018. From June 2015, the company's shares are in the portfolio of NEPTUN – FIZ AN – a subsidiary of the Bank.
BANK POCZTOWY SA	Bank Pocztowy SA specializes in standard banking products offered to retail clients and a supplementary offer for micro-businesses and institutional clients. It also operates in the segment of settlements and treasury. As part of the strategic partnership with Poczta Polska SA (a shareholder with 75% minus 10 shares of the company) it uses the potential of a shareholder and develops a range of products in collaboration with stakeholders across the Poczta Polska Group. The company has two direct subsidiaries in which it exercises full control, whereas one of them has been put into liquidation.
"POZNAŃSKI FUNDUSZ PORĘCZEŃ KREDYTOWYCH" SP. Z O.O.	The company specializes in supporting the development of small- and medium-sized enterprises by providing guarantees and various types of services for business. The company grants guarantees for loans and advances extended by banks, including PKO Bank Polski SA, as well as bank guarantees, lease and factoring transactions, and bid bond guarantees. The entity cooperates with PKO Leasing SA. The company's offer also includes guarantees for small- and medium-sized enterprises, under the JEREMIE (Join European Resources for Micro to Medium Enterprises), which are re-underwritten mutually at 70% or 80% from the Wielkopolski Regionalny Program Operacyjny, managed by Bank Gospodarstwa Krajowego.

(IN PLN MILLION)

	As part of its services for businesses, the company, among other things, prepares business plans, feasibility studies, recovery and restructuring programmes, prepares financial documentation and seeks appropriate forms of financing enterprise operations.
FERRUM SA	The Company's operations comprise manufacturing welded steel tubes, hollow profiles and insulating tubes. The company has three direct subsidiaries in which it exercises full control, whereas one of them has been put into liquidation.[1] The company's shares were taken up under the debt recovery actions (foreclosure of collateral). The company is a public company whose shares are listed on the Warsaw Securities Exchange.

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

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

„Centrum Obsługi Biznesu" Sp. o.o. (in accordance with PAS)	**31.12.2017**	**31.12.2016**
Current assets	10	11
Non-current assets	82	85
Current liabilities	24	18
Non-current liabilities	60	74
	01.01-31.12.2017	**01.01-31.12.2016**
Revenue	28	23
Profit/(loss) for the period	4	(2)

[1] Data consistent with the consolidated financial statements of the FERRUM SA Group for the 3rd quarter of 2017.
[2] In the case of entities which have subsidiaries, the data presented is derived from the consolidated financial statements of such entities.

(IN PLN MILLION)

Bank Pocztowy SA (in accordance with INFRS, data as published by the Company)	30/06/2017	31.12.2016
Total assets	7 107	6 937
Total liabilities	6 572	6 413
	01.01-30.06.2017	01.01-31.12.2016
Revenues	221	469
Profit (loss) on continuing operations	2	3
Profit/(loss) for the period	2	3
Other comprehensive income	9	(21)
Total comprehensive income	11	(19)

„Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o. (in accordance with PAS)	31.12.2017	31.12.2016
Current assets	24	23
Current liabilities	4	3
Non-current liabilities	2	3
	01.01-31.12.2017	01.01-31.12.2016
Revenues	2	3

FERRUM SA (in accordance with INFRS, data as published by the Company)	30.09.2017	31.12.2016
Current assets	137	97
Non-current assets	143	168
Current liabilities	210	201
Non-current liabilities	52	15
	01.01-30.09.2017	01.01-31.12.2016
Revenues	242	316
Profit (loss) on continuing operations	(30)	1
Profit/(loss) for the period	(30)	1
Total comprehensive income	(30)	1

FINANCIAL INFORMATION

JOINT VENTURES	31.12.2017	31.12.2016
„Centrum Obsługi Biznesu" Sp. z o.o.	-	-
Purchase price	17	17
Change in the share in net assets	(14)	(16)
Impairment allowance	(3)	(1)
Grupa Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	244	227
Value of shares as at the date of obtaining joint control	197	197
Change in the share in net assets	47	30
Total	**244**	**227**

(IN PLN MILLION)

ASSOCIATES	31.12.2017	31.12.2016
Bank Pocztowy SA Group	130	133
Purchase price	184	162
Change in the share in net assets	83	84
Impairment allowance	(137)	(113)
„Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o.	-	-
Purchase price	2	2
Change in the share in net assets	4	4
Impairment allowance	(6)	(6)
FERRUM SA Group	19	26
Purchase price	25	25
Change in the share in net assets	(6)	1
Total	**149**	**159**

CHANGE IN INVESTMENTS IN JOINT VENTURES	2017	2016
Investments in joint ventures as at the beginning of the period	227	206
Share in profits/ (losses)	31	30
Net impairment allowance	(2)	2
Dividend	(12)	(11)
Investments in joint ventures as at the end of the period	**244**	**227**

CHANGE IN INVESTMENTS IN ASSOCIATES	2017	2016
Investments in associates as at the beginning of the period	159	186
Net impairment allowance	(24)	(32)
Share in profits/ (losses)	(9)	5
Share in comprehensive income of associated undertakings	1	(1)
Increase in equity investment in associates	22	1
Investments in associates as at the end of the period	**149**	**159**

IMPAIRMENT ALLOWANCES

In 2017, the Group increased impairment allowance on the shares in Bank Pocztowy SA by PLN 24 million, and increased impairment allowances on the shares of "Centrum Obsługi Biznesu" Sp. z o.o by PLN 1.6 million (maintaining a 100% impairment allowance on capital exposure to the aforesaid company).

As at 31 December 2017, and as at 31 December 2016, the parent entity did not have any share in the contingent liabilities of associates acquired together with another investor.

IMPAIRMENT ALLOWANCES – RECONCILIATION OF MOVEMENTS	2017	2016
As at the beginning of the period	120	90
Recognized during the period	26	32
Reversed during the period	-	(2)
As at the end of the period	**146**	**120**
Net - impact on the income statement	(26)	(30)

42. Acquisition of Raiffeisen-Leasing Polska SA by PKO Leasing SA (in 2016)

Description of the transaction

On 2 November 2016, PKO Bank Polski SA (as the guarantor) and PKO Leasing SA (as the acquirer) signed an agreement on purchase of 100% shares in Raiffeisen-Leasing Polska SA (RLPL) with Raiffeisen Bank International AG (as the seller). The transaction was closed on 1 December 2016 after the conditions precedent had been met, including, among other things, gaining the required anti-monopoly consents in Poland and Ukraine.

As a result of the aforementioned transaction, PKO Leasing SA purchased 1,500,038 ordinary shares in Raiffeisen-Leasing Polska SA with a nominal value of PLN 100 each, representing 100% of the Company's share capital and entitling it to 100% of the voting rights at the General Meeting of the company. The purchase price amounted to PLN 850 million. The purchase of the shares was financed entirely with a loan granted by PKO Bank Polski SA. The business operations of the acquired company consist of conducting leasing activities and granting loans.

Due to the purchase of RLPL, its subsidiaries joined the PKO Leasing SA Group in accordance with the International Financial Reporting Standards with an auditor's opinion: Raiffeisen-Leasing Real Estate Sp. z o.o. (financing real properties), "Raiffeisen Insurance Agency" Sp. z o.o. (insurance intermediation), Raiffeisen-Leasing Service Sp. z o.o. (storage and sale of post-lease items) and ROOF Poland Leasing 2014 DAC with its registered office in Ireland (special-purpose vehicle established to handle the securitization of lease receivables).

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

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

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

Settlement of the acquisition transaction

As at 31 December 2017, the final settlement of the acquisition of RLPL was carried out under the acquisition method in accordance with IFRS 3. The date of 1 December 2016 was adopted as the date of assuming control.

As at the date of assuming control, a preliminary valuation of assets from lease receivables and loans granted as well as contingent liabilities was carried out and was recognized in the consolidated financial statements for 2016 in the preliminary values. The final settlement of the transaction on 31 December 2017 did not change in respect of the settlement presented in the consolidated financial statements for 2016.

The purchase price of RLPL shares amounted to PLN 850 million and was paid entirely in cash. PKO Leasing SA had the right to bring, within 3 months of the acquisition date, claims against RBI AG with regard to financial and other transactions stipulated in the agreement for the purchase of shares in RLPL SA which could result in an outflow of cash and conducted within the RLPL Group between 1 July 2016 and the acquisition date. The amount of claims identified and reported, resulting from this condition of the purchase agreement amounted to PLN 2,787 thousand, however until 31 December 2017 the final value of the respective RBI liability had not been agreed by the parties. Therefore, claims reported to RBI were not taken into account in the final purchase price. The future potential reimbursement of the amount from RBI will be recognized in the income statement when received.

The final settlement of the purchase transaction is presented below (in PLN million):

Statement of the financial position - ASSETS	Data of the RLPL Group as at the acquisition date 01.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement and customer relationships	Fair value of assets acquired
			-
Amounts due from banks	279		279
Loans and advances to customers	6 059	25	6 084
Inventories	78	-	78
Intangible assets	14	64	78
Tangible fixed assets	159	-	159
Current income tax receivables	17		17
Deferred income tax assets	433	(17)	416
Other assets	59	-	59
TOTAL ASSETS	**7 098**	**72**	**7 170**

Statement of the financial position - LIABILITIES AND NET ASSETS	Data of the RLPL Group as at the acquisition date 01.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement and customer relationships	Fair value of liabilities assumed
Amounts due to other banks	4 006	-	4 006
Amounts due to customers	696	-	696
Debt securities in issue	1 557	-	1 557
Other liabilities	113	-	113
Current income tax liabilities	4		4
Provisions	1	-	1
TOTAL LIABILITIES	**6 377**	-	**6 377**
NET ASSETS	**721**	**72**	**793**

Information on the assumptions and valuation methods of individual identifiable assets acquired, liabilities assumed as at 1 December 2016 were disclosed in the Group's consolidated financial statements for 2016.

Goodwill	Total RLPL Group companies
Consideration paid	850
Net amount of identifiable acquired assets and liabilities assumed	793
Goodwill	**57**
of which attributable to the following segments:	
corporate segment	16
retail segment	41

43. Other changes to companies comprising the Group

43.1 Acquisition of KBC Towarzystwo Funduszy Inwestycyjnych SA by PKO BP Finat Sp. z o.o.

Description of the transaction

On 8 September 2017, PKO Bank Polski SA (as the guarantor) and PKO BP Finat Sp. z o.o. (as the acquirer) signed a preliminary agreement with KBC Asset Management NV (as the seller) on the purchase of 100% of shares in KBC Towarzystwo Funduszy Inwestycyjnych SA (KBC TFI). The transaction was closed on 12 December 2017, upon prior approval of the President of the Office for Competition and Consumer Protection (UOKiK), and Polish Financial Supervision Authority (KNF).

(IN PLN MILLION)

As a result of the aforementioned transaction, PKO BP Finat Sp. z o.o. purchased 25,257,983 ordinary shares in KBC TFI with a nominal value of PLN 1 (one) each, representing 100% of the share capital of KBC TFI and entitling it to 100% of the voting rights at the General Shareholders' Meeting of the company. The purchase price amounted to PLN 32.9 million. The purchase of the shares was financed from PKO BP Finat Sp. z o.o.'s own funds.

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

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

Ultimately, in 2018, KBC TFI is to be merged with PKO Towarzystwo Funduszy Inwestycyjnych SA, and NetFA is to be merged with PKO BP Finat Sp. z o.o.

The purpose of the acquisition of KBC TFI shares was for the Group to earn economic benefits by reinforcing the position of the subsidiaries of PKO Bank Polski SA in individual segments of the financial market. The planned merger with KBC TFI will accelerate the hitherto dynamic development of PKO TFI and will reinforce its ability to offer customers various attractive forms of investing.

Settlement of the acquisition transaction

The transaction was settled using the acquisition method in accordance with IFRS 3, the application of which requires: identifying the acquirer, determining the date of acquisition, recognizing and measuring identifiable assets acquired, liabilities assumed measured at fair value as at the date of acquisition, and all non-controlling shares in the acquiree, as well as recognizing and measuring goodwill or gains from occasional purchase.

Given that the assumption of control over KBC TFI and its subsidiaries occurred on 12 December 2017, the purchase transaction was settled based on KBC TFI financial statements as at 11 December 2017.

The purchase price of KBC TFI SA shares was determined in the amount paid in cash (PLN 32.9 million). As at the date of preparing the consolidated financial statements of the Group for 2017, a preliminary, temporary valuation of the purchase transaction settlement was carried out. The final transaction settlement may differ from the preliminary settlement presented in these financial statements. In accordance with IFRS 3.45, the Group has 12 months – i.e. to 11 December 2018 to determine the final amounts.

As a result of the settlement of the purchase of KBC TFI shares, a gain from a bargain purchase was recognized constituting the difference between the consideration transferred and the net amount of identifiable assets acquired, and the liabilities assumed were measured in accordance with IFRS.

SETTLEMENT OF THE ACQUISITION TRANSACTION	12.12.2017
Fair value of consideration transferred	33
Fair value of net assets acquired	(35)
GAIN FROM A BARGAIN PURCHASE[1]	**(2)**

[1] negative value as a result of the excess of net assets fair value over the fair value of the payment transferred.

43.2 Other changes to members of the Group and to other subordinated entities.

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

ZenCard Sp. z o.o.

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

(IN PLN MILLION)

As at 31 December 2017, the company's share capital amounted to PLN 90 750 thousand and was divided into 1 815 shares with a nominal value of PLN 50 each.

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

As a result of the settlement of the purchase of ZenCard Sp. z o.o. shares, goodwill was recognized constituting the difference between the consideration transferred and the net amount of identifiable assets acquired, liabilities assumed measured in accordance with IFRS.

SETTLEMENT OF THE ACQUISITION TRANSACTION	26.01.2017
Fair value of consideration transferred	14
Fair value of net assets acquired	2
GOODWILL	**12**

PKO Bank Hipoteczny SA

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

NEPTUN – fundusz inwestycyjny zamknięty aktywów niepublicznych (FIZ AN)

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

"Inter-Risk Ukraina" additional liability company

On 28 April 2017, PKO Bank Polski SA sold within the Group, 100% of its shares in the share capital of "Inter-Risk Ukraina" an additional liability company, of which: 99.9% shares – to Bankowe Towarzystwo Kapitałowe SA, and 0.1% to Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o.

On 28 April 2017, an amendment to the Articles of Association of "Inter-Risk Ukraina" additional liability company with the aforesaid ownership changes was registered in the Single national register of legal entities, individuals-entrepreneurs and organizations of the Ukraine.

Bankowe Towarzystwo Kapitałowe SA

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

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

PKO Finance AB

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

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

Qualia Development Sp. z o.o. Group

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

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

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

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

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

As at 31 December 2017, the company's share capital amounted to PLN 6 979 000 thousand and was divided into 13 958 shares with a nominal value of PLN 500 each.

On 7 April 2017, the Extraordinary Shareholders' Meeting of Sarnia Dolina Sp. z o.o. adopted a resolution on returning to Qualia Development Sp. z o.o. shareholder's contributions totalling PLN 21 549 527 brought to the company in accordance with Art. 177-179 of the Commercial Companies Code. On the same day, the funds were transferred.

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

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

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

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

- **Qualia 3 spółka z ograniczoną odpowiedzialnością – Neptun Park Sp. k.**

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

- **Business combination of selected subsidiaries in the Qualia Development Sp. z o.o. Group**

On 13 October 2017, a business combination of Qualia sp. z o.o. – Sopot Sp. k. and Giełda Nieruchomości Wartościowych Sp. z o.o. (the acquirees) with Qualia Sp. z o.o. (the acquirer) by transferring all the acquirees' assets to the acquirer. The merger plan announced on 26 June 2017 in *Monitor Sądowy i Gospodarczy*, only provided for increasing the share capital of the acquirer and exchange of shares. Before the business combination in 2017 (on 18 January and 10 April, respectively) amendments to the Articles of Association of Qualia sp. z o.o. – Sopot Sp. k. were registered in the KRS, in respect of reducing the contribution of the limited partner – Qualia Development Sp. z o.o. from PLN 10 200 000 to PLN 2 200 000, including a reduction in the general amount from PLN 4 700 000 to PLN 2 200 000. The funds from the reduction in the limited partner's contribution were returned to Qualia Development Sp. z o.o., including the amount of PLN 5 500 000 in December 2016. As at 31 December 2017, the share capital of Qualia Sp. z o.o. amounted to PLN 65 600 thousand and was divided into 1 312 shares with a nominal value of PLN 50 each. Qualia Development Sp. z o.o. is the company's sole shareholder.

Relating to joint ventures and associates

- **Bank Pocztowy SA Group**

On 29 November 2017, an increase in the share capital of Bank Pocztowy SA of PLN 18 145 200 was registered in KRS. PKO Bank Polski SA took up 453 630 shares with a total nominal value of PLN 4 536 300 and with a total issue value of PLN 22 500 048. The remaining shares were taken up by Poczta Polska SA. Eventually, Bank Pocztowy SA received a capital injection from its existing shareholders amounting to PLN 90 000 192. As a result of the aforesaid share capital increase, PKO Bank Polski SA still holds 25% of the company's share capital plus 10 shares. As at 31 December 2017, the share capital of Bank Pocztowy SA amounted to PLN 128 278 080 thousand and was divided into 12 827 808 shares with a nominal value of PLN 10 each. In 2017, the fact that Centrum Operacyjne Sp. z o.o. (a subsidiary of Bank Pocztowy SA) was put into liquidation, was registered in the KRS.

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

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

- **FERRUM SA GROUP**

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

OTHER NOTES

44. Dividends per share

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

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

- supplementary capital of PLN 2 850;
- other reserves of PLN 38 million;

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

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

45. Contingent liabilities and off-balance commitments received and granted

Accounting policies

As part of its operating activities the Group concludes transactions which, at the time of conclusion, are not recognized as assets or liabilities in the statement of financial position, but which give rise to contingent liabilities. Pursuant to IAS 37 a contingent liability is:

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

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

(IN PLN MILLION)

FINANCIAL INFORMATION

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

ISSUER OF UNDERWRITTEN SECURITIES	TYPE OF UNDERWRITTEN SECURITIES	Off-balance sheet liabilities resulting from underwriting agreements	Contract expiry date
As at 31 December 2017			
Company A	corporate bonds	1 453	31/12/2020
Company B	corporate bonds	769	31/07/2020
Company C	corporate bonds	58	31/12/2022
Total		**2 280**	

ISSUER OF UNDERWRITTEN SECURITIES	TYPE OF UNDERWRITTEN SECURITIES	Off-balance sheet liabilities resulting from underwriting agreements	Contract expiry date
As at 31 December 2016			
Company A	corporate bonds	1 126	31/12/2020
Company B	corporate bonds	1 055	31/07/2020
Company C	corporate bonds	512	15/06/2022
Company D	corporate bonds	69	31/12/2022
Company E	corporate bonds	9	31/12/2026
Total		**2 771**	

All contracts relate to the Agreement for Organization, Conducting and Servicing of the Bond Issuance Programme. All securities of the Group under the underwriting programme have unlimited transferability, are not listed on the stock exchange and are not traded on a regulated OTC market.

CONTRACTUAL COMMITMENTS

VALUE OF CONTRACTUAL COMMITMENTS CONCERNING:	31.12.2017	31.12.2016
intangible assets	21	36
property, plant and equipment	78	24
Total	**99**	**60**

FINANCIAL LIABILITIES GRANTED

NOMINAL VALUE OF LOAN COMMITMENTS GRANTED	31.12.2017	31.12.2016
Credit lines and limits		
to financial entities	2 824	2 764
to non-financial entities	37 374	39 525
to public entities	4 273	3 856
Total	**44 471**	**46 145**
of which irrevocable loan commitments	33 607	31 078

(IN PLN MILLION)

GUARANTEE LIABILITIES GRANTED

GUARANTEES AND PLEDGES GRANTED	31.12.2017	31.12.2016
Guarantees granted in domestic and foreign trading	5 813	6 020
to financial entities	320	154
to non-financial entities	5 462	5 856
to public entities	31	10
Guarantees and pledges granted – domestic corporate bonds	2 350	3 769
to non-financial entities	2 350	3 769
to financial entities	-	-
Letters of credit granted	1 409	1 600
to non-financial entities	1 409	1 600
to public entities	-	-
Guarantees and warranties granted – payment guarantees	252	191
Guarantees and pledges granted - domestic municipal bonds	316	351
Total	**10 140**	**11 931**
of which performance guarantees granted	2 630	2 447

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

LIABILITIES GRANTED BY MATURITY

OFF-BALANCE SHEET LIABILITIES GRANTED BY MATURITY AS AT 31.12.2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Loan commitments granted	9 014	524	12 135	15 000	7 798	44 471
Guarantee liabilities granted	752	554	3 213	4 726	895	10 140
Total	**9 766**	**1 078**	**15 348**	**19 726**	**8 693**	**54 611**

OFF-BALANCE SHEET LIABILITIES GRANTED BY MATURITY AS AT 31.12.2016	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Loan commitments granted	13 810	2 543	12 354	10 993	6 445	46 145
Guarantee liabilities granted	266	576	3 722	6 668	699	11 931
Total	**14 076**	**3 119**	**16 076**	**17 661**	**7 144**	**58 076**

OFF-BALANCE SHEET LIABILITIES RECEIVED

OFF-BALANCE SHEET LIABILITIES RECEIVED BY NOMINAL VALUE	31.12.2017	31.12.2016
Financial	95	304
Guarantees	14 227	7 972
Total	**14 322**	**8 276**

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

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

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

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

RIGHT TO SELL OR PLEDGE A COLLATERAL ESTABLISHED FOR THE GROUP

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

46. LEGAL CLAIMS

As at 31 December 2017,the total amount in litigation where the Bank is the defendant, and litigation (suits) in which other PKO Bank Polski SA Group companies are defendants (suits) was PLN 1 709 million, including PLN 17 million in respect of litigation in the Ukraine (as at 31 December 2016 the total amount of the said litigation was PLN 449 million), and the total amount of litigation (suits) as at 31 December 2017 where the Bank is the plaintiff and litigation where other PKO Bank Polski SA Group companies are plaintiffs was PLN 1 363 millions PLN, including 18 million in respect of litigation in the Ukraine (as at 31 December 2016 the total amount under the said litigation was PLN 1 232 million).

The most significant legal claims of PKO Bank Polski SA and the PKO Bank Polski SA Group entities are described below:

a) UNFAIR COMPETITION PROCEEDINGS

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

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

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

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

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

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

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

The Bank appealed to SOKiK against the decision of the President of UOKiK on 2 January 2013. SOKiK reduced the penalty imposed on the Bank to PLN 4 million by a judgement of 25 November 2014 (in respect of the practices described in points 1 and 2 above; and in respect of the practice described in point 3, the penalty was waived, because the Court stated that the Bank practice did not violate collective interest of consumers).
In January 2015 both the Bank and the President of the UOKiK appealed against the judgement. The Court of Appeal in its judgement of 10 February 2016 dismissed the appeal of the Bank and the appeal of the President of UOKiK. The Bank brought a cassation appeal against this judgement. In its judgement of 8 November 2017, the Supreme Court waived the judgement of the Court of Appeal, and changed the judgement of the SOKiK as well as the decision of the President of UOKiK of 19 December 2012 so that it repealed the provisions of the decision of the President of UOKiK which declared the practices described in points 1 and 2 as violating collective consumers' interests and provisions relating to the penalty for the aforesaid practices. Moreover, the Supreme Court indicated that the aforesaid judgement was a reformatory judgement, i.e. the UOKiK may not initiate new proceedings in this case (concluded proceedings).

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

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

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

- **BEFORE SOKIK: THREE PROCEEDINGS INITIATED BY INDIVIDUALS FOR:**

1) the recognition as abusive and for prohibiting the Bank from using in its trading with customers the provisions in template agreements on loans denominated in CHF, indicating that the currency conversion rules used by the Bank for the purposes of loan payment and for the purposes of conversion of loan instalments as well as provisions concerning interest rates were against good practice and grossly violated consumer interests (proceeding suspended);
2) the recognition as illegal of the provisions in templates of mortgage loan agreement Nordea-Habitat and the surety agreement;
3) the recognition as illegal of the provisions in template mortgage loan agreement "Własny Kąt hipoteczny" relating to the insurance of low initial contribution.

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

- **BEFORE THE PRESIDENT OF UOKIK**

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

1) in respect of the alleged practices applied by PKO Bank Polski SA which violate the collective interests of consumers who are party to an agreement for payment services and have access to the electronic banking system, by informing of the proposed changes to the conditions of the agreement for the payment services during its performance exclusively using electronic communications sent through electronic banking channels, which do not constitute a permanent information carrier, and not including in the information appendices in the form of electronic documents (regulations and banking fee and commission tariffs for individuals) sent to consumers on the changes introduced to PKO Bank Polski SA and Inteligo branded products, i.e.: bank accounts and debit cards, credit cards, payment cards, and thus making the verification of the admissibility of changing the conditions of an agreement by consumers impossible. In its pleading of 22 February 2017, the Bank commented on the charges raised by the President of UOKiK and filed an application for an obligating decision referred to in Article 28 of the Act on the competition protection, together with proposed actions aimed at stopping the violation and removing its effects. In its letter of 7 September 2017, (which did not resolve the case), the President of UOKiK informed that he did not anticipate taking into account the Bank's proposed obligations at the current stage of the proceedings. At the same time, the President of UOKiK indicated that the decision dated 10 May 2017 issued against Credit Agricole Bank Polska S.A. should be an indication for the Bank with regard to, among other things, the method of removing the effects of practices which violated collective consumer interests, the form of consumer benefits, or the position of the President of UOKiK connected with a fixed information carrier under electronic banking. The deadline for concluding the proceedings was extended until 12 June 2018.
2) for regarding the provisions of the agreement template as prohibited due to using in the Bank's templates, annexes to mortgage loan and advances agreements revalued/ indexed/ denominated in foreign currencies and appendices thereto, which can be regarded as prohibited provisions, referred to in Art. 385 § 1 of the Civil Code. In its letter of 9 August 2017, the Bank commented on the charges raised by the President of UOKiK. In its letter of 24 October 2017, the Bank filed an application for considering evidence in the form of a document – a summary and comparison of CHF, EUR and USD exchange rates applied by the Bank in the period from 3 January 2011 to 31 July 2017 with CHF, EUR and USD announced in the same period by the NBP in its exchange rate table A with regard to the stability of the relation of the Bank's and NBP exchange rates in the period discussed. In its letter of 15 November 2017, the President of UOKiK called for the Bank to indicate the date on which it started applying the contractual provisions (points 2, 3, 4, 5, 7, 8 and 10) of the appendix to the annex in the template agreements, annexes to mortgage loan and advance agreements revalued/ indexed/ denominated in foreign currencies, which the Bank did in its letter of 30 November 2017. In his letter of 4 December 2017, the President of the UOKiK informed about the extension of the deadline for concluding the proceedings to 31 March 2018. No further steps were taken in this case by the date of approval of these financial statements.
3) in respect of the Bank applying practices which violate collective consumer interests by establishing principal and interest instalments of mortgage-backed loans and advances denominated in foreign currencies, and collecting these instalments from consumers in an amount exceeding the level of the cost of servicing loan exposures on the assumption that there is an increase in the PLN value of the principal loan exposure as a result of the appreciation of the foreign currency against PLN, whereas this level was presented to consumers upon concluding loan/advances agreements as an element of the information on currency risk and was defined as the level of potential increase, which resulted from the initial (arising on the conclusion of the agreement)

transfer of the potential currency risk onto the consumer, and which at the same time may violate good practices, and therefore distort borrowers' behaviour on the market in respect of the aforesaid loans and advances by forcing consumers to repay loan instalments in an unjustified amount and by actually preventing them from earlier repayment, conversion of the loans and advances to another currency, or terminating the aforesaid mortgage loans and advances agreements due to the revaluation of borrowers' liabilities to a level exceeding the level of potential increase in the cost of loan exposure which was presented upon concluding the agreement – which can constitute unfair market practices referred to in Art. 4 (1) of the Act of 23 August 2007 on countervailing unfair market practices, and at the same time may violate collective consumer interests. The Bank responded to the charges in its letter of 23 September 2017. In his letter of 14 February 2018, the President of UOKiK presented to the Bank a detailed justification for the charges made against the Bank in these proceedings. The President of UOKiK upheld his argumentation presented initially in the decision to initiate the proceedings.

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

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

MEMBERS OF THE GROUP:

As at 31 December 2017, PKO Życie Towarzystwo Ubezpieczeń SA – a subsidiary of the Bank – is a party to:

- two proceedings before SOKiK initiated by individuals for regarding certain provisions of template agreements as prohibited in respect of life insurance agreements.

  In all cases the company submitted its responses to suits by applying for dismissing the suits due to the fact that the suits were brought after more than 6 months from the date of ceasing the practices. These cases do not carry the risk of financial penalties for the company.

- proceedings connected with the cassation complaint brought by PKO Życie Towarzystwo Ubezpieczeń SA against the judgement of the Court of Appeal due to the financial penalty levied on the company in 2010 by the President of UOKiK for the violation of collective consumer interests (the fine was paid in 2013).

  In 2015 the Supreme Court issued a verdict repealing the appealed judgement concerning the amount of the fine and referred the case for reconsideration to the court of second instance. In 2017, after re-consideration of the case by the second instance court and another cassation appeal by the company , the Court of Appeal reduced the fine by PLN 139 thousand. After obtaining written justification for the judgement, the company will decide about any potential further appeals.

At the same time, in 2017 PKO Życie Towarzystwo Ubezpieczeń SA conducted activities connected with:

a) the obliging decision issued in October 2015 by the President of UOKiK, in respect of changes in the fees for earlier resignation stipulated in policies with insurance capital fund;

b) arrangement concluded on 19 December 2016 with the President of UOKiK, under which the conditions of the decision referred to in point a) above were extended to the entire active (as at 1 December 2016) portfolio of insurance products with insurance capital fund held by the company's customers, and corresponding solutions were adopted for customers who concluded agreements with insurance capital fund after 1 January 2008 when they were aged 61 or more, and the agreements were terminated after the customer's 65th birthday.

As at 31 December 2017, PKO Życie Towarzystwo Ubezpieczeń SA does not have a provision for an administrative penalty in respect of proceedings relating to products with insurance capital fund (a provision of PLN 8.1 was released in 2015 due to the fact that the obligating decision of the President of UOKiK became final). At the same time, the company maintains provision for damages at a level adequate to the conditions of the obliging decision and the arrangement.

Moreover, in respect of the activities conducted by PKO Bank Polski SA subsidiaries, there are three explanatory proceedings pending before the President of UOKiK and one position of the President of UOKiK presented without initiating proceedings (under Art. 49a of the Act of competition and consumers protection).

b) RE-PRIVATIZATIONS CLAIMS RELATING TO PROPERTIES USED BY THE GROUP

As at the date of these financial statements there are:

1) six proceedings, including three suspended, in respect of the Bank's properties, relating to declaring invalid the decisions which denied the Bank the right to temporary ownership which would transfer the properties under its

administration and on obtaining ex officio right of perpetual usufruct to the land and ownership of the building, return of real property, and regulation of the legal status of the property;

2) fourteen proceedings, including one suspended in respect of real properties of other members of the Bank's Group, related to declaring the invalidity of administrative decisions or refund of the property.

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

c) Tax disputes

As a result of an unfavourable judgement of the Supreme Administrative Court (NSA – *Naczelny Sąd Administracyjny*) passed in August 2016 and the ensuing judgements issued on this basis by the Voivodeship Administrative Court (WSA – *Wojewódzki Sąd Administracyjny*) in Łódź on 10 January, 13 January and 8 February 2017 which dismissed all complaints brought by PKO Leasing SA (legal successor of PKO Bankowy Leasing Sp. z o.o.) in respect of crediting surpluses and refunds against outstanding VAT, as at 31 December 2017 the PKO Leasing SA Group disclosed outstanding VAT totalling PLN 21.1 million, fully written down. Interest payable on the outstanding VAT claimed before administrative courts results from decisions of the Tax Office in Łódź in respect of settling surpluses and refunds of VAT for settlement periods from January 2011 to June 2013 against outstanding VAT in which the settlement of refunds and surpluses of VAT against outstanding VAT was performed at the date of filing correcting VAT returns (in December 2014), and not at the date of the payment of the tax in an amount higher than the amount due, as was argued by the company.

In 2017, PKO Leasing SA continued appeal proceedings against the decisions of the tax authorities. On 7 April 2017, the company filed a cassation appeal against the WSA's judgement in respect of crediting refund of VAT of PLN 20.8 million resulting from its tax return for February 2011 against outstanding VAT for January 2011. Moreover, on 25 July 2017, the company filed a complaint to the WSA against the decision of the Director of the Fiscal Administration Chamber (*Izba Administracji Podatkowej*) in Łódź, issued in the performance of the aforesaid WSA and NSA judgements, relating to the manner of settling the payment made on 7 January 2015 against outstanding amounts due for various settlement periods from January 2011 to June 2013. On 7 November 2017, the WSA waived the disputed decision and awarded the reimbursement of the costs of the court proceedings. The judgement is not yet valid. The Director of the Fiscal Administration Chamber in Łódź filed a cassation complaint against the WSA's judgement. The company is awaiting the date of the hearing before the NSA. The Company also continued other appeal steps available under the law, among others, in respect of the correction of tax returns for the periods of January and February 2011. With regard to the corrections of tax returns, the company is in dispute with the Tax Office in Łódź with regard to the Office's decision on regarding the corrections of VAT returns for January and February 2011 as ineffective. On 23 August 2017, the WSA passed a judgement in response to the company's complaint against a notification regarding the corrections for January and February 2011 as ineffective, and dismissed the complaint arguing that such form is not available for taxpayers in the case of notifications. On 23 October 2017, the company filed a cassation complaint against this judgement. The company is awaiting the date of the hearing before the NSA. There were no changes in the status of the case by 31 December 2017.

47. Notes to the consolidated cash flow statement

Cash and cash equivalents

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

(IN PLN MILLION)

CASH AND CASH EQUIVALENTS	31.12.2017	31.12.2016
Cash and balances with the Central Bank	15 845	11 645
Deposits with the Central Bank	1 965	1 680
Amounts due from banks (current)	5 036	4 471
Restricted cash	154	170
Total	**23 000**	**17 966**

Restricted cash and cash equivalents

Cash and cash equivalents of PLN 154 million (as at 31 December 2016: PLN 170 million), including:

- PLN 11 million (as at 31 December 2016: PLN 13 million) pledged as collateral for securities' transactions conducted by the Dom Maklerski PKO BP SA brokerage house are deposited in the National Depository for Securities (KDPW_CCP), as part of the Guarantee Fund for the Settlement of Stock Exchange Transactions. Each direct participant who holds the status of a settlement-making participant is obliged to make payments to the settlement fund which guarantees proper settlement of the stock exchange transactions covered by that fund. The amount of the payments depends on the value of the transactions made by each participant and is updated by KDPW_CCP on a daily basis;
- PLN 9 million (as at 31 December 2016: PLN 18 million) paid in by participants in IKE, IKZE, PPE and PSO, which was not converted by the transfer agent into investment fund participation units by 31 December 2017 and 31 December 2016, respectively;
- PLN 134 million (as at 31 December 2016: PLN 139 million) pledged as a collateral for securitization transactions.

Cash flows from interests and dividends, both received and paid

INTEREST INCOME – RECEIVED ON:	2017	2016
loans to and other receivables from banks	168	108
loans and advances to customers	8 193	7 492
investment securities	1 087	777
hedging derivatives	391	462
financial assets designated at fair value through profit or loss upon initial recognition	189	227
financial assets held for trading, excluding derivative financial instruments	42	68
Total	**10 070**	**9 134**

INTEREST EXPENSE – PAID ON:	2017	2016
amounts due to banks	(189)	(109)
amounts due to customers	(1 628)	(1 892)
debt securities in issue and subordinated liabilities	(422)	(384)
available-for-sale debt securities	(72)	(32)
financial assets held for trading, excluding derivative financial instruments	(8)	(33)
financial assets designated at fair value through profit or loss upon initial recognition	(11)	(22)
Total	**(2 330)**	**(2 472)**

(IN PLN MILLION)

DIVIDEND INCOME – RECEIVED	2017	2016
Dividend received from joint ventures and associates[1]	12	11
Dividend received from other entities	12	10
Total	**24**	**21**

[1] The item relates to a dividend received from entities accounted for under the equity method.

Cash flow from operating activities – other adjustments

OTHER ADJUSTMENTS	2017	2016
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	(30)	(127)
Accrued interest, discount, premium on debt securities and subordinated liabilities	(126)	(537)
Hedge accounting	(7)	(51)
Actuarial gains and losses	1	2
valuation of shares in associates and joint ventures, and other changes	39	(54)
Foreign exchange differences on translation of foreign branches	(36)	(5)
Scrapping of and impairment allowances on property, plant and equipment and intangible assets	(20)	(65)
Total	**(179)**	**(837)**

Explanation of differences between the consolidated statement of financial position and changes in these items presented under operating activities in the consolidated cash flow statement

(GAIN)/LOSS ON INVESTING ACTIVITIES RELATING TO SALE OR SCRAPPING OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS, SHARES AND PARTICIPATION UNITS	2017	2016
Proceeds from sale or scrapping of property, plant and equipment and intangible assets	(95)	(86)
Costs of sale or scrapping of property, plant and equipment and intangible assets	21	33
Gain on sale of subsidiaries	-	(133)
Gain on sale of shares and participation units	(43)	-
Total	**(117)**	**(186)**

INTEREST AND DIVIDENDS	2017	2016
Interest received on investment securities, presented under investing activities	(935)	(688)
Dividends received presented in investing activities	(24)	(21)
Interest paid on loans received and debt securities in issue, presented under financing activities	494	473
Total	**(465)**	**(236)**

(IN PLN MILLION)

CHANGES IN AMOUNTS DUE FROM BANKS	2017	2016
Change in the balance sheet	112	(792)
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	37	-
Exclusion of the change in cash and cash equivalents	551	1 117
Total	**700**	**325**

CHANGE IN LOANS AND ADVANCES TO CUSTOMERS	2017	2016
Change in the balance sheet	(5 022)	(10 192)
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	-	6 083
Change in write-downs of loans and advances to customers	180	284
Exclusion of the change in cash and cash equivalents	(2)	3
Total	**(4 844)**	**(3 822)**

CHANGE IN OTHER ASSETS, INVENTORIES AND NON-CURRENT ASSETS HELD FOR SALE	2017	2016
Change in the balance sheet sheet and reclassification to other items	59	(1 430)
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	-	137
Movements in impairment allowances for other receivables	(14)	(18)
Total	**45**	**(1 311)**

CHANGE IN AMOUNTS DUE TO BANKS	2017	2016
Change in the balance sheet	(14 648)	920
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	-	(4 006)
Presentation of long-term loans from banks under financing activities	13 446	44
Total	**(1 202)**	**(3 042)**

CHANGE IN AMOUNTS DUE TO CUSTOMERS	2017	2016
Change in the balance sheet	13 734	9 308
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	-	(697)
Presentation of long-term loans from financial institutions other than banks under financing activities	1 603	(19)
Total	**15 337**	**8 592**

Change in liabilities in respect of debt securities in issue	2017	2016
Change in the balance sheet	9 439	5 060
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	-	(1 557)
Presentation of long-term liabilities in respect of debt securities in issue under financing activities	(10 558)	(3 060)
Total	**(1 119)**	**443**

(IN PLN MILLION)

CHANGE IN PROVISIONS AND IMPAIRMENT ALLOWANCES	2017	2016
Change in the balance sheet	(14)	(24)
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	-	(1)
Change in impairment allowances on loans and advances to customers	(180)	(284)
Change in impairment allowances on shares in associated and joint ventures, investment securities and other receivables	22	18
Total	**(172)**	**(291)**

CHANGE IN OTHER LIABILITIES, LIABILITIES IN RESPECT OF INSURANCE ACTIVITIES	2017	2016
Change in the balance sheet	1 130	1 214
Changes resulting from acquisition of entities and exclusion of net assets of controlled companies	(6)	(113)
Total	**1 124**	**1 101**

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

	Note	31.12.2016	Recognized under financing activities in the consolidated cash flow statement		Recognized under operating activities in the consolidated cash flow statement	31.12.2017
			Incurred	Repaid	Other changes, including foreign exchange differences	
Loans and borrowings received		22 229	311	(15 360)	(832)	6 348
from banks	32	17 567	-	(13 446)	(1 336)	2 785
from customers	33	4 662	311	(1 914)	504	3 563
Debt securities in issue	35	14 493	17 836	(7 278)	(1 119)	23 932
Subordinated liabilities	36	2 539	1 700	(2 536)	-	1 720
subordinated loan		922	-	(880)	(42)	-
subordinated bonds		1 617	1 700	(1 656)	59	1 720
Total		**39 261**	**19 847**	**(25 174)**	**(1 951)**	**32 000**

	Note	31.12.2015	Changes resulting from acquisition of business entities	Recognized under financing activities in the consolidated cash flow statement		Recognized under financing activities in the consolidated cash flow	31.12.2016
				Incurred	Repaid	Other changes, including foreign exchange differences	
Loans and borrowings received		20 342	-	460	(485)	1 912	22 229
from banks	32	16 418	-	-	(44)	1 193	17 567
from customers	33	3 924	-	460	(441)	719	4 662
Debt securities issued	35	9 432	1 558	7 807	(4 747)	443	14 493
Subordinated liabilities	36	2 499	-	-	-	40	2 539
subordinated loan		882	-	-	-	40	922
subordinated bonds		1 617	-	-	-	-	1 617
Total		**32 273**	**1 558**	**8 267**	**(5 232)**	**2 395**	**39 261**

(IN PLN MILLION)

48. Transactions with the State Treasury and related parties

Transactions with the State Treasury

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

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

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

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

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

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

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

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

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

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

(IN PLN MILLION)

SIGNIFICANT TRANSACTIONS WITH THE STATE TREASURY'S RELATED ENTITIES

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

	Balance sheet exposure, including exposure to loans and debt instruments		Off-balance sheet exposure		Liabilities in respect of deposits	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
counterparty 1	-	-	2 450	2 450	-	-
counterparty 2	2 936	-	-	-	-	-
counterparty 3	1 004	1 327	1 825	1 529	55	3
counterparty 4	2 024	1 503	308	869	186	126
counterparty 5	29	46	1 832	1 521	4 093	350
counterparty 6	284	386	1 463	385	290	271
counterparty 7	333	332	1 269	1 206	-	533
counterparty 8	1 017	144	548	360	-	-
counterparty 9	1 270	1 289	51	193	-	-
counterparty 10	286	37	815	1 069	-	1 085

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

RELATED-PARTY TRANSACTIONS – CAPITAL LINKS

Transactions of the parent company with associates and joint ventures accounted for under the equity method. All transactions with subsidiaries, joint ventures and associates presented below were arm's length transactions. Repayment terms are within a range of from one month to seventeen years.

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

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

(IN PLN MILLION)

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

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

RELATED-PARTY TRANSACTIONS – PERSONAL LINKS

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

49. BENEFITS FOR THE PKO BANK POLSKI SA KEY MANAGEMENT

ACCOUNTING POLICIES

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

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

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

The variable remuneration components are granted in the form of:

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

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

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

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

In 2017, variable remuneration components were also granted in selected PKO Bank Polski SA Group companies. The regulations on variable remuneration components for members of the Management Board applied in: PKO Bank Hipoteczny SA, PKO BP BANKOWY PTE SA, PKO TFI SA, PKO Leasing SA, PKO Towarzystwo Ubezpieczeń SA and PKO Życie Towarzystwo Ubezpieczeń SA. At the same time, in PKO Bank Hipoteczny SA, PKO Towarzystwo Ubezpieczeń SA and PKO Życie Towarzystwo Ubezpieczeń SA employees in certain managerial positions with a significant impact on the company's risk profile were also covered by the variable remuneration policies.

FINANCIAL INFORMATION

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

REMUNERATION RECEIVED FROM PKO BANK POLSKI SA		
	2017	2016
Supervisory Board of the Bank	1 315	982
Members of the Supervisory Board who ceased to perform their functions in 2016[1]	-	286
Total	**1 315**	**1 268**

[1] including post-employment benefits

EMPLOYEE BENEFITS FOR MEMBERS OF THE MANAGEMENT BOARD DUE OR POTENTIALLY DUE FROM PKO BANK POLSKI SA (IN PLN THOUSAND)

	Short-term employee benefits, including variable remuneration paid in cash - not deferred		Other long-term benefits - deferred variable remuneration paid in cash		Share-based payments settled in cash		
	remuneration in 2017[1]	other received in 2017	received in 2017	contingent, due as at 31.12.2017	received in 2017	due as at 31.12.2017	contingent, due as at 31.12.2017
Meenagment Board of the Bank	7 470	1 423	611	1 642	1 258	2 558	1 642
Members of the Management Board who ceased to perform their functions in 2017 and 2016	1 647	733	698	1 224	1 510	1 719	1 224
Total	**9 117**	**2 156**	**1 310**	**2 865**	**2 768**	**4 277**	**2 865**

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

	Short-term employee benefits, including variable remuneration paid in cash - not deferred		Other long-term benefits - deferred variable remuneration paid in cash		Share-based payments settled in cash		
	remuneration in 2016[1]	other received in 2016	received in 2016	contingent, due as at 31.12.2016	received in 2016	due as at 31.12.2016	contingent, due as at 31.12.2016
Meenagment Board of the Bank	9 129	1 276	702	1 640	1 151	1 692	1 640
Members of the Management Board who ceased to perform their functions in 2016	2 104	785	480	994	802	1 076	994
Total	**11 233**	**2 061**	**1 182**	**2 634**	**1 953**	**2 768**	**2 634**

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

POST-EMPLOYMENT BENEFITS (IN PLN THOUSAND)

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

The policy of remunerating members of the Management and Supervisory Boards were implemented as of 22 June 2017. Service agreements were concluded with the Management Board members to replace the existing employment agreements, and benefits related to the change in the employment relationship were paid as presented below.

POST-EMPLOYMENT BENEFITS	2017	2016
Management Board	1 541	-
Members of the Management Board who ceased to perform their functions in 2017 and 2016	312	1 166
Total benefits	**1 853**	**1 166**

BENEFITS IN RESPECT OF EMPLOYMENT TERMINATION (IN PLN THOUSAND)

BENEFITS IN RESPECT OF EMPLOYMENT TERMINATION FOR MEMBERS OF THE MANAGEMENT BOARD WHO CEASED TO PERFORM THEIR FUNCTIONS IN 2017 AND 2016	2017	2016
Members of the Management Board who ceased to perform their functions in 2017 and 2016	832	3 313

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

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

REMUNERATION RECEIVED BY MEMBERS OF MANAGEMENT BOARDS AND SUPERVISORY BOARDS OF THE PKO BANK POLSKI SA GROUP SUBSIDIARIES (IN PLN THOUSAND)

REMUNERATION OF THE MANAGEMENT AND SUPERVISORY BOARD MEMBERS OF THE SUBSIDIARIES OF THE PKO BANK POLSKI SA GROUP	2017	2016
Supervisory Board	467	485
Management Board	25 095	20 493
Total	**25 562**	**20 978**

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

LOANS AND ADVANCES GRANTED BY THE BANK TO THE MANAGEMENT	31.12.2017	31.12.2016
Supervisory Board	666	608
Management Board	890	930
Total	**1 556**	**1 538**

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

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

(IN PLN MILLION)

VARIABLE REMUNERATION COMPONENTS

Provision for variable remuneration components	31.12.2017 (for 2013-2017)	31.12.2016 (for 2012-2016)
Management Board (including members who ceased to perform their functions in 2017 and 2016)	18	17
Other Risk Takers (persons holding managerial positions other than members of the Bank's Management Board)	30	31
Group entities	25	14
Total provision	**73**	**62**
Remuneration paid during the year	**2017 (for 2013-2017)**	**2016 (for 2012-2016)**
- granted in cash	**16**	**15**
Management Board (including members who ceased to perform their functions in 2017 and 2016)	4	3
Other Risk Takers (persons holding managerial positions other than members of the Bank's Management Board)	7	8
Group entities	5	4
- granted in the form of financial instruments	**14**	**10**
Management Board (including members who ceased to perform their functions in 2017 and 2016)	3	2
Other Risk Takers (persons holding managerial positions other than members of the Bank's Management Board)	9	7
Group entities	2	1
Total remuneration paid	**30**	**25**

50. FAIR VALUE HIERARCHY

ACCOUNTING POLICIES, AND ESTIMATES AND JUDGEMENTS

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

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

LEVEL 1: PRICES QUOTED ON ACTIVE MARKETS

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

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

LEVEL 2: VALUATION TECHNIQUES BASED ON OBSERVABLE MARKET DATA

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

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

LEVEL 3: OTHER VALUATION TECHNIQUES

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

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

(IN PLN MILLION)

FINANCIAL INFORMATION

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31.12.2017	Note	Carrying amount	Level 1 Prices quoted on active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Financial assets held for trading, excluding derivatives financial instruments	21	431	429	2	-
Debt securities		405	405	-	-
Shares in other entities		19	19	-	-
Investment certificates, rights to shares, pre-emptive rights		7	7	-	-
Derivatives financial instruments	22	2 598	1	2 597	-
Hedging instruments		887	-	887	-
Trading instruments		1 711	1	1 710	-
Financial instruments designated at fair value through profit or loss upon initial recognition	24	8 157	3 775	4 382	-
Debt securities		6 688	2 306	4 382	-
Participation units		1 469	1 469	-	-
Available-for-sale investment securities	26	43 651	34 236	7 249	2 166
Debt securities		43 192	34 152	7 249	1 791
Equity securities		203	80	-	123
Participation units in investment funds and shares in collective investment undertakings		256	4	-	252
Total financial assets measured at fair value		**54 837**	**38 441**	**14 230**	**2 166**
Derivatives financial instruments	22	2 740	-	2 740	-
Hedging instruments		204	-	204	-
Trading instruments		2 536	-	2 536	-
Total financial liabilities measured at fair value		**2 740**	-	**2 740**	-

FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION AS AT 31.12.2017	Carrying amount	Level 1	Level 2	Level 3
Debt securities	6 688	2 306	4 382	-
NBP bills	4 199	-	4 199	-
treasury bonds (in PLN)	1 413	1 413	-	-
treasury bonds (in foreign currencies)	893	893	-	-
municipal bonds (in PLN)	106	-	106	-
corporate bonds (in foreign currencies)	77	-	77	-
Participation units in ICF (insurance capital funds) related to insurance products belonging to the group of investment products where the risk is borne by the policyholder	1 469	1 469	-	-
TOTAL	**8 157**	**3 775**	**4 382**	-

AVAILABLE-FOR-SALE INVESTMENT SECURITIES AS AT 31.12.2017	Carrying amount	Level 1	Level 2	Level 3
Securities available for sale	43 192	34 152	7 249	1 791
treasury bonds (in PLN)	33 502	33 502	-	-
treasury bonds (in foreign currencies)	238	-	238	-
municipal bonds (in PLN)	4 928	-	4 928	-
corporate bonds (in PLN)	4 045	321	2 083	1 641
corporate bonds (in foreign currencies)	479	329	-	150
Equity securities	203	80	-	123
Participation units in investment funds and shares in collective investment undertakings	256	4	-	252
TOTAL	**43 651**	**34 236**	**7 249**	**2 166**

(IN PLN MILLION)

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31.12.2016	Note	Carrying amount	Level 1 Prices quoted on active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Financial assets held for trading, excluding derivatives financial instruments	21	326	326	-	-
Debt securities		312	312	-	-
Shares in other entities		11	11	-	-
Investment certificates, rights to shares, pre-emptive rights		3	3	-	-
Derivatives financial instruments	22	2 901	3	2 898	-
Hedging instruments		382	-	382	-
Trading instruments		2 519	3	2 516	-
Financial instruments designated at fair value through profit or loss upon initial recognition	24	13 937	4 620	9 317	-
Debt securities		12 204	2 887	9 317	-
Participation units		1 733	1 733	-	-
Available-for-sale investment securities	26	36 641	27 345	5 922	3 374
Debt securities		36 142	27 236	5 922	2 984
Equity securities		183	91	-	92
Participation units in investment funds and shares in collective investment undertakings		316	18	-	298
Total financial assets measured at fair value		**53 805**	**32 294**	**18 137**	**3 374**
Derivatives financial instruments	22	4 198	1	4 197	-
Hedging instruments		1 135	-	1 135	-
Trading instruments		3 063	1	3 062	-
Total financial liabilities measured at fair value		**4 198**	**1**	**4 197**	-

FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION AS AT 31.12.2016	Carrying amount	Level 1	Level 2	Level 3
Debt securities	12 204	2 887	9 317	-
NBP bills	9 079	-	9 079	-
treasury bonds (in PLN)	1 812	1 812	-	-
treasury bonds (in foreign currencies)	1 075	1 075	-	-
municipal bonds (in PLN)	111	-	111	-
corporate bonds (in foreign currencies)	127	-	127	-
Participation units in ICF (insurance capital funds) related to insurance products belonging to the group of investment products where the risk is borne by the policyholder	1 733	1 733	-	-
TOTAL	**13 937**	**4 620**	**9 317**	-

AVAILABLE-FOR-SALE INVESTMENT SECURITIES AS AT 31.12.2016	Carrying amount	Level 1	Level 2	Level 3
Securities available for sale	36 142	27 236	5 922	2 984
treasury bonds (in PLN)	25 744	25 744	-	-
treasury bonds (in foreign currencies)	678	457	221	-
municipal bonds (in PLN)	4 552	-	4 552	-
corporate bonds (in PLN)	4 590	692	1 149	2 749
corporate bonds (in foreign currencies)	578	343	-	235
Equity securities	183	91	-	92
Participation units in investment funds and shares in collective investment undertakings	316	18	-	298
TOTAL	**36 641**	**27 345**	**5 922**	**3 374**

(IN PLN MILLION)

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

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

RECONCILIATION OF CHANGES IN THE FAIR VALUE OF LEVEL 3 FINANCIAL INSTRUMENTS DURING THE PERIOD	31.12.2017	31.12.2016
Opening balance at the beginning of the period	3 374	3 635
Total gains or losses	**40**	**113**
in the profit or loss	(37)	68
in other comprehensive income	77	45
Taking up a new share issue in the Fund	58	67
Taking up of shares in Visa Inc.	-	81
Sale of shares in Visa Europe Limited	-	(337)
Other issues and redemptions (including settlements)	(1 213)	(185)
Reduction of capital involvement in the Fund	(93)	-
Total	**2 166**	**3 374**

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

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

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

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

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

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

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

- other financial assets and financial liabilities.

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

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

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

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

The fair value of a liability in respect of debt securities issued by PKO Finance AB was estimated based on Bloomberg quotations.

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

Finance lease receivables were estimated based on the expected cash flows discounted using the internal rate of return for lease transactions of the same type concluded by the Group during the period directly preceding the end of the reporting period.

(IN PLN MILLION)

	level of fair value hierarchy	valuation method	31.12.2017 carrying amount	31.12.2017 fair value
Cash and cash balances with the Central Bank	n/a	at amounts due	17 810	17 810
Amounts due from banks	2	discounted cash flows	5 233	5 233
Loans and advances to customers (excluding adjustments relating to fair value hedge accounting)			**205 629**	**203 256**
housing loans	3	discounted cash flows	106 191	101 998
corporate loans	3	discounted cash flows	56 792	56 761
consumer loans	3	discounted cash flows	24 590	26 407
debt securities (corporate)	3	discounted cash flows	1 855	1 855
debt securities (municipal)	3	discounted cash flows	2 513	2 513
receivables in respect of repurchase agreements	2	discounted cash flows	902	902
finance lease receivables	3	discounted cash flows	12 786	12 820
Investment securities held to maturity	1	market quotations	1 812	1 816
Other financial assets	3	at amount due less impairment allowance	2 377	2 377
Amounts due to the Central Bank	2	at amounts due	6	6
Amounts due to other banks	2	discounted cash flows	4 558	4 558
Amounts due to customers			**218 800**	**218 735**
to corporate entities	3	discounted cash flows	56 230	56 229
to public entities	3	discounted cash flows	11 409	11 409
to retail customers	3	discounted cash flows	151 161	151 097
Debt securities in issue	1, 2	market quotations/discounted cash flows	23 932	24 226
Subordinated liabilities	2	discounted cash flows	1 720	1 720
Other financial liabilities	3	at amounts due	4 129	4 129

	level of fair value hierarchy	valuation method	31.12.2016 carrying amount	31.12.2016 fair value
Cash and cash balances with the Central Bank	n/a	at amounts due	13 325	13 325
Amounts due from banks	2	discounted cash flows	5 345	5 344
Loans and advances to customers			**200 606**	**199 125**
housing loans	3	discounted cash flows	106 121	102 351
corporate loans	3	discounted cash flows	52 915	53 731
consumer loans	3	discounted cash flows	23 222	24 701
debt securities (corporate)	3	discounted cash flows	2 283	2 210
debt securities (municipal)	3	discounted cash flows	2 587	2 587
receivables in respect of repurchase agreements	2	discounted cash flows	1 339	1 339
finance lease receivables	3	discounted cash flows	12 139	12 206
Investment securities held to maturity	1	market quotations	466	466
Other financial assets	3	at amount due less impairment allowance	2 247	2 247
Amounts due to the Central Bank	2	at amounts due	4	4
Zobowiązania wobec innych banków	2	discounted cash flows	19 208	19 211
Amounts due to customers			**205 066**	**205 005**
to corporate entities	3	discounted cash flows	48 657	48 650
to public entities	3	discounted cash flows	8 409	8 409
to retail customers	3	discounted cash flows	148 000	147 946
Debt securities in issue	1, 2	market quotations/discounted cash flows	14 493	14 752
Subordinated liabilities	2	discounted cash flows	2 539	2 526
Other financial liabilities	3	at amounts due	3 058	3 058

(IN PLN MILLION)

52. OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

ACCOUNTING POLICIES

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

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

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

FINANCIAL INFORMATION

31.12.2017	Total financial assets	Derivatives	Repurchase agreements
Recognized financial assets, gross	3 503	2 601	902
Financial liabilities subject to offsetting, gross	(3)	(3)	-
Financial assets recognized in the statement of financial position, net	3 500	2 598	902
Financial instruments not subject to offsetting in the financial statements	2 097	2 082	15
Financial liabilities subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 337	1 337	-
Cash or securities received as collateral	760	745	15
Net amount	**1 403**	**516**	**887**

31.12.2017	Total financial liabilities	Derivatives	Repurchase agreements
Recognized financial liabilities, gross	2 791	2 743	48
Financial liabilities subject to offsetting, gross	(3)	(3)	-
Financial assets recognized in the statement of financial position, net	2 788	2 740	48
Financial instruments not subject to offsetting in the financial statements	1 895	1 895	-
Financial assets subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 337	1 337	-
Cash or securities received as collateral	558	558	-
Net amount	**893**	**845**	**48**

(IN PLN MILLION)

31.12.2016	Total financial assets	Derivatives	Repurchase agreements
Recognized financial assets, gross	4 905	2 905	2 000
Financial liabilities subject to offsetting, gross	(4)	(4)	-
Financial assets recognized in the statement of financial position, net	4 901	2 901	2 000
Financial instruments not subject to offsetting in the financial statements	2 096	2 096	-
Financial liabilities subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 698	1 698	-
Cash or securities received as collateral	398	398	-
Net amount	**2 805**	**805**	**2 000**

31.12.2016	Total financial liabilities	Derivatives	Repurchase agreements
Recognized financial liabilities, gross	4 408	4 202	206
Financial liabilities subject to offsetting, gross	(4)	(4)	-
Financial assets recognized in the statement of financial position, net	4 404	4 198	206
Financial instruments not subject to offsetting in the financial statements	3 257	3 223	34
Financial assets subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 698	1 698	-
Cash or securities received as collateral	1 559	1 525	34
Net amount	**1 147**	**975**	**172**

53. Assets pledged as collateral for liabilities and transferred financial assets

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

RECEIVABLES COVERED BY SECURITIZATION OF LEASE RECEIVABLES

As at 31 December 2017, receivables covered by the securitization of lease receivables amounted to PLN 1,381 million. They are pledged as collateral for liabilities in respect of debt securities issued by the special vehicle ROOF Poland Leasing 2014 DAC. Securitized lease receivables are presented as the Group's assets because they do not meet the derecognition criteria. In particular, the Group is not obliged to pay any amounts to final recipients until it has received the corresponding amounts from lessees. In addition, the criterion of an immediate transfer of cash flows from the securitized assets is not met. In the period from launching securitization in December 2014 to 31 December 2017, the Group was able to sell lease receivables not yet due as at the date of their sale, up to PLN 1,475 million when lease receivables had been repaid. In addition, the Group settles its liabilities to buyers of securities on a quarterly basis, while the typical settlement period for securitized lease agreements is one month.

(IN PLN MILLION)

LIABILITIES IN RESPECT OF REPURCHASE TRANSACTIONS

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

CARRYING AMOUNT	31.12.2017	31.12.2016
Debt securities	48	182
Repurchase agreements	48	206
Net balance	-	(24)

LIABILITIES FROM THE NEGATIVE VALUATION OF DERIVATIVE INSTRUMENTS

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

PRELIMINARY SETTLEMENT DEPOSIT OF THE NATIONAL DEPOSITORY FOR SECURITIES (KDPW)

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

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

BANK DEPOSIT GUARANTEE FUND

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

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

(IN PLN MILLION)

FUNDS SECURING LIABILITIES IN RESPECT OF CONTRIBUTIONS TO THE BANK GUARANTEE FUND (BGF)

	31.12.2017
Contributions in the form of payment obligations	120
Nominal value of assets in which funds corresponding to payment obligations are invested	175
Type of collateral	Treasury bonds
Maturity	25.01.2024
Carrying amount of the collateral	174

Since 2017, the value of contributions in the form of payment commitments represents 30% of the contributions to the Bank Guarantee Fund ("the BGF") for the Deposit Guarantee Fund or the Bank Resolution Fund. Assets securing payment commitments include Treasury bonds pledged for BGF in an amount which ensures maintaining the ratio of the value of property rights securing payment commitments to the amount of payment commitments of no less than 110%. For the purposes of establishing the minimum ratio of assets to the amount of payment commitment, the value of property rights securing payment commitments is determined at the amount specified based on the last fixing rate of the day in the electronic market for Treasury securities organized by the minister responsible for budgetary matters, plus interest due as at the valuation date, unless interest has already been included in the fixing rate.

Such assets funds are treated as assets pledged as collateral for own liabilities, they cannot be pledged or encumbered in any way, are excluded from judicial or administrative enforcement proceedings and do not form part of the estate in bankruptcy. The amount of funds securing payment commitments relating to contributions to the BGF will be increased on the payment dates of contributions to the Deposit Guarantee Fund (quarterly) and the Bank Resolution Fund (in the third quarter of a given year) representing not more than 30% of the contribution established by the BGF. The amount of these funds may decrease if the Bank is called by the BGF to transfer in cash the amount corresponding to the value of payment commitments.

LEGAL LIMITATIONS RELATING TO THE GROUP'S TITLE

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

TRANSFERRED FINANCIAL ASSETS

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

54. FIDUCIARY ACTIVITIES

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

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

On 26 January 2017, the Supervisory Board of PKO Bank Polski SA selected KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa as the entity authorized to audit the financial statements of the Bank and consolidated financial statements of the PKO Bank Polski SA Group for 2017–2019. The same entity had audited the Bank's and the Group's financial statements for 2015-2016. KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa with its registered office in Warsaw, Inflancka 4A is entered in the list of audit companies maintained by the National Board of Registered Auditors with the number 3546. The selection of the entity authorized to audit and review the financial statements was made by the Supervisory Board in accordance with the applicable regulations and professional standards, on the basis of §15 section 1, point 4 of the Bank's Articles of Association. On 12 April 2017, the Supervisory Board of PKO Bank Polski SA concluded another agreement with KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa for the audit and review of the financial statements of the Bank and consolidated financial statements of the PKO Bank Polski SA Group for 2017–2019.

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

(IN PLN MILLION)

OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT

56. RISK MANAGEMENT WITHIN THE GROUP.

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

The Group and the Bank identified risks which are to be managed, and some of these risks are considered material. Risk Materiality assessment associated with the Bank's and the Group's operations is conducted at least once a year. This assessment may be performed more often, especially if the scope of operations or the risk profile of the Bank, a Group entity or the Group change significantly. When determining the criteria for classifying a given risk as material, the impact of the risk on both the Bank's and the Group's activities is taken into account. When assessing the materiality of the risks to the Bank and the Group, a list of material, monitored and immaterial risks is determined at Bank and Group level. All risks classified as material for the Bank are also material for the Group. The following risks are considered material for the Bank: credit risk of insolvency, currency risk, interest rate risk, liquidity risk (including financing risk), operating risk, business risk, risk of macroeconomic changes and models risk. Group entities may consider types of risks other than those listed above to be material, taking into account the specific nature and scale of their operations and the markets on which they operate. The Bank verifies the materiality of these risks at Group level. Group entities participate in assessing the materiality of the risks initiated by the Parent Company and assessed at Group level.

TYPE OF RISK	SECTION
CREDIT RISK	57, 58, 60, 61
CONCENTRATION RISK	
RISK OF FOREIGN CURRENCY MORTGAGE LOANS	62
INTEREST RATE RISK	63
CURRENCY RISK	64
LIQUIDITY RISK, INCLUDING FINANCING RISK	65
COMMODITY PRICES RISK	66
EQUITY SECURITIES PRICES	66
OTHER PRICE RISKS	66
DERIVATIVES RISK	67
OPERATING RISK	68
COMPLIANCE AND CONDUCT RISK	69
BUSINESS (STRATEGIC) RISK	69
REPUTATION RISK	69
MODELS RISK	69
RISK OF MACROECONOMIC CHANGES	69
CAPITAL RISK	69
EXCESSIVE LEVERAGE RISK	69
INSURANCE RISK	69

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

RISK MANAGEMENT OBJECTIVE

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

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

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

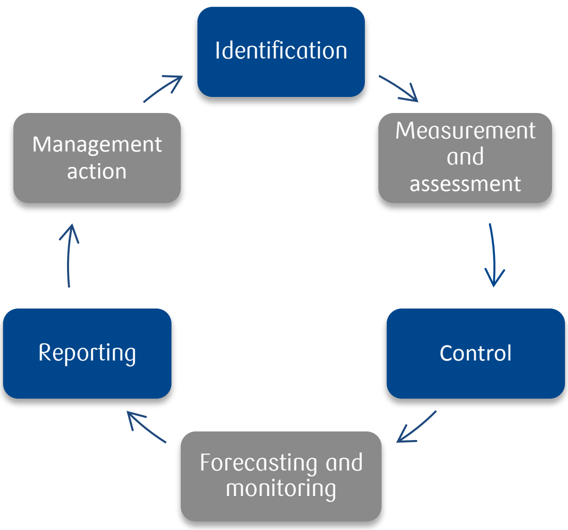
MAIN PRINCIPLES OF RISK MANAGEMENT

The Group's risk management is based, in particular, on the following principles:

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

THE RISK MANAGEMENT PROCESS

The process of risk management in the Group consists of the following stages:



- **RISK IDENTIFICATION:**

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

- **RISK MEASUREMENT AND ASSESSMENT:**

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

- **RISK CONTROL:**

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

- **RISK FORECASTING AND MONITORING:**

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

- **RISK REPORTING:**

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

- **MANAGEMENT ACTIONS:**

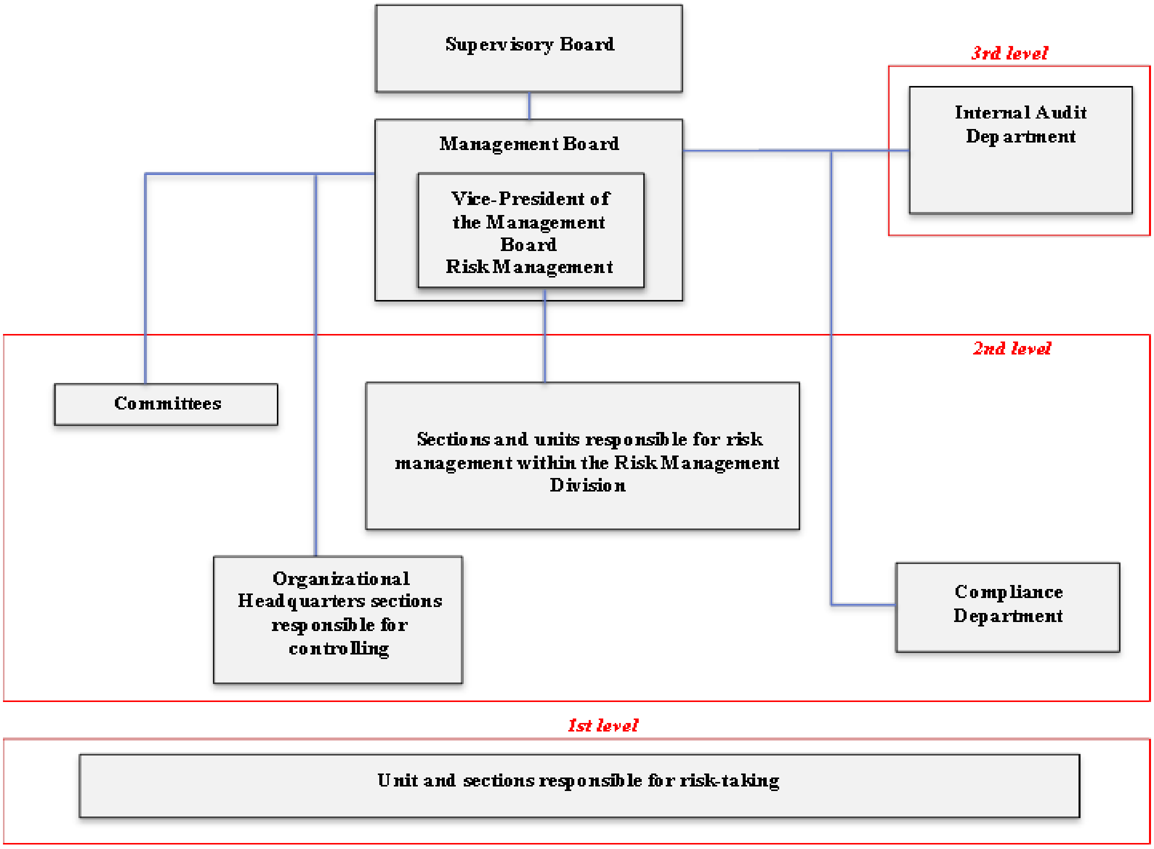
Management actions consist particularly in issuing internal regulations affecting the management processes relating to different types of risk, establishing the level of risk tolerance, establishing limits and thresholds, issuing recommendations, and making decisions, including decisions to use tools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

ORGANIZATION OF RISK MANAGEMENT WITHIN THE GROUP

The Bank supervises the functioning of individual entities in the PKO Bank Polski SA Group. As part of its supervisory role, the Bank monitors their risk management systems and supports their development. In addition, the Bank takes into account the level of risk in particular Group companies for the purposes of the risk monitoring and reporting system at Group level.

Risk management in the Bank takes place in all the Bank's organizational units.

The organization of risk management in PKO Bank Polski SA is presented in the diagram below:



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

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

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

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

THE FIRST LEVEL is formed of organizational structures responsible for product management, executing sales of products and customer servicing, and of other structures which perform risk-generating operating tasks based on the internal regulations of PKO Bank Polski SA. The function is realized in all of the Bank's organizational entities and in all organizational units of the Head Office, as well as in the Group entities. Organizational units of the Head Office implement the appriopriate risk control mechanisms, especially limits, designed by the organizational units of the Head Office in the second level, and ensure their compliance through appriopriate control mechanisms.

At the same time, the Group entities are obliged to have comparable and consistent systems of risk assessment and control, taking into account the specific business characteristic of each entity and the market on which it operates.

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

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

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

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

RISK MANAGEMENT WITHIN THE GROUP

The policies concerning the management of specific risk types in the Bank's Group entities are set out in their internal regulations, implemented by these entities after consulting the Bank's opinion and having taken and taking into account the Bank's recommendations. The internal regulations of the entities of these entities are implemented in accordance with the principles of consistency and comparability of the assessments of individual types of risks in the Bank and in the Bank's Group entities, taking into account the extent and type of relations between the Group entities, the specific characteristics and scale of their operations as well as the markets on which they operate.

The risk management function in the Group entities is executed, in particular, by:

- involving the units from the Bank's Risk Management Area or the Bank's relevant committees in evaluating large transactions in the Group entities;
- giving opinions and reviewing internal regulations concerning risk management in the individual Group entities, being consulted and reviewed by units from the Bank's Risk Management Area;
- reporting of the Group risks to the relevant committees of the Bank or to the Management Board;
- monitoring the strategic limits of risk tolerance for the Group.

SPECIFIC ACTIVITIES IN THE AREA OF RISK MANAGEMENT UNDERTAKEN BY THE GROUP IN 2017

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

To this end, in 2017, the Group replaced its own maturing short-term bonds with short-term bonds amounting to PLN 670 million (in May) and PLN 650 million (in November) and redeemed its own maturing short-term bonds of EUR 200 million (in April).

In 2017, as part of the EMTN programme, the Bank issued: on 25 July 2017 – own bonds of EUR 750 million with a maturity of 4 years and on 2 November 2017, own bonds with a nominal value of CHF 400 million and maturity of 4 years.

On 28 August 2017, the Bank placed an issue of subordinated bonds with a total nominal value of PLN 1 700 million and a maturity of ten years, with the option of early redemption of all the bonds 5 years after the issue date, subject to the consent of the Polish Financial Supervision Authority. On 30 August 2017, the Bank obtained the consent of the Polish Financial Supervision Authority to exercise its right to early redemption (a call option) of subordinated bonds, and on 14 September 2017, the Bank redeemed all of the subordinated bonds in the OP0922 series with a total nominal value of PLN 1 601 million, issued by the Bank on 14 September 2012. The legal basis for early redemption is formed by the terms and conditions of the issuance of series OP0922 subordinated bonds which enable the Bank to exercise the right to redeem all the subordinated bonds in series OP0922 after 5 years from their issue date.

On 21 December 2017, having obtained the necessary corporate consents, the Bank concluded a guarantee agreement with a counterparty ensuring unfunded credit protection with regard to the portfolio for selected corporate loan receivables of the Bank, in accordance with the CRR Regulation. The total value of the Bank's portfolio covered by the Guarantee is PLN 5 495 million, and the portfolio comprises the bond portfolio amounting to PLN 1 097 million and a portfolio of other receivables of PLN 4 398 million.

In 2017, as part of operating risk management, the Bank conducted preparatory work associated with opening a new branch in the Czech Republic. The Branch began operating on 3 April 2017. As part of this work, in February 2017, the Bank obtained the consent of the Polish Financial Supervision Authority to jointly apply an advanced measurement approach (AMA) and basic indicator approach (BIA) to calculate the capital requirement relating to own funds in respect of operating risk using the BIA method to the operations of the Bank's branch in Germany and the Czech Republic, and the AMA approach for the Bank's remaining operations.

Within the Group, the portfolios of mortgage loans originally granted by PKO Bank Polski SA are successively transferred to PKO Bank Hipoteczny SA. The value of the portfolio transferred in 2017 amounted to c. PLN 5,6 billion.

In 2017, PKO Bank Hipoteczny SA conducted three issues of mortgage bonds denominated in PLN addressed to institutional investors with a total nominal value of PLN 1 265 million and redemption period of 4 to 6 years from the date of issue. Both domestic and international institutional investors acquired these mortgage bonds. Mortgage bonds of PKO Bank Hipoteczny SA are among the safest debt instruments on the Polish financial market. This is reflected in the highest possible rating which can be obtained by Polish securities of Aa3 assigned by Moody's.

In 2017, PKO Bank Hipoteczny SA conducted four issues of mortgage bonds denominated in EUR addressed to institutional investors, with a total nominal value of EUR 1 079 million and redemption period of 5 to 7 years from the date of issue. Both domestic and international institutional investors acquired these mortgage bonds.

As a result of the legal merger between PKO Leasing SA and Raiffeisen-Leasing Polska SA (on 28 April 2017), conceptual and implementation work was performed to integrate risk management in the combined PKO Leasing SA Group. In 2017, the works performed included, among other things, harmonizing parts of the internal risk management regulations governing the assumption of the material types of risk (in particular credit risk, market risk and operating risk), and the implementation of new tools for risk measurement and assessment, represented by IT systems also made available to the subsidiaries of PKO Leasing SA.

57. CREDIT RISK MANAGEMENT

DEFINITION

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

RISK MANAGEMENT OBJECTIVE

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

The Bank and the Group subsidiaries are guided mainly by the following credit risk management principles:

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

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

The Group entities which have significant credit risk levels (the KREDOBANK SA Group, the PKO Leasing SA Group, PKO Bank Hipoteczny SA and Finansowa Kompania "Prywatne Inwestycje"' Sp. z o.o.) manage their credit risk individually, but the methods used for credit risk assessment and measurement are adjusted to the methods used by PKO Bank Polski SA, taking into account the specific nature of the activities of these companies.

Any changes to the solutions used by the Group's subsidiaries are agreed every time with the Bank's units responsible for risk management.

The PKO Leasing SA Group, the KREDOBANK SA Group as well as Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. and PKO Bank Hipoteczny SA measure their credit risk regularly and the results of such measurements are submitted to the Bank.

Within the structures of PKO Bank Hipoteczny SA, the KREDOBANK SA Group and the PKO Leasing SA Group, there are organizational units in the risk management areas which are responsible, in particular, for:

- developing methodologies for credit risk assessment, recognition of provisions and allowances,
- controlling and monitoring credit risk during the lending process,
- the quality and efficiency of restructuring and enforcement of the amounts due from clients.

In these companies, the credit decision limits depend primarily on: the amount of the exposure to a given customer; the amount of an individual credit transaction and the period of credit transaction.

The process of credit decision-making in PKO Bank Hipoteczny SA, the KREDOBANK SA Group, the PKO Leasing SA Group is supported by credit committees which are involved in the process for credit transactions which generate an increased credit risk level.

Relevant organizational units of the Risk Management Area participate in managing the credit risk in the Group entities by consulting projects and periodically reviewing the internal regulations of these entities relating to the assessment of credit risk and by making recommendations for amendments to such internal regulations. The Bank supports the implementation of the recommended changes in credit risk assessment policies in the Group entities.

MEASUREMENT AND ASSESSMENT OF CREDIT RISK

• CREDIT RISK MEASUREMENT AND ASSESSMENT METHODS

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

- probability of default (PD),
- expected loss (EL),
- unexpected loss (UL),
- loss given default (LGD),
- credit value at risk (CVaR),
- share and structure of impaired loans,
- coverage ratio of impaired loans with impairment allowances,
- cost of credit risk.

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

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

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

• RATING AND SCORING METHODS

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

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

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

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

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

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

The rating models are implemented in the IT tool which supports the assessment of the Group's credit risk associated with the financing of institutional customers.

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

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

The information on rating and scoring assessments is widely used in the Group to manage credit risk, in the system of credit decision making powers, determining the conditions in which credit risk assessment services are activated and in the credit risk measurement and reporting system.

CREDIT RISK MONITORING

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

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

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

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

Credit risk monitoring at the portfolio level consists of:

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

CREDIT RISK REPORTING

The Group prepares monthly and quarterly credit risk reports. The reporting of credit risk covers cyclic information on the scale of the risk exposure of the loan portfolio. In addition to information for the Bank, the reports also include information on the level of credit risk in the Group entities where a material level of credit risk was identified (e.g. the KREDOBANK SA Group, the PKO Leasing SA Group, PKO Bank Hipoteczny SA).

MANAGEMENT ACTIONS RELATING TO CREDIT RISK

The basic credit risk management tools used by the Group include:

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

USE OF CREDIT RISK MITIGATION TECHNIQUES – COLLATERAL

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

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

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

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

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

(IN PLN MILLION)

When granting loans intended to finance housing and commercial properties, a mortgage is an obligatory type of collateral.

Until an effective protection is established (depending on the type and amount of a loan), the Group can accept temporary collateral in different form.

With regard to consumer loans, usually personal guarantees are used (a civil law surety/guarantee, a bill of exchange) or collateral is established on the customer's bank account, car or securities.

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

When concluding leasing agreements, the PKO Leasing SA Group, as the owner of the leased assets, treats them as collateral.

58. CREDIT RISK – FINANCIAL INFORMATION

Exposure to credit risk
Past due financial assets
Financial assets assessed on an individual basis with a recognized impairment trigger
Internal ratings
External ratings

EXPOSURE TO CREDIT RISK

EXPOSURE TO CREDIT RISK – ITEMS OF THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION	31.12.2017	31.12.2016
Current account with the Central Bank	13 137	9 140
Amounts due from banks	5 233	5 345
Financial assets held for trading - debt securities	405	312
Derivative financial instruments	2 598	2 901
Financial instruments designated at fair value through profit or loss upon initial recognition - debt securities	6 688	12 204
Loans and advances to customers (excluding adjustments relating to fair value hedge accounting)	205 629	200 606
corporate	56 792	52 915
housing	106 191	106 121
consumer	24 590	23 222
debt securities (corporate)	1 855	2 283
debt securities (municipal)	2 513	2 587
receivables in respect of repurchase agreements	902	1 339
finance lease receivables	12 786	12 139
Available-for-sale investment securities - debt securities	43 192	36 142
Investment securities held to maturity	1 812	466
Other assets - other financial assets	2 377	2 247
Total	**281 071**	**269 363**

(IN PLN MILLION)

EXPOSURE TO CREDIT RISK - OFF-BALANCE SHEET ITEMS	31.12.2017	31.12.2016
Irrevocable liabilities granted	33 607	31 078
Guarantees issued	6 065	6 630
Underwriting of securities	2 666	3 701
Letters of credit issued	1 409	1 600
Total	**43 747**	**43 009**

Past due financial assets

FINANCIAL ASSETS PAST DUE BUT NOT IMPAIRED, GROSS	31.12.2017			
	up to 1 month	1 - 3 months	over 3 months	Total
Loans and advances to customers	4 194	900	274	5 368
Other assets - other financial assets	1	-	9	10
Total	**4 195**	**900**	**283**	**5 378**

FINANCIAL ASSETS PAST DUE BUT NOT IMPAIRED, GROSS	31.12.2016			
	up to 1 month	1 - 3 months	over 3 months	Total
Loans and advances to customers	3 535	849	179	4 563
Other assets - other financial assets	-	-	11	11
Total	**3 535**	**849**	**190**	**4 574**

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

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

Financial assets assessed on an individual basis for which individual impairment has been recognized

FINANCIAL ASSETS ASSESSED ON AN INDIVIDUAL BASIS FOR WHICH INDIVIDUAL IMPAIRMENT HAS BEEN RECOGNIZED, AT GROSS CARRYING AMOUNT	31.12.2017	31.12.2016
Loans and advances to customers	4 346	5 049
corporate loans	3 640	3 963
housing loans	505	789
consumer loans	201	224
debt securities	-	73
Available-for-sale investment securities	822	1 297
Total	**5 168**	**6 346**

Loans and advances to customers were secured by the following collateral established for the PKO Bank Polski SA Group: mortgages, registered pledges, debtor's promissory notes and transfers of receivables.

The financial effect of the collateral held in the amount which is the best reflection of the maximum exposure to credit risk as at 31 December 2017 amounted to PLN 2 251 million (PLN 2 801 million as at 31 December 2016).

(IN PLN MILLION)

INTERNAL RATINGS

Taking into consideration the type of the Group's business activity and the volume of credit and leasing debts, the most important portfolios are managed by the Bank and PKO Leasing SA.

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

The following portfolios are covered by the rating system:

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

Loans and advances which are not individually impaired and are not rated, are characterized with a satisfactory level of credit risk. This applies in particular to retail loans (including housing loans) which do not have individually significant exposures and thus do not create significant credit risk.

FINANCIAL ASSETS NOT IMPAIRED, NOT PAST DUE	31.12.2017	31.12.2016
Loans and advances to customers	**196 406**	**191 827**
corporate loans	50 584	47 030
A (first rate)	875	949
B (very good)	5 616	2 065
C (good)	9 575	6 665
D (satisfactory)	9 236	7 205
E (average)	11 205	12 232
F (acceptable)	10 541	14 245
G (poor)	3 536	3 669
consumer and housing loans	119 712	121 434
A (first rate)	105 780	99 924
B (very good)	8 976	8 939
C (good)	3 054	5 481
D (average)	1 216	4 653
E (acceptable)	686	2 437
PKO Leasing SA Group	**4 851**	**8 776**
A (good)	3 281	7 180
B (average)	1 365	768
C (risky)	205	828
without an internal rationg - financial, non-financial and public sector customers (consumer loans, housing loans and other)	21 259	14 587
Debt securities available for sale	**5 147**	**5 088**
A (first rate)	55	12
B (very good)	409	353
C (good)	1 061	712
D (satisfactory)	1 589	1 376
E (average)	1 131	1 462
F (acceptable)	795	1 070
G (poor)	74	63
G3 (low)	33	40
Total	**201 553**	**196 915**

(IN PLN MILLION)

EXTERNAL RATINGS

The structure of debt securities and amounts due from banks which are neither past due nor impaired by external rating classes is presented below:

PORTFOLIO/RATING	AAA	AA- to AA+	A- to A+	BBB- to BBB+	BB- to BB+	B- to B+	CCC- to CCC+	Caa2[1]	31.12.2017
Amounts due from banks	7	1 030	2 340	585	21	4	79	-	**4 066**
Debt securities	132	-	42 713	2 412	630	50	-	384	**46 321**
NBP money market bills	-	-	4 199	-	-	-	-	-	**4 199**
Treasury bonds	-	-	37 763	-	-	-	-	384	**38 147**
municipal bonds	-	-	183	68	42	-	-	-	**293**
corporate bonds	132	-	568	2 344	588	50	-	-	**3 682**
TOTAL	**139**	**1 030**	**45 053**	**2 997**	**651**	**54**	**79**	**384**	**50 387**

[1] This applies to the securities of the KREDOBANK SA Group - according to the Moody's rating

PORTFOLIO/RATING	AAA	AA- to AA+	A- to A+	BBB- to BBB+	BB- to BB+	B- to B+	CCC- to CCC+	Caa3[1]	31.12.2016
Amounts due from banks	24	1 527	2 273	531	21	4	96	-	**4 476**
Debt securities	154	1 426	38 674	1 935	38	49	-	486	**42 762**
NBP money market bills	-	-	9 079	-	-	-	-	-	**9 079**
Treasury bonds	-	-	29 481	-	-	-	-	486	**29 967**
municipal bonds	-	15	114	104	38	-	-	-	**271**
corporate bonds	154	1 411	-	1 831	-	49	-	-	**3 445**
TOTAL	**178**	**2 953**	**40 947**	**2 466**	**59**	**53**	**96**	**486**	**47 238**

[1] This applies to the securities of the KREDOBANK SA Group – according to the Moody's rating

59. CONCENTRATION OF CREDIT RISK AT THE GROUP

The Group defines credit concentration risk as the risk arising from a considerable exposure to single entities or groups of entities whose repayment capacity depends on a common risk factor. The Group analyses the risk of concentration towards:

- the largest entities;
- the largest groups;
- industry sectors;
- geographical regions;
- currencies;
- exposures secured with a mortgage.

(IN PLN MILLION)

CONCENTRATION BY THE LARGEST ENTITIES

The Polish Banking Law sets the limits of the maximum exposure of the Bank which are translated to the Group. The concentration risk of exposures to individual customers and groups of related customers is monitored in accordance with Regulation of the European Parliament and the Council (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms (CRR), according to which the Group shall not assume an exposure to a customer or a group of related customers whose value exceeds 25% of the value of its recognized capital.

As at 31 December 2017 and 31 December 2016, concentration limits were not exceeded. As at 31 December 2017, the largest exposure to a single entity accounted for 8.6% of the recognized consolidated capital (10.4% as at 31 December 2016).

The Group's exposure to the 20 largest non-banking customers:

31.12.2017			31.12.2016		
No.	CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[1]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES	No.	CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[1]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES
1.	2 936	1,06%	1.	3 200	1,16%
2.	2 856	1,03%	2.	2 887	1,05%
3.	2 450	0,88%	3.	2 450	0,89%
4.	2 332	0,84%	4.	2 371	0,86%
5.	1 895	0,68%	5.	2 065	0,75%
6.	1 747	0,63%	6.	1 583	0,57%
7.	1 602	0,58%	7.	1 571	0,57%
8.	1 566	0,56%	8.	1 482	0,54%
9.	1 322	0,48%	9.	1 435	0,52%
10.	1 101	0,40%	10.	1 081	0,39%
11.	819	0,30%	11.	992	0,36%
12.	796	0,29%	12.	956	0,35%
13.	746	0,27%	13.	883	0,32%
14.	724	0,26%	14.	872	0,32%
15.	708	0,26%	15.	828	0,30%
16.	682	0,25%	16.	774	0,28%
17.	655	0,24%	17.	761	0,28%
18.	650	0,23%	18.	705	0,26%
19.	636	0,23%	19.	672	0,24%
20.	566	0,20%	20.	618	0,22%
Total	**26 789**	**9,66%**	**Total**	**28 184**	**10,21%**

[1] off-balance sheet exposure includes the liability arising from derivative transactions in the amount equal to their balance sheet equivalent.

(IN PLN MILLION)

CONCENTRATION BY THE LARGEST GROUPS

The largest concentration of the PKO Bank Polski SA's Group's exposure to a group of related borrowers amounted to 1.13% of the Group's loan portfolio (1.14% as at 31 December 2016). Only the clients of PKO Bank Polski SA are included in the five largest group.

As at 31 December 2017, the largest concentration of the Group's exposure amounted to 9.2% of the recognized capital (10.2% as at 31 December 2016).

The Group's exposure to the 5 largest capital groups

31.12.2017			31.12.2016		
No.	CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[1]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES	No.	CREDIT EXPOSURES INCLUDE LOANS, ADVANCES, PURCHASED DEBT, DISCOUNTED BILL OF EXCHANGE, REALIZED GUARANTEES, INTEREST RECEIVABLES AND OFF-BALANCE SHEET AND CAPITAL EXPOSURES[1]	SHARE IN THE LOAN PORTFOLIO, INCLUDING OFF-BALANCE SHEET AND CAPITAL EXPOSURES
1.	3 122	1,13%	1.	3 160	1,14%
2.	3 064	1,11%	2.	2 468	0,89%
3.	2 336	0,84%	3.	2 396	0,87%
4.	2 169	0,78%	4.	2 118	0,77%
5.	1 989	0,72%	5.	2 091	0,76%
Total	**12 680**	**4,57%**	**Total**	**12 233**	**4,43%**

[1] off-balance sheet exposure includes the liability arising from derivative transaction in the amount equal to their balance sheet equivalent.

CONCENTRATION BY INDUSTRY

An increase in the Group's exposure to entities conducting economic activity is observed. The structure of the Group's exposure to industry sectors is dominated by entities operating in the Financial and insurance activities section.

The structure of exposure to industry sectors as at 31 December 2017 and 31 December 2016 is presented in the table below:

SYMBOL	SECTION NAME	31.12.2017		31.12.2016	
		EXPOSURE	NUMBER OF ENTITIES	EXPOSURE	NUMBER OF ENTITIES
K	Financial and insurance activities	15,01%	2,07%	14,57%	2,07%
C	Industrial processing	14,76%	11,31%	14,90%	11,35%
L	Real estate administration	10,61%	16,61%	12,54%	17,09%
G	Wholesale and retail trade, repair of motor vehicles	12,82%	23,33%	12,67%	23,74%
O	Public administration and national defence, obligatory sc	12,56%	0,32%	13,23%	0,36%
Other exposures		34,24%	46,36%	32,09%	45,38%
Total		**100,00%**	**100,00%**	**100,00%**	**100,00%**

The structure by industry presented above excludes the exposure arising from debt securities reclassified from 'available-for-sale' to 'loans and advances to customers'.

(IN PLN MILLION)

CONCENTRATION BY GEOGRAPHICAL REGIONS

The Group's loan portfolio is diversified in terms of geographical concentration.

The structure of the loan portfolio by geographical regions is identified by the Group depending on the customer area – it is different for the Retail Market Area (ORD) and for the Corporate and Investment Banking Area (OKI).

In 2017, the largest concentration of the ORD loan portfolio was in the Warsaw region (warszawski) and Katowice region (katowicki) - these two regions account for around 26% of the total ORD portfolio(25% as at 31 December 2016.

CONCENTRATION OF CREDIT RISK BY GEOGRAPHICAL REGION FOR RETAIL CUSTOMERS	31.12.2017	31.12.2016
warszawski	15,09%	14,35%
katowicki	10,98%	10,82%
poznański	9,85%	9,85%
krakowski	8,94%	9,06%
łódzki	8,36%	8,76%
wrocławski	9,30%	9,15%
gdański	8,50%	8,64%
bydgoski	7,17%	7,43%
lubelski	6,90%	6,87%
białostocki	6,45%	6,42%
szczeciński	6,11%	6,17%
Head Office	0,81%	0,83%
other	0,76%	0,84%
foreign countries	0,78%	0,81%
Total	**100,00%**	**100,00%**

In 2017, the largest concentration of the OKI loan portfolio was in the central macroregion which accounted for 44% of the OKI portfolio (28% as at 31 December 2016).

CONCENTRATION OF CREDIT RISK BY GEOGRAPHICAL REGION FOR CORPORATE CUSTOMERS	31.12.2017	31.12.2016[1]
Head Office	0,28%	0,33%
central macroregion	44,09%	39,82%
northern macroregion	10,69%	12,32%
western macroregion	10,99%	12,16%
southern macroregion	10,08%	11,81%
south-eastern macroregion	11,60%	10,28%
north-eastern macroregion	4,99%	5,55%
south-western macroregion	6,59%	7,49%
other	0,00%	0,00%
foreign countries	0,69%	0,24%
Total	**100,00%**	**100,00%**

[1] The change in comparable data for 2016 relating to geographical concentration is due to a change in the algorithm used to attribute geographical location to the Head Office region.

CONCENTRATION OF CREDIT RISK BY CURRENCY

As at 31 December 2017, the share of exposure in convertible currencies other than PLN in the entire Group's portfolio amounted to 19.2%, which represents a decrease of approx. 5.0 p.p. compared with 31 December 2016.

Exposures in CHF relating to the Bank's loan portfolio represent the largest part of the Group's currency exposure. The share of loans in CHF accounted for approx. 57% of the Group's loan portfolio as at the end of 2017, which represents a decrease of approx. 2 p.p. compared with the end of 2016. Loans in EUR are the second largest group of loans denominated in foreign currencies. As at the end of 2017, their share in the entire loan portfolio was 7%, and 36% in the foreign currency portfolio.

(IN PLN MILLION)

CONCENTRATION OF CREDIT RISK BY CURRENCY	31.12.2017	31.12.2016
PLN	80,77%	75,77%
Foreign currencies, of which:	19,23%	24,23%
CHF	10,94%	14,28%
EUR	6,92%	8,28%
USD	0,88%	1,10%
UAH	0,39%	0,38%
GBP	0,04%	0,04%
Total	**100,00%**	**100,00%**

OTHER TYPES OF CONCENTRATION

The Group analyses the structure of its housing loan portfolio by LTV levels. Both in 2017 and in 2016, the largest concentration was in the LTV range of 61%–80%.

LOAN PORTFOLIO STRUCTURE BY LTV	31.12.2017	31.12.2016
0% - 40%	19,07%	16,53%
41%-60%	22,72%	19,01%
61% - 80%	33,80%	27,30%
81% - 90%	16,21%	17,52%
91% - 100%	4,02%	9,10%
powyżej 100%	4,18%	10,53%
Total	**100,00%**	**100,00%**

In accordance with recommendations S and T of the Polish Financial Supervision Authority, the Group applies internal limits associated with the loan exposures of the Group's customers which determine the appetite for credit risk.

As at 31 December 2017 amounted to 62.38% , and as at 31 December 2016 it amounted to 69.48%.

60. FORBEARANCE PRACTICES

Forbearance is defined by the Group as actions aimed at amending the contractual terms agreed with a debtor or an issuer, forced by the debtor's or issuer's difficult financial situation (restructuring activities introducing concessions that otherwise would not have been granted). The aim of forbearance activities is to restore a debtor's or an issuer's ability to settle their liabilities towards the Group and to maximize the efficiency of managing non-performing loans, i.e. obtaining the highest possible recoveries while minimizing the costs incurred.

Forbearance consists in amending repayment terms which are agreed individually for each agreement. Such changes may consist in:

- dividing the debt due into instalments;
- changing the repayment scheme (fixed payments, degressive) payments);
- extending the loan period;
- changing interest rate;
- changing the margin;
- reducing the debt.

As a result of signing and repaying the amounts due under the forbearance agreement on a timely basis, a non-performing loan becomes performing. The forbearance process also involves evaluating the debtor's capacity to meet the terms of the settlement agreement on a timely basis (repayment of the debt at agreed dates). Forbearance agreements are monitored on an on-going basis. If impairment is recognized in relation to the related credit exposures, impairment allowances are recognized to reflect the impairment loss identified.

Forborne exposures classified as non-performing are included in the portfolio of performing exposures when the following conditions are met simultaneously:

- a receivable does not meet the condition of an individual impairment trigger and there is no impairment recognized;
- at least 12 months have passed from the conclusion of the restructuring agreement;
- the entire debt is covered by the restructuring agreement;

(IN PLN MILLION)

- the debtor demonstrated the capacity to fulfil the terms of the restructuring agreement.

Exposures cease to meet the criteria of a forborne exposure when all of the following conditions are met:

- at least 24 months have passed from the date of including the exposure in the portfolio of performing exposures (conditional period;
- as at the end of the conditional period referred to above, the customer has no debt towards the Group overdue for more than 30 days;
- at least 12 instalments have been repaid on a timely basis and in the amounts agreed.

LOANS AND ADVANCES TO CUSTOMERS

EXPOSURES SUBJECT TO FORBEARANCE IN THE LOAN PORTFOLIO	31.12.2017	31.12.2016
Loans and advances to customers, gross, of which:	213 452	208 609
subject to forbearance	4 137	4 132
Impairment allowances on loans and advances to customers, of which:	(7 823)	(8 003)
subject to forbearance	(1 083)	(988)
Loans and advances to customers, net, of which:	**205 629**	**200 606**
subject to forbearance	**3 054**	**3 144**

LOANS AND ADVANCES TO CUSTOMERS SBJECT TO FORBEARANCE BY PRODUCT TYPE	CARRYING AMOUNT	
	31.12.2017	31.12.2016
Loans and advances to customers subject to forbearance, gross	**4 137**	**4 132**
corporate loans	2 431	2 262
housing loans	1 416	1 563
consumer loans	290	307
Impairment allowances on loans and advances to customers subject to forbearance	**(1 083)**	**(988)**
Loans and advances to customers subject to forbearance, net	**3 054**	**3 144**

LOANS AND ADVANCES TO CUSTOMERS SBJECT TO FORBEARANCE, GROSS BY GEOGRAPHICAL REGION	31.12.2017	31.12.2016
Poland	4 085	4 063
mazowiecki	1 040	700
wielkopolski	346	382
śląsko-opolski	441	497
małopolsko-świętokrzyski	289	323
pomorski	269	303
podlaski	197	278
łódzki	321	314
dolnośląski	299	308
kujawsko-pomorski	386	377
zachodnio-pomorski	257	337
lubelsko-podkarpacki	230	219
warmińsko-mazurski	9	25
Ukraine	52	69
Total	**4 137**	**4 132**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE - THE GROUP'S EXPOSURE TO CREDIT RISK	EXPOSURE BY CARRYING AMOUNT, GROSS	
	31.12.2017	31.12.2016
Loans and advances impaired	2 229	2 250
Loans and advances not impaired, of which:	1 908	1 882
not past due	1 590	1 520
past due	318	362
Total, gross	**4 137**	**4 132**

Change in carrying amounts of loans and advances to customers subject to forbearance at the beginning and end of the period.

CHANGE IN CARRYING AMOUNTS OF LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE AT THE BEGINNING AND END OF THE PERIOD	2017	2016
Carrying amount as at the beginning of the period, net	3 144	4 548
Impairment allowance	(95)	19
Gross book value of loans and advances which ceased to meet the forbearance criteria during the period	(700)	(1 990)
New loans and advances recognized in the period, gross	1 380	1 084
Other changes/repayment	(662)	(514)
Foreign exchange differences	(13)	(3)
Carrying amount as at the end of the period, net	**3 054**	**3 144**

LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO FORBEARANCE BY TYPE OF CHANGES IN TERMS OF REPAYMENT	CARRYING AMOUNT, GROSS	
	31.12.2017	31.12.2016
Dividing the debt due into instalments	2 365	2 745
Change in the repayment scheme (fixed payments, degressive)	1 671	1 867
Extension of the loan period	1 700	1 431
Change in interest rate	772	600
Change in margin	896	536
Debt reduction	150	114
Other terms	72	81

More than one change in the terms and condition of repayment may be applied to a forborne exposure.

The amount of recognized interest income on forborne loans and advances to customers for the period ended 31 December 2017 amounted to PLN 141 million (PLN 161 million for the period ended 31 December 2016).

(IN PLN MILLION)

AVAILABLE-FOR-SALE INVESTMENT SECURITIES SUBJECT TO FORBEARANCE

EXPOSURES SUBJECT TO FORBEARANCE IN THE PORTFOLIO OF AVAILABLE-FOR-SALE INVESTMENT SECURITIES	31.12.2017	31.12.2016
Available-for-sale debt securities, gross, of which	43 441	36 419
subject to forbearance	1 050	1 303
Impairment allowances on available-for-sale investment securities, of which:	(249)	(277)
subject to forbearance	(246)	(274)
Available-for-sale investment securities, net, of which:	**43 192**	**36 142**
subject to forbearance	**804**	**1 029**

AVAILABLE-FOR-SALE INVESTMENT SECURITIES SUBJECT TO FORBEARANCE – THE GROUP'S EXPOSURE TO CREDIT RISK	EXPOSURE BY CARRYING AMOUNT, GROSS	
	31.12.2017	31.12.2016
Available-for-sale investment securities, impaired	819	1 303
Available-for-sale investment securities, not impaired	231	-
Total, gross	**1 050**	**1 303**

CHANGE IN CARRYING AMOUNTS OF AVAILABLE-FOR-SALE INVESTMENT SECURITIES SUBJECT TO FORBEARANCE AT THE BEGINNING AND END OF THE PERIOD	2017	2016
Carrying amount as at the beginning of the period, net	1 029	350
Impairment allowance (change during the period)	28	(221)
New available-for-sale investment securities recognized in the period, gross	-	900
Other changes/repayment	(253)	-
Carrying amount as at the end of the period, net	**804**	**1 029**

INVESTMENT SECURITIES SUBJECT TO FORBEARANCE, GROSS, BY TYPE OF CHANGES IN REPAYMENT TERMS	Carrying amount, gross	
	31.12.2017	31.12.2016
Dividing the debt due into instalments	1 050	1 204
Change of the repayment scheme	1 050	716
Extension of the loan period;	1 050	716
Change in interest rate	819	716
Change in margin	819	716
Debt reduction	133	129

(IN PLN MILLION)

61. EXPOSURE TO THE COUNTERPARTY CREDIT RISK

CREDIT RISK OF FINANCIAL INSTITUTIONS ON THE WHOLESALE MARKET

CONCENTRATION OF CREDIT RISK – INTERBANK MARKET – EXPOSURE TO INTERBANK MARKET AS AT 31.12.2017[1]

Counterparty	COUNTRY	RATING	TYPE OF INSTRUMENT			TOTAL
			INVESTMENT (NOMINAL VALUE)	DERIVATIVES (MARKET VALUE, EXCLUDING COLLATERAL IF POSITIVE)	SECURITIES (NOMINAL VALUE)	
Counterparty 1	Belgium	BBB	692	(6)	-	692
Counterparty 2	Germany	AA	592	-	-	592
Counterparty 3	Belgium	A	480	-	-	480
Counterparty 4	Poland	A	-	-	400	400
Counterparty 5	Austria	BBB	396	-	-	396
Counterparty 6	China	A	332	-	-	332
Counterparty 7	Supranational institution	AAA	170	16	130	316
Counterparty 8	Sweden	AA	190	84	-	274
Counterparty 9	Austria	A	209	-	-	209
Counterparty 10	France	A	-	171	-	171
Counterparty 11	Poland	A	-	-	150	150
Counterparty 12	UK	AA	-	120	-	120
Counterparty 13	US	A	115	-	-	115
Counterparty 14	US	AA	-	103	-	103
Counterparty 15	France	A	-	88	-	88
Counterparty 16	Poland	BBB	10	44	-	54
Counterparty 17	Denmark	A	50	(3)	-	50
Counterparty 18	Poland	A	-	47	-	47
Counterparty 19	Germany	BBB	-	42	-	42
Counterparty 20	Germany	A	-	29	-	29

[1] Excluding exposures to the State Treasury and the National Bank of Poland

(IN PLN MILLION)

CONCENTRATION OF CREDIT RISK – INTERBANK MARKET – EXPOSURE TO INTERBANK MARKET AS AT 31.12.2016[1]

Counterparty	COUNTRY	RATING	TYPE OF INSTRUMENT			TOTAL
			INVESTMENT (NOMINAL VALUE)	DERIVATIVES (MARKET VALUE, EXCLUDING COLLATERAL IF POSITIVE)	SECURITIES (NOMINAL VALUE)	
Counterparty 4	Poland	A	-	-	900	900
Counterparty 69	Switzerland	AA	494	-	-	494
Counterparty 1	Belgium	BBB	398	7	-	405
Counterparty 70	Switzerland	AA	397	-	-	397
Counterparty 6	Luxembourg	A	323	-	-	323
Counterparty 5	Austria	BBB	288	-	-	288
Counterparty 71	Norway	A	167	-	-	167
Counterparty 7	Luxembourg	AAA	-	(19)	155	155
Counterparty 14	US	AA	-	132	-	132
Counterparty 72	UK	A	-	110	-	110
Counterparty 18	Poland	A	100	(36)	-	100
Counterparty 16	Poland	BBB	-	65	-	65
Counterparty 20	Germany	A	-	45	-	45
Counterparty 40	UK	A	-	40	-	40
Counterparty 25	France	A	-	38	-	38
Counterparty 73	Poland	BB	-	34	-	34
Counterparty 23	Poland	NONE	20	1	-	21
Counterparty 56	Poland	BB	-	12	-	12
Counterparty 49	UK	AAA	-	10	-	10
Counterparty 29	Poland	BBB	-	10	-	10

[1] Excluding exposures to the State Treasury and the National Bank of Poland

As at 31 December 2017 and 31 December 2016, the Group had access to two clearing houses (as an indirect participant in one, and as a direct participant in the other) through which the Bank settled interest rate derivatives referred to in the EMIR Regulation (Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, including the related delegated and executive regulations) with selected domestic and foreign counterparties. In nominal terms, the share of transactions cleared centrally was 70% of the entire IRS/OIS portfolio, and in the case of FRA, all transactions were submitted for clearing to clearing houses.

As at 31 December 2017, the Group had framework agreements under the ISDA/ZBP standard signed with 22 domestic banks and 66 foreign banks and credit institutions, and CSA/ZBP collateral agreements with 21 domestic banks and 64 foreign banks and credit institutions. In addition, the Group was a party to 27 repo agreements (under the GMRA/ZBP standard). As at 31 December 2016, the Group had framework agreements under the ISDA/ZBP standard signed with 23 domestic banks and 62 foreign banks and credit institutions, and CSA/ZBP collateral agreements with 21 domestic banks and 52 foreign banks and credit institutions. In addition, the Group was a party to 22 repo agreements (under the GMRA/ZBP standard).

(IN PLN MILLION)

CREDIT RISK OF FINANCIAL INSTITUTIONS ON THE NON-WHOLESALE MARKET

In addition to the interbank market exposure, as at 31 December 2017 and 31 December 2016, the Group had an exposure to financial institutions on the non-wholesale market (e.g. loans granted, bonds purchased outside the interbank market).

The structure of exposures exceeding PLN 10 million is presented in the table below:

2017	Nominal exposure		Country of the counterparty's registered office
	balance sheet	off-balance sheet	
Counterparty 22	44	-	Poland
Counterparty 21	50	-	Poland
Counterparty 8	27	25	Sweden
Counterparty 14	-	60	US

For comparison, the structure of exposure over PLN 10 million as at 31 December 2016 is presented in the table below:

2016	Nominal exposure		Country of the counterparty's registered office
	balance sheet	off-balance sheet	
Counterparty 4	500	-	Poland
Counterparty 22	89	-	Poland
Counterparty 21	50	-	Poland
Counterparty 8	-	20	Denmark
Counterparty 14	-	60	US

62. RISK MANAGEMENT OF FOREIGN CURRENCY RISK ASSOCIATED WITH MORTGAGE LOANS FOR HOUSEHOLDS

The Group analyses its portfolio of foreign currency mortgage loans to households in a specific manner. The Group monitors the quality of the portfolio on an on-going basis and reviews the risk of deterioration in the quality of the portfolio. Currently, the quality of the portfolio is at an acceptable level. The Group takes into consideration the risk of foreign currency mortgage loans for households in the capital adequacy and own fund management.

The tables below present an analysis of the quality of loans denominated in CHF.

LOANS AND ADVANCES TO CUSTOMERS IN CHF BY METHOD OF CALCULATING IMPAIRMENT ALLOWANCES (translated into PLN at the exchange rate of 1 CHF = 3.5672)	31.12.2017			
	Financial institutions	Corporates	Households	Total
Assessed on an individual basis, of which:	-	113	102	215
impaired	-	104	90	194
Assessed on a portfolio basis, impaired	-	17	1 041	1 058
Assessed on a group basis (IBNR)	2	270	23 277	23 549
Loans and advances to customers, gross	**2**	**400**	**24 420**	**24 822**
Impairment allowances on exposures assessed on an individual basis, of which:	-	(51)	(42)	(93)
impaired	-	(51)	(42)	(93)
Impairment allowances on exposures assessed on a portfolio basis	-	(14)	(749)	(763)
Impairment allowances on exposures assessed on a group basis (IBNR)	-	(3)	(49)	(52)
Total impairment allowances on exposures	**-**	**(68)**	**(840)**	**(908)**
Loans and advances to customers, net	**2**	**332**	**23 580**	**23 914**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS IN CHF BY METHOD OF CALCULATING IMPAIRMENT ALLOWANCES (translated into PLN at the exchange rate of 1 CHF = 4.1173)	31.12.2016			
	Financial institutions	Corporates	Households	Total
Assessed on an individual basis, of which:	-	247	166	413
impaired	-	220	137	357
Assessed on a portfolio basis, impaired	-	26	1 184	1 210
Assessed on a group basis (IBNR)	5	361	29 361	29 727
Loans and advances to customers, gross	**5**	**634**	**30 711**	**31 350**
Impairment allowances on exposures assessed on an individual basis, of which:	-	(90)	(64)	(154)
impaired	-	(63)	(64)	(127)
Impairment allowances on exposures assessed on a portfolio basis	-	(19)	(793)	(812)
Impairment allowances on exposures assessed on a group basis (IBNR)	-	(2)	(70)	(72)
Total impairment allowances on exposures	**-**	**(111)**	**(927)**	**(1 038)**
Loans and advances to customers, net	**5**	**523**	**29 784**	**30 312**

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR)	31.12.2017		
	PLN	CHF	Other currencies
Loans and advances to customers, gross	162 281	23 549	14 848
past due	3 715	512	830
not past due	158 566	23 037	14 018
Impairment allowances on exposures assessed on a group basis (IBNR)	(518)	(52)	(150)
past due	(138)	(27)	(11)
not past due	(380)	(25)	(139)
Loans and advances to customers, net	**161 763**	**23 497**	**14 698**

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR)	31.12.2016		
	PLN	CHF	Other currencies
Loans and advances to customers, gross	147 632	29 727	17 516
past due	3 149	658	510
not past due	144 483	29 069	17 006
Impairment allowances on exposures assessed on a group basis (IBNR)	(457)	(72)	(100)
past due	(147)	(35)	(11)
not past due	(310)	(37)	(89)
Loans and advances to customers, net	**147 175**	**29 655**	**17 416**

(IN PLN MILLION)

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR) SUBJECT TO FORBEARANCE, BY CURRENCY	31.12.2017		
	PLN	CHF	Other currencies
Loans and advances to customers subject to forbearance, gross	1 055	397	232
Impairment allowances on exposures assessed on a group basis (IBNR) subject to forbearance	(57)	(14)	(5)
Loans and advances to customers subject to forbearance, net	**998**	**383**	**227**

LOANS AND ADVANCES TO CUSTOMERS ASSESSED ON A GROUP BASIS (IBNR) SUBJECT TO FORBEARANCE, BY CURRENCY	31.12.2016		
	PLN	CHF	Other currencies
Loans and advances to customers subject to forbearance, gross	941	557	162
Impairment allowances on exposures assessed on a group basis (IBNR) subject to forbearance	(33)	(21)	(7)
Loans and advances to customers subject to forbearance, net	**908**	**536**	**155**

As at 31 December 2017, the average LTV for the portfolio of CHF-denominated loans amounted to 67.00% (82.7% as at 31 December 2016) compared with the average LTV for the entire loan portfolio of 62.38% (69.5% as at 31 December 2016).

63. Interest rate risk management

Interest rate risk management
Financial information:
Repricing gap
Sensitivity measures

Interest rate risk management

Definition

Interest rate risk is a risk of losses being incurred on the Group's balance sheet and off-balance sheet items sensitive to interest rate fluctuations, as a result of changes in the market interest rates.

Risk management objective

To reduce the potential losses resulting from market interest rate fluctuations to an acceptable level by properly shaping the structure of balance sheet and off-balance sheet items.

Risk identification and measurement

The Group uses the following measures of interest rate risk: interest income sensitivity, economic value sensitivity, value at risk (VaR), stress tests and repricing gaps.

Risk control

Control over interest rate risk consists in determining the interest rate risk limits and thresholds tailored to the scale and complexity of the Group's operations, in particular the strategic limit of tolerance to interest rate risk.

Risk forecasting and monitoring

The following measures are monitored by the Group on a regular basis:

- the levels of interest rate risk measures;
- utilization of the strategic limit of tolerance to interest rate risk;
- utilization of internal limits and thresholds of interest rate risk.

Reporting

Reports on interest rate risk are prepared on a daily, weekly, monthly and quarterly basis.

Management actions

The main tools for interest rate risk management used by the Group are: interest rate risk management procedures, interest rate risk limits and thresholds.

The Group established limits and thresholds for interest rate risk comprising, among other things, of the following: interest income sensitivity, sensitivity of the economic value and losses.

Financial information

Repricing gap

The repricing gap shows the difference between the present value of assets and liabilities exposed to interest rate risk which are repriced in a given time range, with the items recognized on the transaction date.

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
PLN (in PLN million)								31.12.2017
The Group - Periodic gap	53 418	37 380	(12 316)	(14 757)	(14 560)	(27 570)	4 247	25 842
The Group - Cumulative gap	53 418	90 798	78 482	63 725	49 165	21 595	25 842	-
PLN (in PLN million)								31.12.2016
The Group - Periodic gap	57 495	15 015	(16 037)	(7 719)	(12 247)	(25 600)	5 938	16 845
The Group - Cumulative gap	57 495	72 510	56 473	48 754	36 507	10 907	16 845	-

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
USD (in USD million)								31.12.2017
The Group - Periodic gap	841	(347)	(445)	(84)	12	(109)	1	(131)
The Group - Cumulative gap	841	494	49	(35)	(23)	(132)	(131)	-
USD (in USD million)								31.12.2016
The Group - Periodic gap	731	(829)	(159)	104	175	8	(123)	(93)
The Group - Cumulative gap	731	(98)	(257)	(153)	22	30	(93)	-

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
EUR (in EUR million)								31.12.2017
The Group - Periodic gap	3 866	(1 794)	(803)	(548)	(888)	141	18	(8)
The Group - Cumulative gap	3 866	2 072	1 269	721	(167)	(26)	(8)	-
EUR (in EUR million)								31.12.2016
The Group - Periodic gap	2 641	(960)	(611)	(117)	(132)	(834)	70	57
The Group - Cumulative gap	2 641	1 681	1 070	953	821	(13)	57	-

Repricing gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
CHF (in CHF million)								31.12.2017
The Group - Periodic gap	289	866	75	(83)	(216)	(2)	(590)	339
The Group - Cumulative gap	289	1 155	1 230	1 147	931	929	339	-
CHF (in CHF million)								31.12.2016
The Group - Periodic gap	119	2 962	159	(1 839)	2	(325)	(677)	401
The Group - Cumulative gap	119	3 081	3 240	1 401	1 403	1 078	401	-

As at the end of 2017 and 2016, the Group had a positive cumulative gap in PLN in all the time horizons.

SENSITIVITY MEASURES

The PKO Bank Polski SA Group's exposure to interest rate risk remained within the adopted limits as at 31 December 2017 and 31 December 2016. The Group was mainly exposed to PLN interest rate risk. Among all the stress tests performed by the Group involving a parallel shift of interest rate curves, the most unfavourable for the Group was the scenario of a parallel shift of interest rate curves in PLN.

Interest rate risk generated by the Group companies did not materially affect the interest rate risk of the entire Group and therefore did not change its risk profile significantly.

The Bank's VaR and a stress-test analysis of the Group's exposure to interest rate risk are presented in the table below:

SENSITIVITY MEASURE	31.12.2017	31.12.2016
VaR for a 10-day time horizon at the confidence level of 99% (in PLN million)[1]	301	269
Parallel movement of interest rate curves by 200 b.p. (in PLN million) (stress-test)[2]	2 150	2 059

1 Taking into account the nature of the operation of the other Group companies which generate material interest rate risk and the specific characteristics of the market in which they operate, the Group does not determine the consolidated VaR sensitivity measure. Such companies use their own risk measures to manage their interest rate risk. KREDOBANK SA applies the 10-day VaR for interest rates in the main currencies; as at 31 December 2017 it amounted to approx PLN 10 million and as at 31 December 2016, to PLN 9 million.

2 The table presents the value of the most adverse stress-test scenario: a movement of interest rate curves in particular currencies by 200 b.p. upwards and by 200 b.p. downwards.

As at 31 December 2017, the Bank's interest rate VaR for a 10-day time horizon (10-day VaR) amounted to PLN 302 million, and as at 31 December 2016, the Bank's VaR amounted to PLN 269 million.

64. CURRENCY RISK MANAGEMENT

CURRENCY RISK MANAGEMENT

DEFINITION

Currency risk is the risk of incurring losses due to unfavourable fluctuations in the exchange rate. The risk is generated by maintaining open currency positions in various foreign currencies.

RISK MANAGEMENT OBJECTIVE

To reduce the potential losses resulting from exchange rate fluctuations to an acceptable level by properly shaping the currency structure of balance sheet and off-balance sheet items.

RISK IDENTIFICATION AND MEASUREMENT

The group uses the following measures of the currency risk: value-at-risk (VaR) and stress tests.

RISK CONTROL

Control over currency risk consists in determining currency risk limits and thresholds tailored to the scale and complexity of the Group's operations, in particular the strategic limit of tolerance to currency risk.

RISK FORECASTING AND MONITORING

The following measures are monitored by the Group on a regular basis:
- the level of currency risk measures;
- utilization of the strategic limit of tolerance to currency risk;
- utilization of internal limits and thresholds of currency risk.

REPORTING

Reports on currency risk are prepared on a daily, weekly, monthly and quarterly basis.

MANAGEMENT ACTIONS

The main tools for currency risk management used by the Group are:
- currency risk management procedures;
- currency risk limits and thresholds;
- defining allowable types of foreign currency transactions and the exchange rates used in such transactions.

The Group has set limits and thresholds for currency risk for among other things: currency positions. Value at Risk calculated for a 10-day time horizon and daily loss on the currency market.

(IN PLN MILLION)

FINANCIAL INFORMATION

SENSITIVITY MEASURES

The Bank's VaR and a stress-test analysis of the Bank's exposure to currency risk, presented cumulatively for all currencies, are presented in the table below:

SENSITIVITY MEASURE	31.12.2017	31.12.2016
VaR for a 10-day time horizon at the confidence level of 99%[1]	3	10
Change in CUR/PLN by 20% (stress-test)[2]	48	25

[1] Taking into account the nature of the operation of the other Group companies which generate material currency risk and the specific characteristics of the market in which they operate, the Group does not determine the consolidated VaR sensitivity measure. Such companies use their own risk measures to manage their interest rate risk. KREDOBANK SA applies the 10-day VaR which amounted to PLN 0.1 million as at 31 December 2017 and to PLN 0,4 million as at 31 December 2016.

[2] The table presents the value of the most adverse stress-test scenario: PLN appreciation by 20% and PLN depreciation by 20%.

FOREIGN CURRENCY POSITION

The Group's foreign currency positions are presented in the table below:

FOREIGN CURRENCY POSITION	31.12.2017	31.12.2016
EUR	(157)	(170)
USD	(28)	30
CHF	8	(36)
GBP	11	9
Other (Global, Net)	61	89

Currency positions (in addition to volatility of foreign exchange rates) are a key factor determining the level of currency risk to which the Group is exposed. The foreign currency positions is determined by all foreign currency transactions concluded, both in the statement of financial position and off-balance sheet transactions. The Bank's exposure to currency risk is low.

(IN PLN MILLION)

CURRENCY STRUCTURE

	Foreign currencies translated into PLN as at 31.12.2017				
	PLN	EUR	CHF	Other	Total
Cash and cash balances with the Central Bank	16 491	733	78	508	17 810
Amounts due from banks	1 020	2 282	16	1 915	5 233
Financial assets held for trading, excluding derivative financial instruments	292	137	-	2	431
Derivative financial instruments	2 442	117	2	37	2 598
Financial instruments designated at fair value through profit or loss upon initial recognition	6 920	274	893	70	8 157
Loans and advances to customers	166 395	12 842	23 914	2 477	205 628
Available-for-sale investment securities	42 582	595	-	498	43 675
Investment securities held to maturity	1 663	2	-	147	1 812
Investments in associates and joint ventures	393	-	-	-	393
Non-current assets held for sale	135	-	-	3	138
Inventories	185	-	-	1	186
Intangible assets	3 231	-	-	11	3 242
Property, plant and equipment	2 833	-	-	82	2 915
Current income tax receivable	1	-	-	1	2
Deferred income tax asset	1 762	-	-	5	1 767
Other assets	2 757	108	1	59	2 925
Total assets	**249 102**	**17 090**	**24 904**	**5 816**	**296 912**
Amounts due to the Central Bank	6	-	-	-	6
Amounts due to banks	817	2 488	1 104	149	4 558
Derivative financial instruments	2 493	185	2	60	2 740
Amounts due to customers	190 340	16 005	1 872	10 583	218 800
Liabilities in respect of insurance activities	2 999	-	-	-	2 999
Debt securities issued	6 905	12 070	1 427	3 530	23 932
Subordinated liabilities	1 720	-	-	-	1 720
Other liabilities	4 402	488	4	168	5 062
Current income tax liabilities	585	-	-	3	588
Deferred income tax provision	35	-	-	1	36
Provisions	191	20	1	3	215
Equity	36 256	-	-	-	36 256
Total liabilities and equity	**246 749**	**31 256**	**4 410**	**14 497**	**296 912**
Off-balance sheet liabilities granted	47 475	4 386	157	2 593	54 611

(IN PLN MILLION)

	Foreign currencies translated into PLN as at 31.12.2016				
	PLN	EUR	CHF	Other	Total
Cash and cash balances with the Central Bank	11 928	718	79	600	13 325
Amounts due from banks	1 980	2 160	503	702	5 345
Financial assets held for trading, excluding derivative financial instruments	318	8	-	-	326
Derivative financial instruments	2 543	355	3	-	2 901
Financial instruments designated at fair value through profit or loss upon initial recognition	12 735	171	1 031	-	13 937
Loans and advances to customers	153 983	14 195	30 312	2 116	200 606
Available-for-sale investment securities	34 621	1 086	-	969	36 676
Investment securities held to maturity	199	267	-	-	466
Investments in associates and joint ventures	386	-	-	-	386
Non-current assets held for sale	10	-	-	4	14
Inventories	259	-	-	1	260
Intangible assets	3 412	-	-	10	3 422
Property, plant and equipment	3 010	-	-	76	3 086
Current income tax receivable	8	-	-	2	10
Deferred income tax asset	1 771	-	-	8	1 779
Other assets	1 478	719	-	837	3 034
Total assets	**228 641**	**19 679**	**31 928**	**5 325**	**285 573**
Amounts due to the Central Bank	4	-	-	-	4
Amounts due to banks	1 220	2 683	15 239	66	19 208
Derivative financial instruments	4 198	-	-	-	4 198
Amounts due to customers	180 146	14 080	2 550	8 290	205 066
Liabilities in respect of insurance activities	2 942	1	-	1	2 944
Debt securities issued	4 702	5 567	-	4 224	14 493
Subordinated liabilities	1 617	-	922	-	2 539
Other liabilities	3 300	448	3	236	3 987
Current income tax liabilities	305	-	-	-	305
Deferred income tax provision	31	-	-	-	31
Provisions	216	5	1	7	229
Equity	32 569	-	-	-	32 569
Total liabilities and equity	**231 250**	**22 784**	**18 715**	**12 824**	**285 573**
Off-balance sheet liabilities granted	50 441	4 001	189	3 445	58 076

65. LIQUIDITY RISK MANAGEMENT

LIQUIDITY RISK MANAGEMENT

DEFINITION

Liquidity risk is the risk of the inability to settle liabilities as they become due because of an absence of liquid assets. The lack of liquidity may be due to the inappropriate structure of the statement of financial position, a mismatch of cash flows, customers' failing to settle their liabilities, a sudden withdrawal of funds by the customers or other market developments.

The Group also manages the financing risk which takes into account the risk of losing the existing sources of financing and the inability of renewing the required means of financing or loss of access to new sources of financing.

RISK MANAGEMENT OBJECTIVE

To ensure the necessary level of funds needed to settle current and future liabilities (also potential ones) as they become due, taking into account the nature of the activities conducted and the needs which may arise due to changes in the market environment, by appropriately shaping the structure of the statement of financial position and off-balance sheet liabilities.

RISK IDENTIFICATION AND MEASUREMENT

The Group uses the following measures of the liquidity risk:

- contractual and adjusted liquidity gap;
- liquidity reserve;
- liquidity surplus;
- the ratio of stable funds to illiquid assets;
- liquidity coverage ratio (LCR);
- domestic supervisory liquidity measures (M1-M4);
- measures of stability of the deposit and loan portfolios;
- liquidity stress tests.

RISK CONTROL

Control over the liquidity risk consists of determining liquidity risk limits and thresholds tailored to the scale and complexity of the Group's operations, in particular the strategic limit of tolerance to liquidity risk.

RISK FORECASTING AND MONITORING

The following measures are monitored by the Group on a regular basis:

- utilization of the strategic limit of tolerance to liquidity risk;
- utilization of regulatory liquidity standards;
- utilization of internal limits and thresholds of liquidity risk;
- concentration of the sources of financing;
- early warning indicators – monitored for the early detection of unfavourable developments which may have a negative impact on the Group's or the financial sector's liquidity position (when exceeded, early warning indicators trigger liquidity contingency plans).

(IN PLN MILLION)

The Group also makes regular liquidity forecasts which take into account the current developments in the Group operations. Liquidity forecasts include primarily the levels of selected liquidity risk measures envisaged in the forecasts of the Group's statement of financial position and in selected stress test scenarios.

REPORTING

Liquidity reports are developed on a daily, weekly, monthly and quarterly basis and once a year, an in-depth long-term liquidity analysis is performed.

MANAGEMENT ACTIONS / RISK MANAGEMENT TOOLS

The main tools for liquidity risk management used by the Group are:

- procedures for liquidity risk management, in particular contingency plans;
- limits and thresholds to mitigate short-term, medium-term and long-term liquidity risk;
- national and European supervisory liquidity standards;
- deposit, investment and purchase and sale securities transactions and well as derivatives, including structural currency transactions and transactions for the sale or purchase of securities;
- transactions ensuring long-term financing of the lending activities.

The Group's policy concerning liquidity is based on keeping a portfolio of an appropriate level of liquidity surplus through an increase in the portfolio of liquid securities, and stable sources of financing (a stable deposit base, in particular). In liquidity risk management, money market instruments, including NBP open market operations, are also used.

FINANCIAL INFORMATION

LIQUIDITY GAP

The liquidity gaps presented below represent the sum of adjusted liquidity gaps of the Bank (adjustments relate to, among other things, the Bank's core deposits from non-financial entities and their maturities, core overdrafts of non-financial entities and their maturities, and liquid securities and their maturities), PKO Bank Hipoteczny and KREDOBANK and the contractual liquidity gaps of the other Group companies.

	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
31.12.2017								
The Group - adjusted periodic gap in real terms	16 011	27 220	(871)	(177)	6 091	10 150	30 400	(88 824)
The Group - adjusted cumulative periodic gap in real terms	16 011	43 231	42 360	42 183	48 274	58 424	88 824	-

	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	more than 60 months
31.12.2016								
The Group - adjusted periodic gap in real terms	11 983	28 501	493	579	6 582	11 193	24 592	(83 923)
The Group - adjusted cumulative periodic gap in real terms	11 983	40 484	40 977	41 556	48 138	59 331	83 923	-

In all time horizons, the adjusted cumulative liquidity gap of the Group, determined as the sum of the adjusted liquidity gaps of the Bank, PKO Bank Hipoteczny and KREDOBANK and the contractual liquidity gaps of the other Group companies, was positive. As at 31 December 2017 and as at 31 December 2016 this means that the Group has a surplus of the assets receivable over the liabilities payable.

LIQUIDITY RESERVE AND LIQUIDITY SURPLUS

LIQUIDITY RISK MEASURE	31.12.2017	31.12.2016
Liquidity reserve up to 1 month[1] (in PLN billion)	37	31
Liquidity surplus in the horizon of up to 30 days[2] (in PLN billion)	14	13

[1] Liquidity reserve - the difference between the most liquid assets and the expected and potential liabilities which will mature in a given period.

[2] Liquidity surplus – determines the Bank's ability to meet the liquidity needs in a given survival horizon if the scenarios defined in stress tests materialize.

SUPERVISORY LIQUIDITY MEASURES

SUPERVISORY LIQUIDITY MEASURES	31.12.2017	31.12.2016
M1 - short-term liquidity gap	22 446	24 464
M2 - short-term liquidity ratio	1,66	1,89
M3 - coverage ratio of non-liquid assets by own funds	13,92	11,63
M4 - coverage ratio of non-liquid assets and liquidity-restricted assets with own funds and stable external funds	1,19	1,19
NSFR - net stable funding ratio	113,9%	115,2%
LCR - liquidity coverage ratio	156,0%	136,3%

In the periods from 31 December 2016 to 31 December 2017, liquidity measures remained above their respective supervisory limits.

CORE DEPOSIT BASE

As at 31 December 2017, the core deposit base constituted approx. 93.6% of all deposits placed with the Bank (excluding the interbank market), which represents a decrease of approx. 0.2 p.p. compared with the end of 2016.

STRUCTURE OF THE SOURCES OF FINANCING

	31.12.2017	31.12.2016
Total deposits (excluding interbank market)	76,80%	76,50%
Interbank market deposits	0,70%	0,30%
Equity	12,30%	12,40%
Market financing	10,20%	10,80%
Total	**100,00%**	**100,00%**

CONTRACTUAL CASH FLOWS FROM THE GROUP'S LIABILITIES, EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS

The tables below show the contractual maturity analysis presenting the outstanding contractual maturity dates by individual categories of the statement of financial position and off-balance sheet liabilities, excluding derivative financial instruments.

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2017 and as at 31 December 2016. The amounts disclosed comprise non-discounted future cash flows, both in respect of principal and interest (if applicable), in accordance with the contract, for the entire period to the date of the liability's maturity. Where the party to whom the Group has a liability is able to select the settlement deadline, it has been assumed that the earliest date on which the Group is obliged to settle the liability will be taken into account. Where the Group is obliged to settle the liabilities in instalments, each instalment is allocated to the earliest period in which the Group might be obligated to settle. In the case of liabilities where instalment amounts are not fixed, the terms binding as at the reporting date have been adopted.

(IN PLN MILLION)

Contractual flows of the Group's liabilities as at 31 December 2017 and as at 31 December 2016 by maturity

GROUP'S LIABILITIES AS AT 31 DECEMBER 2017, BY MATURITY	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 year	Over 5 years	Contractual amount	Carrying amount
Liabilities:							
Amounts due to the Central Bank	6	-	-	-	-	6	6
Amounts due to banks	1 703	6	176	2 656	-	4 540	4 558
Amounts due to customers	158 505	16 759	30 107	8 308	7 808	221 486	218 800
Debt securities issued	122	205	1 235	11 761	-	13 324	23 932
Subordinated liabilities	9	32	68	289	2 080	2 478	1 720
Other liabilities	4 336	15	347	179	185	5 062	5 062
Off-balance sheet liabilities:							
financing, granted	8 672	2 696	13 365	15 004	7 798	47 535	-
guarantees, granted	752	555	3 234	8 010	2 191	14 742	-

GROUP'S LIABILITIES AS AT 31 December 2016, BY MATURITY	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 year	Over 5 years	Contractual amount	Carrying amount
Liabilities:							
Amounts due to the Central Bank	4	-	-	-	-	4	4
Amounts due to banks	1 137	126	235	17 516	-	19 014	19 208
Amounts due to customers	135 850	19 152	35 265	13 277	6 099	209 642	205 066
Debt securities issued	301	948	2 487	4 148	7 815	15 699	14 493
Subordinated liabilities	-	33	46	351	2 604	3 034	2 539
Other liabilities	3 375	24	256	161	171	3 987	3 987
Off-balance sheet liabilities:						-	
financing, granted	13 608	5 859	13 706	11 233	6 433	50 839	-
guarantees, granted	266	570	3 705	8 583	1 538	14 662	-

CONTRACTUAL CASH FLOWS FROM LIABILITIES IN RESPECT OF DERIVATIVE FINANCIAL INSTRUMENTS

DERIVATIVE FINANCIAL INSTRUMENTS SETTLED ON A NET BASIS

Derivative financial instruments settled by the Group on a net basis include:

- interest rate swaps (IRS);
- Forward Rate Agreements (FRA);
- Non Deliverable Forwards (NDF);
- options.

The tables below show the contractual maturity analysis presenting the outstanding contractual maturity dates by individual categories of derivative financial instruments in respect of which the valuation as at the balance sheet date was negative (a liability).

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2017 and as at 31 December 2016. In the case of IRS transactions, non-discounted future net cash flows in respect of interest have been presented and in the case of the remaining derivative instruments settled on a net basis, the amount of the valuation as at 31 December 2017 and as at 31 December 2016 respectively was adopted as the cash flow amount.

As at 31 December 2017	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 year	over 5 years	Contractual amount
Derivative financial instruments - liabilities:						
- Interest rate swap (IRS)	(22)	(1)	94	(676)	(100)	(705)
- other derivatives (options, FRA, NDF)	(143)	(304)	(927)	(1 400)	(0)	(2 775)

(IN PLN MILLION)

As at 31 December 2016	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 year	over 5 years	Contractual amount
Derivative financial instruments - liabilities:						
- Interest rate swap (IRS)	(22)	(16)	(325)	(769)	(180)	(1 313)
- other derivatives (options, FRA, NDF)	(110)	(73)	(624)	(524)	-	(1 332)

Derivative financial instruments settled on a gross basis

Derivative financial instruments settled by the Bank on a gross basis include:

- foreign currency swaps;
- foreign currency forwards;
- Cross Currency IRS (CIRS).

The tables below show the contractual maturity analysis, presenting the outstanding contractual maturity dates by individual categories of derivative financial instruments (inflows and outflows) in respect of which valuation the balance sheet date was negative (a liability).

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2017 and as at 31 December 2016. The amounts disclosed comprise non-discounted future cash flows, both in respect of principal and interest (if applicable).

As at 31 December 2017	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 year	over 5 years	Contractual amount
- outflows	(7 347)	(2 196)	(4 812)	(2 946)	(238)	(17 539)
- inflows	7 238	2 072	5 008	6 745	250	21 313

As at 31 December 2016	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 year	over 5 years	Contractual amount
- outflows	(7 030)	(2 243)	(4 700)	(3 089)	(41)	(17 103)
- inflows	8 058	2 593	4 944	9 908	142	25 644

Current and non-current assets and liabilities

The Group classifies an asset as current when:

- it expects to realize the asset or intends to sell or consume it in the course of the normal operating cycle;
- it holds the asset primarily for the purpose of trading;
- it expects that the asset will be realized within twelve months after the reporting period, or
- the asset is cash or a cash equivalent, unless it is restricted from being exchanged or used to settle a liability for at least twelve months from the end of the reporting period.

All other assets are classified as non-current.

The Group classifies a liability as current when:

- it expect that the liability will be settled in the normal operating cycle;
- it holds the liability primarily for the purpose of trading;
- the liability matures within twelve months from the end of the reporting period, or
- the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

(IN PLN MILLION)

All other liabilities are classified as non-current.

31.12.2017	Current	Non-current	Impairment	Total carrying amount
Cash and cash balances with the Central Bank	17 810	-	-	17 810
Amounts due from banks	4 874	359	-	5 233
Financial assets held for trading	431	-	-	431
Derivative financial instruments	741	1 857	-	2 598
Financial instruments designated at fair value through profit or loss upon initial recognition	7 000	1 157	-	8 157
Loans and advances to customers	46 848	166 603	(7 823)	205 628
Available-for-sale investment securities	5 006	38 995	(326)	43 675
Securities held to maturity	150	1 662	-	1 812
Inventories	207	-	(21)	186
Other assets	4 681	7 408	(707)	11 382
Total assets	87 748	218 041	(8 877)	296 912
Amounts due to the Central Bank	6	-	-	6
Amounts due to banks	2 744	1 814	-	4 558
Derivative financial instruments	1 464	1 276	-	2 740
Amounts due to customers	203 823	14 977	-	218 800
Liabilities in respect of insurance activities	268	2 731	-	2 999
Debt securities issued	4 067	19 865	-	23 932
Subordinated liabilities	-	1 720	-	1 720
Other liabilities	5 519	382	-	5 901
Total liabilities	**217 891**	**42 765**	**-**	**260 656**
Equity	-	36 256	-	36 256
Total liabilities and equity	**217 891**	**79 021**	**-**	**296 912**

31.12.2016	Current	Non-current	Impairment	Total carrying amount
Cash and cash balances with the Central Bank	13 325	-	-	13 325
Amounts due from banks	5 333	12	-	5 345
Financial assets held for trading	326	-	-	326
Derivative financial instruments	998	1 903	-	2 901
Financial instruments designated at fair value through profit or loss upon initial recognition	10 993	2 944	-	13 937
Loans and advances to customers	48 222	160 387	(8 003)	200 606
Available-for-sale investment securities	1 924	35 096	(344)	36 676
Securities held to maturity	98	368	-	466
Inventories	285	-	(25)	260
Other assets	5 511	6 885	(665)	11 731
Total assets	**87 015**	**207 595**	**(9 037)**	**285 573**
Amounts due to the Central Bank	4	-	-	4
Amounts due to banks	3 562	15 646	-	19 208
Derivative financial instruments	1 628	2 570	-	4 198
Amounts due to customers	186 905	18 161	-	205 066
Liabilities in respect of insurance activities	161	2 783	-	2 944
Debt securities issued	3 705	10 788	-	14 493
Subordinated liabilities	-	2 539	-	2 539
Other liabilities	3 946	606	-	4 552
Total liabilities	**199 911**	**53 093**	**-**	**253 004**
Equity	-	32 569	-	32 569
Total liabilities and equity	**199 911**	**85 662**	**-**	**285 573**

66. OTHER MARKET RISKS

COMMODITY PRICE RISK MANAGEMENT

DEFINITION – Commodity price risk is the risk of incurring a loss due to changes in commodity prices, generated by maintaining open positions on particular types of goods.

MANAGEMENT OBJECTIVE – The objective of commodity price risk management is to reduce potential losses resulting from changes in commodity prices to the acceptable level by shaping the appropriate structure of these items.

RISK IDENTIFICATION AND MEASUREMENT – In respect of the measurement of the prices of commodities, information on the positions taken by the Group in particular commodities is utilized, and stress-test analyses are performed.

CONTROL – Control of commodity prices risk covers determining the respective limits and threshold tailored to the scale and complexity of the Group's operations.

FORECASTING AND MONITORING – In respect of the commodity price risk, the Group regularly monitors, in particular: open commodity positions, the outcome of stress-tests and utilization of internal risk limits.

REPORTING - Reports on commodity price risks are prepared on a daily, weekly, monthly and quarterly basis.

MANAGEMENT ACTIONS – Commodity price risk is managed by imposing limits on instruments generating the commodity price risk, monitoring their use and reporting the risk level. The effect of commodity price risk on the Group's financial position is immaterial.

MANAGEMENT OF THE EQUITY SECURITIES PRICE RISK

DEFINITION - The risk of equity securities price is the risk of losses being incurred as a result of changes in the prices of equity securities on the public market, or stock exchange indices, generated by maintaining open positions in instruments sensitive to changes in these market parameters. The risk results from operations conducted as part of trading activities of the Brokerage House of the Bank, investing activities and from other operations as part of banking activities which generate positions in equity securities.

MANAGEMENT OBJECTIVE - Managing the risk of equity securities prices is aimed at limiting potential losses resulting to changes in the prices of equity securities on the public market or stock exchange indices to an acceptable level, by optimizing the positions taken in instruments sensitive to changes in these market parameters.

RISK IDENTIFICATION AND MEASUREMENT - For the purpose of equity securities price risk management the Group utilizes:

- analyses of stress tests, taking into account the changes in market prices of the underlying instruments and changes in their volatility;
- information on the utilization of limits adopted for positions taken in the equity securities portfolio.

CONTROL – Control over equity securities price risk consists of determining equity securities risk limits and thresholds tailored to the scale and complexity of the Group's operations.

FORECASTING AND MONITORING - The Group regularly monitors the level of equity securities price risk and the utilization of the limits on positions taken in the equity securities portfolio.

REPORTING – Reports on the risk of equity securities prices are prepared on a monthly and quarterly basis.

MANAGEMENT ACTIONS – The risk is managed by imposing limits on the activities of the Brokerage House of the Bank and by monitoring the utilization thereof. The effect of the equity securities prices risk on the financial position of the Group was assessed as immaterial. The positions taken in equity securities and index instruments are being limited, and are not expected to increase significantly.

OTHER PRICE RISKS

Taking into consideration other price risks, as at the end of 2017 and 2016, the Group was exposed to the price risk of participation units in collective investment funds. The impact of this risk to the Group's financial situation is immaterial.

67. DERIVATIVE INSTRUMENTS RISK MANAGEMENT

DEFINITION

Derivative instrument risk is the risk resulting from the Group's taking up a position in derivative financial instruments.

RISK MANAGEMENT OBJECTIVE

To limit potential losses in respect of changes in factors specific for derivatives (other than foreign exchange rates or interest rates) to acceptable levels by appropriately shaping the structure of positions taken in those instruments.

RISK IDENTIFICATION AND MEASUREMENT

For the purpose of managing derivatives risk, the Group uses:

- the Value at Risk (VaR) model;
- analysis of stress tests, taking into account the changes in market prices of the underlying instruments, in their volatility, and in interest rates;
- sensitivity ratios for options.

RISK CONTROL

Control over derivatives risk consists of determining derivatives risk limits and thresholds tailored to the complexity of the Group's operations.

RISK FORECASTING AND MONITORING

Monitoring the risk of derivative instruments takes place as part of monitoring of other types of financial and credit risk. The Group places particular emphasis on monitoring the financial risk related to the maintenance of the currency options portfolio and the customer credit risk resulting from amounts due to the Group in respect of derivative instruments.

REPORTING

The reports on derivative risk are prepared on a daily, weekly, monthly and quarterly basis.

MANAGEMENT ACTIONS

The main tools used in derivative risk management are as follows:

- procedures for derivative risk management;
- limits and threshold of the derivative risk.
- master agreements defining, e.g. settlement mechanisms;
- collateral agreements, under which selected Bank customers are required to establish a collateral on exposures arising from derivative instruments.

The risk is managed by imposing limits on the derivative transactions, monitoring these limits and reporting the level of risk.

The derivative risk management process is integrated with the management of the following types of risk: interest rate, currency, liquidity and credit risk. However, due to the specific nature of derivative instruments, it is subject to specific control specified in the internal regulations of the Bank.

68. OPERATIONAL RISK MANAGEMENT

DEFINITION

Operational risk is defined as the risk of losses being incurred due to a failure or the unreliability of the internal processes, people and systems or due to external events. Operational risk includes legal risk and excludes reputation risk and business risk.

RISK MANAGEMENT OBJECTIVE

The objective of operational risk management is to enhance the safety of the operational activities conducted by the Group by improving the efficiency – tailored to the profile and the scale of operations – of the mechanisms for identifying, assessing, measuring, controlling, monitoring, mitigating and reporting operational risk.

RISK IDENTIFICATION AND MEASUREMENT

Operational risk management comprise of the identification of operational risk in particular through collecting data about the operational risk and the self-assessment of operational risk.

In order to manage the operational risk, the Bank gathers internal and external data about operational events and the causes and consequences of their occurrence, data on the factors of the business environment, results of operational risk self-assessment, data on KRI and data related to the quality of internal functional controls.

The operational risk self-assessment comprises the identification and assessment of the operational risk for the Bank's products, processes and applications as well as organizational changes and it is conducted cyclically and before the introduction of new or changed Bank products, processes and applications.

The measurement of operational risk comprises:

- calculating Key Risk Indicators (KRI);
- calculating the requirement for own funds to cover operational risk under the AMA approach (the Bank) and BIA approach (the German and Czech Branches and the Group companies covered by prudential consolidation):
- stress-tests;
- calculating the Group's internal capital.

RISK CONTROL

Control of operational risk includes setting up risk controls tailored to the scale and complexity of the Bank's and Group's activities, in the form of limits on operational risk, in particular the strategic limits of tolerance to operational risk, loss limits, KRIs with thresholds and critical values.

RISK FORECASTING AND MONITORING

The following measures are monitored by the Group on a regular basis:

- utilization of the strategic tolerance and operational risk losses limits for the Bank;
- operational events and their consequences;
- results of the operational risk self-assessment;
- the requirement in respect of own funds to cover operational risk, in accordance with the BIA approach in the case of the German and Czech Branches and in accordance with the AMA approach in the case of the remaining activity of the Bank, and in accordance with the BIA approach in the case of Group companies included in prudential consolidation;
- the results of stress tests;
- Key Risk Indicators (KRI) in relation to threshold and critical values;
- the risk level for the Bank and the Group, and for the operational risk management areas and tools within the Bank;

- the effectiveness and timeliness of actions undertaken to reduce or transfer operational risk;
- management actions relating to the presence of elevated or high levels of operational risk and their effectiveness in reducing the level of operational risk.

In 2017, the following entities had a decisive impact on the operational risk profile of the Group: PKO Bank Polski, Qualia Development, the PKO Leasing SA Group and the KREDOBANK SA Group. Other Group entities, considering their significantly smaller scale and type of activity, generate only limited operational risks.

REPORTING

Reporting of information concerning operational risk is performed for the needs of the senior management staff, the ORC, the RC, the Management Board and the Supervisory Board. Each month, information about operational risk is prepared and forwarded to the ORC, senior management staff, the organizational units of the Head Office and specialist organizational units responsible for system-based operational risk management. The scope of the information is diversified and tailored to the scope of responsibilities of individual recipients of information.

MANAGEMENT ACTIONS

Management actions are taken in the following cases:

- on an initiative of ORC or the Management Board
- on the initiative of organizational units and cells of the Bank managing operational risk;
- when operational risk has exceeded the levels determined by the Management Board or ORC.

In particular when the risk level is elevated or high, the Bank uses the following approach and instruments to manage the operational risk:

- risk reduction – mitigating the impact of risk factors or the consequences of its materialization by introducing or strengthening various types of instruments for managing operational risk such as: control instruments, human resources management instruments, determination or verification of thresholds and critical KRIs, determination or verification of operational risk levels, and contingency plans;
- risk transfer – transfer of responsibility for covering potential losses to a third-party: insurance and outsourcing;
- risk avoidance – resignation from the risk-generating activity or elimination of the probability of materialization.

69. OTHER RISKS

Compliance and conduct risk management Business risk management Reputation risk management Model risk management Macroeconomic risk management Capital risk management Insurance risk management Management of the risk of excessive leverage

COMPLIANCE AND CONDUCT RISK MANAGEMENT

DEFINITION

Compliance risk is defined as the risk of legal sanctions, incurring financial losses or loss of reputation due to the failure of the Group, its employees or entities acting on its behalf to comply with the provisions of the law, internal regulations, standards adopted by the Group, including market standards.

Conduct risk is the risk of damages arising on the part of: 1) the customer, 2) the Group, including its credibility, 3) financial markets, with regard to their credibility, as a result of inappropriate action (also unintentional) or omission by the Group, its staff or related entities, with regard to offering and providing financial services.

RISK MANAGEMENT OBJECTIVE

The objectives of the compliance and conduct risks management are as follows:

- strengthening the image of the Group as an institution acting in accordance with the law and the accepted market standard, trustworthy, reliable and fair, among the Group's shareholders, customers, employees, business partners and other market participants;
- preventing financial losses, legal penalties or loss or reputation which may result from breaching the law, the Group's internal regulations and the market standards adopted by the Group;
- preventing losses on the part of the Group's customers, which may result from inappropriate conduct (also unintentional) or omission by the Group, its staff or related entities, with regard to offering and providing financial services.

IDENTIFICATION

To identify and assess the compliance and conduct risks, information on compliance incidents and their reasons is used, including information resulting from internal audits, internal controls and external inspections.

Identification and assessment of compliance and conduct risks is based mainly on the following:

1) estimating the potential impact of non-compliance;
2) the results of operational risk self-assessment;
3) the results of a review and assessment of the adequacy and effectiveness of control mechanisms;
4) information on irregularities identified during internal controls;
5) an evaluation of the existence of additional risk of non-compliance with the law.

During the assessment, the nature and the potential scale of the losses is identified and the possible ways of mitigating or eliminating the compliance risk. The assessment is conducted in the form of workshops.

MONITORING

Monitoring the compliance and conduct risk is performed using information provided by the Bank's organizational units and consists of:

- analysing compliance incidents occurring in the Group and in the banking sector, their reasons and effects;
- evaluating changes in the key legal regulations affecting the operations of the Bank and the Group;
- evaluating actions undertaken by the Bank and the Group companies as part of compliance risk management;
- evaluating the effectiveness and adequacy of the controls relating to mitigation of the compliance risk;
- analysing information on the status of the major projects conducted within the Group to ensure compliance with the generally applicable provisions of the law, market standards adopted by the Group and information from external regulatory and inspection bodies;
- analysing information on operational events, security incidents, disputes (including court cases) against the Group, complaints and irregularities relating to conduct risk.

REPORTING

The reporting of compliance risk and conduct risk takes the form of quarterly reports addressed to the Risk Committee, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board, and information submitted for the purposes of external regulatory and inspection bodies.

MANAGEMENT ACTIONS

Compliance risk management covers, in particular, the following issues:

- preventing the Group from engaging in illegal activities;
- promoting ethical standards and monitoring their application;
- managing conflicts of interests;
- preventing situations in which the Group's employees could be perceived as pursuing their own interest in a professional context;
- professional, fair and transparent formulation of the product offer, advertising and marketing communication;
- ensuring data protection;
- prompt, fair and professional consideration of the customers' complaints, suggestions and claims;
- preventing situations when a product which does not meet a customer's needs is offered;
- determining an adequate manner and form of offering a product, depending on the product's character;
- monitoring sales and the fair execution of the agreements concluded with customers.

The Group has adopted a zero tolerance policy against compliance risk, which means that the Group focuses its actions on eliminating this risk.

BUSINESS (STRATEGIC) RISK MANAGEMENT

Business risk is the risk of failing to achieve the adopted financial targets, including incurring losses, due to adverse changes in the business environment, taking bad decisions, incorrectly implementing the decisions made, or not taking appropriate actions in response to changes in the business environment.

RISK MANAGEMENT OBJECTIVE

Maintaining, on an acceptable level, the potential negative financial consequences resulting from adverse changes in the business environment, making wrong decisions, improperly implementing the adopted decisions or not taking appropriate actions in response to changes in the business environment.

RISK IDENTIFICATION AND MEASUREMENT

Risk identification consists of determining both existing and potential factors arising from the current and planned activities of the Group which may significantly affect the Group's financial position and the level of the Group's income and expenses. Business risk identification is performed by identifying and analysing the factors which contributed to significant deviations in the actual income and costs from their budgeted values.

The measurement of business risk is aimed at defining the scale of threats related to the existence of business risk using the adopted risk measures. The measurement of business risk includes: calculating internal capital, conducting stress-tests and backtesting.

RISK CONTROL

Control of business risk is aimed at maintaining it at an acceptable level. It involves setting and periodic review of the risk controls in the form of tolerance limits on business risk along with its thresholds and critical values, tailored to the scale and complexity of the Group.

RISK FORECASTING AND MONITORING	Forecasting of the business risk is intended to determine the anticipated extent of achievement of the planned results by the Group. Forecasts are prepared on a quarterly basis with a 1-year horizon and include a forecast of internal capital. Business risk forecasts are verified on a quarterly basis (backtesting). Business risk is monitored to identify areas which require management action. Business risk monitoring includes: • strategic limits of business risk tolerance; • results of stress tests; • results of backtesting; • internal capital level; • deviations in business risk materialization from the forecast; • results of a qualitative assessment of the business risk.
REPORTING	Reporting is performed on a quarterly basis. The reports on the business risk level are addressed to the ALCO, the RC, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board.
MANAGEMENT ACTIONS	Management actions involve, in particular: • verifying and updating quarterly financial forecasts, including actions aimed at lowering the business risk level in accordance with the limits; • monitoring the level of the strategic limit of tolerance to business risk.

REPUTATION RISK MANAGEMENT

DEFINITION	The reputation risk is understood as the risk of a deterioration in reputation among customers, counterparties, investors, supervisory and inspection authorities, and the general public, as a result of business decisions adopted, operating events, instances of non-compliance or other events.
RISK MANAGEMENT OBJECTIVE	The objective of managing reputation risk is to protect the Group's reputation by preventing reputation losses and mitigating the negative effect of image-related events on the Group's reputation.
IDENTIFICATION	Identifying reputation risks covers the developments observed in the Group's internal processes and in its external environment, including in particular: image-related events and factors related to the business environment, i.e. quantitative and qualitative information, including especially the data which describes the Group and its external environment, which suggest the existence of reputation risk.
ASSESSMENT	An assessment of the reputation risk involves evaluating the impact of image-related events on the Group's reputation, and in particular, quantifying and determining the severity of reputation losses. The evaluation of a reputation loss includes the impact, credibility and the opinion-forming potential of the disclosure of an image-related event to the public.
MONITORING	Monitoring reputation risk consists of regularly assessing the reputation risk measures compared to the adopted thresholds. The level of reputation risk is determined based on the reputation risk measures.
REPORTING	Information on the reputation risk is reported in the form of: 1) a semi-annual management report addressed to the Risk Committee, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board. 2) ad-hoc information on current events having a material impact on the Group's reputation, addressed to the President of the Management Board and to his Office. 3) information included in the Bank's and the Group's financial statements and provided at the request of the external supervisory and inspection bodies.

MANAGEMENT ACTIONS	Based on the specific level of reputation risk, management actions are taken. These may involve: 1) analysing the reasons behind a specific level of risk; 2) evaluating the effects of such a level of risk occurring; 3) developing suggestions of the management actions to be taken in order to reduce the level of reputation risk or a justification for refraining from taking such action if not needed, e.g. in the event of incidental extraordinary events occurring.

MODEL RISK MANAGEMENT

DEFINITION	Model risk is the risk of incurring losses as a result of making incorrect business decisions based on the existing models. Within the Group, model risk is managed both at the level of a given Group entity (an owner of the model) and at the level of the Bank as the Group's parent company.
RISK MANAGEMENT OBJECTIVE	The objective of model risk management is to mitigate the level of risk of incurring losses as a result of making incorrect business decisions on the basis of existing models in the Group through a well-defined and implemented process of models management. One of the elements of the model management process is to regularly perform independent validation of all significant models in the Group.
RISK IDENTIFICATION, MEASUREMENT AND ASSESSMENT	Identification of the model risk consists of, in particular, collecting information about the existing models and models planned to be implemented as well as periodically determining the materiality of the models. Model risk evaluation is aimed at determining the scale of the threats associated with the occurrence of the model risk. The evaluation is made at the level of each model as well as on an aggregate basis at the level of the Group.
RISK CONTROL	Control of the model risk is aimed at maintaining an aggregate evaluation of the model risk at a level which is acceptable to the Group. Control of the model risk consists in determining the mechanisms used to diagnose the model risk level and tools for reducing the level of this risk. The tools used to diagnose the model risk include, in particular, a strategic limit of tolerance to the model risk and the thresholds for the model risk.
MONITORING	Periodical monitoring of the model risk is aimed at diagnosing areas requiring management actions and includes, in particular: • updating the model risk level; • evaluating the utilization of the strategic limit of tolerance to the model risk and the thresholds of the model risk; • verifying the stage of implementation and evaluating the effectiveness of the implementation of actions intended to mitigate the model risk.
REPORTING	The results of model risk monitoring risk are presented periodically in reports addressed to the RC, the Management Board, and the Supervisory Board.
MANAGEMENT ACTIONS	The purpose of management actions is to shape the model risk management process and to affect the level of this risk, in particular by determining acceptable risk levels and making decisions about the use of tools supporting model risk management.

MACROECONOMIC RISK MANAGEMENT

DEFINITION	Macroeconomic risk is the risk of a deterioration in the Group's financial position as a result of and the adverse impact of changes in macroeconomic conditions.
RISK MANAGEMENT OBJECTIVE	The objective of macroeconomic risk management is to identify macroeconomic factors having a significant impact on the Group's activities and taking actions to reduce the adverse impact of the potential changes in the macroeconomic situation on the financial position of the Group.
RISK IDENTIFICATION, MEASUREMENT AND ASSESSMENT	Identification of the risk of macroeconomic changes consists in determining scenarios of the potential macroeconomic changes and determining those risk factors which have the greatest impact on the financial position of the Group. Macroeconomic risk arises due to the impact of both factors which depend on the Group's activities (in particular, the structure of the balance sheet and response plans prepared for the purposes of stress test scenarios) and those which are independent of it (macroeconomic factors). The Bank identifies factors which contribute to the level of macroeconomic risk when conducting comprehensive stress tests. The risk of macroeconomic changes is measured in order to determine the scale of threats associated with the occurrence of macroeconomic changes. Macroeconomic risk measurement includes: • calculating the profit or loss and its components, and the risk measures, as part of the comprehensive stress tests; • backtesting; • calculating the internal capital level; The risk of macroeconomic changes is assessed on a yearly basis, based on the results of periodical comprehensive stress tests. The level of macroeconomic risk is described as moderate, elevated or high.
RISK CONTROL	Control of the risk of macroeconomic changes is intended to mitigate the adverse effect of the potential changes in the macroeconomic developments on the financial position of the Group. Macroeconomic risk control consists of determining the acceptable level of the risk, tailored to the scale of the Group's operations, and the impact of the risk of the Group's operations and financial position. An acceptable level of the risk of macroeconomic changes means a situation where stress test results do not signal a need to take any corrective measures, or the corrective measures which need to be taken will be sufficient to improve the financial position of the Group.
RISK FORECASTING AND MONITORING	Forecasting the macroeconomic risk is intended to determine the anticipated impact of the future materialization of an adverse scenario on the Bank's results, including its capital. The forecast includes a forecast of the internal capital and is prepared on a quarterly basis with a 1-year horizon based on the results of comprehensive stress tests. Monitoring the macroeconomic risk consists in analysing macroeconomic developments, the macroeconomic factors to which the Group is sensitive, the level of the risk and the results of comprehensive stress tests.
REPORTING	Reports on the macroeconomic risk are prepared on a quarterly basis. The reports are addressed to the ALCO, the RC, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board.
MANAGEMENT ACTIONS	Management actions involve, in particular: • determining acceptable levels of risk; • proposals of actions aimed at reducing the level of risk in the event of an elevated or high risk of macroeconomic changes.

CAPITAL RISK MANAGEMENT

DEFINITION	Capital risk is the risk of failing to ensure an appropriate level and structure of own funds and inability to ensure that the level of capital which would be adequate to the risk borne by the Bank in connection with its operations and is necessary to absorb unexpected losses and complies with the regulatory requirements which enable the Bank to continue to operate independently.
RISK MANAGEMENT OBJECTIVE	The objective of managing the capital risk is to ensure an appropriate level and structure of own funds, with respect to the scale of the operations and risk exposure of the Group and the Group, taking into account the assumptions of the Group's dividend policy as well as supervisory instructions and recommendations concerning capital adequacy.
RISK IDENTIFICATION AND MEASUREMENT	The capital risk level for the Group is determined based on the thresholds and strategic tolerance limits, including, among other things, the total capital ratio and basic capital (Tier 1) ratio. The capital risk level is determined as follows: 1) low level – when all capital adequacy measures exceed the thresholds; 2) elevated level – when at least one adequacy measure is lower than the respective threshold and no capital adequacy measure is lower than the strategic tolerance limit; 3) high level - when at least one capital adequacy measure is lower than the strategic tolerance limit.
MONITORING	The Group regularly monitors the level of capital adequacy measures in order to determine the degree of compliance with the supervisory standards, internal strategic limits, and to identify instances which require taking capital contingency actions. Should a high level of capital risk be identified, the Group takes measures to bring capital adequacy measures to a lower level, taking into account the assumptions of the dividend policy as well as the supervisory instructions and recommendations concerning capital adequacy.

INSURANCE RISK MANAGEMENT

DEFINITION	Insurance risk is the risk of a loss or of an adverse change in the value of insurance liabilities resulting from inadequate pricing and provisioning assumptions (in particular for technical provisions).
RISK MANAGEMENT OBJECTIVE	The objective of insurance risk management is to achieve the company's targets while maintaining exposure to the said risk on an acceptable level, and ensuring the company's solvency.

RISK IDENTIFICATION, MEASUREMENT AND ASSESSMENT	The exposure to insurance risks in the Group relating to insurance companies is monitored and shaped in accordance with the adopted risk management strategy.
	In PKO Życie Towarzystwo Ubezpieczeń SA (PKO Życie), the type of prevailing insurance risk depends on the type of product in the Company's portfolio:
	• insurance products where the benefit is determined based on specific indices or other underlying values and insurance products with a capital fund – mainly the risk of withdrawal from the contract;
	• protection products:
	    o mortality and claims risk;
	    o negative selection (decreasing risk);
	• for all products – the risk associated with volatility of the future unit costs (which depend on the size of the portfolio and the level of the company's total costs).
	
	PKO Towarzystwo Ubezpieczeń S.A. (PKO TU) which started operating in 2016 is exposed to the following types of insurance risk:

- unearned premium and reserve risk;
- catastrophic risk;
- contract withdrawal risk.

The type of prevailing risk depends on the type of product:

- multi-annual loss of source of income insurance contracts – unearned premium and reserve risk;
- property insurance – catastrophic risk (flood).

In order to reduce its exposure to insurance risk, PKO Życie and PKO TU apply, among others, the following measures:

- reinsurance of the risks (mortality and morbidity), including the catastrophic risk;
- grace periods;
- exemptions;
- retention actions.

Ceded reinsurance of the insurance companies is performed based on the following agreements:

- quota share and surplus treaties;
- proportional reinsurance contracts, obligatory or facultative-obligatory;
- catastrophe reinsurance and excess of loss reinsurance contracts.

In the case of new products and risks, PKO Życie and PKO TU select the reinsurer, level of protection, conditions of reinsurance, update the concluded reinsurance contracts, if appropriate, or conclude new reinsurance contracts in relation to the newly introduced or modified insurance products and new risks.

The measurement of the insurance risk in insurance companies is performed as part of the analysis of contract withdrawals, claims ratio analysis, the analysis of the amounts of assets to cover technical reserves (APR), and an annual analysis of shock scenarios – stress tests conducted as part of the process of the risk and solvency self-assessment. PKO Życie and PKO TU have implemented the requirements of the new Solvency II regulations and have been calculating capital ratios under the new regime since 1 January 2016.

MONITORING

As part of risk monitoring, PKO Życie and PKO TU implemented a number of mechanisms such as setting and reviewing limits, ensuring the operation of the relevant processes and taking care of the adequacy of reinsurance products and programs.

REPORTING

In PKO Życie and in PKO TU, the reporting of insurance risk is provided in the form of periodical reports to the Management Board and for the Asset and Liabilities Committee, and the Risk Committee of the Supervisory Board.

Assets to cover technical reserves (APR) remained at a sufficient level (over 100%) and had an appropriate structure. As at the end of 2017, the aggregate assets to reserves ratio amounted to 106% for PKO Życie and 132% for PKO TU.

MANAGEMENT OF THE RISK OF EXCESSIVE LEVERAGE

DEFINITION

The risk of excessive financial leverage is the risk resulting from vulnerability to threats resulting from financial leverage or conditional financial leverage which may require taking unintended action to adjust business plans, including an emergency sale of assets which could result in losses or the need to adjust the valuation of other assets.

RISK MANAGEMENT OBJECTIVE

The objective of managing the risk of excessive leverage is to ensure an appropriate objective relationship between the amount of the core capital (Tier 1) and the total of balance sheet assets and off-balance sheet liabilities granted by the Group.

IDENTIFICATION, ASSESSMENT AND MEASUREMENT	Risk identification consists of recognizing the existing and potential sources of risk and estimating the significance of their potential impact on the Bank's and the Group's operations. For the purpose of measuring the risk of excessive financial leverage, a leverage ratio is calculated as a measure of Tier 1 capital divided by the measure of total exposure and is expressed as a percentage rate. The Group calculated the leverage ratio as at the reporting date. As at 31 December 2017, the leverage ratio is calculated both with reference to Tier 1 capital and in accordance with the transitional definition of Tier 1 capital. When assessing the risk of excessive leverage, the mismatch of assets and liabilities ratio is also used.
MONITORING AND FORECASTING	The risk of excessive leverage is monitored on a quarterly basis by verifying: • the current level of the leverage ratio, by comparing it with the strategic tolerance limits and threshold; • deviation of the leverage ratio from forecasts. Leverage ratio forecasts are prepared on a quarterly basis. The level of the excessive leverage ratio is described as low – when the leverage ratio is equal to or lower than the threshold, elevated – when the leverage ratio is lower than the threshold and equal to or higher than the strategic tolerance limit, or high – when the leverage ratio is below the strategic tolerance limit.
RISK CONTROL	The objective of the control over the risk of excessive leverage is to maintain the Bank's risk at an acceptable level. To maintain the risk of excessive leverage at an acceptable level, a tolerance limit and a threshold for the ratio are determined.
REPORTING	Reporting is performed on a quarterly basis. Reports on the excessive leverage risk include the current and forecast levels of the leverage ratio in relation to the strategic tolerance limits and the threshold. Information on the level of risk of excessive leverage is presented in the "Report on Capital Adequacy of PKO Bank Polski SA". The reports on the level of the risk of excessive leverage are addressed to ALCO, the RC, the Management Board, the Risk Committee of the Supervisory Board, and the Supervisory Board.
MANAGEMENT ACTIONS	In the event of a high or elevated risk level, proposals for management actions are developed, taking into account the current macroeconomic situation and the costs of the actions proposed. The impact of the recommended management actions on the level of risk of excessive leverage is identified. As part of updating quarterly financial forecasts and developing the financial plan, management actions intended to reduce the level of risk of excessive leverage to an acceptable level are taken into account,

70. COMPREHENSIVE STRESS-TESTS

Comprehensive stress-tests are an integral part of the Group's risk management and are complementary to stress-tests specific to particular types of risks. They collectively include the types of risk considered by the Group to be significant. They include an analysis of the impact of changes in the environment and the functioning of the Group on the Group's financial position, in particular: the income statement, statement of financial position, own funds, capital adequacy (including capital requirements), internal capital, capital adequacy measures and selected liquidity measures.

Comprehensive stress tests include periodical tests and supervisory tests. Periodical stress tests are conducted once a year, with a 3-yearly horizon. Supervisory tests are carried out at the request of the supervisory authorities in accordance with the assumptions provided by the supervisory authorities. Periodical and thematic comprehensive stress tests are conducted taking into account the changes in amounts and structure of the statement of financial position and the income statement.

71. CAPITAL ADEQUACY

Capital adequacy management is a process intended to ensure that the level of risk which the bank and the Group assumes in relation to the development of its business activities may be covered with its capital, taking into account a specific risk tolerance level and time horizon. The process of managing capital adequacy comprises, in particular, compliance with the applicable regulations of the supervisory and control authorities, as well as the risk tolerance level determined within the Bank and the Bank's Group and the capital planning process, including the policy concerning the sources of acquisition of capital.

The objective of capital adequacy management is to maintain own funds at a level which is adequate to the scale and profile of the risk relating to the Group's activities at all times.

The process of managing the Group's capital adequacy comprises:

- specifying and pursuing the Group's capital targets;
- identifying and monitoring significant types of risk;
- measuring or estimating internal capital to cover individual risk types of risk and total internal capital;
- determining strategic tolerance limits and thresholds of capital adequacy measures;
- forecasting, monitoring and reporting the level and structure of equity and capital adequacy;
- managing the structure of the balance sheet to optimize the quality of the Bank's own funds;
- emergency measures with regard to capital;
- stress-tests;
- planning and allocating own funds and internal capital to business areas and customer segments in the Bank as well as individual Group companies;
- assessing the profitability of individual business areas and customer segments.

Capital adequacy measures include:

- total capital ratio (TCR);
- the ratio of own funds to internal capital;
- Tier 1 core capital ratio (CET1);
- Tier 1 capital ratio (T1);
- leverage ratio.

The objective of monitoring the level of capital adequacy measures is to determine the degree of compliance with supervisory standards and to identify cases which require that emergency measures be implemented.

Major regulations applicable in the capital adequacy assessment process include:

- the CRR Regulation;
- the Polish Banking Law;
- the Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system (hereinafter referred to as 'the Act on macroprudential supervision').

In accordance with Article 92 of the CRR Regulation, the minimum levels of the capital ratios to be maintained by the Group are as follows:

- total capital ratio (TCR) – 8.0%;
- Tier 1 capital ratio (T1) – 6.0%;
- Tier 1 core capital ratio (CET1) – 4.5%.

In accordance with the CRR Regulation and the Act on macroprudential supervision, the Group is obliged to maintain a combined buffer representing the sum of the applicable buffers, namely:

- a capital buffer which applies to all banks. Every year, the capital buffer will be increased to the target level of 2.5% (in 2019). As at 31 December 2017, the systemic risk buffer amounted to 1.25%, and will amount to 1.875% after 1 January 2018.
- the countercyclical buffer imposed to mitigate the systemic risk arising from the credit cycle. The Group calculates the countercyclical buffer at the level specified by the relevant authority of the country where the Group has exposures. Starting from 1 January 2017, the countercyclical buffer is equal to 0% for credit exposures in the Republic of Poland.
- a systemic risk buffer – intended to prevent and mitigate long-term non-cyclical risk or prudential risk which may cause strong negative consequences for the financial system and the economy of a given country. As at 31 December 2017, the systemic risk buffer was equal to 0%. Starting from 1 January 2018, the systemic risk buffer amounts to 3%.
- the buffer relating to the fact that the Bank has been identified as a systemically important institution ('O-SII') – on 24 November 2017, on the basis of an assessment of the Bank's systemic importance in accordance with the Act on macroprudential supervision, the Bank received an individual decision of the Polish Financial Supervision Authority imposing a buffer on the Bank of 0.75% of its total risk exposure calculated in accordance with the CRR Regulation.

In addition, the Group is obliged to maintain own funds to cover an additional capital requirement in order to hedge the risk resulting from mortgage-secured loans and advances to households denominated in foreign currencies ("a discretionary capital requirement"). On 15 December 2017, the Group received a letter from the Polish Financial Supervision Authority concerning an individual recommendation to meet an additional capital requirement (a discretionary capital requirement) for the consolidated capital ratios: the total capital ratio: 0.61 p.p.; Tier 1 capital ratio: 0.46 p.p.; and Tier 1 core capital ratio: 0.34 p.p.

The total value of buffers and additional discretionary capital requirements which the Group was obliged to meet as at 31 December 2017 was 2.61% of the total exposure to risk calculated in accordance with the CRR Regulation. The same values as at 31 December 2016 amounted to 2.79%.

In 2017 and in 2016, the Group maintained a safe capital base in excess of the supervisory and regulatory limits.

OWN FUNDS FOR CAPITAL ADEQUACY PURPOSES

In 2017, the Group's capital adequacy level remained at a safe level, well above the supervisory limits.

An increase in Tier 1 capital before regulatory adjustments and reductions between 31 December 2017 and 31 December 2016 resulted from:

- a decision adopted on 22 June 2017 by the Ordinary General Shareholders' Meeting on the appropriation of the Bank's net profit for 2016 by transferring it to supplementary and reserve capital, without distributing any amounts as dividend. The resulting increase in own funds amounted to PLN 1 299 million, and the remaining part of the net profit for 2016 (PLN 1 589 million) had already been included in own funds as at 31 December 2016 since the Bank had received the required permission from the PFSA to include the net profit earned for the three quarters of 2016, less the anticipated charges, in Tier 1 core capital;
- a permission from the PFSA received by the Bank on 21 September 2017 to include the net profit of PKO Bank Polski SA for the first half of 2017, less the anticipated charges (of PLN 1,118 million) in Tier 1 core capital;
- a permission from the PFSA received by the Bank on 15 December 2017 to include the net profit of PKO Bank Polski SA for the third quarter of 2017, less the anticipated charges (of PLN 704 million) in Tier 1 core capital.

(IN PLN MILLION)

Changes in Tier 2 capital between 31 December 2017 and 31 December 2016 resulted from the following:

- having obtained the necessary permissions from the PFSA, the Bank exercised a call option for subordinated bonds of PLN 1 600 million and made an early repayment of a subordinated loan of CHF 224 million (the equivalent of PLN 884 million). As at 31 December 2016, both these instruments were classified as Tier 2 capital. Since the receipt of the said permission, they have no longer been included in the Bank's own funds;
- the Bank obtained permission from the PFSA to include a new issue of the Bank's subordinated bonds amounting to PLN 1,700 million in own funds.

REQUIREMENTS RELATING TO OWN FUNDS (PILLAR I)

The Group calculates own funds requirements for the following types of risk:

CREDIT RISK	under the standard approach, using the following formulas with regard to: STATEMENT OF FINANCIAL POSITION ITEMS – a product of a carrying amount (considering value of adjustments for specific credit risk), a risk weight of the exposure calculated according to the standardized method of credit risk requirement as regards own funds and 8% (considering recognized collateral); OFF-BALANCE SHEET LIABILITIES GRANTED – a product of value of liability (considering value of adjustments for specific credit risk), a risk weight of the product, a risk weight of off-balance sheet exposure calculated according to the standardized method of credit risk requirement for own funds and 8% (considering recognized collateral); OFF-BALANCE SHEET TRANSACTIONS (DERIVATIVE INSTRUMENTS) – a product of risk weight of the off-balance sheet transaction calculated according to the standardized method of credit risk requirement for own funds, equivalent in the statement of financial position of off-balance sheet transaction and 8% (the value of the equivalent in the statement of financial position is calculated in accordance with the mark-to-market method).
OPERATIONAL RISK	• in accordance with the AMA approach – with respect to the Bank's activities, excluding the Bank's branches in Germany and the Czech Republic; • in accordance with the BIA approach – with respect to the activities of the Bank's branches in Germany and the Czech Republic and with respect to the Group companies covered by prudential consolidation.
MARKET RISK	• currency risk – calculated under the core approach; • commodity risk – calculated under the simplified approach; • equity instruments risk – calculated under the simplified approach; • specific risk of debt instruments – calculated under the core approach; • general risk of debt instruments – calculated under the duration-based approach, • other types of risk, other than delta risk (non-delta risk) calculated under the scenario approach in the case of options for which the Bank uses its own valuation models and under the delta plus approach for other options.
OTHER RISKS	• settlement risk and delivery risk – calculated under the approach specified in Title V, "Own funds requirements for settlement risk" of the CRR Regulation; • counterparty credit risk – calculated under the approach set out in Chapter 6, "Counterparty credit risk" of Title II, "Capital requirements for credit risk" of the CRR Regulation; • credit valuation adjustment risk – calculated under the approach specified in Title VI, "Own funds requirements for credit valuation adjustment risk" of the CRR Regulation; • exceeding the large exposures limit – calculated under the approach set out in paragraphs 395-401 of the CRR Regulation; • for exposures to a central counterparty, a requirement for transactions and contributions made to the default fund of a qualifying central counterparty is calculated.

(IN PLN MILLION)

	31.12.2017	31.12.2016
Total own funds	**34 026**	**30 873**
Tier 1 capital	**32 326**	**28 350**
Tier 1 capital before regulatory adjustments and reductions, of which:	35 270	32 060
Share capital	1 250	1 250
Other reserves	30 891	27 970
General banking risk fund for unidentified risk of banking activities	1 070	1 070
Retained earnings	2 059	1 770
(-) Goodwill	(1 160)	(1 160)
(-) Other intangible assets	(1 654)	(1 821)
Accumulated other comprehensive income	(113)	(709)
Deferred income tax assets which depend on the future profitability but are not related to temporary timing differences	-	(1)
Adjustments in Tier 1 basic capital due to prudential filters	55	30
Other adjustments in transitional period in Tier 1 basic capital	(72)	(49)
Tier 2 capital	**1 700**	**2 523**
Equity instruments and subordinated loans eligible as Tier 2 capital	1 700	2 523
Requirements for own funds	**15 670**	**15 626**
Credit risk	14 499	14 271
Operational risk	656	657
Market risk	474	651
Credit valuation adjustment risk	41	47
Total capital adequacy ratio	**17,37%**	**15,81%**
Tier 1 capital ratio	**16,50%**	**14,51%**

The leverage ratio calculated in accordance with the transitional definition amounted to 10.53% as at 31 December 2017 and 9,62% as at 31 December 2016.

INTERNAL CAPITAL (PILLAR II)

In 2017, the Group calculated internal capital in accordance with external regulations:

- the CRR Regulation
- the Polish Banking Law;
- the Regulation of the Minister of Finance and Development of 6 March 2017 on the risk management and internal control systems, remuneration policy and the detailed procedure for estimating the internal capital in banks;
- the Act on Macro-prudential supervision;

and the internal regulations of the Bank and the Group.

Internal capital is the amount of capital estimated by the Group that is necessary to cover all of the identified significant risks characteristic of the Group's activities and the effect of changes in the business environment, taking account of the anticipated risk level.

The estimation of internal capital is aimed at determining the minimum level of own funds which ensures the safety of operations, taking into account changes in the profile and scale of the operations as well as adverse stress conditions.

The internal capital for covering the individual risk types is determined using the methods specified in the internal regulations. In the event of performing internal capital estimates based on statistical models, the annual forecast horizon is adopted and a 99.9% confidence level. The total internal capital of the Group is the sum of the internal capital necessary to cover all significant types of risks to which the Bank and the Group are exposed, taking into account the entities included in prudential consolidation. The correlation coefficient for different types of risk and different Group entities used in the internal capital calculation is equal to 1.

(IN PLN MILLION)

In 2017 and 2016, the relation of the Group's own funds to its internal capital remained on a level exceeding both the threshold set by the law and the Group's internal limits.

Disclosures (Pillar III)

The Group annually announces information, in particular, about risk management and capital adequacy in accordance with: the CRR regulation and the implementing acts thereto, Recommendation H, the Polish Banking Law, the Act on Macro-Prudential Supervision, Recommendation M relating to operational risk management in banks and Recommendation P relating to liquidity risk, issued by the Polish Financial Supervision Authority.

Details of the scope of information disclosed, the method of its verification and publication are presented in PKO Bank Polski SA Capital Adequacy Information Policies and other information to be published, which are available on the Bank's website (www.pkobp.pl).

72. Information on securitization of lease portfolio and portfolio sale of receivables

In connection with the acquisition of Raiffeisen-Leasing Polska SA and its subsidiaries (for details, see note Acquisition of Raiffeisen-Leasing Polska SA by PKO Leasing SA), the Group consolidated a special purpose vehicle ROOF Poland Leasing 2014 DAC with its registered office in Ireland. The SPV is buying securitized receivables resulting from lease agreements sold by Raiffeisen-Leasing Polska SA under the securitization plan which was initiated in December 2014. The receivables acquired by the SPV were financed by an issue of securities. The objective and benefit of selling these receivables to the SPV was to obtain and diversify sources of long-term financing.

Carrying amounts of the financial assets and financial liabilities covered by securitization are presented in the table below:

31.12.2017	Transaction value	Amount of risk remaining in the Group
Carrying amount of assets	1 381	1 381
Carrying amount of liabilities	1 261	1 261
Net balance	120	120

31.12.2016	Transaction value	Amount of risk remaining in the Group
Carrying amount of assets	1 376	1 376
Carrying amount of liabilities	1 261	1 261
Net balance	115	115

Moreover, in 2017 the Group performed sales of impaired loan portfolios (balance sheet and off-balance sheet receivables) of more than 17.8 thousand individual receivables from retail and business customers amounting to approximately PLN 1.5 billion. The total carrying amount of the provision for potential claims on sale of impaired loan portfolios as at 31 December 2017 amounted to PLN 2 million (as at 31 December 2016 it was PLN 3 million). As a result of loan sale all risks and rewards were transferred, hence the Group derecognized these assets.

The Group did not receive any securities on account of the above-mentioned transactions.

Subsequent events

73. Subsequent events

1. On 30 January 2018, the Bank adopted a resolution consenting to an issue of subordinated bonds in the 10NC5 format, i.e. with 10-year maturity and the Bank's right to early redemption, subject to permission from the PFSA, all bonds after 5 years of the issuance date (the call option). The total nominal value of the bonds in this issue will amount to no more than PLN 1 billion. Bonds will be issued based on the Bonds Act, and the funds obtained from the issue will be used, subject to permission from the PFSA, to increase the Bank's Tier 2 capital. The nominal value of one bond will amount to PLN 500 000. Bonds will bear interest at a market level, with a half-yearly interest period, and the interest on the bonds will increase their nominal value.

(IN PLN MILLION)

2. On 8 February 2018, the Bank made full and final early repayment of a credit line granted by Nordea Bank AB (publ) based on an agreement dated 1 April 2014. Initially, the credit line was granted for a period of 7 years, which means that the Bank repaid it 3 years before its original maturity.

SIGNATURES OF ALL MEMBERS OF THE BANK'S MANAGEMENT BOARD

27.02.2018	ZBIGNIEW JAGIEŁŁO	PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	RAFAŁ ANTCZAK	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	RAFAŁ KOZŁOWSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	MAKS KRACZKOWSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	MIECZYSŁAW KRÓL	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	ADAM MARCINIAK	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	PIOTR MAZUR	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	JAKUB PAPIERSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
27.02.2018	JAN EMERYK ROŚCISZEWSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)

SIGNATURE OF THE PERSON RESPONSIBLE
FOR MAINTAINING THE BOOKS OF ACCOUNT
27.02.2018
DANUTA SZYMAŃSKA
DIRECTOR OF THE ACCOUNTING DIVISION

....
(SIGNATURE)