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

Warsaw, February 2018

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

Table of content

Unconsolidated income statement ... **3**

Unconsolidated statement of comprehensive income ... **4**

Unconsolidated statement of financial position ... **5**

Unconsolidated statement of changes in equity ... **6**

Unconsolidated cash flow statement ... **8**

Notes to financial statements ... **10**

1. General information ... 10
2. Business combination ... 11
3. Statement of compliance ... 11
4. Significant accounting policies ... 11
5. Risk management ... 44
6. Custody activity ... 82
7. Brokerage activity ... 82
8. Interest income and expense ... 84
9. Fee and commission income and expense ... 85
10. Dividend income ... 85
11. Result on financial assets and liabilities held for trading ... 86
12. Gains (losses) on disposal ... 86
13. Administrative expenses ... 87
14. Depreciation and amortization ... 88
15. Net other operating income and expenses ... 88
16. Net impairment losses on financial assets and off-balance sheet commitments ... 89
17. Gains (losses) on subsidiaries and associates ... 91
18. Gains (losses) on disposal of property, plant and equipment, and intangible assets ... 91
19. Income tax ... 92
20. Earnings per share ... 95
21. Dividend proposal ... 95
22. Cash and balances with Central Bank ... 96
23. Loans and advances to banks ... 97
24. Financial assets and liabilities held for trading ... 98
25. Derivative financial instruments (held for trading) ... 99
26. Loans and advances to customers ... 104
27. Hedge accounting ... 105
28. Investment (placement) securities ... 110
29. Reclassification of securities ... 112
30. Assets held for sale and discontinued operations ... 113
31. Investments in subsidiaries ... 114
32. Investments in associates ... 116
33. Intangible assets ... 117
34. Property, plant and equipment ... 120
35. Investment property ... 122
36. Other assets ... 123
37. Assets pledged as collateral ... 123
38. Amounts due to other banks ... 124
39. Amounts due to customers ... 125
40. Debt securities issued ... 125
41. Subordinated liabilities ... 126
42. Provisions ... 126
43. Other liabilities ... 127
44. Defined benefit plans ... 127
45. Share - based payments ... 129
46. Operating and finance leases ... 133
47. Contingent commitments ... 134
48. Share capital ... 138
49. Other capital and reserves, retained earnings and profit for the period ... 139
50. Additional information to the cash flow statement ... 140
51. Related party transactions ... 141
52. Repo and reverse repo transactions ... 156
53. Company Social Benefits Fund (‘ZFŚS’) ... 157
54. Subsequent events ... 157

Glossary ... **I**

Unconsolidated income statement

(In PLN thousand)

	NOTE	2017	2016 RESTATED
Interest income	8	5 511 253	5 309 548
Interest expense	8	(1 024 509)	(1 042 675)
Net interest income		**4 486 744**	**4 266 873**
Fee and commission income	9	2 403 995	2 440 868
Fee and commission expense	9	(325 898)	(306 473)
Net fee and commission income		**2 078 097**	**2 134 395**
Dividend income	10	**188 070**	**132 824**
Result on financial assets and liabilities held for trading	11	**31 822**	**39 158**
Result on fair value hedge accounting	27	**4 616**	**1 313**
Gains (losses) on disposal of:	12	**186 757**	**435 903**
loans and other financial receivables		145 981	159 493
available for sale financial assets and held to maturity investments		41 048	276 493
financial liabilities		(272)	(83)
Operating income		**6 976 106**	**7 010 466**
Net impairment losses on financial assets and off-balance sheet commitments:	16	**(515 905)**	**(491 385)**
loans and other financial receivables		(494 561)	(390 638)
off-balance sheet commitments		(21 344)	(100 747)
Net result on financial activity		**6 460 201**	**6 519 081**
Administrative expenses	13	**(3 488 435)**	**(3 398 574)**
personnel expenses		(1 739 984)	(1 701 176)
other administrative expenses		(1 748 451)	(1 697 398)
Depreciation and amortization	14	**(329 140)**	**(323 231)**
Net result on other provisions		**(28 526)**	**(15 471)**
Net other operating income and expenses	15	**113 593**	**29 505**
Operating costs		**(3 732 508)**	**(3 707 771)**
Gains (losses) on subsidiaries and associates	17	**-**	**46 853**
Gains (losses) on disposal of property, plant and equipment, and intangible assets	18	**92**	**5 030**
Profit before income tax		**2 727 785**	**2 863 193**
Income tax expense	19	**(639 656)**	**(584 818)**
Net profit for the period		**2 088 129**	**2 278 375**
Earnings per share (in PLN per share)	20		
basic for the period		7.96	8.68
diluted for the period		7.96	8.68

Notes to the financial statements presented on pages 10 – 157 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of comprehensive income

(In PLN thousand)

	NOTE	2017	2016
Net profit for the period		**2 088 129**	**2 278 375**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss:			
Change in fair value of available-for-sale financial assets		229 601	(608 638)
Change in fair value of cash flow hedges	27	(33 143)	(5 557)
Tax on items that are or may be reclassified subsequently to profit or loss	19	(37 327)	116 697
Items that will never be reclassified to profit or loss:			
Remeasurements of the defined benefit liabilities	44	8 589	(11 400)
Tax on items that will never be reclassified to profit or loss	19	(1 632)	2 166
Other comprehensive income (net of tax)		**166 088**	**(506 732)**
Total comprehensive income		**2 254 217**	**1 771 643**

Notes to the financial statements presented on pages 10 – 157 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of financial position

(In PLN thousand)

	NOTE	31.12.2017	31.12.2016
ASSETS			
Cash and due from Central Bank	22	5 186 259	5 861 342
Loans and advances to banks	23	2 692 930	3 454 679
Financial assets held for trading	24	1 734 768	721 031
Derivative financial instruments (held for trading)	25	1 351 344	1 955 499
Loans and advances to customers	26	128 873 178	119 033 599
Hedging instruments	27	259 396	289 752
Investment (placement) securities	28	36 625 996	34 864 031
1. Available for sale		33 259 172	31 938 170
2. Held to maturity		3 366 824	2 925 861
Assets held for sale	30	51 450	48 277
Investments in subsidiaries	31	1 693 825	1 063 050
Investments in associates	32	-	27 552
Intangible assets	33	629 321	571 076
Property, plant and equipment	34	1 401 291	1 405 100
Investment properties	35	12 462	12 710
Income tax assets		717 726	875 287
1. Current tax assets		9 497	97 009
2. Deferred tax assets	19	708 229	778 278
Other assets	36	847 062	805 867
TOTAL ASSETS		**182 077 008**	**170 988 852**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to Central Bank	22	6 079	6 091
Amounts due to other banks	38	3 438 801	3 367 125
Financial liabilities held for trading	24	469 448	673 165
Derivative financial instruments (held for trading)	25	2 036 928	1 949 335
Amounts due to customers	39	146 898 298	138 066 129
Hedging instruments	27	862 331	1 638 718
Debt securities issued	40	1 470 000	300 945
Subordinated liabilities	41	1 257 188	-
Income tax liabilities		188 505	-
1. Current tax liabilities		188 505	-
2. Deferred tax liabilities		-	-
Provisions	42	593 635	560 483
Other liabilities	43	2 597 261	2 144 304
TOTAL LIABILITIES		**159 818 474**	**148 706 295**
Equity			
Share capital	48	262 470	262 470
Other capital and reserves	49	19 907 935	19 741 712
Retained earnings and net profit for the period	49	2 088 129	2 278 375
TOTAL EQUITY		**22 258 534**	**22 282 557**
TOTAL LIABILITIES AND EQUITY		**182 077 008**	**170 988 852**

Notes to the financial statements presented on pages 10 – 157 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of changes in equity

(In PLN thousand)

For the period from 1 January 2017 to 31 December 2017

	SHARE CAPITAL	OTHER CAPITAL AND RESERVES						RETAINED EARNINGS AND NET PROFIT FOR THE PERIOD	TOTAL EQUITY
		TOTAL OTHER CAPITAL AND RESERVES	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	OTHER		
Note	48	49						49	
Equity as at 1.01.2017	**262 470**	**19 741 712**	**9 137 221**	**1 982 324**	**8 612 550**	**(223 510)**	**233 127**	**2 278 375**	**22 282 557**
Management options	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options exercised (share issue)	-	-	-	-	-	-	-	-	-
Revaluation of management share options	-	-	-	-	-	-	-	-	-
Comprehensive income	**-**	**166 088**	**-**	**-**	**-**	**166 088**	**-**	**2 088 129**	**2 254 217**
Remeasurements of the defined benefit liabilities (net of tax)	-	6 957	-	-	-	6 957	-	-	6 957
Revaluation of available-for-sale investments (net of tax)	-	185 977	-	-	-	185 977	-	-	185 977
Revaluation of hedging financial instruments (net of tax)	-	(26 846)	-	-	-	(26 846)	-	-	(26 846)
Net profit for the period	-	-	-	-	-	-	-	2 088 129	2 088 129
Appropriation of retained earnings	**-**	**135**	**-**	**135**	**-**	**-**	**-**	**(2 278 375)**	**(2 278 240)**
Dividend paid	-	-	-	-	-	-	-	(2 278 240)	(2 278 240)
Profit appropriation	-	135	-	135	-	-	-	(135)	-
Equity as at 31.12.2017	**262 470**	**19 907 935**	**9 137 221**	**1 982 459**	**8 612 550**	**(57 422)**	**233 127**	**2 088 129**	**22 258 534**

Notes to the financial statements presented on pages 10 – 157 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of changes in equity (cont.)

(In PLN thousand)

For the period from 1 January 2016 to 31 December 2016

	SHARE CAPITAL	OTHER CAPITAL AND RESERVES						RETAINED EARNINGS AND NET PROFIT FOR THE PERIOD	TOTAL EQUITY
		TOTAL OTHER CAPITAL AND RESERVES	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	OTHER		
Note	48	49						49	
Equity as at 1.01.2016	**262 470**	**20 241 535**	**9 137 221**	**1 975 415**	**8 612 550**	**283 222**	**233 127**	**2 290 398**	**22 794 403**
Management options	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options exercised (share issue)	-	-	-	-	-	-	-	-	-
Revaluation of management share options	-	-	-	-	-	-	-	-	-
Comprehensive income	**-**	**(506 732)**	**-**	**-**	**-**	**(506 732)**	**-**	**2 278 375**	**1 771 643**
Remeasurements of the defined benefit liabilities (net of tax)	-	(9 234)	-	-	-	(9 234)	-	-	(9 234)
Revaluation of available-for-sale investments (net of tax)	-	(492 997)	-	-	-	(492 997)	-	-	(492 997)
Revaluation of hedging financial instruments (net of tax)	-	(4 501)	-	-	-	(4 501)	-	-	(4 501)
Net profit for the period	-	-	-	-	-	-	-	2 278 375	2 278 375
Appropriation of retained earnings	**-**	**6 909**	**-**	**6 909**	**-**	**-**	**-**	**(2 290 398)**	**(2 283 489)**
Dividend paid	-	-	-	-	-	-	-	(2 283 489)	(2 283 489)
Profit appropriation	-	6 909	-	6 909	-	-	-	(6 909)	-
Equity as at 31.12.2016	**262 470**	**19 741 712**	**9 137 221**	**1 982 324**	**8 612 550**	**(223 510)**	**233 127**	**2 278 375**	**22 282 557**

Notes to the financial statements presented on pages 10 – 157 constitute an integral part of the unconsolidated financial statements.

Unconsolidated cash flow statement

(In PLN thousand)

	NOTE	2017	2016
Cash flow from operating activities – indirect method			
Net profit for the period		**2 088 129**	**2 278 375**
Adjustments for:		**(1 443 511)**	**9 051 320**
Depreciation and amortization	14	329 140	323 231
(Gains) losses on investing activities		(40 756)	(280 478)
impairment on Investments in subsidiaries	16	4 600	-
Net interest income	8	(4 486 744)	(4 266 873)
Dividend income	10	(188 070)	(132 824)
Interests received		5 470 654	5 200 248
Interests paid		(1 035 829)	(1 081 547)
Income tax		639 656	760 897
Income tax paid		(336 586)	(588 333)
Change in loans and advances to banks		(22 423)	254 845
Change in financial assets held for trading		(1 013 029)	395 262
Change in derivative financial instruments (assets)		604 155	1 298 618
Change in loans and advances to customers and bill of exchange eligible for rediscounting at Central Bank		(9 765 225)	(433 828)
Change in investment (placement) securities		(198 390)	(915 972)
Change in other assets		(354 287)	1 274 345
Change in amounts due to banks		210 848	(1 041 057)
Change in financial liabilities held for trading		(203 717)	61 723
Change in derivative financial instruments (liabilities)		87 593	(1 252 463)
Change in amounts due to customers		8 857 960	8 831 221
Change in debt securities issued		(8 462)	(518)
Change in subordinated liabilities		7 188	-
Change in provisions		33 152	137 553
Change in other liabilities		(34 939)	507 270
Net cash flows from operating activities		**644 618**	**11 329 695**
Cash flow from investing activities			
Investing activity inflows		**63 947 355**	**83 108 936**
Sale of investment securities		63 083 547	82 209 397
Sale of intangible assets and property, plant and equipment		152	11 729
Dividend received	10	188 070	132 824
Other investing inflows		675 586	754 986
Investing activity outflows		**(66 043 715)**	**(96 483 471)**
Acquisition of shares in subsidiary		(607 825)	-
Acquisition of investment securities		(65 083 389)	(96 231 218)
Acquisition of intangible assets and property, plant and equipment	33, 34	(352 501)	(252 253)
Net cash flows from investing activities		**(2 096 360)**	**(13 374 535)**

Notes to the financial statements presented on pages 10 – 157 constitute an integral part of the unconsolidated financial statements.

Unconsolidated cash flow statement (cont.)

(In PLN thousand)

	NOTE	2017	2016
Cash flows from financing activities			
Financing activity inflows		**2 628 944**	**1 096 805**
Due to loans and advances received from banks	50	-	17 072
Issue of debt securities	50	1 378 944	1 079 733
Issue of subordinated liabilities	50	1 250 000	-
Financing activity outflows		**(2 633 506)**	**(4 870 376)**
Repayment of loans and advances received from banks	50	(139 462)	(155 835)
Redemption of debt securities	50	(215 804)	(2 431 052)
Dividends and other payments to shareholders		(2 278 240)	(2 283 489)
Net cash flows from financing activities		**(4 562)**	**(3 773 571)**
Total net cash flows		**(1 456 304)**	**(5 818 411)**
including: effect of exchange rate fluctuations on cash and cash equivalents held		(154 966)	98 767
Net change in cash and cash equivalents		**(1 456 304)**	**(5 818 411)**
Cash and cash equivalents at the beginning of the period		**8 750 011**	**14 568 422**
Cash and cash equivalents at the end of the period	50	**7 293 707**	**8 750 011**

Notes to the financial statements presented on pages 10 – 157 constitute an integral part of the unconsolidated financial statements.

Notes to the financial statements

(In PLN thousand)

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

1. General information

Bank Polska Kasa Opieki Spółka Akcyjna (hereafter referred to as 'Bank Pekao S.A.' or 'the Bank'), with Head Office in Warsaw, at 53/57 Grzybowska Street, 00-950 Warsaw, operates as a public listed company in compliance with binding law regulations, especially the Banking Act, Commercial Code and the Bank's Articles of Association.

The Bank was incorporated on 29 October 1929 in the Commercial Register of the District Court in Warsaw and has been continuously in operation since its incorporation.

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

The Bank's statistical REGON number is 000010205.

The entity has been established for an indefinite period of time.

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

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

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

Changes in share ownership structure of the Bank

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

2. Business combination

In 2017 the Bank acquired 51% of the share capital of Pekao Investment Management S.A. and 50% of the share capital of Dom Inwestycyjny Xelion Sp. z o.o. The transactions were detailed in the consolidated financial statements of Bank Pekao S.A. Group the period ended on 31 December 2017.

3. Statement of compliance

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

The Bank also prepares the Consolidated Financial Statements of Bank Pekao S.A. Group.

These unconsolidated financial statements were authorized for issue by the Management Board on 26 February 2018.

4. Significant accounting policies

4.1 Basis of preparation of Unconsolidated Financial Statements

General information

The Financial Statements of Bank Pekao S.A. have been prepared for the period from 1 January 2017 to 31 December 2017. Comparable data have been presented for the period from 1 January 2016 to 31 December 2016.

The financial statements have been prepared in Polish zloty, and all amounts are presented in PLN thousand, unless indicated otherwise.

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

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

Unconsolidated Financial Statements of the Bank have been prepared based on the following valuation methods:

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

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in presentation of financial data

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

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

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

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

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

	2016 (BEFORE RESTATEMENT)	RESTATEMENT	2016 (AFTER RESTATEMENT)
Interest income	5 309 548		5 309 548
Interest expense	(1 042 675)		(1 042 675)
Net interest income	**4 266 873**		**4 266 873**
Fee and commission income	2 009 842	431 026	2 440 868
Fee and commission expense	(306 473)		(306 473)
Net fee and commission income	**1 703 369**	431 026	**2 134 395**
Dividend income	**132 824**		**132 824**
Result on financial assets and liabilities held for trading	**470 184**	(431 026)	**39 158**
Result on fair value hedge accounting	**1 313**		**1 313**
Gains (losses) on disposal of:	**435 903**		**435 903**
loans and other financial receivables	159 493		159 493
available for sale financial assets and held to maturity investments	276 493		276 493
financial liabilities	(83)		(83)
Operating income	**7 010 466**		**7 010 466**
Net impairment losses on financial assets and off-balance sheet commitments	**(491 385)**		**(491 385)**
loans and other financial receivables	(390 638)		(390 638)
off-balance sheet commitments	(100 747)		(100 747)
Net result on financial activity	**6 519 081**		**6 519 081**
Administrative expenses	**(3 398 574)**		**(3 398 574)**
personnel expenses	(1 701 176)		(1 701 176)
other administrative expenses	(1 697 398)		(1 697 398)
Depreciation and amortization	**(323 231)**		**(323 231)**
Net result on other provisions	**(15 471)**		**(15 471)**
Net other operating income and expenses	**29 505**		**29 505**
Operating costs	**(3 707 771)**		**(3 707 771)**
Gains (losses) on subsidiaries and associates	**46 853**		**46 853**
Gains (losses) on disposal of property, plant and equipment, and intangible assets	**5 030**		**5 030**
Profit before income tax	**2 863 193**		**2 863 193**
Income tax expense	**(584 818)**		**(584 818)**
Net profit	**2 278 375**		**2 278 375**
Earnings per share (in PLN per share)			
basic for the period	8.68		8.68
diluted for the period	8.68		8.68

Notes to the financial statements (cont.)

(In PLN thousand)

The unconsolidated financial statements include the requirements of all the International Financial Reporting Standards and International Accounting Standards approved by the European Union and related interpretations. Changes in published standards and interpretations, which became effective on or after 1 January 2017, had no material impact on the unconsolidated financial statements (Note 4.9).

The financial statements does not take into consideration interpretations and amendments to Standards, pending approval by the European Union or approved by the European Union but came into force or shall come into force after the balance sheet date (Note 4.10 and Note 4.11).

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

Disclosures IFRS 9 'Financial Instruments'

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

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

Classification and measurement

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

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

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

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

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

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

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

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

Impairment of financial assets

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

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

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

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

Hedge accounting

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

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

Disclosures and comparatives

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

	IAS 39 MEASUREMENT CATEGORY	IFRS 9 MEASUREMENT CATEGORY	IAS 39 CARRYING AMOUNT	IFRS 9 CARRYING AMOUNT
Cash and due from Central Bank	Loans and advances (Amortised cost)	Amortised cost	5 186 259	5 186 048
Loans and advances to banks	Loans and advances (Amortised cost)	Amortised cost	2 692 930	2 692 936
Financial assets held for trading	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	1 734 768	1 734 768
Derivative financial instruments	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	1 351 344	1 351 344
Hedging derivatives	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	259 396	259 396
Loans and advances to customers	Loans and advances (Amortised cost)	Amortised cost	113 969 946	112 921 825
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through profit or loss (mandatory)	363 079	365 137
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through other comprehensive income	1 882 180	1 841 682
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Amortised cost	7 550 390	7 543 879
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Fair value through other comprehensive income	5 107 583	5 096 743
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Amortised cost	1 505 400	1 505 348
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Fair value through other comprehensive income	1 861 424	1 887 731
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Amortised cost	2 229 193	2 336 021
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	30 906 852	30 906 852
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through profit or loss (mandatory)	52 339	52 339
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	70 788	263 787
Other assets	Loans and advances (Amortised cost)	Amortised cost	802 989	798 016
FINANCIAL ASSETS			**177 526 860**	**176 743 852**

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

		CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
	FINANCIAL ASSETS				
	AMORTISED COST				
	Cash and due from Central Bank				
	Opening balance	5 186 259			
	Remeasurement			(211)	
	Closing balance				**5 186 048**
	Loans and advances to banks				
	Opening balance	2 692 930			
	Remeasurement			6	
	Closing balance				**2 692 936**
	Loans and advances to customers				
	Opening balance	128 873 178			
	Remeasurement			(1 048 121)	
A	Reclassification to fair value through other comprehensive income		(1 882 180)		
B	Reclassification to fair value through profit or loss		(363 079)		
C	Reclassification to Investments (placement) securities at fair value through other comprehensive income		(5 107 583)		
D	Reclassification to Investments (placement) securities at amortised cost		(7 550 390)		
	Closing balance				**112 921 825**
	Investments (placement) securities				
	Opening balance	3 366 824			
	Remeasurement			100 265	
D	Reclassification from Loans and advances to customers		7 550 390		
E	Reclassification from available for sale		2 229 193		
F	Reclassification to fair value through other comprehensive income		(1 861 424)		
	Closing balance				**11 385 248**
	Other assets				
	Opening balance	802 989			
	Remeasurement			(4 973)	
	Closing balance				**798 016**
	MEASURED AT AMORTISED COST TOTAL				**132 984 073**

Notes to the financial statements (cont.)

(In PLN thousand)

		CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
	AVAILABLE FOR SALE				
	Investments (placement) securities				
	Opening balance	33 259 172			
E	Reclassification to amortised cost		(2 229 193)		
G	Reclassification to fair value through other comprehensive income – debt securities		(30 906 852)		
H	Reclassification to fair value through other comprehensive income – equity instruments		(70 788)		
I	Reclassification to fair value through profit or loss – equity instruments		(52 339)		
	Closing balance				**-**
	FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME				
	Investments (placement) securities (debt securities)				
	Opening balance	-			
	Remeasurement			15 467	
G	Reclassification from available for sale		30 906 852		
C,F	Reclassification from amortised cost		6 969 007		
	Closing balance				**37 891 326**
	Investments (placement) securities (equity instruments)				
	Opening balance	-			
	Remeasurement			192 999	
H	Reclassification from available for sale		70 788		
	Closing balance				**263 787**
	Loans and advances to customers				
	Opening balance	-			
	Remeasurement			(40 498)	
A	Reclassification from amortised cost		1 882 180		
	Closing balance				**1 841 682**
	MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME TOTAL				**39 996 795**

Notes to the financial statements (cont.)

(In PLN thousand)

		CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
	FAIR VALUE THROUGH PROFIT OR LOSS				
	Financial assets held for trading	1 734 768			**1 734 768**
	Derivative financial instruments (held for trading)	1 351 344			**1 351 344**
	Hedging instruments	259 396			**259 396**
	Loans and advances to customers				
	Opening balance	-			
	Remeasurement			2 058	
B	Reclassification from amortised cost		363 079		
	Closing balance				**365 137**
	Investments (placement) securities – equity instruments				
	Opening balance	-			
I	Reclassification from available for sale		52 339		
	Closing balance				52 339
	FAIR VALUE THROUGH PROFIT OR LOSS TOTAL				**3 762 984**

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

Loans and advances to customers

A) Certain loans and advances to customers are measured at fair value through other comprehensive income because they are classified into a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Before applying the requirements of IFRS 9, these loans were measured at amortized cost, in accordance with IAS 39.

B) Some of the loans and advances to customers are classified as measured at fair value through profit or loss, as their contractual cash flows failed to meet the 'solely payments of principal and interest' (SPPI) requirement, due to the leverage that increases the volatility of the contractual cash flows. This applies mainly to student loans, loans with subsidies of the Agency for Restructuring and Modernization of Agriculture and several corporate exposures. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39.

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

Corporate and municipal debt securities

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

D) The remaining part of the portfolio, which is held to collect contractual cash flows, has been reclassified to the item Securities and is measured at amortized cost. Before applying the requirements of IFRS 9, these items were presented as 'Loans and advances to customers', as they were classified in the loans and receivables category in accordance with IAS 39.

Notes to the financial statements (cont.)

(In PLN thousand)

Investments (placement) securities

E) The Bank assessed the business model for investment securities, which are mostly held to collect cash flows and sell, and identified that in relation to certain of these securities its past practice has been to hold to collect the contractual cash flows and the intention of the Bank remains unchanged. Therefore, the Bank assessed that the appropriate business model for these securities is a model whose objective is to hold to collect contractual cash flows and reclassified them to the amortized cost measurement. Previously, these securities were classified as available for sale and measured at fair value through other comprehensive.

F) The Bank assessed the business model for held-to-maturity securities and, due to the intention to sell certain securities in this portfolio, reclassified securities to be measured at fair value through other comprehensive income, because it assessed that the appropriate business model for these securities is the model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39. Other securities previously classified as held to maturity were classified as amortized cost.

G) Other securities previously classified as available for sale were classified as at fair value through other comprehensive income, without the change in the measurement method.

Equity instruments

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

I) Other equity instruments that, in accordance with IAS 39, were classified as available for sale and were measured at fair value through other comprehensive income, and were not irrevocably designated for measurement at fair value through other comprehensive income, were reclassified to fair value through profit or loss.

Notes to the financial statements (cont.)

(in PLN thousand)

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

	IAS 39 MEASUREMENT CATEGORY	IFRS 9 MEASUREMENT CATEGORY	IMPAIRMENT ALLOWANCE IAS 39/IAS 37 31.12.2017	RECLASSIFICATIONS(*)	REMEASUREMENTS	IMPAIRMENT ALLOWANCE IFRS 9 01.01.2018
Cash and due from Central Bank	Loans and advances (Amortised cost)	Amortised cost	-	-	211	211
Loans and advances to banks	Loans and advances (Amortised cost)	Amortised cost	16 933	4 494	(6)	21 421
Loans and advances to customers	Loans and advances (Amortised cost)	Amortised cost	5 216 710	3 175 774	1 048 121	9 440 605
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through profit or loss (mandatory)	4 057	3 869	(7 926)	-
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through other comprehensive income	10 517	-	15 548	26 065
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Amortised cost	84 535	(31 680)	4 517	57 372
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Fair value through other comprehensive income	12 979	-	9 209	22 188
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Amortised cost	-	-	52	52
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Fair value through other comprehensive income	-	-	179	179
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Amortised cost	-	-	196	196
Investments (placement) securities – debt instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	-	-	1 846	1 846
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through profit or loss (mandatory)	-	-	-	-
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	1 020	(1 020)	-	-
Other assets	Loans and advances (Amortised cost)	Amortised cost	90 884	5 926	4 973	101 783
Provisions for undrawn credit facilities and guarantees issued	Provisions	Provisions	245 993	-	60 355	306 348
		IMPAIRMENT ALLOWANCES TOTAL	**5 683 628**	**3 157 363**	**1 137 275**	**9 978 266**

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

	IMPACT OF FIRST TIME ADOPTION OF IFRS 9 AT 01.01.2018		
	BEFORE TAX	DEFERRED TAX	NET
REVALUATION RESERVES			
Revaluation reserves at 31.12.2017 under IAS 39	**(70 892)**	**13 469**	**(57 423)**
Remeasurement of debt securities / loans and advances to customers reclassified from amortised cost to fair value through other comprehensive income	(48 527)	9 220	(39 307)
Remeasurement of debt securities reclassified from available for sale to amortised cost	105 030	(19 956)	85 074
Reclassification of equity instruments from available for sale to fair value through profit or loss	(3 232)	614	(2 618)
Remeasurement of equity instruments reclassified from available for sale to fair value through other comprehensive income	192 999	(36 670)	156 329
Recognition of ECL for debt securities / loans and advances to customers at fair value through other comprehensive income	50 278	(9 553)	40 725
Revaluation reserves at 01.01.2018 under IFRS 9	**225 656**	**(42 876)**	**182 780**
RETAINED EARNINGS			
Retained earnings at 31.12.2017 under IAS 39	**-**	**-**	**-**
Reclassification of equity instruments from available for sale to fair value through profit or loss	3 232	(614)	2 618
Remeasurement of loans and advances to customers mandatory at fair value through profit or loss	(5 868)	1 115	(4 753)
Recognition of ECL for financial assets and off-balance sheet commitments	(1 137 275)	202 662	(934 613)
Retained earnings at 01.01.2018 under IFRS 9	**(1 139 911)**	**203 163**	**(936 748)**
TOTAL IMPACT OF FIRST TIME ADOPTION OF IFRS 9 ON EQUITY	**(843 363)**	**146 818**	**(696 545)**

The provisions of IFRS 9 are not unambiguous and are subject to interpretation by both entities implementing the standard as well as by the regulator or audit firms, and the position of all interested parties is not uniform in all aspects.
The market practice of applying the standard's provisions is still changing and may be subject to change.

Notes to the financial statements (cont.)

(In PLN thousand)

Impact of IFRS 9 on capital adequacy

The Bank has decided to apply transitional arrangements specified in art. 473a of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 as amended Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State.

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

	IMPACT OF IFRS 9 WITH TRANSITIONAL ARRANGEMENTS	IMPACT OF IFRS 9 WITHOUT TRANSITIONAL ARRANGEMENTS
Total capital requirement	9 046 752	8 995 466
Total own funds (Tier 1 and Tier 2)	20 757 778	20 096 308
Total Capital Ratio (%)	18.4%	17.9%

IFRS 15 'Revenue from Contracts with Customers'

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

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

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

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

IFRS 15 defines a five-step revenue recognition model:

Step 1: Identifying the contract with a client

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

Step 2: Identifying performance obligations

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

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

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

Step 3: Determining the transaction price

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

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

Step 4: Allocating the transaction price to distinct performance obligations

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

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

Step 5: Revenue recognition

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

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

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

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

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

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

The Bank applies IFRS 15 from 1 January 2018. In 2017, the Bank analyzed the impact of implementing IFRS 15. The analysis covered the following types of contracts with clients:

1. Agreements with card organizations regarding marketing and promotional activities and related to the development of card activities,
2. Lease agreements in which the Bank is the lessor and, in addition to the rental rent, agree with the client (tenant) how to settle the maintenance fees for maintenance of the property. In such contracts, the Bank buys and resells, for example, municipal services and electricity,
3. Contracts for cash transport services for clients,
4. Bank accounts contracts, in relation to fees and commissions that are not included in effective interest rate,
5. Credit and loan agreements, in relation to fees and commissions that are not included in effective interest rate,
6. Agreements regarding the intermediation in the sale of insurance products,
7. Agreements regarding the investment funds management.

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

4.2 Accounting estimates

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

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

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

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

Impairment of loans and advances to customers

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

The Bank compares the estimated future cash flows applied for measurement of individual impairment allowances with the actual cash flows on a regular basis.

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

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

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

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

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

Impairment of non-current assets

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

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

Measurement of derivatives and unquoted debt securities available for sale

The fair value of non-option derivatives and debt securities available for sale that do not have a quoted market price on an active market is measured using valuation models based on discounted cash flows. Options are valued using option valuation models. Variables used for valuation purposes include, where possible, the data from observable markets. However, the Bank also adopts assumptions concerning counterparty's credit risks which affect the valuation of instruments. The adoption of other measurement assumptions may affect the valuation of these financial instruments. The assumptions used for fair value measurement are described in detail in Note 5.7 'Fair value of financial assets and liabilities'.

Provisions for defined benefit plans

The principal actuarial assumptions applied to estimation of provisions for defined benefit plans, as well as the sensitivity analysis were presented in Note 44.

Goodwill

The Bank performs an impairment test of goodwill on a yearly basis or more often if impairment triggers occur. The assessment of goodwill impairment requires an estimate of value in use of all cash-generating units to which the goodwill relates. The principal assumptions applied to an impairment test of goodwill were presented in Note 33.

4.3 Foreign currencies

- Transactions and balances

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

  Foreign currency translation differences arising from non-monetary items such as equity instruments classified as available for sale financial assets are recognized in the revaluation reserves.

4.4 Income statement

Interest income and expense

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

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

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

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

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

Fee and commission income and expense

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

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

Income and expense from bancassurance

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

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

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

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

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

Result on financial assets and liabilities held for trading

Result on financial assets and liabilities held for trading include:

- Foreign exchange result

  The foreign exchange gains (losses) are calculated taking into account the positive and negative foreign currency translation differences, whether realized or unrealized from the daily valuation of assets and liabilities denominated in foreign currencies. The revaluation is perform using the average exchange rate announced by the NBP on the balance sheet date.

  The foreign exchange result includes swap points from derivative transactions, entered into by the Bank for the purpose of managing the Bank's liquidity in foreign currencies.

  Income from foreign exchange positions includes also foreign currency translation differences from valuation of investments in foreign operations arising on disposal thereof. Until the disposal, foreign currency translation differences from valuation of assets in foreign operations are recognized in 'Other capital and reserves'.

- Income from derivatives and securities held for trading

  The income referred to above includes gains and losses realized on a sale or a change in the fair value of assets and liabilities held for trading.

  The accrued interest and unwinding of a discount or a premium on securities held for trading is presented in the net interest income.

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

Other operating income/expense

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

4.5 Valuation of financial assets and liabilities, derivative financial instruments

Financial assets

Financial assets are classified into the following categories:

- Financial assets measured at fair value through profit or loss

  This category comprises two sub-categories: financial assets held for trading and financial assets designated at initial recognition as financial assets measured at fair value through profit or loss.

  Financial assets held for trading include: debt and equity securities, loans and receivables purchased or classified into this category for the purpose of disposal thereof on a short-term basis. The classification also includes derivative instruments (not used as hedging instruments).

  Financial assets classified at the moment of original recognition as financial assets measured at fair value through profit or loss include debt securities acquired by the Bank for the purpose of elimination or considerable reduction of inconsistencies in the valuation between these securities and the derivatives, which are economically hedging the interest rate risk of such securities. Otherwise, such securities would have been classified into the 'available for sale' portfolio, with the effect of valuation recognized in revaluation reserves, and valuation of derivatives economically hedging such securities reported in the income statement.

- Held to maturity

  These are non-derivative financial assets with fixed or determinable payments and fixed maturity, for which the entity has an intent and ability to hold to maturity, other than:

  a) those that the entity upon initial recognition designates as at fair value through profit or loss,
  b) those that the entity designates as available for sale, and
  c) those that meet the definition of loans and receivables.

  Financial assets classified into this category are measured at amortized cost using the effective interest rate method. The recognition of amortized cost with the use of effective interest rate is recognized in interest income.

- Loans and receivables

  Loans and receivables are non-derivative financial assets, with fixed or determinable payments, not quoted on active markets, other than:

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

  This category also contains debt securities, purchased from the issuer, for which there is no active market, as well as credits, loans, receivables from reverse repo transactions and other receivables acquired and granted. Loans and receivables are measured at amortized cost using the effective interest rate method and with consideration of impairment.

Notes to the financial statements (cont.)

(In PLN thousand)

- Available for sale

  This includes financial assets with an undefined holding period. The portfolio includes: debt and equity securities, as well as loans and receivables not classified into other categories. Interest on assets available for sale is calculated using the effective interest rate method, and is recognized in the income statement.

  Available for sale financial assets are measured at fair value, whereas gains and losses resulting from changes in fair value against amortized cost are recognized in the revaluation reserves. Amounts in the revaluation reserves are recognized in the income statement either on the sale of an asset, or its impairment. In case of impairment of an asset, previous increases from revaluation to fair value will decrease the 'Revaluation reserves'. Should the amount of previously recognized increases be insufficient to cover the impairment, the difference will be recorded in the income statement as 'Net impairment losses on financial assets and off-balance sheet commitments'.

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

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

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

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

Derivative instruments are recognized or derecognized on transaction dates.

Reclassification of financial assets

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Impairment of financial assets

Assets measured at amortized cost – loans and advances

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

The amount of the impairment loss is recognized in profit or loss. If, in a subsequent period, the amount of impairment loss decreases, then the previously recognized impairment loss is reversed by adjusting an allowance account. The amount of the reversal is recognized in profit or loss.

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Financial assets available for sale

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

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

Off-balance sheet commitments

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

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

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

Repo and reverse-repo agreements

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

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

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

Derivative financial instruments and hedge accounting

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

This occurs under the following conditions:

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

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

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

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

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

Fair value hedge accounting principles

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

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

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

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

An adjustment for the hedged risk on hedged interest position is amortized in the profit and loss account at the point of ceasing to apply hedge accounting.

Cash flow hedge accounting principles

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

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

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

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

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

Financial liabilities

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

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

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

Subordinated liabilities

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

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

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

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

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

4.6 Valuation of other items in the Bank's unconsolidated statement of financial position

Investments in subsidiaries and associates

Subsidiaries

Subsidiaries are entities controlled by the Bank, i.e. the Bank has existing rights that give it the current ability to direct the relevant activities - the activities that significantly affect the investee's returns and is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary.

Associates

Associates are entities, over which the Bank has a significant influence and which are neither subsidiaries, nor joint ventures. The Bank usually holds from 20% to 50% of voting rights at the governing body of the entity.

Recognition and measurement

In the Bank's Financial Statements, the investments in subsidiaries, associates and entities under common control are measured at purchase price. The carrying amount of the investment is tested for impairment according to IAS 36 'Impairment of assets'.

The impairment is recognized in the income statement under 'Gains (losses) from associates and subsidiaries. Dividends constituting an income from the investments are recognized in the income statement at the payment date.

Moreover, the capital investments in the entity operating abroad are non-financial assets. Non-financial assets are valued at historical cost in foreign currency, are translated into PLN using the exchange rate at the transaction date. Investments in foreign entity, acquired before the date of adoption of IFRS, are recognized at the carrying amount as at that date.

Business combinations

The Bank recognizes a business combination (except for purchase transactions under common control) using the acquisition method. The consideration transferred in the business combination of projects is measured at fair value of the assets given, liabilities incurred to the former owners of the acquiree and the equity interests issued by the Bank. The consideration transferred includes the fair value of an asset or liability resulting from a contingent payment arrangements. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at initial recognition at their fair values at the acquisition date.

Costs related to the acquisition of a business are recorded as expenses in the period.

Notes to the financial statements (cont.)

(In PLN thousand)

The excess of the consideration transferred over the fair value of the identifiable net assets acquired is recognized as goodwill. If all of the consideration transferred, the recognized non-controlling interests and the previously held shares is lower than the fair value of the net assets of the subsidiary acquired in a bargain purchase, the difference is recognized directly in the income statement.

Recognition of common control transactions at book value

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

The adopted accounting principles are as follows:

- the acquirer recognizes the assets and liabilities of the target entity at their existing book value adjusted only as a result of aligning the combining enterprises' accounting policies. Neither goodwill, nor negative goodwill is recognized. The difference between the book value of acquired net assets and the fair value of the amount paid is recognized in the Bank's equity. In applying the book value method of accounting, the data concerning the comparative periods is not restated,
- if the transaction results in acquisition of non-controlling interests, the acquisition of any non-controlling interest is recognized separately.

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

Intangible assets

Goodwill

Goodwill arising in a business combination is recognized in the amount of the excess of the consideration transferred over the fair value of the identified assets, liabilities and contingent liabilities at the date of acquisition. Goodwill at initial recognition is carried at purchase price reduced by any accumulated impairment losses. Impairment is determined by estimating the recoverable value of the cash generating unit, to which given goodwill pertains. If the recoverable value of the cash generating unit is lower than the carrying amount, an impairment charge is made. Impairment identified in the course of such tests is not subject to subsequent adjustments.

Other intangible assets

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

These assets mainly include:

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Property, plant and equipment

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

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

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

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

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

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

Depreciation and amortization

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

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

a) depreciation rates applied for non-current assets

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

b) amortization rates for intangible assets

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

c) depreciation rates for investment properties

Buildings and structures	1.5% – 10.0%

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

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

Investment properties

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

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

Non-current assets held for sale and discontinued operations

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

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

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

Leases

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

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

Operating leases

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

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

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

Finance leases

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

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

Provisions

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

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

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

Deferred income and accrued expenses (liabilities)

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

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

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

Government grants

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

The Bank’s equity

Equity is comprised of the capital and funds created by the Bank in accordance with the binding legal regulations and the appropriate laws and Articles of Association. Equity also includes retained earnings and net profit for the period.

The Bank’s equity comprises of the following:

a) share capital – can be increased through the issue of new shares or through an increase of the nominal value of already issued shares. At the General Shareholder’s Meeting the share capital can be increased by means of reserve capital or other capital, if it is in accordance with the Bank’s Articles of Association and Corporate Code,
b) reserve capital – created out of the annual net profit write-offs to be called in the event of loss, which may occur due to the Bank’s operations. Annual write-off should amount to at least 8% of net profit and should be made until the reserve capital reaches 1/3 of share capital value. Share premium formed from agio obtained from the issue of share, reduced by the attributable direct costs incurred with that issue is also a part of reserve capital,
c) revaluation reserve arises from the revaluation of financial instruments classified as available for sale, cash flow hedging derivatives, remeasurements of the defined benefit liabilities and the value of deferred tax for items classified as temporary differences recognized as revaluation reserve. In the statement of financial position revaluation reserve is recognized in net value,
d) other reserve capital utilized for the purposes defined in the Articles of Association is created from appropriations of profits,
e) capital components:
   - bonds convertible to shares - includes the fair value of financial instruments issued as part of transactions settled in equity instruments, and
   - provision for purchase of parent entity stocks,
f) general banking risk fund in Bank Pekao S.A. is created in accordance with the Banking Act dated 29 August 1997 with subsequent amendments, from profit after tax,
g) retained earnings from prior periods is created from undistributed result from previous years,
h) net profit/loss, which constitutes of profit/loss for the period. Net profit is after taxation.

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

4.7 Income tax

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

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

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

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

4.8 Other

Contingent liabilities and commitments

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

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

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

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

Cash and cash equivalents

Cash and cash equivalents in the unconsolidated cash flow statement include 'Cash and due from Central Bank' as well as loans and receivables from banks with maturity up to three months.

Segment reporting

Information concerning segment reporting of the Group are presented in Consolidated Financial Statements of Bank Pekao S.A. Group for the year ended on 31 December 2017.

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

4.10 New standards, interpretations and amendments to published standards that have been published by the International Accounting Standards Board (IASB) and adopted by the EU but not yet effective

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 9 'Financial Instruments'	New regulations constitute a part of changes designed to replace IAS 39 'Financial Instruments: Recognition and Measurement'. The main changes, introduced by the new standard, are as follows: • new categorisation of financial assets, • new criteria of assets classification to the group of financial assets measured at amortized cost, • new impairment model – expected credit losses model, • new principles for recognition of changes in fair value measurement of capital investment in financial instruments, • elimination of the necessity to separate embedded derivatives from financial assets. The major part of IAS 39 requirements relating to financial liabilities classification and valuation were transferred to IFRS 9 unchanged. Date of application: the first financial year beginning on or after 1 January 2018.	The impact assessment of the new standard implementation on Bank's financial statements is described in note 4.1 Basis of preparation of unconsolidated financial statements.
IFRS 15 'Revenue from Contracts with Customers'	The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally. The core principle of the new Standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. In accordance with new IFRS 15, the revenue is recognized when the control over the goods or services is transferred to the customer. Date of application: the first financial year beginning after 1 January 2018.	The impact assessment of the new standard implementation on Bank's financial statements is described in note 4.1 Basis of preparation of unconsolidated financial statements.
IFRS 15 (amendment) 'Revenue from Contracts with Customers'	Clarifications to IFRS 15 Revenue from Contracts with Customers. Date of application: annual periods beginning on or after 1 January 2018.	The Bank is currently analyzing the impact of those changes on the financial statements.
IFRS 16 'Leases'	Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. IFRS 16 defines a lease term as the noncancellable period for which the lessee has the right to use an underlying asset including optional periods when an entity is reasonably certain to exercise an option to extend (or not to terminate) a lease. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis. Date of application: annual periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of this Standard.	The Bank did not use the option of early application of IFRS 16 and will apply the standard from 1 January 2019. As part of the implementation of the new standard, the Bank commenced the assessment of contracts to identify whether the contract meets the definition of leasing and estimate of the leasing period. The new requirements eliminate nearly all off balance sheet accounting for lessees. The new standard requires lessees to recognise nearly all leases on the balance sheet which will reflect their right to use an asset for a period of time and the associated liability for payments. This will redefine many commonly used financial metrics. The Bank plans to elect not to apply the new requirements to short-term leases and leases for which the underlying asset is of low value. The value of leasing payments according to maturity dates as at 31 December 2017 is presented in the Note 46.
IFRS 4 (amendment) 'Insurance Contracts'	The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing the replacement standard that the Board is developing for IFRS 4. Date of application: annual periods beginning on or after 1 January 2018 or when IFRS 9 'Financial Instruments' is applied first time.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
Improvements to IFRS 2014-2016	Amendments result from the annual improvement project of IFRS. Amendments relate to IFRS 1, IFRS 12 and IAS 28 and were introduced primarily with a view to removing inconsistencies and clarifying wording. Date of application: amendments to I IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.

(In PLN thousand)

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

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 14 'Regulatory deferral accounts'	The aim of this standard is to enhance the comparability of financial reporting by entities that are engaged in rate-regulated activities. Date of application: the first financial year beginning on or after 1 January 2016. The European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard.	The Bank claims that the new standard will not have a material impact on its financial statements in the period of its first application.
IFRS 17 'Insurance Contracts'	The new standard requires insurance liabilities to be measured at a current fulfillment value and provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of a consistent, principle-based accounting for insurance contracts. IFRS 17 supersedes IFRS 4 'Insurance Contracts' and related interpretations while applied. Date of application: annual periods beginning on or after 1 January 2021.	The Bank claims that the new standard will not have a material impact on its financial statements in the period of its first application.
IFRS 10 (amendment) 'Consolidated Financial Statements' and **IAS 28 (amendment)** 'Investments in Associates and Joint Ventures'	The amendments concern the sale or contribution of assets between the investor and the associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. Effective date has been deferred indefinitely until the research project on the equity method has been concluded.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IFRS 2 (amendment) 'Share-based Payment'	The amendments provide requirements on the accounting for: (a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, (b) share-based payment transactions with a net settlement feature for withholding tax obligations, and (c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. Date of application: annual periods beginning on or after 1 January 2018. At the date of authorisation of these financial statements the amendment has not been endorsed by EU.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IFRS 9 (amendment) 'Financial Instruments'	Amendments to IFRS 9 - Prepayment Features with Negative Compensation – modify the existing requirements regarding termination rights in order to allow measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments. Under the amendments, the sign of the prepayment amount is not relevant, i. e. depending on the interest rate prevailing at the time of termination, a payment may also be made in favour of the contracting party effecting the early repayment. The calculation of this compensation payment must be the same for both the case of an early repayment penalty and the case of an early repayment gain. Date of application: annual periods beginning on or after 1 January 2019.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 19 (amendment) 'Employee Benefits'	Amendments to IAS 19 'Employee Benefits' - Plan Amendment, Curtailment or Settlement – require to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. Date of application: annual periods beginning on or after 1 January 2019.	The Bank is currently analyzing the impact of those changes on the financial statements.
IAS 28 (amendment) 'Investments in Associates and Joint Ventures'	Amendments to IAS 28 - Long-term Interests in Associates and Joint Ventures - were introduced to clarify that an entity applies IFRS 9 including its impairment requirements, to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. Amendments also delete paragraph 41 because the Board felt that it merely reiterated requirements in IFRS 9 and had created confusion about the accounting for long-term interests. Date of application: annual periods beginning on or after 1 January 2019.	The Bank is currently analyzing the impact of those changes on the financial statements.

Notes to the financial statements (cont.)

(In PLN thousand)

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IAS 40 (amendment) 'Investment Property'	Amendments to IAS 40 'Investment Property' - Transfers of Investment Property state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. Amendments also state that the list of evidence in paragraph 57 was designated as non-exhaustive list of examples instead of the previous exhaustive list. Date of application: annual periods beginning on or after 1 January 2018. At the date of authorisation of these financial statements the amendment has not been endorsed by EU.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IFRIC 22 'Foreign Currency Transactions and Advance Consideration'	Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. Date of application: annual periods beginning on or after 1 January 2018. At the date of authorisation of these financial statements the amendment has not been endorsed by EU.	The Bank claims that the interpretation will not have a material impact on its financial statements in the period of its first application.
IFRIC 23 'Uncertainty over Income Tax Treatments'	It may be unclear how tax law applies to a particular transaction or circumstance, or whether a taxation authority will accept a company's tax treatment. IAS 12 Income Taxes specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. IFRIC 23 provides requirements that add to the requirements in IAS 12 by specifying how to reflect the effects of uncertainty in accounting for income taxes. Date of application: annual periods beginning on or after 1 January 2019.	The Bank is currently analyzing the impact of those changes on the financial statements.
Improvements to IFRS 2015-2017	Amendments to various standards resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording. The amendments clarify that: a company remeasures its previously held interest in a joint operation when it obtains control of the business (IFRS 3); a company does not remeasure its previously held interest in a joint operation when it obtains joint control of the business (IFRS 11); a company accounts for all income tax consequences of dividend payments in the same way (IAS 12); and a company treats as part of general borrowings any borrowing originally made to develop an asset when the asset is ready for its intended use or sale (IAS 23). Date of application: annual periods beginning on or after 1 January 2019.	The Bank is currently analyzing the impact of those changes on the financial statements.

5. Risk management

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

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

5.1 Organizational structure of risk management

Supervisory Board

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

Management Board

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

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

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

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

Committees

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

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

5.2 Credit risk

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

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

The Bank established the following portfolio limits:

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

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

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

Rating models utilized in the credit risk management process

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Rating scale

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

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

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

	31.12.2017	31.12.2016
Loans with no impairment:	**126 560 577**	**116 694 165**
Loans to individuals:	**61 262 073**	**55 008 720**
Covered by internal rating model:	59 051 653	52 788 310
Mortgage loans	48 725 080	44 031 290
Consumer loans	10 326 573	8 757 020
Other, not covered by internal rating model	2 210 420	2 220 410
Loans to corporates:	**65 298 504**	**61 685 445**
Covered by internal rating model:	20 433 962	20 110 510
Specialized lending exposures	7 247 765	8 149 239
Debt securities, not covered by internal rating model	12 657 973	12 352 160
Repo transactions, not covered by internal rating model	-	-
Other, not covered by internal rating model	24 958 804	21 073 536
Impaired loans	**2 312 601**	**2 339 434**
Total loans and advances to customers (*)	**128 873 178**	**119 033 599**

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

Notes to the financial statements (cont.)

(In PLN thousand)

Client/transaction rating and credit risk decision-making level

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

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

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

Validation of rating models

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

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

Bank's exposure to credit risk

The maximum credit risk exposure

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

	31.12.2017	31.12.2016
Due from Central Bank	2 499 686	3 221 816
Loans and advances from banks and from customers	131 566 108	122 488 278
Financial assets held for trading	1 734 768	721 031
Derivative financial instruments (held for trading)	1 351 344	1 955 499
Hedging instruments	259 396	289 752
Investment securities	36 625 996	34 864 031
Other assets (*)	2 496 812	1 848 418
Balance sheet exposure (**)	**176 534 110**	**165 388 825**
Obligations to grant loans	34 765 034	32 123 412
Other contingent liabilities	14 180 470	13 155 896
Off-balance sheet exposure	**48 945 504**	**45 279 308**
Total	**225 479 614**	**210 668 133**

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Credit risk mitigation methods

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

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

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

The financial effect of pledged collaterals for exposure portfolio with recognized impairment defined individually amounts to PLN 1 113 719 thousand as at 31 December 2017 (PLN 1 364 336 thousand as at 31 December 2016). The level of required impairment allowances for the portfolio would increase by this amount, if the discounted cash flows from collateral were not taken into account during estimation.

Notes to the financial statements (cont.)

(In PLN thousand)

Offsetting financial assets and financial liabilities

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

The netting agreements concluded by the Bank are:

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

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

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

- derivatives,
- repo and reverse-repo transactions.

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

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

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

31.12.2017	CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL RECEIVED	
FINANCIAL ASSETS				
Derivatives	1 330 858	(897 385)	(265 808)	167 665
TOTAL	**1 330 858**	**(897 385)**	**(265 808)**	**167 665**

31.12.2017	CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL PLEDGED	
FINANCIAL LIABILITIES				
Derivatives	2 582 790	(1 472 267)	(954 537)	155 986
TOTAL	**2 582 790**	**(1 472 267)**	**(954 537)**	**155 986**

Notes to the financial statements (cont.)

(In PLN thousand)

31.12.2016	CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL RECEIVED	
FINANCIAL ASSETS				
Derivatives	1 890 313	(1 429 548)	(182 765)	278 000
TOTAL	**1 890 313**	**(1 429 548)**	**(182 765)**	**278 000**

31.12.2016	CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL PLEDGED	
FINANCIAL LIABILITIES				
Derivatives	3 260 756	(1 429 548)	(1 651 984)	179 224
TOTAL	**3 260 756**	**(1 429 548)**	**(1 651 984)**	**179 224**

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

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

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

31.12.2017	NET CARRYING AMOUNT	ITEM IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES	NOTE
FINANCIAL ASSETS					
Derivatives	1 254 062	Derivative financial instruments (held for trading)	1 351 344	97 282	25
	76 796	Hedging instruments	259 396	182 600	27
FINANCIAL LIABILITIES					
Derivatives	1 724 385	Derivative financial instruments (held for trading)	2 036 928	312 543	25
	858 405	Hedging instruments	862 331	3 926	27

31.12.2016	NET CARRYING AMOUNT	ITEM IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES	NOTE
FINANCIAL ASSETS					
Derivatives	1 833 754	Derivative financial instruments (held for trading)	1 955 499	121 745	25
	56 559	Hedging instruments	289 752	233 193	27
FINANCIAL LIABILITIES					
Derivatives	1 624 494	Derivative financial instruments (held for trading)	1 949 335	324 841	25
	1 636 262	Hedging instruments	1 638 718	2 456	27

Overall characteristics of monitoring process

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

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

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

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

Overall characteristics of provisioning model

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

The quality analysis of the Bank's financial assets

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

	LOANS AND ADVANCES TO BANKS		LOANS AND ADVANCES TO CUSTOMERS	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
GROSS CARRYING AMOUNT OF EXPOSURE INDIVIDUALLY IMPAIRED				
- not past due	-	-	975 601	633 702
- up to 1 month	-	-	35 274	91 713
- between 1 month and 3 months	-	-	99 440	16 619
- between 3 months and 1 year	-	-	94 454	196 924
- between 1 year and 5 years	6 833	8 192	1 544 735	2 476 782
- above 5 years	-	-	2 050 785	1 411 099
Total gross carrying amount	**6 833**	**8 192**	**4 800 289**	**4 826 839**
ALLOWANCE FOR IMPAIRMENT				
- not past due	-	-	(250 081)	(294 032)
- up to 1 month	-	-	(23 419)	(27 867)
- between 1 month and 3 months	-	-	(84 182)	(5 750)
- between 3 months and 1 year	-	-	(33 760)	(112 383)
- between 1 year and 5 years	(6 833)	(8 192)	(1 091 124)	(1 538 621)
- above 5 years	-	-	(1 607 718)	(1 139 166)
Total allowance for impairment	**(6 833)**	**(8 192)**	**(3 090 284)**	**(3 117 819)**
Net carrying amount of exposure individually impaired	**-**	**-**	**1 710 005**	**1 709 020**
GROSS CARRYING AMOUNT OF EXPOSURE COLLECTIVELY IMPAIRED				
- not past due	-	-	211 456	158 064
- up to 1 month	-	-	57 971	68 614
- between 1 month and 3 months	-	-	66 230	54 001
- between 3 months and 1 year	-	-	293 001	275 341
- between 1 year and 5 years	-	-	1 015 377	1 165 552
- above 5 years	9 800	9 800	751 207	905 203
Total gross carrying amount	**9 800**	**9 800**	**2 395 242**	**2 626 775**
ALLOWANCE FOR IMPAIRMENT				
- not past due	-	-	(74 083)	(47 813)
- up to 1 month	-	-	(18 995)	(20 823)
- between 1 month and 3 months	-	-	(23 681)	(18 903)
- between 3 months and 1 year	-	-	(153 717)	(143 406)
- between 1 year and 5 years	-	-	(859 579)	(930 466)
- above 5 years	(9 800)	(9 800)	(662 591)	(834 950)
Total gross carrying amount	**(9 800)**	**(9 800)**	**(1 792 646)**	**(1 996 361)**
Net carrying amount of exposure collectively impaired	**-**	**-**	**602 596**	**630 414**

Notes to the financial statements (cont.)

(In PLN thousand)

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

	LOANS AND ADVANCES TO BANKS		LOANS AND ADVANCES TO CUSTOMERS (*)			
			CORPORATE		RETAIL	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
GROSS CARRYING AMOUNT OF EXPOSURE WITH NO IMPAIRMENT						
- not past due	2 693 230	3 455 272	65 436 872	61 768 472	60 067 833	53 518 115
- up to 30 days	-	-	66 232	94 810	976 696	1 269 909
- between 30 days and 60 days	-	-	19 212	11 356	177 766	169 422
- above 60 days	-	-	85 808	83 182	176 026	178 158
Total gross carrying amount	**2 693 230**	**3 455 272**	**65 608 124**	**61 957 820**	**61 398 321**	**55 135 604**
IBNR PROVISION						
- not past due	(300)	(593)	(303 258)	(264 727)	(93 073)	(79 646)
- up to 30 days	-	-	(2 660)	(4 999)	(24 877)	(30 590)
- between 30 days and 60 days	-	-	(2 649)	(1 322)	(11 275)	(9 530)
- above 60 days	-	-	(1 053)	(1 327)	(7 023)	(7 118)
Total gross carrying amount	**(300)**	**(593)**	**(309 620)**	**(272 375)**	**(136 248)**	**(126 884)**
Net carrying amount of exposure with no impairment	**2 692 930**	**3 454 679**	**65 298 504**	**61 685 445**	**61 262 073**	**55 008 720**

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

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

	LOANS AND ADVANCES TO BANKS		LOANS AND ADVANCES TO CUSTOMERS (*)	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
IMPAIRED EXPOSURE				
Gross carrying amount	16 633	17 992	7 195 531	7 453 614
Allowance for impairment	(16 633)	(17 992)	(4 882 930)	(5 114 180)
Total net carrying amount	**-**	**-**	**2 312 601**	**2 339 434**
EXPOSURES WITH IMPAIRMENT TRIGGERS FOR WHICH NO IMPAIRMENT HAS BEEN IDENTIFIED				
Gross carrying amount, in this:	-	-	83 300	23 231
Exposure with collateral value included in expected discounted cash flow, in this:	-	-	*83 300*	*23 231*
Past due exposures	-	-	*9 368*	*7 338*
IBNR provision	-	-	(7 629)	(2 380)
Total net carrying amount	**-**	**-**	**75 671**	**20 851**
EXPOSURES WITH NO IMPAIRMENT TRIGGERS				
Gross carrying amount	2 693 230	3 455 272	126 923 145	117 070 193
IBNR provision	(300)	(593)	(438 239)	(396 879)
Total net carrying amount	**2 692 930**	**3 454 679**	**126 484 906**	**116 673 314**

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

RATING	DEBT SECURITIES				
	HELD FOR TRADING	AVAILABLE FOR SALE	HELD TO MATURITY	REPO TRANSACTIONS (***)	TOTAL
AA+ to AA-	-	722 151	-	-	722 151
A+ to A-	1 646 757	20 695 128	3 335 371	492 419	26 169 675
no rating	88 011	11 718 765 (*)	31 453 (**)	-	11 838 229
Total	**1 734 768**	**33 136 044**	**3 366 824**	**492 419**	**38 730 055**

(*) Including NBP bills in an amount of PLN 11 066 168 thousand.
(**) Including NBP bills in an amount of PLN 31 453 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

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

RATING	DEBT SECURITIES				
	HELD FOR TRADING	AVAILABLE FOR SALE	HELD TO MATURITY	REPO TRANSACTIONS (***)	TOTAL
AA+ to AA-	-	327 613	-	-	327 613
A+ to A-	654 918	24 580 189	2 905 255	700 960	28 841 322
no rating	66 113	6 903 060 (*)	20 606 (**)	-	6 989 779
Total	**721 031**	**31 810 862**	**2 925 861**	**700 960**	**36 158 714**

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

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

RATING	DERIVATIVE INSTRUMENTS						
	TRADING DERIVATIVES			DERIVATIVE HEDGING INSTRUMENTS			TOTAL
	BANKS	OTHET FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	BANKS	OTHET FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	
AAA	129	-	-	-	-	-	129
AA+ to AA-	59 784	-	-	-	-	-	59 784
A+ to A-	588 677	102 882	-	40 143	-	-	731 702
BBB+ to BBB-	40 019	-	-	-	-	-	40 019
no rating	227 026	67 080	265 747	36 653	182 600	-	779 106
Total	**915 635**	**169 962**	**265 747**	**76 796**	**182 600**	**-**	**1 610 740**

Notes to the financial statements (cont.)

(In PLN thousand)

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

RATING	DERIVATIVE INSTRUMENTS						
	TRADING DERIVATIVES			DERIVATIVE HEDGING INSTRUMENTS			TOTAL
	BANKS	OTHET FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	BANKS	OTHET FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	
AAA	143	-	-	-	-	-	143
AA+ to AA-	75 047	-	-	1 044	-	-	76 091
A+ to A-	581 997	179 546	-	22 224	-	-	783 767
BBB+ to BBB-	379 748	-	-	4 414	-	-	384 162
no rating	344 785	69 631	324 602	26 868	235 202	-	1 001 088
Total	**1 381 720**	**249 177**	**324 602**	**54 550**	**235 202**	**-**	**2 245 251**

Forbearance measures

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

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

Share of forborne exposures in the Bank's loan portfolio

	31.12.2017	31.12.2016
LOANS AND ADVANCES TO CUSTOMERS		
Exposures with no impairment, of which:	**126 560 577**	**116 694 165**
forborne exposures	664 135	521 923
Impaired exposures, of which:	**2 312 601**	**2 339 434**
forborne exposures	1 459 420	1 423 229
Total net carrying amount, of which:	**128 873 178**	**119 033 599**
forborne exposures	2 123 555	1 945 152

The quality analysis of forborne exposures

	31.12.2017	31.12.2016
Exposures with no impairment		
Gross carrying amount	676 581	534 259
IBNR provisions	(12 446)	(12 336)
Net carrying amount	**664 135**	**521 923**
Impaired exposures		
Gross carrying amount, of which:	3 234 128	3 091 811
exposures individually impaired	2 845 179	2 765 086
exposures collectively impaired	388 949	326 725
Allowances for impairment, of which:	(1 774 708)	(1 668 582)
exposures individually impaired	(1 594 747)	(1 518 812)
exposures collectively impaired	(179 961)	(149 770)
Net carrying amount	**1 459 420**	**1 423 229**
Total net carrying amount	**2 123 555**	**1 945 152**

The Bank holds the collaterals for forborne exposures amounting to PLN 983 044 thousand as at 31 December 2017 (PLN 942 225 thousand as at 31 December 2016).

Notes to the financial statements (cont.)

(In PLN thousand)

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

	31.12.2017	31.12.2016
Gross carrying amount of exposures with no impairment, of which:	**676 581**	**534 259**
- not past due	628 675	449 697
- up to 30 days	23 597	59 739
- between 30 days and 60 days	13 341	14 172
- above 60 days	10 968	10 651
IBNR provisions for exposures with no impairment, of which:	**(12 446)**	**(12 336)**
- not past due	(9 538)	(7 639)
- up to 30 days	(1 228)	(3 012)
- between 30 days and 60 days	(1 079)	(1 020)
- above 60 days	(601)	(665)
Gross carrying amount of impaired exposures, of which:	**3 234 128**	**3 091 811**
- not past due	1 008 390	623 317
- up to 1 month	52 846	135 962
- between 1 month and 3 months	46 688	36 283
- between 3 months and 1 year	108 778	198 096
- between 1 year and 5 years	1 369 427	2 015 678
- above 5 years	647 999	82 475
Allowances for impairment, of which:	**(1 774 708)**	**(1 668 582)**
- not past due	(317 947)	(273 702)
- up to 1 month	(16 814)	(42 111)
- between 1 month and 3 months	(16 832)	(13 064)
- between 3 months and 1 year	(43 956)	(113 155)
- between 1 year and 5 years	(956 366)	(1 165 597)
- above 5 years	(422 793)	(60 953)
Total net carrying amount	**2 123 555**	**1 945 152**

Changes in net carrying amount of forborne exposures

	2017	2016
Net carrying amount at the beginning	**1 945 152**	**1 867 181**
Amount of exposures recognized in the period	738 324	526 305
Amount of exposures derecognized in the period	(149 565)	(191 032)
Changes in impairment allowances	(114 473)	(115 927)
Other changes	(295 883)	(141 375)
Net carrying amount at the end	**2 123 555**	**1 945 152**
Interest income	133 757	134 743

Forborne exposures by type of forbearance activity

	31.12.2017	31.12.2016
Modification of terms and conditions	3 738 310	3 432 795
Refinancing	172 399	193 275
Total gross carrying amount	**3 910 709**	**3 626 070**
Impairment allowances	(1 787 154)	(1 680 918)
Total net carrying amount	**2 123 555**	**1 945 152**

Notes to the financial statements (cont.)

(In PLN thousand)

Forborne exposures by product type

	31.12.2017	31.12.2016
Mortgage loans	1 616 774	1 241 146
Current accounts	275 530	264 371
Operating loans	958 423	977 785
Investment loans	761 581	844 813
Cash loans	196 501	221 506
Other loans and advances	101 900	76 449
Total gross carrying amount	**3 910 709**	**3 626 070**
Impairment allowances	(1 787 154)	(1 680 918)
Total net carrying amount	**2 123 555**	**1 945 152**

Forborne exposures by industrial sectors

	31.12.2017	31.12.2016
Corporations:	3 358 210	3 056 648
Real estate activities	879 952	469 314
Construction	836 437	779 262
Manufacturing	672 408	756 890
Professional, scientific and technical activities	508 804	552 400
Accommodation and food service activities	185 439	201 257
Wholesale and retail trade	124 777	151 160
Mining and quarrying	57 084	57 156
Transportation and storage	49 495	52 817
Agriculture, forestry and fishing	23 120	14 495
Other sectors	20 694	21 897
Individuals	552 499	569 422
Total gross carrying amount	**3 910 709**	**3 626 070**
Impairment allowances	(1 787 154)	(1 680 918)
Total net carrying amount	**2 123 555**	**1 945 152**

Forborne exposures by geographical structure

	31.12.2017	31.12.2016
Poland	3 609 562	3 278 979
Ukraine	271 325	319 396
Cyprus	28 747	26 874
Other countries	1 075	821
Total gross carrying amount	**3 910 709**	**3 626 070**
Impairment allowances	(1 787 154)	(1 680 918)
Total net carrying amount	**2 123 555**	**1 945 152**

Notes to the financial statements (cont.)

(In PLN thousand)

Credit risk concentration

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

a) Breakdown by individual entities.

As at 31 December 2017

EXPOSURE TO 10 LARGERST CLIENTS OF THE BANK	% SHARE OF PORTFOLIO
Client 1	2.9%
Client 2	1.3%
Client 3	1.2%
Client 4	1.0%
Client 5	0.8%
Client 6	0.7%
Client 7	0.7%
Client 8	0.7%
Client 9	0.6%
Client 10	0.5%
Total	**10.4%**

b) Concentration by capital groups.

As at 31 December 2017

EXPOSURE TO 5 LARGEST CAPITAL GROUPS SERVICED BY THE BANK	% SHARE OF PORTFOLIO
Group 1	4.4%
Group 2	1.5%
Group 3	1.5%
Group 4	1.0%
Group 5	0.9%
Total	**9.3%**

c) Breakdown by industrial sectors.

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

The table below presents the structure of exposures by industrial sectors

SECTOR DESCRIPTION	31.12.2017	31.12.2016
Wholesale and retail trade; repair of motor vehicles	14.2%	14.2%
Real estate activities	12.9%	11.9%
Financial and insurance activities	10.1%	9.1%
Public administration and defence	9.3%	10.5%
Electricity, gas, steam	6.6%	7.5%
Construction	6.3%	6.5%
Transportation and storage	5.2%	5.4%
Manufacture of metals, metal products and machinery	5.0%	4.8%
Manufacture of coke, rafined petroleum products, chemicals and pharmaceutical products	5.0%	4.3%
Manufacture of beverages and food products	4.2%	4.0%
Other manufacturing	6.2%	6.7%
Other sectors	15.0%	15.1%
Total	**100.0%**	**100.0%**

CHF loans to individuals

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

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

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

Gross and net amount of CHF loans to individuals

	31.12.2017	31.12.2016
Gross carrying amount, of which:	**3 169 019**	**4 103 581**
- denominated in CHF	3 149 127	4 072 572
- indexed to CHF	19 892	31 009
Impairment allowances, of which:	**(74 068)**	**(88 990)**
- denominated in CHF	(73 782)	(88 663)
- indexed to CHF	(286)	(327)
Net carrying amount, of which:	**3 094 951**	**4 014 591**
- denominated in CHF	3 075 345	3 983 909
- indexed to CHF	19 606	30 682

Notes to the financial statements (cont.)

(In PLN thousand)

Quality of CHF loans to individuals

	31.12.2017	31.12.2016
Gross carrying amount of exposures with no impairment, of which:	**3 029 027**	**3 940 307**
- not past due	2 872 144	3 629 664
- up to 30 days	116 099	254 847
- between 30 days and 60 days	30 541	42 417
- above 60 days	10 243	13 379
IBNR provisions for exposures with no impairment, of which:	**(7 371)**	**(10 208)**
- not past due	(3 420)	(3 812)
- up to 30 days	(2 231)	(4 341)
- between 30 days and 60 days	(1 268)	(1 465)
- above 60 days	(452)	(590)
Gross carrying amount of impaired exposures, of which:	**139 992**	**163 274**
- not past due	31 833	27 090
- up to 1 month	9 843	13 256
- between 1 month and 3 months	8 076	12 014
- between 3 months and 1 year	13 271	24 676
- between 1 year and 5 years	41 292	50 362
- above 5 years	35 677	35 876
Allowances for impairment, of which:	**(66 697)**	**(78 782)**
- not past due	(6 600)	(5 769)
- up to 1 month	(1 914)	(2 610)
- between 1 month and 3 months	(1 652)	(2 712)
- between 3 months and 1 year	(4 181)	(8 636)
- between 1 year and 5 years	(24 951)	(31 571)
- above 5 years	(27 399)	(27 484)
Total net carrying amount	**3 094 951**	**4 014 591**

As of 31 December 2017 the average LTV for CHF loans to individuals granted by the Bank amounted to 45.7% (55.5% as at 31 December 2016), with an average LTV for the whole portfolio of 64.3% (66.0% as at 31 December 2016).

Notes to the financial statements (cont.)

(In PLN thousand)

Credit exposures towards Ukraine

As at 31 December 2017, the net balance sheet value of remaining exposures towards Ukraine amounted to PLN 28 million (which constitutes 0.02% of total Bank exposures), less by PLN 83 million in comparison to the end of December 2016.

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

	31.12.2017	31.12.2016
Balance sheet exposure		
Loans and advances to banks	-	-
Loans and advances to customers	273 941	320 736
Total gross carrying amount	**273 941**	**320 736**
IBNR / Impairment allowances	(246 012)	(209 687)
Total net carrying amount	**27 929**	**111 049**
Off-balance sheet exposure		
Credit lines granted	263	428
Total gross carrying amount	**263**	**428**
IBNR	-	-
Total net carrying amount	**263**	**428**

5.3 Market risk

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Market risk of the trading book

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

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

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

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

	31.12.2017	MINIMUM VALUE	AVERAGE VALUE	MAXIMUM VALUE
foreign exchange risk	739	13	364	1 918
interest rate risk	791	496	1 013	1 925
Trading portfolio	1 058	533	1 150	3 030

	31.12.2016	MINIMUM VALUE	AVERAGE VALUE	MAXIMUM VALUE
foreign exchange risk	60	14	275	1 958
interest rate risk	819	804	1 106	1 677
Trading portfolio	845	845	1 207	2 309

Interest rate risk of the banking book

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

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

SENSITIVITY IN %	31.12.2017	31.12.2016
NII	(8.04)	(8.00)
EVE	0.65	(0.89)

Notes to the financial statements (cont.)

(In PLN thousand)

Currency risk

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

The table below presents the Bank's foreign currency risk profile by major foreign currencies measured at Value at Risk:

	31.12.2017	31.12.2016
Currencies total (*)	782	183

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

Currency exposure of the Bank

31.12.2017	BALANCE SHEET OPERATIONS		OFF-BALANCE SHEET OPERATIONS DERIVETIVES		NET POSITION
	ASSETS	LIABILITIES	LONG POSITION	SHORT POSITION	
EUR	17 972 461	18 576 246	12 845 293	12 286 334	(44 826)
USD	4 764 950	8 140 879	9 031 037	5 582 828	72 280
CHF	3 189 863	596 078	4 130 033	6 726 102	(2 284)
GBP	267 299	946 157	786 010	104 930	2 222
CZK	188 269	336 573	158 242	9 956	(18)
Other currencies	326 178	229 077	147 429	243 119	1 411
TOTAL	**26 709 020**	**28 825 010**	**27 098 044**	**24 953 269**	**28 785**

31.12.2016	BALANCE SHEET OPERATIONS		OFF-BALANCE SHEET OPERATIONS DERIVETIVES		NET POSITION
	ASSETS	LIABILITIES	LONG POSITION	SHORT POSITION	
EUR	19 671 015	15 647 626	12 841 581	16 829 373	35 597
USD	5 185 673	7 692 982	6 416 406	3 980 769	(71 672)
CHF	4 115 624	677 268	4 487 951	7 931 700	(5 393)
GBP	211 993	869 070	687 217	29 324	816
CZK	34 786	529 413	602 343	107 358	358
Other currencies	262 334	163 986	208 033	304 055	2 326
TOTAL	**29 481 425**	**25 580 345**	**25 243 531**	**29 182 579**	**(37 968)**

5.4 Liquidity risk

The objective of liquidity risk management is to:

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

Structure of financial liabilities by contractual maturity (*)

31.12.2017	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
BALANCE SHEET LIABILITIES						
Amounts due to banks (**)	1 928 108	17 075	1 931	573 489	984 799	3 505 402
Amounts due to customers	113 202 543	15 231 425	18 373 399	411 396	34 176	147 252 939
Debt securities issued	162 449	311 588	947 126	62 145	-	1 483 308
Subordinated liabilities	-	-	35 606	180 573	1 526 158	1 742 337
Financial liabilities held for trading	-	-	-	309 328	160 120	469 448
Total	**115 293 100**	**15 560 088**	**19 358 062**	**1 536 931**	**2 705 253**	**154 453 434**
OFF-BALANCE SHEET COMMITMENTS						
Off-balance sheet commitments Financial liabilities granted	34 677 534	-	-	-	-	34 677 534
Off-balance sheet commitments Guarantees liabilities granted	13 658 150	-	-	-	-	13 658 150
Total	**48 335 684**	**-**	**-**	**-**	**-**	**48 335 684**

31.12.2016	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
BALANCE SHEET LIABILITIES						
Amounts due to banks (**)	1 597 596	6 921	-	46 688	1 775 926	3 427 131
Amounts due to customers	107 841 287	11 537 418	18 576 061	518 100	73 296	138 546 162
Debt securities issued	28 689	185 841	-	87 861	-	302 391
Financial liabilities held for trading	102 076	-	131 194	263 435	176 460	673 165
Total	**109 569 648**	**11 730 180**	**18 707 255**	**916 084**	**2 025 682**	**142 948 849**
OFF-BALANCE SHEET COMMITMENTS						
Off-balance sheet commitments Financial liabilities granted	32 305 984	-	-	-	-	32 305 984
Off-balance sheet commitments Guarantees liabilities granted	12 942 576	-	-	-	-	12 942 576
Total	**45 248 560**	**-**	**-**	**-**	**-**	**45 248 560**

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

(**) Including Central Bank.

Notes to the financial statements (cont.)

(In PLN thousand)

Adjusted liquidity gap

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

Adjusted liquidity gap

31.12.2017	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Balance sheet assets	41 971 214	4 892 595	26 563 183	52 608 083	56 041 933	182 077 008
Balance sheet liabilities	18 924 004	10 491 005	23 885 964	20 324 418	108 451 617	182 077 008
Off-balance sheet assets/liabilities (net)	(6 214 174)	(132 591)	77 116	2 437 234	3 158 279	(674 136)
Periodic gap	**16 833 036**	**(5 731 001)**	**2 754 335**	**34 720 899**	**(49 251 405)**	**(674 136)**
Cumulated gap	**-**	**11 102 035**	**13 856 370**	**48 577 269**	**(674 136)**	**-**

31.12.2016	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Balance sheet assets	41 021 838	3 706 081	26 287 829	47 701 059	52 272 045	170 988 852
Balance sheet liabilities	18 663 527	6 572 791	18 984 512	18 086 818	108 681 204	170 988 852
Off-balance sheet assets/liabilities (net)	(5 077 072)	(11 391)	987 124	1 315 395	1 527 260	(1 258 684)
Periodic gap	**17 281 239**	**(2 878 101)**	**8 290 441**	**30 929 636**	**(54 881 899)**	**(1 258 684)**
Cumulated gap	**-**	**14 403 138**	**22 693 579**	**53 623 215**	**(1 258 684)**	**-**

Off-balance derivative transactions

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

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

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

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

- Cross-Currency Interest Rate Swaps (CIRS),
- Foreign currency forward contracts,
- Foreign currency swaps,
- Securities forwards.

(In PLN thousand)

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

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2017	32 892	27 031	649 422	837 586	285 318	**1 832 249**
31.12.2016	26 757	51 901	131 714	1 224 593	440 202	**1 875 167**

Flows related to off-balance derivative transactions settled in gross amounts

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2017						
Inflows	21 026 914	8 869 804	6 701 203	7 126 694	2 837 283	**46 561 898**
Outflows	21 031 547	8 907 287	6 812 217	7 504 531	2 923 301	**47 178 883**
31.12.2016						
Inflows	20 879 240	6 032 490	7 812 463	9 162 449	3 219 881	**47 106 523**
outflows	20 901 281	6 055 624	7 914 130	9 871 447	3 611 588	**48 354 070**

5.5 Operational risk

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

Operational risk management is based on internal procedures that are consistent with the law requirements, resolutions, recommendations and guidelines of the supervisor. Operational risk management includes identification, assessment, monitoring, preventing and reporting.

Identification and assessment of operational risk is based on an analysis of internal factors and external factors that may have a significant impact on the achievement of the objectives of the Bank. The main tools used in identifying and assessing operational risk are: internal operational events, external operational events, key risk indicators, scenario analysis and self-assessment of operational risk.

Monitoring activities are conducted on three levels of control: operational control (all employees), risk management control (Financial and Operational Risk Management Department) and internal audit (Internal Audit Department). Preventing operational risk includes definition of operational risk limits, and the obligation to initiate mitigation actions in case they are exceeded, the system of internal control, business continuity plans and insurance coverage.

Operational risk reporting system enables the assessment of the Bank's exposure to operational risk and the effective management of this risk, and also plays a fundamental role in the process of informing the Supervisory Board, the Management Board and executives of the Bank's exposure to operational risk. It is based in particular on the quarterly reports on operational risk control that include, among others: profile of operational risk, loss limit utilization, analysis of trends in the relevant categories of operational risk, potential losses, information on key indicators of operational risk and operational risk capital requirement.

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

OPERATING EVENTS BY CATEGORIES	2017	2016
Internal frauds	42.02%	5.28%
External frauds	26.96%	18.45%
Employment practices and workplace safety	1.73%	15.07%
Clients, products and business practices Execution, delivery and process management	3.40%	10.60%
Damages to physical assets	8.84%	34.27%
Business disruption and system failures	0.51%	0.42%
Execution, delivery and process management	16.54%	15.91%
Total	**100.00%**	**100.00%**

Notes to the financial statements (cont.)

(In PLN thousand)

5.6 Capital management

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

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

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

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

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

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

(In PLN thousand)

Regulatory capital requirements

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

Capital ratios are the basic measures applied for the measurement of capital adequacy. Minimum capital ratios required by law equal 9.75% for TCR and 7.75% for CET1 which are the sum of minimum value defined in Regulation 575/2013 (8.0% for TCR and 6.0% for T1) and the combined buffer requirement defined in Act of 5 August 2015 on macro-prudential supervision over financial system and crisis management in financial system (a conservation buffer of 1.25% and other systemically important institution buffer of 0.50%, according to the Polish Financial Supervision Authority (KNF) decision on 19 December 2017 (total of 1.75%). According to the recommendation of the KNF total capital ratio of the Bank must be not lower than 13.75% and Tier 1 capital ratio not lower than 10.75%.

As at 31 December 2017 total capital ratio of the Bank amounted at 18.4% (as at 31 December 2016 – 18.2%).

	31.12.2017	31.12.2016
CAPITAL REQUIREMENTS		
Credit and counterparty risk including CVA	8 538 883	8 045 784
Market risk	49 129	43 616
Operational risk	450 011	436 612
Total capital requirement	**9 038 023**	**8 526 012**
OWN FUNDS		
Common Equity Tier 1 capital	19 529 433	19 368 617
Capital Tier 1	1 250 000	-
Own funds for total capital ratio	**20 779 433**	**19 368 617**
OWN FUNDS REQUIREMENTS		
Common Equity Tier 1 capital ratio (%)	**17.3%**	**18.2%**
Total capital ratio (%)	**18.4%**	**18.2%**

Total capital ratio at the end of 2017 compared with the end of 2016 increased by 0.2 p.p.

Total capital requirement increased by 6.0%, mainly due to higher credit risk capital requirement resulting from, among others, increase in loan volumes and KNF recommendation on application of credit conversion factor (CCF) 0%.

Common Equity Tier 1 capital was higher by 0.8% as compared to December 2016. Increase in own funds for total capital ratio calculation by 7.3% resulted from including in Tier 2 capital, after obtaining KNF approval, the amount of PLN 1.25 billion from the issue of subordinated bonds.

For the purpose of capital requirement calculation the Bank uses:

- Standardised Approach for credit risk capital requirement calculation,
- Financial Collateral Comprehensive Method for credit risk mitigation,
- Mark-to-Market Method for counterparty credit risk capital requirement calculation,
- Standardised Approach for capital requirement calculation of specific risk and duration-based calculation for general risk of debt instruments,
- Standardised Approach for capital requirement calculation of general and specific risk of equity instruments,
- Standardised Approach for capital requirement calculation for pre-funded contributions to the default fund of a qualifying central counterparty,
- Standardised Approach for foreign-exchange risk capital requirement calculation,
- Simplified approach for commodities risk capital requirement calculation,
- Standardised Approach for capital requirements for credit risk valuation adjustment risk,
- Advanced Measurement Approach for operational risk measurement.

Notes to the financial statements (cont.)

(In PLN thousand)

Own funds

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

The Bank's own funds consist of Common Equity Tier 1 capital. Additional Tier 1 capital and Tier 2 capital.

	31.12.2017	31.12.2016
OWN FUNDS		
Capital	**22 258 534**	**22 282 557**
Component of the capital not included into own funds, in which:	**(2 088 129)**	**(2 278 375)**
Current year net profit	(2 088 129)	(2 278 375)
Regulatory adjustments, in which:	**(640 972)**	**(635 565)**
Intangible assets	(562 315)	(506 244)
Cash flow hedges	(5 331)	(32 177)
Unrealised loss from debt and capital instruments available for sale	-	-
Unrealised gain from debt and capital instruments available for sale	(28 386)	(51 443)
Additional value adjustments due to prudent calculation	(44 940)	(45 701)
Common Equity Tier 1 capital	**19 529 433**	**19 368 617**
Equity Tier 2 capital	**1 250 000**	**-**
Own funds for total capital ratio	**20 779 433**	**19 368 617**

Components of capital not included into own funds:

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

Regulatory adjustments:

- intangible assets (after deduction of related deferred tax liabilities) decrease Common Equity Tier 1 capital, according to Article 36 of Regulation No 575/2013,
- capital from revaluation reflects fair value of cash flow hedges is not included in any element of own funds, according to Article 33 of Regulation No 575/2013,
- unrealised losses from debt and capital instruments classified as available for sale according to Article 467 of Regulation No 575/2013 and Article 171a. Banking Act, decrease Common Equity Tier 1 capital in 100%,
- unrealised gains from debt and capital instruments classified as available for sale according to Article 468 of Regulation No 575/2013 and Article 171a. Banking Act are included in 80% to Common Equity Tier 1 capital,
- additional value adjustments due to prudent valuation are created for every asset measured at fair value, according to Article 34 of Regulation No 575/2013.

Internal capital adequacy assessment

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

The Bank takes the following risks into consideration:

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

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

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

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

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

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

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

5.7 Fair value of financial assets and liabilities

Financial instruments that are measured at fair value in the unconsolidated statement of financial position of the Bank

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

31.12.2017	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:	**19 692 416**	**16 185 012**	**727 252**	**36 604 680**
Financial assets held for trading	1 624 890	95 667	14 211	1 734 768
Derivative financial instruments, including:	-	1 350 126	1 218	1 351 344
- Banks	-	914 417	1 218	915 635
- Customers	-	435 709	-	435 709
Hedging instruments, including:	-	259 396	-	259 396
- Banks	-	76 796	-	76 796
- Customers	-	182 600	-	182 600
Securities available for sale	18 067 526	14 479 823	711 823	33 259 172
Liabilities:	**456 510**	**2 912 197**	**-**	**3 368 707**
Financial liabilities held for trading	456 510	12 938	-	469 448
Derivative financial instruments, including:	-	2 036 928	-	2 036 928
- Banks	-	822 329	-	822 329
- Customers	-	1 214 599	-	1 214 599
Hedging instruments, including:	-	862 331	-	862 331
- Banks	-	858 274	-	858 274
- Customers	-	4 057	-	4 057

31.12.2016	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:	**20 802 716**	**13 718 142**	**383 594**	**34 904 452**
Financial assets held for trading	634 666	20 252	66 113	721 031
Derivative financial instruments, including:	-	1 955 499	-	1 955 499
- Banks	-	1 381 720	-	1 381 720
- Customers	-	573 779	-	573 779
Hedging instruments, including:	-	289 752	-	289 752
- Banks	-	54 550	-	54 550
- Customers	-	235 202	-	235 202
Securities available for sale	20 168 050	11 452 639	317 481	31 938 170
Liabilities:	**527 836**	**3 733 382**	**-**	**4 261 218**
Financial liabilities held for trading	527 836	145 329	-	673 165
Derivative financial instruments, including:	-	1 949 335	-	1 949 335
- Banks	-	1 345 751	-	1 345 751
- Customers	-	603 584	-	603 584
Hedging instruments, including:	-	1 638 718	-	1 638 718
- Banks	-	1 636 262	-	1 636 262
- Customers	-	2 456	-	2 456

Notes to the financial statements (cont.)

(In PLN thousand)

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

2017	FINANCIAL ASSETS HELD FOR TRADING	DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS)	SECURITIES AVAILABLE FOR SALE
Opening balance	**66 113**	**-**	**317 481**
Increases, including:	1 388 818	2 353	717 283
Reclassification	-	-	674 519
Acquisition	1 387 394	-	-
Settlement	-	-	-
Derivatives transactions made in 2017	-	2 353	-
Gains on financial instruments	1 424	-	42 764
recognized in the income statement	1 424	-	41 152
recognized in revaluation reserves	-	-	1 612
Decreases, including:	(1 440 720)	(1 135)	(322 941)
Reclassification	-	-	-
Settlement/redemption	(1 020)	-	(290 030)
Sale	(1 439 693)	-	-
Losses on financial instruments	(7)	(1 135)	(32 911)
recognized in the income statement	(7)	(1 135)	(9 955)
recognized in revaluation reserves	-	-	(22 956)
Closing balance	**14 211**	**1 218**	**711 823**
Unrealized income from financial instruments held in portfolio at the end of the period, recognized in:	**400**	**(1 135)**	**2 853**
Income statement:	400	(1 135)	23 456
net interest income	178	-	23 456
result on financial assets and liabilities held for trading	222	(1 135)	-
Other comprehensive income	-	-	(20 603)

2016	FINANCIAL ASSETS HELD FOR TRADING	DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS)	SECURITIES AVAILABLE FOR SALE
Opening balance	**47 389**	**943**	**432 447**
Increases, including:	188 786	-	68 170
Reclassification	-	-	-
Acquisition	187 298	-	58 952
Settlement	-	-	-
Gains on financial instruments	1 488	-	9 218
recognized in the income statement	1 488	-	7 598
recognized in revaluation reserves	-	-	1 620
Decreases, including:	(170 062)	(943)	(183 136)
Reclassification	-	(943)	-
Settlement/redemption	(23 454)	-	(181 678)
Sale	(146 585)	-	-
Losses on financial instruments	(23)	-	(1 458)
recognized in the income statement	(23)	-	-
recognized in revaluation reserves	-		(1 458)
Closing balance	**66 113**	**-**	**317 481**
Unrealized income from financial instruments held in portfolio at the end of the period, recognized in:	**25**	**-**	**(1 187)**
Income statement:	25	-	271
net interest income	41	-	271
result on financial assets and liabilities held for trading	(16)	-	-
Other comprehensive income	-	-	(1 458)

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Financial instruments that are not measured at fair value in the unconsolidated statement of financial position of the Bank

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

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

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

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Assets and liabilitiesnot measured at fair value in the financial statement in breakdown by fair value hierarhy levels

31.12.2017	CARRYING AMOUNT	FAIR VALUE	OF WHICH:		
			LEVEL 1	LEVEL 2	LEVEL 3
ASSETS					
Cash and due from Central Bank	5 186 259	5 186 259	2 686 573	2 499 686	-
Receivables from banks	2 692 930	2 692 271	-	1 101 094	1 591 177
Loans and advances to customers	128 873 178	128 024 820	-	8 153 945	119 870 875
Debt securities held to maturity	3 366 824	3 400 630	3 369 179	31 451	-
Total assets	**140 119 191**	**139 303 980**	**6 055 752**	**11 786 176**	**121 462 052**
LIABILITIES					
Amounts due to Central Bank	6 079	6 080	-	-	6 080
Amounts due to other banks	3 438 801	3 433 767	-	671 642	2 762 125
Amounts due to customers	146 898 298	147 081 381	-	788 437	146 292 944
Debt securities issued	2 727 188	2 727 212	-	2 727 212	-
Total liabilities	**153 070 366**	**153 248 440**	**-**	**4 187 291**	**149 061 149**

31.12.2016	CARRYING AMOUNT	FAIR VALUE	OF WHICH:		
			LEVEL 1	LEVEL 2	LEVEL 3
ASSETS					
Cash and due from Central Bank	5 861 342	5 861 234	2 639 526	3 221 708	-
Receivables from banks	3 454 679	3 454 792	-	1 149 710	2 305 082
Loans and advances to customers	119 033 599	118 358 480	-	5 789 241	112 569 239
Debt securities held to maturity	2 925 861	2 940 300	2 919 694	20 606	-
Total assets	**131 275 481**	**130 614 806**	**5 559 220**	**10 181 265**	**114 874 321**
LIABILITIES					
Amounts due to Central Bank	6 091	6 185	-	-	6 185
Amounts due to other banks	3 367 125	3 411 401	-	482 375	2 929 026
Amounts due to customers	138 066 129	138 385 021	-	1 436 240	136 948 781
Debt securities issued	300 945	300 216	-	300 216	-
Total liabilities	**141 740 290**	**142 102 823**	**-**	**2 218 831**	**139 883 992**

(In PLN thousand)

6. Custody activity

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

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

7. Brokerage activity

Bank Pekao S.A. provides access to a wide range of the capital market services and products offered by the separated organizational unit of the Bank – Dom Maklerski Pekao, designed to sell capital market products.

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

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

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

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

	31.12.2017		31.12.2016	
	QUANTITY (PCS)	VALUE	QUANTITY (PCS)	VALUE
CLIENTS' FINANCIAL INSTRUMENTS				
Held on securities accounts	710 345 757	2 840 005	662 512 818	2 502 567
Equity securities and rights to such financial assets	709 650 397	2 441 801	661 813 492	2 421 214
Debt instruments and rights to such financial assets	695 360	398 204	699 326	81 353

Notes to the financial statements (cont.)

(In PLN thousand)

Customers' cash on brokerage accounts

	31.12.2017	31.12.2016
Deposited on cash accounts in brokerage house and paid for securities bought in IPO or on the primary market	294 437	285 398
Other customers' cash	2 749	15 136
Total	**297 186**	**300 534**

Settlements due to unsettled transactions

	31.12.2017	31.12.2016
Receivables from executed transactions	2 924	3 227
Liabilities from executed transactions	130	-

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

	31.12.2017	31.12.2016
Receivables from clearing fund	1 016	1 273
Receivables from margin deposits	13 156	11 786
Other receivables	64	59
Total receivables	**14 236**	**13 118**

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

	31.12.2017	31.12.2016
Receivables from compensation fund	474	423
Prepaid expenses - system maintenance payments	148	111
Deferred income - benefits from system	(622)	(534)
Total net balance sheet items concerning participation In the compensation fund	**-**	**-**

(In PLN thousand)

8. Interest income and expense

Interest income

	2017	2016
Loans and other receivables from customers	4 596 628	4 296 707
Interbank placements	80 792	79 740
Reverse repo transactions	30 427	50 078
Investment securities	667 367	732 706
Hedging derivatives	123 610	138 866
Financial assets held for trading	12 429	11 451
Total	**5 511 253**	**5 309 548**

Interest income for 2017 includes income from impaired financial assets in the amount of PLN 217 231 thousand (in 2016 PLN 234 113 thousand).

Total amount of interest income for 2017, measured at amortized cost using the effective interest rate method which applies to financial assets not measured at fair value through profit or loss amounted to PLN 3 875 686 thousand (in 2016 PLN 3 623 080 thousand).

Interest expense

	2017	2016
Deposits from customers	(924 150)	(949 238)
Interbank deposits	(16 301)	(24 586)
Repo transactions	(55 274)	(44 045)
Loans and advances received	(10 807)	(11 290)
Debt securities issued	(17 977)	(13 516)
Total	**(1 024 509)**	**(1 042 675)**

Total amount of interest expense for 2017, measured at amortized cost using the effective interest rate method with reference to financial liabilities, which are not valued at fair value through profit or loss amounted to PLN 781 187 thousand (in 2016 PLN 843 447 thousand).

Notes to the financial statements (cont.)

(In PLN thousand)

9. Fee and commission income and expense

Fee and commission income

	2017	2016
Accounts maintenance, payment orders and cash transactions	605 256	632 360
Payment cards	586 843	598 264
Loans and advances	414 696	439 541
Margin on foreign exchange transactions with clients	439 623	431 026
Investment products sales intermediation	187 614	176 425
Securities operations	16 717	13 836
Custody activity	67 488	62 842
Guarantees, letters of credit and similar transactions	55 062	55 196
Other	30 696	31 378
Total	**2 403 995**	**2 440 868**

Fee and commission expense

	2017	2016
Payment cards	(229 717)	(218 108)
Money orders and transfers	(20 757)	(20 077)
Securities and derivatives operations	(22 941)	(20 044)
Custody activity	(14 781)	(14 378)
Acquisition services	(31 173)	(27 597)
Accounts maintenance	(5 036)	(5 215)
Other	(1 493)	(1 054)
Total	**(325 898)**	**(306 473)**

10. Dividend income

	2017	2016
Subsidiaries	168 402	64 816
Associates	-	51 342
Other entities	19 668	16 666
Total	**188 070**	**132 824**

(In PLN thousand)

11. Result on financial assets and liabilities held for trading

	2017	2016
Foreign currency exchange result	(31 802)	(18 713)
Gains (losses) on derivatives	44 338	37 604
Gains (losses) on securities	19 286	20 267
Total	**31 822**	**39 158**

In 2017, the total change in the fair value of financial instruments valued at fair value through profit or loss, determined with the use of valuation techniques (when no published quotations from active markets are available) amounted to PLN 51 745 thousand (in 2016 PLN 44 825 thousand).

12. Gains (losses) on disposal

Realized gains

	2017	2016
Loans and other financial receivables (*)	146 046	159 495
Available for sale financial assets – debt instruments	34 537	14 530
Available for sale financial assets – equity instruments (**)	5 875	262 827
Held to maturity investments	638	-
Debt securities issued	-	1
Total	**187 096**	**436 853**

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

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

Realized losses

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

Net realized profit	**186 757**	**435 903**

The change in fair value of financial assets available for sale referred in 2017 directly to equity amounted to PLN 270 013 thousand (increase), in 2016 PLN 332 145 thousand (decrease).

The change in fair value of financial assets, related in 2017 from equity to financial income amounted to PLN 40 412 thousand (profit), in 2016 PLN 276 493 thousand (profit).

Notes to the financial statements (cont.)

(In PLN thousand)

13. Administrative expenses

Personnel expenses

	2017	2016
Wages and salaries	(1 462 194)	(1 432 602)
Insurance and other charges related to employees	(258 023)	(259 100)
Share-based payments expenses	(19 767)	(9 474)
Total	**(1 739 984)**	**(1 701 176)**

Other administrative expenses

	2017	2016
General expenses	(912 718)	(925 041)
Taxes and charges	(35 310)	(35 347)
Bank Guarantee Fund fee (*)	(266 425)	(276 868)
Financial supervision authority fee (KNF)	(11 717)	(10 609)
Tax on certain financial institutions (**)	(522 281)	(449 533)
Total	**(1 748 451)**	**(1 697 398)**

Total administrative expenses	**(3 488 435)**	**(3 398 574)**

(*) In 2016 this item includes the amount of PLN 16 603 thousand contributed by the Bank to BFG for the purpose of payments of the funds guaranteed to the depositors of Bank Spółdzielczy in Nadarzyn.
(**) On 1 February 2016 tax on certain financial institutions was introduced under the Act on tax on certain financial institutions.

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

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

As a result of application of the Interpretation IFRIC 21 Levies for recognition of the above obligations, the costs of quarterly contributions to deposit guarantee fund of banks in the amount of PLN 89 529 thousand and the costs of annual contribution to resolution fund of banks in the amount of PLN 176 897 thousand are charged to the income statement of Bank Pekao for the year of 2017.

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

Notes to the financial statements (cont.)

(In PLN thousand)

14. Depreciation and amortization

	2017	2016
Property, plant and equipment	(164 557)	(157 796)
Investment property	(330)	(444)
Intangible assets	(164 253)	(164 991)
Total	**(329 140)**	**(323 231)**

15. Net other operating income and expenses

Other operating income

	2017	2016
Rental income	23 280	23 511
Miscellaneous income	10 288	16 473
Recovery of debt collection costs	13 484	13 005
Excess payments, repayments	1 349	8 917
Compensation, recoveries, penalty fees and fines received	81 641	4 026
Refunding of administrative expenses	4 418	4 022
Income from written off liabilities	93	3 437
Releases of impairment allowances for litigation and other assets	9 660	413
Other	4 404	3 328
Total	**148 617**	**77 132**

Other operating expenses

	2017	2016
Credit insurance expenses	(7 870)	(11 163)
Sundry expenses	(6 490)	(13 300)
Reimbursement and deficiencies	(2 921)	(2 804)
Customers complaints expenses	(1 551)	(1 730)
Impairment allowance for litigations and other assets	(238)	(1 587)
Costs of litigation and claims	(1 894)	(1 383)
Compensation, penalty fees and fines paid	(717)	(1 609)
Other	(13 343)	(14 051)
Total	**(35 024)**	**(47 627)**

Net other operating income and expenses	**113 593**	**29 505**

Notes to the financial statements (cont.)

(In PLN thousand)

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

2017	OPENING BALANCE	INCREASES		DECREASES			CLOSING BALANCE	IMPACT ON INCOME STATEMENT
		IMPARIMENT CHARGES	OTHER (*)	WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET	RELEASE OF IMPARIMENT CHARGES	OTHER (*)		
Impairment of financial assets and off-balance sheet commitments								
Loans and advances to banks valued at amortized cost	18 585	313	217	-	(756)	(1 426)	16 933	443
Loans and advances to customers valued at amortized cost	5 513 439	1 118 194	91 893	(355 410)	(623 190)	(416 128)	5 328 798	(495 004)
Financial assets available for sale	1 257	-	-	-	-	(237)	1 020	-
Off-balance sheet commitments	226 322	75 745	-	-	(54 401)	(1 673)	245 993	(21 344)
Total financial assets and off-balance sheet commitments	**5 759 603**	**1 194 252**	**92 110**	**(355 410)**	**(678 347)**	**(419 464)**	**5 592 744**	**(515 905)**
Impairment of other assets								
Investments in subsidiaries and associates	73 845	-	4 600	-	-	-	78 445	-
Intangible assets	-	-	-	-	-	-	-	-
Property, plant and equipment	7 758	531	-	-	-	(1 115)	7 174	(531)
Investment properties	879	-	-	-	-	(860)	19	-
Other	75 737	238	26 471	(254)	(9 660)	(1 648)	90 884	9 422
Total impairment of other assets	**158 219**	**769**	**31 071**	**(254)**	**(9 660)**	**(3 623)**	**176 522**	**8 891**
Total	**5 917 822**	**1 195 021**	**123 181**	**(355 664)**	**(688 007)**	**(423 087)**	**5 769 266**	**(507 014)**

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

Notes to the financial statements (cont.)

(In PLN thousand)

2016	OPENING BALANCE	INCREASES		DECREASES			CLOSING BALANCE	IMPACT ON INCOME STATEMENT(**)
		IMPARIMENT CHARGES	OTHER (*)	WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET	RELEASE OF IMPARIMENT CHARGES	OTHER (*)		
Impairment of financial assets and off-balance sheet commitments								
Loans and advances to banks valued at amortized cost	20 393	590	1 451	-	(2 961)	(888)	18 585	2 371
Loans and advances to customers valued at amortized cost	5 630 902	1 000 600	164 262	(555 723)	(588 368)	(138 234)	5 513 439	(412 232)
Financial assets available for sale	100	-	1 157	-	-	-	1 257	-
Off-balance sheet commitments	124 583	162 088	992	-	(61 341)	-	226 322	(100 747)
Total financial assets and off-balance sheet commitments	**5 775 978**	**1 163 278**	**167 862**	**(555 723)**	**(652 670)**	**(139 122)**	**5 759 603**	**(510 608)**
Impairment of other assets								
Investments in subsidiaries and associates	73 905	-	-	-	-	(60)	73 845	-
Intangible assets	10 961	-	-	(10 961)	-	-	-	-
Property, plant and equipment	8 375	-	-	(617)	-	-	7 758	-
Investment properties	2 530	-	-	(926)	-	(725)	879	-
Other	73 927	1 587	1 435	(341)	(413)	(458)	75 737	(1 174)
Total impairment of other assets	**169 698**	**1 587**	**1 435**	**(12 845)**	**(413)**	**(1 243)**	**158 219**	**(1 174)**
Total	**5 945 676**	**1 164 865**	**169 297**	**(568 568)**	**(653 083)**	**(140 365)**	**5 917 822**	**(511 782)**

(*) Including foreign exchange differences and transfers between positions.
(**) 'Impairment of financial assets and off-balance sheet commitments' includes net impairment in the amount of PLN minus 510 608 thousand and proceeds from recovered bad debt in the amount of PLN 19 223 thousand, the total is PLN minus 491 385 thousand.

Notes to the financial statements (cont.)

(In PLN thousand)

17. Gains (losses) on subsidiaries and associates

	2017	2016
Gains on liquidation of subsidiaries	-	46 853
Total gains (losses) from subsidiaries and associates	**-**	**46 853**

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

	2017	2016
Gains (losses) on disposal of property, plant and equipment classified as assets held for sale	1 491	688
Gains (losses) on de-recognition of property, plant and equipment and intangible assets other than classified as assets held for sale	(1 399)	4 342
Total gains (losses) on disposal of property, plant and equipment and intangible assets	**92**	**5 030**

(In PLN thousand)

19. Income tax

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

	2017	2016
Profit before income tax	**2 727 771**	**2 863 193**
Tax charge according to applicable tax rate 19%	**518 276**	**544 007**
Permanent differences:	**121 380**	**40 811**
Non taxable income	(38 928)	(58 869)
Non tax deductible costs	169 296	103 939
Impact of other tax rates applied in accordance with art.19.1.2 of CIT Act	-	-
Tax relieves not included in the income statement	109	80
Other	(9 097)	(4 339)
Effective income tax charge on gross profit	**639 656**	**584 818**

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

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

	2017	2016
INCOME STATEMENT		
Current tax	**(608 566)**	**(560 609)**
Current tax charge in the income statement	(621 041)	(559 564)
Adjustments related to the current tax from previous years	12 796	(288)
Other taxes (e.g. withholding tax, income tax relating to foreign branch)	(321)	(757)
Deferred tax	**(31 090)**	**(24 209)**
Occurrence and reversal of temporary differences	(31 090)	(24 209)
Tax charge in the Bank's income statement	**(639 656)**	**(584 818)**
EQUITY		
Deferred tax	**(38 959)**	**118 863**
Income and costs disclosed in other comprehensive income:		
revaluation of financial instruments, used as cash flows hedges	6 297	1 056
revaluation of available for sale financial assets – debt securities	(41 545)	77 137
revaluation of available for sale financial assets – equity securities	(2 079)	38 504
Tax on items that are or may be reclassified subsequently to profit or loss	**(37 327)**	**116 697**
Tax charge on items that will never be reclassified to profit or loss	**(1 632)**	**2 166**
revaluation of the defined benefit liabilities	(1 632)	2 166
Total tax charge	**(678 615)**	**(465 955)**

Notes to the financial statements (cont.)

(In PLN thousand)

	CHANGES IN TEMPORARY DIFFERENCES IN 2017							
	OPENING BALANCE			CHANGES RECOGNIZED IN		CLOSING BALANCE		
	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	EQUITY	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY
DEFFERED TAX LIABILITY								
Accrued income – securities	46 022	46 022	-	(34 222)	-	11 800	11 800	-
Accrued income – loans	137 003	137 003	-	1 430	-	138 433	138 433	-
Change in revaluation of financial assets	7 711	-	7 711	133 658	(4 149)	137 220	133 658	3 562
Accelerated depreciation	114 194	114 194	-	431	-	114 625	114 625	-
Investment relief	4 481	4 481	-	(282)	-	4 199	4 199	-
Other	99 715	99 715	-	12 931	-	112 646	112 646	-
Gross deferred tax liability	**409 126**	**401 415**	**7 711**	**113 946**	**(4 149)**	**518 923**	**515 361**	**3 562**
DEFFERED TAX ASSET								
Accrued expenses - securities	-	-	-	-	-	-	-	-
Accrued expenses - deposits and loans	37 868	37 868	-	(2 497)	-	35 371	35 371	-
Downward revaluation of financial assets	299 876	258 400	41 476	109 006	(41 476)	367 406	367 406	-
Income received to be amortized over time from loans and current accounts	176 922	176 922	-	20 856	-	197 778	197 778	-
Loan provisions charges	512 459	512 459	-	(22 716)	-	489 743	489 743	-
Personnel related provisions	111 788	93 125	18 663	(22)	(1 632)	110 134	93 103	17 031
Accruals	12 034	12 034	-	4 359	-	16 393	16 393	-
Previous year losses	-	-	-	-	-	-	-	-
Other	36 457	36 457	-	(26 130)	-	10 327	10 327	-
Gross deferred tax asset	**1 187 404**	**1 127 265**	**60 139**	**82 856**	**(43 108)**	**1 227 152**	**1 210 121**	**17 031**
Deferred tax charge	**x**	**x**	**x**	**(31 090)**	**(38 959)**	**x**	**x**	**x**
Net deferred tax assets	**778 278**	**725 850**	**52 428**	**x**	**x**	**708 229**	**694 760**	**13 469**
Net deferred tax provision	**-**	**-**	**-**	**x**	**x**	**-**	**-**	**-**

Notes to the financial statements (cont.)

(In PLN thousand)

	CHANGES IN TEMPORARY DIFFERENCES IN 2016							
	OPENING BALANCE			CHANGES RECOGNIZED IN		CLOSING BALANCE		
	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	EQUITY	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY
DEFFERED TAX LIABILITY								
Accrued income – securities	-	-	-	46 022	-	46 022	46 022	-
Accrued income – loans	121 160	121 160	-	15 843	-	137 003	137 003	-
Change in revaluation of financial assets	98 733	15 801	82 932	(15 801)	(75 221)	7 711	-	7 711
Accelerated depreciation	121 465	121 465	-	(7 271)	-	114 194	114 194	-
Investment relief	4 814	4 814	-	(333)	-	4 481	4 481	-
Other	85 745	85 745	-	13 970	-	99 715	99 715	-
Gross deferred tax liability	**431 917**	**348 985**	**82 932**	**52 430**	**(75 221)**	**409 126**	**401 415**	**7 711**
DEFFERED TAX ASSET								
Accrued expenses - securities	22 084	22 084	-	(22 084)	-	-	-	-
Accrued expenses - deposits and loans	45 215	45 215	-	(7 347)	-	37 868	37 868	-
Downward revaluation of financial assets	254 227	254 227	-	4 173	41 476	299 876	258 400	41 476
Income received to be amortized over time from loans and current accounts	173 211	173 211	-	3 711	-	176 922	176 922	-
Loan provisions charges	464 291	464 291	-	48 168	-	512 459	512 459	-
Personnel related provisions	108 175	91 678	16 497	1 447	2 166	111 788	93 125	18 663
Accruals	13 522	13 522	-	(1 488)	-	12 034	12 034	-
Previous year losses	-	-	-	-	-	-	-	-
Other	34 816	34 816	-	1 641	-	36 457	36 457	-
Gross deferred tax asset	**1 115 541**	**1 099 044**	**16 497**	**28 221**	**43 642**	**1 187 404**	**1 127 265**	**60 139**
Deferred tax charge	**x**	**x**	**x**	**(24 209)**	**118 863**	**x**	**x**	**x**
Net deferred tax assets	**683 624**	**750 059**	**(66 435)**	**x**	**x**	**778 278**	**725 850**	**52 428**
Net deferred tax provision	**-**	**-**	**-**	**x**	**x**	**-**	**-**	**-**

Notes to the financial statements (cont.)

(In PLN thousand)

In the opinion of the Bank the deferred tax asset in the amount of PLN 708 229 thousand reported as at 31 December 2017 is sustainable in total amount. The analysis was performed based on the past results of the company and assumed results in the future periods. The analysis assumed the five years' time horizon.

As at 31 December 2017 and 31 December 2016, there were no temporary differences related to investments in subsidiaries and associates, for which deferred tax liability was not created as a result of meeting the conditions of controlling the terms of temporary differences' reversing and being probable that these differences will not reverse in foreseeable future.

As at 31 December 2017 and 31 December 2016, there were no temporary differences, unused tax losses and unused tax relieves which were not included in the deferred tax assets.

20. Earnings per share

Basic earnings per share

Basic earnings per share are calculated by dividing net profit by the weighted average number of the ordinary shares outstanding during the given period.

	2017	2016
Net profit	2 088 129	2 278 375
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Earnings per share (in PLN per share)	7.96	8.68

Diluted earnings per share

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

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

	2017	2016
Net profit	2 088 129	2 278 375
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Weighted average number of ordinary shares for the purpose of calculation of diluted earnings per share	262 470 034	262 470 034
Diluted earnings per share (in PLN per share)	7.96	8.68

21. Dividend proposal

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

(In PLN thousand)

22. Cash and balances with Central Bank

CASH AND DUE FROM CENTRAL BANK	31.12.2017	31.12.2016
Cash	2 686 561	2 639 526
Current account at Central Bank	2 264 686	1 718 775
Other	235 012	1 503 041
Total	**5 186 259**	**5 861 342**

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

Cash and balances with Central Bank by currency

31.12.2017	ASSETS	LIABILITIES
PLN	4 302 520	6 079
EUR	463 160	-
USD	168 562	-
CHF	58 882	-
Other currencies	193 135	-
Total	**5 186 259**	**6 079**

31.12.2016	ASSETS	LIABILITIES
PLN	4 932 757	6 091
EUR	443 480	-
USD	260 015	-
CHF	59 727	-
Other currencies	165 363	-
Total	**5 861 342**	**6 091**

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

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

(In PLN thousand)

23. Loans and advances to banks

Loans and advances to banks by product type

	31.12.2017	31.12.2016
Current accounts	334 688	117 659
Interbank placements	271 823	267 827
Loans and advances	95 755	171 743
Cash collaterals	1 006 332	1 771 842
Reverse repo transactions	494 706	703 635
Debt securities	-	60 700
Cash in transit	506 559	379 858
Total gross amount	**2 709 863**	**3 473 264**
Impairment allowances	(16 933)	(18 585)
Total net amount	**2 692 930**	**3 454 679**

Loans and advances to banks by quality

	31.12.2017	31.12.2016
Loans and advances to banks, including:		
non impaired (gross)	2 693 230	3 455 272
impaired (gross)	16 633	17 992
individual impairment allowances	(6 833)	(8 192)
collective impairment allowances (*)	(10 100)	(10 393)
Total	**2 692 930**	**3 454 679**

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

Loans and advances to banks by contractual maturity

	31.12.2017	31.12.2016
Loans and advances to banks, including:		
up to 1 month	2 618 664	3 273 858
between 1 and 3 months	7	436
between 3 months and 1 year	67 160	110 827
between 1 and 5 years	29	60 656
over 5 years	50	2
past due	23 953	27 485
Total gross amount	**2 709 863**	**3 473 264**
Impairment allowances	(16 933)	(18 585)
Total net amount	**2 692 930**	**3 454 679**

Loans and advances to banks by currency

	31.12.2017	31.12.2016
PLN	700 872	1 037 761
CHF	23 340	19 462
EUR	1 413 116	2 181 400
USD	209 142	68 816
Other currencies	346 460	147 240
Total	**2 692 930**	**3 454 679**

Changes in impairment allowances in 2017 and 2016 are presented in the Note 16.

Notes to the financial statements (cont.)

(In PLN thousand)

24. Financial assets and liabilities held for trading

Financial assets and liabilities held for trading by product type

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
Debt securities	1 734 768	721 031
Total financial assets	**1 734 768**	**721 031**
FINANCIAL LIABILITIES		
Debt securities	469 448	673 165
Total financial liabilities	**469 448**	**673 165**

Debt securities held for trading

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
Debt securities issued by State Treasury	1 646 757	654 918
T- bills	-	-
T- bonds	1 646 757	654 918
Debt securities issued by banks	50 258	-
Debt securities issued by business entities	37 753	66 113
Total financial assets	**1 734 768**	**721 031**
FINANCIAL LIABILITIES		
Debt securities issued by State Treasury	469 448	673 165
T- bonds	469 448	673 165
Total financial liabilities	**469 448**	**673 165**

Debt securities held for trading by maturity

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
Debt securities, including:		
up to 1 month	123 505	-
between 1 and 3 months	-	239
between 3 months and 1 year	21 516	117 804
between 1 and 5 years	1 461 522	324 868
over 5 years	128 225	278 120
unspecified term	-	-
Total financial assets	**1 734 768**	**721 031**
FINANCIAL LIABILITIES		
Debt securities, including:		
up to 1 month	-	102 076
between 1 and 3 months	-	-
between 3 months and 1 year	-	131 194
between 1 and 5 years	309 328	263 435
over 5 years	160 120	176 460
Total financial liabilities	**469 448**	**673 165**

(In PLN thousand)

Debt securities held for trading by currency

	31.12.2017	31.12.2016
FINANCIAL ASSETS		
PLN	1 727 112	700 856
EUR	4 542	5 629
USD	3 114	14 546
Total financial assets	**1 734 768**	**721 031**
FINANCIAL LIABILITIES		
PLN	469 448	673 165
Total financial liabilities	**469 448**	**673 165**

25. Derivative financial instruments (held for trading)

Derivative financial instruments at the Bank

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Derivative financial instruments embedded in other instruments

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

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

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

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

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

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

Risk involved in financial derivatives

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

Fair value of trading derivatives

31.12.2017	ASSETS	LIABILITIES
Interest rate transactions		
Interest Rate Swaps (IRS)	967 793	1 533 696
Forward Rate Agreements (FRA)	176	-
Options	6 161	2 252
Other	461	416
Foreign currencies and in gold transactions		
Cross-Currency Interest Rate Swaps (CIRS)	56 601	32 407
Currency Forward Agreements	120 421	185 923
Currency Swaps (FX–Swap)	87 610	173 735
Options for currency and for gold	27 932	24 955
Transactions based on equity securities and stock indexes		
Options	10 225	10 219
Other	-	-
Transactions based on commodities and precious metals		
Options	14 739	14 366
Other	59 225	58 959
Total	**1 351 344**	**2 036 928**

31.12.2016	ASSETS	LIABILITIES
Interest rate transactions		
Interest Rate Swaps (IRS)	1 517 838	1 508 186
Forward Rate Agreements (FRA)	347	155
Options	1 837	1 710
Other	426	618
Foreign currencies and in gold transactions		
Cross-Currency Interest Rate Swaps (CIRS)	91 731	162 461
Currency Forward Agreements	183 630	84 759
Currency Swaps (FX–Swap)	62 219	93 641
Options for currency and for gold	52 971	53 605
Transactions based on equity securities and stock indexes		
Options	5 403	5 422
Other	-	-
Transactions based on commodities and precious metals		
Options	2 113	1 971
Other	36 984	36 807
Total	**1 955 499**	**1 949 335**

Notes to the financial statements (cont.)

(In PLN thousand)

Nominal value of trading derivatives

31.12.2017	CONTRACTUAL MATURITY UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Interest rate transactions						
Interest Rate Swaps (IRS)	1 781 188	1 815 069	18 506 468	49 917 986	11 372 737	83 393 448
Forward Rate Agreements (FRA)	-	500 000	450 000	-	-	950 000
Options	-	270 951	1 349 236	3 860 482	11 248	5 491 917
Other	785 253	-	-	-	-	785 253
Foreign currencies and in gold transactions						
Cross-Currency Interest Rate Swaps (CIRS) – currency bought	129 765	330 611	911 633	2 661 861	1 164 672	5 198 542
Cross-Currency Interest Rate Swaps (CIRS) – currency sold	127 707	323 370	910 417	2 651 187	1 164 672	5 177 353
Currency Forward Agreements – currency bought	7 090 041	3 030 242	3 239 011	735 665	-	14 094 959
Currency Forward Agreements – currency sold	7 078 207	3 075 685	3 286 933	740 000	-	14 180 825
Currency Swaps (FX-Swap) – currency bought	13 075 025	5 315 571	1 263 965	-	-	19 654 561
Currency Swaps (FX-Swap) – currency sold	13 169 617	5 320 541	1 241 015	-	-	19 731 173
Options bought	428 084	807 930	2 414 151	502 929	-	4 153 094
Options sold	429 477	799 227	2 418 390	502 929	-	4 150 023
Transactions based on equity securities and stock indexes						
Options	73 865	-	-	68 404	-	142 269
Other	-	-	-	-	-	-
Transactions based on commodities and precious metals						
Options	4 526	44 052	418 842	135 353	-	602 773
Other	104 966	147 378	233 076	189 527	-	674 947
Total	**44 277 721**	**21 780 627**	**36 643 137**	**61 966 323**	**13 713 329**	**178 381 137**

31.12.2016	CONTRACTUAL MATURITY UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Interest rate transactions						
Interest Rate Swaps (IRS)	2 064 679	2 846 675	11 640 203	51 600 434	12 317 504	80 469 495
Forward Rate Agreements (FRA)	275 000	750 000	300 000	-	-	1 325 000
Options	700 000	604 917	857 351	3 907 471	165 096	6 234 835
Other	458 570	-	-	-	-	458 570
Foreign currencies and in gold transactions						
Cross-Currency Interest Rate Swaps (CIRS) – currency bought	-	413 339	763 574	3 091 361	1 375 894	5 644 168
Cross-Currency Interest Rate Swaps (CIRS) – currency sold	-	427 850	755 711	3 148 727	1 375 894	5 708 182
Currency Forward Agreements – currency bought	6 765 609	2 525 196	3 177 714	1 337 691	-	13 806 210
Currency Forward Agreements – currency sold	6 791 355	2 541 317	3 101 465	1 346 657	-	13 780 794
Currency Swaps (FX-Swap) – currency bought	13 454 161	2 643 905	2 799 405	115 108	-	19 012 579
Currency Swaps (FX-Swap) – currency sold	13 443 801	2 644 057	2 797 880	110 600	-	18 996 338
Options bought	463 120	540 425	2 526 286	186 400	-	3 716 231
Options sold	465 995	545 333	2 538 592	186 400	-	3 736 320
Transactions based on equity securities and stock indexes						
Options	-	-	-	73 865	-	73 865
Other	-	-	-	-	-	-
Transactions based on commodities and precious metals						
Options	8 693	13 039	80 418	-	-	102 150
Other	61 558	78 176	218 647	272 791	-	631 172
Total	**44 952 541**	**16 574 229**	**31 557 246**	**65 377 505**	**15 234 388**	**173 695 909**

Notes to the financial statements (cont.)

(In PLN thousand)

26. Loans and advances to customers

Loans and advances to customers by product type

	31.12.2017	31.12.2016
Mortgage loans	58 268 309	53 072 200
Current accounts	11 247 655	10 840 866
Operating loans	16 595 277	16 918 463
Investment loans	18 844 017	16 997 240
Cash loans	12 190 872	10 211 931
Payment cards receivables	1 081 499	970 673
Factoring	2 153 913	1 858 606
Other loans and advances	1 018 105	1 162 199
Debt securities	12 749 288	12 451 372
Reverse repo transactions	-	-
Cash in transit	53 041	63 488
Total gross amount	**134 201 976**	**124 547 038**
Impairment allowances	(5 328 798)	(5 513 439)
Total net amount	**128 873 178**	**119 033 599**

Loans and advances to customers by customer type

	31.12.2017	31.12.2016
Corporate	60 676 737	56 558 364
Individuals	63 442 059	57 399 265
Budget entities	10 083 180	10 589 409
Total gross amount	**134 201 976**	**124 547 038**
Impairment allowances	(5 328 798)	(5 513 439)
Total net amount	**128 873 178**	**119 033 599**

Loans and advances to customers by quality

	31.12.2017	31.12.2016
Loans and advances to customers, including:		
non impaired (gross)	127 006 445	117 093 424
impaired (gross)	7 195 531	7 453 614
individual impairment allowances	(3 353 328)	(3 148 477)
collective impairment allowances (*)	(1 975 470)	(2 364 962)
Total	**128 873 178**	**119 033 599**

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

Notes to the financial statements (cont.)

(In PLN thousand)

Loans and advances to customers by contractual maturity

	31.12.2017	31.12.2016
Loans and advances to customers, including:		
up to 1 month	14 278 559	14 781 907
between 1 and 3 months	4 550 183	2 970 439
between 3 months and 1 year	11 110 492	13 523 300
between 1 and 5 years	43 865 360	38 209 661
over 5 years	55 107 893	49 386 721
expired	5 289 489	5 675 010
Total gross amount	**134 201 976**	**124 547 038**
Impairment allowances	(5 328 798)	(5 513 439)
Total net amount	**128 873 178**	**119 033 599**

Loans and advances to customers by currency

	31.12.2017	31.12.2016
PLN	109 437 147	97 790 221
CHF	3 107 444	4 036 421
EUR	13 611 471	13 756 867
USD	2 485 846	3 274 083
Other currencies	231 270	176 007
Total	**128 873 178**	**119 033 599**

Changes in impairment allowances in 2017 and 2016 are presented in the Note 16.

27. Hedge accounting

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

The tables below present the fair values of hedging derivatives

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

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

The tables below present nominal values of hedging derivatives

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

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

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

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

Notes to the financial statements (cont.)

(In PLN thousand)

Detailed description of hedging relationships applied by the Bank during the period from 1 January to 30 December 2017.

DESCRIPTION OF THE HEDGING RELATIONSHIP	HEDGED ITEM	HEDGING DERIVATIVES	FINANCIAL STATEMENTS PRESENTATION	PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR
1. Fair value hedge of fixed-coupon debt securities				
The Bank hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions.	The hedged items are fixed coupon debt securities classified as AFS, denominated in PLN, EUR and USD.	The hedging derivatives consist of IRS transactions in PLN, EUR and USD (short position in fixed-rate) for which the Bank receives floating-rate payments, and pays fixed-rate.	The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. The remaining portion of the change in the hedged items' fair value (resulting from spread between swap yield curve and bond yield curve) is recognized in accordance with the accounting principles applicable to AFS (i.e. in the revaluation reserve in equity). Interest accrued on AFS bonds is presented in the net interest income. Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 18 January 2036.
2. Cash flow hedge of floating-rate loans and floating-rate deposits				
The Bank hedges a portion of the interest rate risk and the foreign currency risk resulting from the volatility of cash flows from floating-rate assets and liabilities with the designated CIRS transactions (basis swap).	Hedged item consists of two separate components, which are cash flows arising from floating-rate assets portfolio and floating-rate liabilities portfolio.	Hedging derivatives consist of a portfolio of CIRS transactions (basis swap), where the Bank pays floating-rate currency cash flows, and receives floating-rate PLN/currency cash-flows. CIRS transactions are decomposed into the part hedging the assets portfolio and the part hedging the liabilities portfolio.	The effective portion of the change in fair value of hedging derivatives' is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on CIRS transactions and hedged items is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 15 May 2029.
3. Cash flow hedge of floating-rate loans				
The Bank hedges a portion of the interest rate risk related to the volatility of cash flows on floating-rate assets with the designated IRS transactions.	The hedged items consist of the cash flows from floating-rate assets.	The hedging derivatives consist of portfolio of IRS transactions (short position in floating rate – the Bank receives fixed payments and pays floating-rate).	The effective portion of the change in fair value of hedging derivatives is recognized in t he revaluation reserve in equity. The ineffective portion of change in fair value hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on IRS transactions and hedged items is presented in the net interest income.	It is expected that the cash flows related to the hedged items will occur until 29 April 2020.
4. Cash flow hedge of floating-rate currency assets hedged with FX-Swap transactions against the exchange and interest rate risk				
The Bank hedges volatility of cash flows constituting floating-rate financial assets (loans in EUR and USD) with FX-Swap transactions. The currency and interest rate risk is hedged.	Loans with variable interest rate risk, denominated in EUR and USD constitute hedged items.	FX-Swap transaction portfolio constitutes the hedging position.	The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. Settled part of the swap points on the hedging instrument is transferred from the revaluation reserve in equity and recognized in interest income. Currency revaluation regarding the first capital exchange on the hedging instrument is transferred from the revaluation reserve in equity and recognized in the foreign currency exchange result.	It is expected that the cash flows related to the hedged items will occur until 12 October 2018.

Notes to the financial statements (cont.)

(In PLN thousand)

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

Notes to the financial statements (cont.)

(In PLN thousand)

28. Investment (placement) securities

	31.12.2017	31.12.2016
Debt securities available for sale (AFS)	33 136 044	31 810 862
Equity securities available for sale (AFS)	123 128	127 308
Debt securities held to maturity (HTM)	3 366 824	2 925 861
Total	**36 625 996**	**34 864 031**

Debt securities available for sale (AFS)

	31.12.2017	31.12.2016
Securities issued by State Treasury	21 417 279	24 907 802
T-bills	-	-
T-bonds	21 417 279	24 907 802
Securities issued by Central Banks	11 066 168	5 978 629
Securities issued by business entities	-	249 912
Securities issued by local governments	652 597	674 519
Total	**33 136 044**	**31 810 862**
including impairment of assets	-	-

Equity securities available for sale (AFS)

	31.12.2017	31.12.2016
Shares	123 128	127 308
Total	**123 128**	**127 308**
including impairment of assets	(1 020)	(1 257)

Debt securities held to maturity (HTM)

	31.12.2017	31.12.2016
Securities issued by State Treasury	3 335 371	2 905 255
T-bills	-	-
T-bonds	3 335 371	2 905 255
Securities issued by Central Banks	31 453	20 606
Total	**3 366 824**	**2 925 861**
including impairment of assets	-	-

Notes to the financial statements (cont.)

(In PLN thousand)

Investment debt securities according to contractual maturity

	31.12.2017	31.12.2016
Debt securities, including:		
up to 1 month	11 097 621	7 404 199
between 1 and 3 months	121 753	573 661
between 3 months and 1 year	6 037 318	6 036 603
between 1 and 5 years	11 599 628	11 933 357
over 5 years	7 646 548	8 788 903
Total	**36 502 868**	**34 736 723**

Investment debt securities according to currencies

	31.12.2017	31.12.2016
PLN	32 742 429	30 612 780
EUR	2 091 122	2 790 183
USD	1 669 317	1 333 760
Total	**36 502 868**	**34 736 723**

Changes in investment (placement) securities

	2017	2016
SECURITIES AVAILABLE FOR SALE (AFS)		
Opening balance	**31 938 170**	**17 699 881**
Increases (purchase)	62 171 979	89 683 288
Decreases (sale and redemption)	(61 322 608)	(75 813 948)
Changes in fair value	167 177	(460 553)
Exchange rate differences	(418 639)	170 926
Accrued interest	593 371	703 200
Other changes	129 722	(44 624)
Closing balance	**33 259 172**	**31 938 170**
DEBT SECURITIES HELD UNTIL MATURITY (HTM)		
Opening balance	**2 925 861**	**3 290 061**
Increases (purchase)	2 911 408	6 606 880
Decreases (sale and redemption)	(2 527 713)	(7 028 711)
Accrued interest	41 004	25 748
Other changes	16 264	31 883
Closing balance	**3 366 824**	**2 925 861**
Total investment (placement) securities	**36 625 996**	**34 864 031**

Notes to the financial statements (cont.)

(In PLN thousand)

29. Reclassification of securities

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

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

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

The tables below present the information on the reclassified financial assets

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

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

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

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

Net interest income on reclassified financial assets

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

Notes to the financial statements (cont.)

(In PLN thousand)

30. Assets held for sale and discontinued operations

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

As at 31 December 2017, non-current assets classified as held for sale included following items classified as held for sale:

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

Assets held for sale

	31.12.2017	31.12.2016
Property, plant and equipment	28 082	25 703
Other assets	23 368	22 574
Total	**51 450**	**48 277**

The table below presents changes in the balance of non-current assets held for sale

ASSETS HELD FOR SALE	2017	2016
Opening balance	**48 277**	**45 302**
Increases, including:	4 362	9 301
transfer from property, plant and equipment	2 580	818
transfer from investment properties	15	8 295
other	1 767	188
Decreases, including:	(1 189)	(6 326)
transfer to property, plant and equipment	-	(451)
disposal	(302)	(1 322)
other	(887)	(4 553)
Closing balance	**51 450**	**48 277**

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

	31.12.2017	31.12.2016
Sales revenues	1 798	2 011
Net carrying amount of disposed assets (including costs to sell)	(307)	(1 323)
Profit/loss on sale before income tax	**1 491**	**688**

Notes to the financial statements (cont.)

(In PLN thousand)

31. Investments in subsidiaries

Condensed information about subsidiaries as at 31 December 2017 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT /LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
Centralny Dom Maklerski Pekao S.A.	Warsaw	Brokerage services	885 067	730 125	120 135	33 128	100.00	56 332
Pekao Investment Banking S.A.	Warsaw	Brokerage services	403 785	146 034	46 580	4 697	100.00	274 334
Pekao Faktoring Sp. z o.o.	Lublin	Factoring	1 335 539	1 273 190	44 057	11 000	100.00	50 268
Pekao Fundusz Kapitałowy Sp. z o.o.	Warsaw	Business consulting	52 152	61	596	373	100.00	51 380
Pekao Powszechne Towarzystwo Emerytalne S.A. (ex Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A)	Warsaw	Pension funds management	46 699	7 175	18 002	(3 116)	100.00	72 589
Pekao Financial Services Sp. z o.o.	Warsaw	Transferable agent	33 427	5 387	37 505	5 967	100.00	4 500
Pekao Leasing Sp. z o.o.	Warsaw	Lease services	4 730 736	4 242 964	165 691	34 824	100.00	278 798
Centrum Kart S.A.	Warsaw	Additional financial services	44 805	12 616	197	755	100.00	17 592
Pekao Bank Hipoteczny S.A.	Warsaw	Banking services	1 966 897	1 636 798	66 117	5 774	100.00	233 823
Pekao Property S.A.	Warsaw	Real estate development services	47 588	21 243	13	(24 476)	100.00	26 774
Centrum Bankowości Bezpośredniej Sp. z o.o.	Cracow	Call-center services	19 506	8 750	22 056	3 805	100.00	522
Pekao Investment Management S.A. (**) (ex Pekao Pioneer Investment Management S.A.)	Warsaw	Holding	366 753	33 634	29 370	5 811	100.00	605 794
Dom Inwestycyjny Xelion Sp. z o.o.	Warsaw	Financial intermediation	66 603	35 720	5 159	316	100.00	21 119
Total								**1 693 825**

(*) Data available at the date of financial statements.
(**) Consolidated data together a company of Pekao TFI SA

Notes to the financial statements (cont.)

(In PLN thousand)

Condensed information about subsidiaries as at 31 December 2016 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT /LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
Centralny Dom Maklerski Pekao S.A.	Warsaw	Brokerage services	988 304	841 063	105 020	25 287	100.00	56 332
Pekao Investment Banking S.A.	Warsaw	Brokerage services	384 493	109 943	67 154	23 513	100.00	274 334
Pekao Faktoring Sp. z o.o.	Lublin	Factoring	1 040 653	970 289	35 379	9 678	100.00	50 268
Pekao Fundusz Kapitałowy Sp. z o.o.	Warsaw	Business consulting	51 798	81	585	337	100.00	51 380
Pekao Powszechne Towarzystwo Emerytalne S.A.	Warsaw	Pension funds management	44 855	2 217	13 996	1 397	65.00	64 126
Pekao Financial Services Sp. z o.o.	Warsaw	Transferable agent	34 577	5 010	38 743	7 466	100.00	4 500
Pekao Leasing Sp. z o.o.	Warsaw	Lease services	4 278 427	3 731 603	158 023	39 972	100.00	278 799
Centrum Kart S.A.	Warsaw	Additional financial services	43 449	11 705	216	335	100.00	17 592
Pekao Bank Hipoteczny S.A.	Warsaw	Banking services	2 193 500	1 870 376	72 973	8 721	100.00	233 823
Pekao Property S.A.	Warsaw	Real estate development services	56 684	5 863	4	(319)	100.00	31 374
Centrum Bankowości Bezpośredniej Sp. z o.o.	Cracow	Call-center services	12 931	6 010	17 632	3 405	100.00	522
Total								**1 063 050**

(*) Data available at the date of financial statements.

Changes in investment into subsidiaries

	2017	2016
Opening balance	**1 063 050**	**1 099 654**
Increases, including:	635 375	-
acquisition	596 995	-
transfer from Investments in associates	27 551	-
settlement hedge accounting	10 829	-
Decreases, including	(4 600)	(36 604)
changes of impairment allowances	(4 600)	-
liquidation	-	(36 604)
Closing balance	**1 693 825**	**1 063 050**

The structure of investments in subsidiaries

	31.12.2017	31.12.2016
Investment in subsidiaries, including:		
banks	233 823	233 823
other financial institutions	1 381 326	745 951
non-financial institutions	78 676	83 276
Total	**1 693 825**	**1 063 050**

Notes to the financial statements (cont.)

(In PLN thousand)

32. Investments in associates

Information about associates as at 31 December 2017 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT/LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
CPF Management	Tortola, British Virgin Islands	Advisory services– currently does not provide its services	n/a	n/a	n/a	n/a	40.00	-
Total								**-**

(*) Data available at the date of financial statements.

Information about associates as at 31 December 2016 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT/LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
Pekao Investment Management S.A. (**)	Warsaw	Assets Management	289 881	37 841	324 839	74 437	49.00	14 995
Dom Inwestycyjny Xelion Sp. z o.o.	Warsaw	Financial intermediation	56 172	30 728	53 082	4 359	50.00	12 557
CPF Management	Tortola, British Virgin	Advisory services– currently does not	n/a	n/a	n/a	n/a	40.00	-
Polish Banking System S.A. (in liquidation)	Warsaw	Company in liquidation	n/a	n/a	n/a	n/a	48.90	-
PPU Budpress Sp. z o.o. (in liquidation)	Żyrardów	Company in liquidation	n/a	n/a	n/a	n/a	36.20	-
Total								**27 552**

(*) - Data available at the date of financial statements.
(**) Consolidated data together a company of Pekao TFI SA

Changes in investment in associates

	2017	2016
Opening balance	**27 552**	**27 552**
Decreases, including	(27 552)	-
Investments in subsidiaries	(27 552)	-
Closing balance	**-**	**27 552**

The structure of investments in associates

	31.12.2017	31.12.2016
Investment in associates, including:		
banks	-	-
other financial institutions	-	27 552
non-financial institutions	-	-
Total	**-**	**27 552**

As at 31 December 2017 and 31 December 2016, the Bank did not have the investment in entities under common control.

(In PLN thousand)

33. Intangible assets

	31.12.2017	31.12.2016
Intangible assets, including:	576 686	518 441
research and development expenditures	1 073	3 024
licenses and patents	471 554	438 109
other	5 344	7 688
assets under construction	98 715	69 620
Goodwill	52 635	52 635
Total	**629 321**	**571 076**

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

Moreover there is also goodwill recognized upon acquisition of Spółdzielcza Kasa Oszczędnościowo – Kredytowa im. Mikołaja Kopernika by Bank Pekao S.A. It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 960 thousand.

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

The impairment test is performed by comparing the carrying amount of the CGU, including the goodwill, with the recoverable amount of the CGU. The recoverable amount is estimated on the basis of value in use of the CGU. The value in use is the present, estimated value of the future cash flows for the period of 5 years, taking into account the residual value of the CGU. The residual value of the CGU is calculated based on an extrapolation of cash flows projections beyond the forecast period using the growth rate of 2.5%. The forecasts of the future cash flows are based on the assumptions included the Bank's budget for 2018 and financial plan for 2019-2022. To discount the future cash flows, it is applied the discount rate of 8.18%, which includes the risk-free rate and the risk premium. The impairment test performed as at 31 December 2017 showed the surplus of the recoverable amount over the carrying amount of the CGU, and therefore no CGU impairment was recognized.

Notes to the financial statements (cont.)

(In PLN thousand)

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

2017	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	GOODWILL	TOTAL
GROSS VALUE						
Opening balance	**90 173**	**2 332 019**	**35 176**	**69 620**	**52 635**	**2 579 623**
Increases, including:	-	191 812	1 594	221 377	-	414 783
Acquisitions	-	-	-	221 377	-	221 377
Other	-	-	1 124	-	-	1 124
transfer from investments outlays	-	191 812	470	-	-	192 282
Decreases, including:	(244)	(84 751)	(1 358)	(192 282)	-	(278 635)
Liquidation	(244)	(84 747)	(1 358)	-	-	(86 349)
Sale	-	(4)	-	-	-	(4)
Other	-	-	-	-	-	-
transfer to investments outlays	-	-	-	(192 282)	-	(192 282)
Closing balance	**89 929**	**2 439 080**	**35 412**	**98 715**	**52 635**	**2 715 771**
ACCUMULATED AMORTIZATION						
Opening balance	**87 149**	**1 893 910**	**27 488**	**-**	**-**	**2 008 547**
Amortization	1 951	158 364	3 938	-	-	164 253
Liquidation	(244)	(84 744)	(1 358)	-	-	(86 346)
Sale	-	(4)	-	-	-	(4)
Other	-	-	-	-	-	-
Closing balance	**88 856**	**1 967 526**	**30 068**	**-**	**-**	**2 086 450**
IMPAIRMENT						
Opening balance	**-**	**-**	**-**	**-**	**-**	**-**
Closing balance	**-**	**-**	**-**	**-**	**-**	**-**
NET VALUE						
Opening balance	**3 024**	**438 109**	**7 688**	**69 620**	**52 635**	**571 076**
Closing balance	**1 073**	**471 554**	**5 344**	**98 715**	**52 635**	**629 321**

(In PLN thousand)

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

2016	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	GOODWILL	TOTAL
GROSS VALUE						
Opening balance	**90 173**	**2 187 909**	**51 305**	**109 335**	**52 635**	**2 491 357**
Increases, including:	-	164 144	312	123 565	-	288 021
acquisitions	-	-	-	123 565	-	123 565
other	-	1 176	-	-	-	1 176
transfer from investments outlays	-	162 968	312	-	-	163 280
Decreases, including:	-	(20 034)	(16 441)	(163 280)	-	(199 755)
liquidation	-	(19 765)	(16 441)	-	-	(36 206)
other	-	(269)	-	-	-	(269)
transfer to investments outlays	-	-	-	(163 280)	-	(163 280)
Closing balance	**90 173**	**2 332 019**	**35 176**	**69 620**	**52 635**	**2 579 623**
ACCUMULATED AMORTIZATION						
Opening balance	**82 225**	**1 757 390**	**29 161**	**-**	**-**	**1 868 776**
Amortization	4 924	156 730	3 337	-	-	164 991
Liquidation	-	(19 765)	(5 010)	-	-	(24 775)
Other	-	(445)	-	-	-	(445)
Closing balance	**87 149**	**1 893 910**	**27 488**	**-**	**-**	**2 008 547**
IMPAIRMENT						
Opening balance	**-**	**-**	**10 961**	**-**	**-**	**10 961**
Closing balance	**-**	**-**	**-**	**-**	**-**	**-**
NET VALUE						
Opening balance	**7 948**	**430 519**	**11 183**	**109 335**	**52 635**	**611 620**
Closing balance	**3 024**	**438 109**	**7 688**	**69 620**	**52 635**	**571 076**

In the period from 1 January to 31 December 2017, the Bank acquired intangible assets in the amount of PLN 221 377 thousand (in 2016 - PLN 123 565 thousand). In the period from 1 January to 31 December 2017 and in 2016 there have been no intangible assets whose title is restricted and pledged as security for liabilities.

Contractual commitments

As at 31 December 2017 the contractual commitments for the acquisition of intangible assets amounted to PLN 32 054 thousand, whereas as at 31 December 2016 - PLN 42 723 thousand.

Notes to the financial statements (cont.)

(In PLN thousand)

34. Property, plant and equipment

	31.12.2017	31.12.2016
Non-current assets, including:	1 303 502	1 292 800
land and buildings	977 090	1 005 234
machinery and equipment	245 312	231 888
transport vehicles	44 766	19 251
other	36 334	36 427
Non-current assets under construction and prepayments	97 789	112 300
Total	**1 401 291**	**1 405 100**

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

2017	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	**2 235 446**	**1 392 373**	**67 634**	**307 658**	**112 300**	**4 115 411**
Increases, including:	43 386	90 723	39 319	7 250	131 125	311 803
acquisitions	-	-	-	-	131 125	131 125
other	-	12	39 319	2	-	39 333
transfer from non-current assets under construction	43 386	90 711	-	7 248	-	141 345
Decreases, including:	(18 918)	(100 294)	(32 919)	(11 677)	(145 636)	(309 444)
liquidation and sale	(11 515)	(99 870)	(32 919)	(11 605)	-	(155 909)
transfer to non-current assets held for sale	(7 403)	(412)	-	(72)	-	(7 887)
other	-	(12)	-	-	(4 291)	(4 303)
transfer from non-current assets under construction	-	-	-	-	(141 345)	(141 345)
Closing balance	**2 259 914**	**1 382 802**	**74 034**	**303 231**	**97 789**	**4 117 770**
ACCUMULATED DEPRECIATION						
Opening balance	**1 226 359**	**1 156 699**	**48 383**	**271 113**	**-**	**2 702 554**
Increases, including:	68 034	76 140	12 941	6 921	-	164 036
depreciation	68 034	76 130	12 941	6 921	-	164 026
other	-	10	-	-	-	10
Decreases, including:	(15 953)	(98 058)	(32 056)	(11 218)	-	(157 285)
liquidation and sale	(11 130)	(97 661)	(32 056)	(11 146)	-	(151 993)
transfer to non-current assets held for sale	(4 823)	(386)	-	(72)	-	(5 281)
other	-	(11)	-	-	-	(11)
Closing balance	**1 278 440**	**1 134 781**	**29 268**	**266 816**	**-**	**2 709 305**
IMPAIRMENT						
Opening balance	**3 853**	**3 786**	**-**	**118**	**-**	**7 757**
Increases	531	-	-	-	-	531
Decreases	-	(1 077)	-	(37)	-	(1 114)
Closing balance	**4 384**	**2 709**	**-**	**81**	**-**	**7 174**
NET VALUE						
Opening balance	**1 005 234**	**231 888**	**19 251**	**36 427**	**112 300**	**1 405 100**
Closing balance	**977 090**	**245 312**	**44 766**	**36 334**	**97 789**	**1 401 291**

Notes to the financial statements (cont.)

(In PLN thousand)

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

2016	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	**2 247 432**	**1 376 797**	**68 297**	**312 518**	**83 907**	**4 088 951**
Increases, including:	19 245	72 901	2 074	4 366	128 689	227 275
acquisitions	-	-	-	-	128 689	128 689
other	2	610	2 074	48	-	2 734
transfer from non-current assets under construction	19 243	72 291	-	4 318	-	95 852
Decreases, including:	(31 231)	(57 325)	(2 737)	(9 226)	(100 296)	(200 815)
liquidation and sale	(30 640)	(56 879)	(2 737)	(9 148)	-	(99 404)
transfer to non-current assets held for sale	(591)	(149)	-	(78)	-	(818)
other	-	(297)	-	-	(4 444)	(4 741)
transfer to non-current assets under construction	-	-	-	-	(95 852)	(95 852)
Closing balance	**2 235 446**	**1 392 373**	**67 634**	**307 658**	**112 300**	**4 115 411**
ACCUMULATED DEPRECIATION						
Opening balance	**1 185 184**	**1 138 918**	**40 323**	**272 394**	**-**	**2 636 819**
Increases, including:	65 219	74 528	10 557	7 796	-	158 100
depreciation	65 219	74 224	10 557	7 796	-	157 796
other	-	304	-	-	-	304
Decreases, including:	(24 044)	(56 747)	(2 497)	(9 077)	-	(92 365)
liquidation and sale	(23 818)	(56 310)	(2 497)	(9 000)	-	(91 625)
transfer to non-current assets held for sale	(226)	(147)	-	(77)	-	(450)
other	-	(290)	-	-	-	(290)
Closing balance	**1 226 359**	**1 156 699**	**48 383**	**271 113**	**-**	**2 702 554**
IMPAIRMENT						
Opening balance	**3 853**	**3 821**	**-**	**118**	**583**	**8 375**
Increases	-	-	-	-	-	-
Decreases	-	(35)	-	-	(583)	(618)
Closing balance	**3 853**	**3 786**	**-**	**118**	**-**	**7 757**
NET VALUE						
Opening balance	**1 058 395**	**234 058**	**27 974**	**40 006**	**83 324**	**1 443 757**
Closing balance	**1 005 234**	**231 888**	**19 251**	**36 427**	**112 300**	**1 405 100**

In the period from 1 January to 31 December 2017 the Bank acquired property, plant and equipment in the amount of PLN 131 125 thousand (in 2016 - PLN 128 689 thousand), while the value of property, plant and equipment sold amounted to PLN 3 thousand (in 2016 - PLN 5 873 thousand).

The amount of compensations received from third parties for impairment of loss of property, plant and equipment items recognized in the income statement for 2017 stood at PLN 3 526 thousand (PLN 3 519 thousand in 2016).

In 2017 and 2016 there have been no restrictions to legal titles to property, plant and equipment, nor pledges in place as security for liabilities.

Contractual commitments

As at 31 December 2017 the contractual commitments for the acquisition of property, plant and equipment amounted to PLN 20 114 thousand, whereas as at 31 December 2016 - PLN 17 344 thousand.

(In PLN thousand)

35. Investment property

The Bank values investment property using the historical cost model.

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

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

	2017	2016
GROSS VALUE		
Opening balance	**21 358**	**32 047**
Increases, including:	97	431
acquisitions	-	431
other	97	-
Decreases, including:	(1 595)	(11 120)
sale of real estate	-	(2 777)
transfer to non-current assets held for sale	(1 595)	(8 295)
other	-	(48)
Closing balance	**19 860**	**21 358**
ACCUMULATED DEPRECIATION		
Opening balance	**7 769**	**12 200**
Increases, including:	330	444
depreciation	330	444
other	-	-
Decreases, including:	(720)	(4 875)
sale of real estate	-	(1 134)
transfer to non-current assets held for sale	(720)	(3 741)
other	-	-
Closing balance	**7 379**	**7 769**
IMPAIRMENT		
Opening balance	**879**	**2 530**
Increases, including:	-	-
impairment charges	-	-
Decreases, including:	(860)	(1 651)
sale of real estate	-	(926)
transfer to non-current assets held for sale	(860)	(725)
Closing balance	**19**	**879**
NET VALUE		
Opening balance	**12 710**	**17 317**
Closing balance	**12 462**	**12 710**

The fair value of investment property as at 31 December 2017 stood at PLN 14 478 thousand (PLN 12 736 thousand as at 31 December 2016). The fair value of investment property are categorized in Level 3 of the fair value hierarchy. The fair value was measured based on valuations of the property appraisers, having appropriate professional qualifications and recent experience in the location of the properties being valued. The valuations of investment property are based on investment method or profits method, taking into account such unobservable input data as expected rental growth rate, void periods, occupancy rate, discount rate.

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

	2017	2016
Rental revenues from investment properties	2 215	2 785
Direct operating expenses associated with investment properties (including repair and maintenance costs) which generated rental revenues during the reporting period	(610)	(551)
Direct operating expenses associated with investment properties (including repair and maintenance costs) which did not generate rental revenues during the reporting period	-	-

Notes to the financial statements (cont.)

(In PLN thousand)

36. Other assets

	31.12.2017	31.12.2016
Prepaid expenses	30 239	33 176
Perpetual usufruct rights	13 834	14 876
Accrued income	70 957	76 851
Interbank and interbranch settlements	2	156
Other debtors	158 709	200 812
Card settlements	573 321	479 996
Total	**847 062**	**805 867**

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

Impairment allowances for other assets and their changes in 2017 and 2016 are presented in the Note 16.

37. Assets pledged as collateral

As at 31 December 2017 the Bank held the financial assets pledged as security for liabilities

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transactions	bonds	1 088 646	1 045 716	1 089 876
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	763 727	770 000	-
Coverage of payment commitments to the guarantee fund for the Bank Guarantee Fund	bonds	32 488	32 000	26 858
Coverage of payment commitments to the resolution fund for the Bank Guarantee Fund	bonds	62 946	62 000	53 069
Lombard and technical loan	bonds	4 697 247	4 587 519	-
Other loans	bonds	320 074	317 300	234 731
Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	cash deposit	13 156	13 156	-
Derivatives	bonds	648 671	653 999	574 882

Notes to the financial statements (cont.)

(In PLN thousand)

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

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transactions	bonds	1 774 747	1 678 677	1 775 808
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	750 499	720 000	-
Lombard and technical loan	bonds	4 808 629	4 515 159	-
Other loans	bonds	357 614	353 900	297 497
Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	cash deposit	11 786	11 786	-
Derivatives	bonds	60 792	65 302	31 987

The freeze on securities is a consequence of:

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

38. Amounts due to other banks

Amounts due to other banks by product type

	31.12.2017	31.12.2016
Current accounts	962 813	931 753
Interbank deposits and other liabilities	642 961	309 858
Loans and advances received	1 507 313	1 764 184
Repo transactions	301 439	339 568
Cash in transit	24 275	21 762
Total	**3 438 801**	**3 367 125**

Amounts due to other banks by currency

	31.12.2017	31.12.2016
PLN	1 570 970	1 388 977
CHF	257 553	359 958
EUR	1 523 157	1 561 382
USD	76 977	48 694
Other currencies	10 144	8 114
Total	**3 438 801**	**3 367 125**

Notes to the financial statements (cont.)

(In PLN thousand)

39. Amounts due to customers

Amounts due to customers by entity and product type

	31.12.2017	31.12.2016
Amounts due to corporate, including:	58 822 796	59 029 038
current accounts	39 036 375	34 878 412
term deposits and other liabilities	19 786 421	24 150 626
Amounts due to budget entities, including:	12 192 073	7 809 234
current accounts	9 392 005	5 461 223
term deposits and other liabilities	2 800 068	2 348 011
Amounts due to individuals, including:	74 891 544	69 589 205
current accounts	42 618 570	39 237 788
term deposits and other liabilities	32 272 974	30 351 417
Repo transactions	788 436	1 436 241
Cash in transit	203 449	202 411
Total	**146 898 298**	**138 066 129**

Amounts due to customers by currency

	31.12.2017	31.12.2016
PLN	120 695 015	115 403 290
CHF	336 054	315 757
EUR	16 451 858	13 347 287
USD	7 924 185	7 466 751
Other currencies	1 491 186	1 533 044
Total	**146 898 298**	**138 066 129**

40. Debt securities issued

Debt securities issued by type

	31.12.2017	31.12.2016
Certificates of deposit	1 470 000	300 945
Total	**1 470 000**	**300 945**

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

Debt securities issued by currency

	31.12.2017	31.12.2016
PLN	1 470 000	300 945
EUR	-	-
USD	-	-
Total	**1 470 000**	**300 945**

Changes in the balance sheet value of debt securities issued are presented in the Note 50.

Notes to the financial statements (cont.)

(In PLN thousand)

41. Subordinated liabilities

On 30 October 2017, the Bank issued 10 years subordinated bonds with a total nominal value of PLN 1.25 billion. The funds from the issue were designated – after receiving the approval of the Polish Financial Supervision Authority on 21 December 2017 – to increase the Bank's supplementary capital, pursuant to art. 127 para. 2 point 2 of the Banking Law and art. 63 of Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. The bonds were introduced to trading on the ASO Catalyst market.

Subordinated liabilities

TYPE OF TRANSACTION	NOMINAL AMOUNT	CURRENCY	INTEREST RATE	ISSUE DATE	MATURITY DATE	SPECIAL TERMS	BALANCE SHEET VALUE AS AT 31.12.2017
Subordinated bonds	1 250 000	PLN	variable, WIBOR 6M + margin	30.10.2017	29.10.2027	call option giving the Bank the right of early redemption within 5 years from the issue date, subject to the approval of the PFSA	1 257 188

Changes in the balance sheet value of subordinated liabilities are presented in the Note 50.

42. Provisions

Changes in provisions in the reporting period

2017	PROVISIONS FOR LITIGATION AND CLAIM	PROVISIONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	**7 002**	**290 611**	**226 322**	**36 548**	**560 483**
Provision charges/revaluation	7 225	27 489	75 745	41 714	152 173
Provision utilization	(3 253)	(13 959)	-	(5 376)	(22 588)
Provision releases	(699)	-	(54 401)	-	(55 100)
Foreign currency exchange differences	-	-	(1 673)	-	(1 673)
Other changes	4 929	(8 590)	-	(35 999)	(39 660)
Closing balance	**15 204**	**295 551**	**245 993**	**36 887**	**593 635**
Short term	2 401	33 206	51 119	-	86 726
Long term	12 803	262 345	194 874	36 887	506 909

2016	PROVISIONS FOR LITIGATION AND CLAIM	PROVISIONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	**7 870**	**265 911**	**124 583**	**24 566**	**422 930**
Provision charges/revaluation	3 283	26 198	162 088	23 189	214 758
Provision utilization	(2 797)	(12 898)	-	(11 207)	(26 902)
Provision releases	(1 812)	-	(61 341)	-	(63 153)
Foreign currency exchange differences	-	-	992	-	992
Other changes	458	11 400	-	-	11 858
Closing balance	**7 002**	**290 611**	**226 322**	**36 548**	**560 483**
Short term	2 600	47 166	71 290	14 016	135 072
Long term	4 402	243 445	155 032	22 532	425 411

(In PLN thousand)

Litigation provisions

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

Provisions for defined benefit plans

Detailed information in respect to provisions for defined benefit plans were presented in Note 44.

Other provisions

Other provisions include in particular provisions for long term employee benefits.

43. Other liabilities

	31.12.2017	31.12.2016
Deferred income	116 700	113 647
Provisions for holiday leave	48 230	49 987
Provisions for other employee-related liabilities	198 735	223 887
Provisions for administrative costs	101 229	82 280
Other costs to be paid (*)	95 969	105 084
Other creditors	364 259	235 066
Interbank and interbranch settlements	1 385 384	1 029 899
Card settlements	286 755	304 454
Total	**2 597 261**	**2 144 304**

(*) in this as at 31 December 2017 is PLN 81 842 thousand of provision for future refunds of the part of the remuneration for sale of insurance products linked to loans (PLN 95 346 as at 31 December 2016).

44. Defined benefit plans

Based on internal regulations in respect to remuneration, the employees of the Bank or their families are entitled to defined benefits other than remuneration:

a) retirement benefits,
b) death-in-service benefits.

The present value of such obligations is measured by an independent actuary using the projected unit credit method.

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

These defined benefit plans expose the Bank to actuarial risk, such as:

- interest rate risk – the decrease in market yields on government bonds would increase the defined benefit plans obligations,
- remuneration risk – the increase in remuneration of the Bank’s employees would increase the defined benefit plans obligations,
- longevity risk – the increase in life expectancy of the Bank’s employees would increase the defined benefit plans obligations.

Notes to the financial statements (cont.)

(In PLN thousand)

The principal actuarial assumptions as at 31 December 2017 are as follows:

- the discount rate at the level of 3.20% (3.50% as at 31 December 2016),
- the future salary growth rate at the level of 2.50 (2.50% as at 31 December 2016),
- the probable number of leaving employees calculated on the basis of historical data concerning personnel rotation in the Bank,
- the mortality adopted in accordance with Life Expectancy Tables for men and women, published the Central Statistical Office, adequately adjusted on the basis of historical data of the Bank.

Reconciliation of the present value of defined benefit plans obligations

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

	2017	2016
Opening balance	**290 611**	**265 911**
Current service cost	17 317	18 486
Interest expense	10 171	7 711
Remeasurements of the defined benefit obligations:	(8 589)	11 400
actuarial gains and losses arising from changes in demographic assumptions	(2 780)	33 437
actuarial gains and losses arising from changes in financial assumptions	7 455	(15 984)
actuarial gains and losses arising from experience adjustments	(13 264)	(6 053)
Contributions paid by the employer	(13 959)	(12 897)
Closing balance	**295 551**	**290 611**

Sensitivity analysis

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

31.12.2017	DEFINED BENEFIT PLANS OBLIGATIONS	
	1 PERCENT INCREASE	1 PERCENT DECREASE
Discount rate	(23 615)	27 451
Future salary growth rate	26 166	(23 026)

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

Maturity of defined benefit plans obligations

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

	31.12.2017	31.12.2016
The weighted average duration of the defined benefit plans obligations (in years)	8.6	8.8

(In PLN thousand)

45. Share - based payments

Incentive programs

In the current and comparative reporting periods the following incentive programs granted to employees of the Bank:

- The long-term UniCredit Group Incentive Program 2008 in respect to share options is realize by the Bank. The rights to exercise the option were acquired in 2012. Strike price is EUR 4.185. The option will expire in 2018,
- The long-term UniCredit Group Incentive Program 2007 has been finished in respect to share options. The options were expired in 2017,
- Employee Share Ownership Plan that offered to eligible the Bank Pekao S.A. Group employees the possibility to buy UniCredit ordinary shares has been finished.

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

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

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

2017	STOCK OPTIONS	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE (*)
Opening balance	2 093 140	17.51
Granted during the year	-	-
Redeemed during the year	(542 469)	-
Exercised during the year	-	-
Terminated during the year	(478 011)	-
Existing at the period-end	1 072 660	17.51
Executable at the period-end	1 072 660	17.51

(*)The value of PLN 17.51 relates to the stock options program 2008.

2016	STOCK OPTIONS	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE (*)
Opening balance	2 117 307	17.83/30.23
Granted during the year	-	-
Redeemed during the year	(24 167)	-
Exercised during the year	-	-
Terminated during the year	-	-
Existing at the period-end	2 093 140	17.83/30.23
Executable at the period-end	2 093 140	17.83/30.23

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

The fair value of granted rights to shares under Employee Share Ownership Plan until 31 December 2017 amounted to PLN 220 thousand as at 31 December 2017 (PLN 1 180 thousand as at 31 December 2016).

The remuneration expenses for 2017 relating to the incentive programs granted to the emloyees of the Bank by UniCredit Group amounted to PLN 54 thousand (in 2016 - PLN 284 thousand).

Notes to the financial statements (cont.)

(In PLN thousand)

System of Variable Remuneration for the Management Team

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

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

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

Notes to the financial statements (cont.)

(in PLN thousand)

During the reporting period ending on 31 December 2017 the Bank had the following share-based payments transactions:

	SYSTEM 2013	SYSTEM 2014	SYSTEM 2015	SYSTEM 2016	SYSTEM 2017
Transaction type	Cash-settled share based payments				
Start date of the assessment period	1 January 2013	1 January 2014	1 January 2015	1 January 2016	1 January 2017
Program announcement date	April 2013	June 2014	July 2015	June 2016	April 2017
Program granting date	12 June 2014	30 April 2015	16 June 2016	19 April 2017	Date of General Shareholders Meeting
Number of instruments granted (pcs)	76 013	68 040	93 359	127 256	Will be defined on granting date
Maturity date	31 July 2018	31 July 2020	31 July 2021	31 July 2022	31 July 2023
Vesting date for Management Board Members and Executive Vice President	• 40% in the year of program granting (settlement after 2 years retention period) • 40% after 2 years from program granting date (settlement after 1 year retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 3 years retention period) • 30% after 3 years from program granting date (settlement after 1 year retention period) • 30% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)
Vesting date for remaining participants	• 20% after 1 year from program granting date • 40% after 2 years from program granting date • 40% after 3 years from program granting date	• 60% in the year of program granting (settlement after 3 years retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period) • 20% after 4 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 3 years retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period) • 20% after 4 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 2 years retention period) • 20% after 2 years from program granting date (settlement after 1 year retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 2 years retention period) • 20% after 2 years from program granting date (settlement after 1 year retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period)
Vesting conditions	Compliance assessment, Continuous employment, Reaching the aim based on financial results of the Bank for a given period				
Program settlement	The participant will receive a cash payment amounting to the number the possessed phantom shares times the arithmetic mean of the Bank's share prices at the Warsaw Stock Exchange: • in case of the settlement made at the dates of instalment after the mandatory retention period, for a month preceding the day of General Meeting approving the financial statements for a given year, • in case of settlement made in the voluntary retention period, for 10 working days following the day of release of the financial report in a given quarter, and benefits from acquired phantom shares in the amount equivalent to dividend paid to shareholders in the retention period for shares acquired by the participant.				

Notes to the financial statements (cont.)

(In PLN thousand)

For the System 2013, 2014, 2015 and 2016 the fair value of the program was estimated based upon the Bank's shares price on the WSE as of the balance sheet date and expected number of phantom shares to which the rights will be acquired.

For the System 2017, as of 31 December 2017 the Bank prepared the program valuation, presuming that the phantom shares were granted on 31 December 2017. This value will be changed at the actual date of granting the program.

The system of variable remuneration realized in the form of phantom shares is a program settled in cash, and therefore its fair value is adjusted on each balance sheet date until the the program settlement, which in case of this program coincides with the vesting date.

The carrying amount of liabilities for cash - settled phantom shares amounted to PLN 36 887 thousand as at 31 December 2017 (as at 31 December 2016 – PLN 22 532 thousand).

The total intrinsic value of liabilities for vested rights to phantom shares amounted to PLN 38 524 thousand as at 31 December 2017 (as at 31 December 2016 – PLN 26 446 thousand).

The remuneration expenses for 2017 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 19 714 thousand (in 2016 - PLN 9 189 thousand).

The table below presents changes in the number of Bank's phantom shares.

	2017	2016
Opening balance	210 223	191 060
Granted during the year	127 256	93 359
Redeemed during the year	-	-
Exercised during the year	(39 996)	(74 196)
Terminated during the year	-	-
Existing at the period-end	297 483	210 223

The table above does not present the number of shares granted in respect of System 2017. This number will be determined in 2018 after approval of the financial statements for 2017 by the General Shareholder's Meeting. The hypothetical number of shares determined on the basis of the base value of the granted bonus to each of the program participants and arithmetic mean of the Bank's share price on the WSE in December 2017 amounts to 156 872.

(In PLN thousand)

46. Operating and finance leases

Bank as a Lessor

In operating lease of buildings classified as investment properties the Bank acts as a lessor.

The amount of future minimum lease payments expected to be received under non-cancellable operating lease can be summarized as follows:

	31.12.2017	31.12.2016
Up to 1 year	6 522	6 465
Between 1 and 5 years	3 513	2 769
Over 5 years	816	820
Total	**10 851**	**10 054**

The amount of the minimum operating lease payments classified as income in 2017 amounted to PLN 21 674 thousand (PLN 21 276 thousand in 2016).

Bank as a Lessee

The Bank is a lessee of buildings' lease contracts classified as operating lease.

The amount of future minimum lease payments expected to be paid under non-cancellable operating lease can be summarized as follows:

	31.12.2017	31.12.2016
Up to 1 year	95 815	93 353
Between 1 and 5 years	188 583	195 129
Over 5 years	17 865	56 777
Total	**302 263**	**345 259**

The amount of the minimum operating lease payments recognized as an expense in 2017 amounted to PLN 160 837 thousand (expense in 2016 amounted to PLN 162 239 thousand).

The lease agreements are usually entered into for an indefinite period. In case of lease agreements concluded for an indefinite term, the minimum lease payments are determined based upon notice of termination periods ensuing from relevant contracts. The notice period is usually fixed at 3 or 6 months. Lease agreements are denominated in PLN as well as in foreign currencies. Payments are made in PLN, regardless of the contract currency.

Finance leases

In addition, the Bank as a lessee of cars concludes finance lease contracts with its subsidiary Pekao Leasing Sp. z o.o.

His contract gives the Bank opportunity to buy an asset after termination of lease contract.

The carrying amount of net assets being subject of finance lease contracts as at 31 December 2017 amounted to PLN 44 766 thousand and as at 31 December 2016 amounted to PLN 19 250 thousand.

	31.12.2017	31.12.2016
Gross liabilities on finance leases	60 487	29 312
Unrealized financial costs	(13 996)	(7 306)
Present value of minimum lease payments	**46 491**	**22 006**

The amount of future minimum lease payments under finance lease by maturity dates can be summarized as follows:

	31.12.2017	31.12.2016
Up to 1 year	22 254	13 353
Between 1 and 5 years	38 233	15 959
Total	**60 487**	**29 312**

(In PLN thousand)

47. Contingent commitments

Litigation

In the entire year of 2017 the total value of the litigation subject in the ongoing court proceedings against the Bank was PLN 171 844 198 thousand (in 2016 it was PLN 1 084 793 thousand).

In 2017 still going on was the court litigation against the Bank, brought by a minority shareholder of the Bank for an ascertainment of invalidity or alternatively for repealing the resolutions no 5 and 21 of the Ordinary General Meeting of Shareholders dated 19 April 2017 for an approval of financial statements for 2016 and for granting of approval of the performance by the member of the Management Board of his duties in 2016. In the opinion of the Bank, the claim is unfounded and the value of the litigation subject in the amount of PLN 170 988 852 thousand indicated by the plaintiff is incorrect, as confirmed by the value of the litigation subject by a decision of the District Court in Warsaw of 5 September 2017, the value of the litigation subject was set at PLN 6 850. As at 31 December 2017, the value of the litigation subject in the above case amounted to PLN 6 850.

In 2017 there were no proceedings before the court or state administration bodies related to the receivables or payables of the Bank and its subsidiaries in which the pursued claim value (amount to be paid) is at least 10% of the Group's equity.

In 2017 still going on was the court litigation against Bank Pekao SA and Pekao SA Central Brokerage House, brought by private individuals for the payment of damage arising from the purchase of stocks and the financial compensation for the injury resulting from the execution process, in which the value of the litigation subject, as in 2017, was PLN 206 422 thousand (previously PLN 306 622 thousand). In the first half of 2015 the sentence dismissing the plaint against defendants was adjudicated. The plaintiffs lodged an appeal against the sentence, i.e. its part related to the amount of PLN 206 422 thousand. In the third quarter of 2016 was issued a judgment dismissing the appeal. The verdict of the Court of II instance has been appealed against by the plaintiffs by means of a cassation appeal. In the fourth quarter of 2017, the Supreme Court refused to accept the cassation appeal. In connection with the ruling of the Supreme Court, the case is finally ended in favor of the Bank.

Moreover against the Bank currently are pending the following essential litigations, in which the Bank – in the current factual and legal circumstances – assess the risk of outflow as possible:

- proceedings instigated in the second quarter of 2014 as a result of the plaint brought by a guarantee beneficiary for the payment of PLN 55 996 thousand as the bank guarantee drawing,
- proceedings instigated in the first quarter of 2015 as a result of the plaint brought by guarantee beneficiary for the payment of PLN 29 205 thousand as the bank guarantee drawing,
- proceeding instigated in the fourth quarter of 2016 as a result plaint brought by private individual for the payment of PLN 38 916 thousand taken by the Bank way of settlement of term financial transactions.

As at 31 December 2017, the Bank created provisions for litigations against the Bank which, according to the legal opinion, are connected with a risk of the funds outflow resulting from the fulfillment of the obligation. The value of the above provisions as at 31 December 2017 is PLN 15 204 thousand (PLN 7 002 thousand as at 31 December 2016).

Notes to the financial statements (cont.)

(In PLN thousand)

Financial off–balance commitments granted

Financial commitments granted by entities

	31.12.2017	31.12.2016
Financial commitments to:		
financial entities	2 574 403	1 757 518
non - financial entities	31 543 959	30 066 984
budget entities	559 172	481 482
Total	**34 677 534**	**32 305 984**

Off–balance guarantees issued

Guarantees issued by entities

	31.12.2017	31.12.2016
Liabilities to financial entities, including:	3 276 855	2 712 868
guarantees	3 166 855	2 712 868
sureties	110 000	-
Liabilities to non-financial entities, including:	9 946 558	9 960 469
guarantees	6 726 612	6 194 199
securities' underwriting guarantees	3 070 727	3 455 429
sureties	149 219	310 841
Liabilities to budget entities, including:	434 737	269 239
guarantees	13 186	11 279
securities' underwriting guarantees	421 551	257 960
Total	**13 658 150**	**12 942 576**

Securities underwriting

As at 31 December 2017, the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 1	bonds	1 009 000	23.07.10 - 30.06.20
Client 2	bonds	484 880	23.10.13 - 31.05.22
Client 3	bonds	60 775	26.07.17 - 31.03.19
Client 4	bonds	32 600	27.01.14 - 27.04.18
Client 5	bonds	83 300	30.06.14 - 24.02.18
Client 6	bonds	2 940	15.09.14 - 30.06.18
Client 7	bonds	150 000	24.05.14 - 31.03.18
Client 8	bonds	100 000	23.02.15 - 30.11.22
Client 9	bonds	12 500	14.10.15 - 31.12.18
Client 10	bonds	33 576	18.12.15 - 27.04.18
Client 11	bonds	57 000	21.05.16 - 21.06.19
Client 12	bonds	4 000	06.07.16 - 31.12.18
Client 13	bonds	79 480	31.08.16 - 31.12.18
Client 14	bonds	323 600	31.08.16 - 30.12.19
Client 15	bonds	4 300	23.12.16 - 31.12.18
Client 16	bonds	2 050	23.12.16 - 31.12.18
Client 17	bonds	53 235	20.12.16 - 31.12.18
Client 18	bonds	9 000	03.03.17 - 31.12.19
Client 19	bonds	14 083	03.03.17 - 31.12.18
Client 20	bonds	1 530	03.03.17 - 31.12.18

Notes to the financial statements (cont.)

(In PLN thousand)

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 21	bonds	23 210	09.06.17 - 31.12.18
Client 22	bonds	4 132	27.06.17 - 31.12.19
Client 23	bonds	2 500	22.06.17 - 31.12.18
Client 24	bonds	1 000	28.06.17 - 31.12.18
Client 25	bonds	3 000	27.06.17 - 31.12.18
Client 26	bonds	49 844	09.03.16 - 30.06.19
Client 27	bonds	1 500	04.07.17 - 31.12.18
Client 28	bonds	5 000	17.07.17 - 31.12.18
Client 29	bonds	9 739	23.08.17 - 31.12.18
Client 30	bonds	8 700	06.09.17 - 31.12.18
Client 31	bonds	6 200	08.09.17 - 31.12.19
Client 32	bonds	4 500	13.09.17 - 31.12.18
Client 33	bonds	116 900	15.09.17 - 29.06.19
Client 34	bonds	20 900	25.09.17 - 31.12.18
Client 35	bonds	20 625	26.09.17 - 31.12.19
Client 36	bonds	35 338	25.09.17 - 31.12.19
Client 37	bonds	10 400	27.09.17 - 31.12.19
Client 38	bonds	51 800	11.10.17 - 31.03.22
Client 39	bonds	67 800	11.10.17 - 20.04.22
Client 40	bonds	98 000	24.10.17 - 31.12.19
Client 41	bonds	25 000	24.10.17 - 31.12.19
Client 42	bonds	3 500	03.11.17 - 31.12.18
Client 43	bonds	80 000	03.11.17 - 31.08.19
Client 44	bonds	51 041	15.11.17 - 31.12.20
Client 45	bonds	2 000	21.11.17 - 31.12.18
Client 46	bonds	3 750	09.11.17 - 31.12.18
Client 47	bonds	17 000	15.11.17 - 31.12.19
Client 48	bonds	4 100	05.12.17 - 31.12.18
Client 49	bonds	7 000	11.12.17 - 31.12.19
Client 50	bonds	8 400	31.12.17 - 31.12.19
Client 51	bonds	6 000	15.12.17 - 31.12.18
Client 52	bonds	115 000	19.12.17 - 31.12.19
Client 53	bonds	17 100	11.12.17 - 31.12.19
Client 54	bonds	4 900	19.12.17 - 31.12.18
Client 55	bonds	5 000	21.12.17 - 31.12.18
Client 56	bonds	5 000	22.12.17 - 31.12.18
Client 57	bonds	8 500	27.12.17 - 31.12.18
Client 58	bonds	70 050	21.12.17 - 31.12.18

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and not subject to regulated over-the-counter trading.

Notes to the financial statements (cont.)

(In PLN thousand)

As at 31 December 2016, the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OF SECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT ITSELF	CONTRACT LIFE
Client 1	bonds	1 385 000	23.07.10 - 30.06.20
Client 2	bonds	265 000	21.06.12 - 31.12.17
Client 3	bonds	484 880	22.10.13 - 31.05.22
Client 4	bonds	35 000	27.01.14 - 28.04.17
Client 5	bonds	110 510	30.06.14 - 31.03.17
Client 6	bonds	2 200	15.09.14 - 31.03.18
Client 7	bonds	20 000	15.09.14 - 31.03.18
Client 8	bonds	150 000	24.05.16 - 31.03.18
Client 9	bonds	49 000	22.12.14 - 30.06.17
Client 10	bonds	230 000	23.02.15 - 30.06.17
Client 11	bonds	100 000	23.02.15 - 30 11.22
Client 12	bonds	84 000	27.01.15 - 31.12.17
Client 13	bonds	30 000	14.10.15 - 31.12.17
Client 14	bonds	7 500	14.10.15 - 31.12.17
Client 15	bonds	119 985	18.12.15 - 28.04.17
Client 16	bonds	20 270	28.12.15 - 31.12.17
Client 17	bonds	19 504	09.03.16 - 30.06.17
Client 18	bonds	22 810	09.03.16 - 30.06.17
Client 19	bonds	53 500	21.05.16 - 21.06.19
Client 20	bonds	3 500	21.05.16 - 21.06.19
Client 21	bonds	8 000	06.07.16 - 31.12.18
Client 22	bonds	67 200	06.07.16 - 31.12.18
Client 23	bonds	8 680	06.07.16 - 31.12.18
Client 24	bonds	8 000	06.07.16 - 31.12.18
Client 25	bonds	310 600	31.08.16 - 30.12.19
Client 26	bonds	13 000	31.08.16 - 30.12.19
Client 27	bonds	6 000	08.11.16 - 31.12.17
Client 28	bonds	4 300	23.12.16 - 31.12.18
Client 29	bonds	1 000	22.12.16 - 30.12.16
Client 30	bonds	6 650	23.12.16 - 31.12.18
Client 31	bonds	66 000	20.12.16 - 31.12.20
Client 32	bonds	15 000	28.12.16 - 31.08.17
Client 33	bonds	6 300	29.12.16 - 31.08.17

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and not subject to regulated over-the-counter trading.

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance commitments received

Commitments received by entities

	31.12.2017	31.12.2016
Financial commitments from:	176 416	209 731
financial entities	176 416	209 731
non - financial entities	-	-
budget entities	-	-
Guarantees from:	13 865 863	10 814 323
financial entities	3 111 013	1 548 141
non - financial entities	9 824 811	8 344 980
budget entities	930 039	921 202
Total	**14 042 279**	**11 024 054**

Moreover, the Bank has the ability to obtain financing from National Bank of Poland secured by government securities.

48. Share capital

Shareholding structure

CLASS/ISSUE	TYPE OF SHARES	NUMBER OF SHARES	NOMINAL VALUE OF CLASS/ISSUE	EQUITY COVERAGE	DATE OF REGISTRATION	DIVIDEND RIGHTS (FROM DATE)
A	Common bearer stock	137 650 000	137 650	Fully paid-up	21.12.1997	01.01.1998
B	Common bearer stock	7 690 000	7 690	Fully paid-up	06.10.1998	01.01.1998
C	Common bearer stock	10 630 632	10 631	Fully paid-up	12.12.2000	01.01.2000
D	Common bearer stock	9 777 571	9 777	Fully paid-up	12.12.2000	01.01.2000
E	Common bearer stock	373 644	374	Fully paid-up	29.08.2003	01.01.2003
F	Common bearer stock	621 411	621	Fully paid-up	29.08.2003	19.05.2006 16.05.2007
G	Common bearer stock	603 377	603	Fully paid-up	29.08.2003	15.05.2008
H	Common bearer stock	359 840	360	Fully paid-up	12.08.2004	01.01.2004
I	Common bearer stock	94 763 559	94 764	Fully paid-up	29.11.2007	01.01.2008
Total number of Shares (pcs)		**262 470 034**				
Total share capital in PLN thousand			**262 470**			
Nominal value per share = PLN 1.00						

Change in the number of shares (pcs)

2017	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

2016	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

Notes to the financial statements (cont.)

(In PLN thousand)

49. Other capital and reserves, retained earnings and profit for the period

The table below presents the structure of the Bank's equity

	31.12.2017	31.12.2016
Reserve capital, including:	9 326 529	9 326 529
issue of shares above face value	9 137 221	9 137 221
other	189 308	189 308
Revaluation reserve, including:	(57 422)	(223 510)
remeasurements of the defined benefit liabilities	(89 641)	(98 230)
deferred tax	17 032	18 664
revaluation of financial assets portfolio available for sale	12 169	(217 433)
deferred tax	(2 312)	41 313
revaluation of financial hedging instruments portfolio	6 580	39 724
deferred tax	(1 250)	(7 548)
Foreign currency translation differences	-	-
General Banking Risk Fund	1 982 459	1 982 324
Other reserve capital	8 612 550	8 612 550
Bonds convertible into shares- capital component	28 819	28 819
Funds for brokerage activities	15 000	15 000
Total other capital	**19 907 935**	**19 741 712**
Profit (loss) from previous periods	-	-
Net profit for the period	2 088 129	2 278 375
Total retained earnings and profit for the period	**2 088 129**	**2 278 375**
Total	**21 996 064**	**22 020 087**

The net profit of the Bank for 2016 in the amount of PLN 2 278 375 thousand was distributed in the following way: PLN 2 278 240 thousand – to dividend, PLN 135 thousand – to General Banking Risk Fund.

From 1982 to 1984 and from 1988 to 1996, the Bank operated in a hyperinflationary economic environment.

IAS 29 'Financial Reporting in Hyperinflationary Economies' requires restatement of each component of owners' equity (except for retained earnings and revaluation surplus) by applying a general price index for the period of hyperinflation. This retrospective application would have resulted in an increase in share capital and other reserves and a decrease in retained earnings in equivalent amounts. This restatement would not have any effect on the total amount of the Bank's equity.

Notes to the financial statements (cont.)

(In PLN thousand)

50. Additional information to the cash flow statement

Cash and cash equivalents

	31.12.2017	31.12.2016
Cash and amounts due from Central Bank	5 186 259	5 861 342
Loans and receivables from banks with maturity up to 3 months	2 107 448	2 888 669
Cash and Cash equivalents presented in the cash flow statement	**7 293 707**	**8 750 011**

Restricted availability cash and cash equivalents as at 31 December 2017 amounted to PLN 4 786 930 thousand (PLN 4 605 707 thousand as at 31 December 2016).

Changes in liabilities arising from financing activities

			NON-CASH CHANGES				
	BALANCE AS AT 1 JANUARY 2017	CHANGES FROM FINANCING CASH FLOWS	CHANGES ARISING FROM OBTAINING OR LOSING CONTROL OF SUBSIDIARIES OR OTHER BUSINESSES	THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES	CHANGES IN FAIR VALUES	OTHER CHANGES (*)	BALANCE AS AT 31 DECEMBER 2017
Debt securities issued	300 945	1 163 140	-	-	-	5 915	1 470 000
Subordinated liabilities	-	1 250 000	-	-	-	7 188	1 257 188
Loans and advances received	1 764 184	(139 462)	-	(117 358)	-	(51)	1 507 313
Total	**2 065 129**	**2 273 678**	**-**	**(117 358)**	**-**	**13 052**	**4 234 501**

(*)The item 'Other changes' refers to interest accruals and payments as well as discount/premium settlements.

			NON-CASH CHANGES				
	BALANCE AS AT 1 JANUARY 2016	CHANGES FROM FINANCING CASH FLOWS	CHANGES ARISING FROM OBTAINING OR LOSING CONTROL OF SUBSIDIARIES OR OTHER BUSINESSES	THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES	CHANGES IN FAIR VALUES	OTHER CHANGES (*)	BALANCE AS AT 31 DECEMBER 2016
Debt securities issued	1 668 706	(1 351 319)	-	-	-	(16 442)	300 945
Loans and advances received	1 832 841	(138 763)	-	70 358	-	(252)	1 764 184
Total	**3 501 547**	**(1 490 082)**	**-**	**70 358**	**-**	**(16 694)**	**2 065 129**

(*)The item 'Other changes' refers to interest accruals and payments as well as discount/premium settlements.

51. Related party transactions

Transactions between the Bank and related parties are typical transactions arising from current operating activities conducted by the Bank. Such transactions mainly include loans, deposits, foreign currency transactions and guarantees.

The credit granting process applicable to the Bank's management and entities related to the Bank

According to the Banking Act, credit transactions with Members of the Banks Management Board and Supervisory Board, persons holding managerial positions at the Bank, with the entities related financially or organizationally therewith, shall be effected according to Regulation adopted by the Supervisory Board of the Bank.

The Regulation provides detailed decision-making procedures, applicable to transactions with such persons and entities, also defining the decision-making levels authorized to take decisions. In particular, the transactions with the Members of the Bank's Management Board or Supervisory Board or with an entity related therewith financially or organizationally, are subject to decisions taken by the Bank's Management Board and Supervisory Board.

Members of the Bank's Management Board and entities related therewith financially or organizationally may take advantage of credit products offered by the Bank on standard terms and conditions of the Bank. In particular, the Bank may not offer more advantageous credit interest rates to such persons or entities.

Credit risk assessment is performed using the methodology applied by the Bank, tailored to the client's segment and type of transaction.

In case of entities related to the Bank, the standard credit procedures are applied, with transaction-related decisions taken exclusively at level of the Bank's Head Office.

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions

Related party transactions as at 31 December 2017

NAME OF ENTITY	RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
PZU S.A. – the Bank ‘s parent entity	-	-	-	877	477 485	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group	1 010	-	489	16	489 057	5 062	-
Bank Pekao S.A. Group entities							
Subsidiaries							
Pekao Investment Banking S.A.	-	-	-	11 002	311 268	-	-
Pekao Leasing Sp. z o.o.	2 783 176	8 911	167	20 443	40 941	-	17 348
Pekao Faktoring Sp. z o.o.	1 244 100	-	-	3	4 272	-	-
Centralny Dom Maklerski Pekao S.A.	-	-	-	-	722 510	-	-
Pekao Fundusz Kapitałowy Sp. z o.o. (in liguidation)	-	-	-	-	52 148	-	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	-	-	-	98	14 778	-	-
Centrum Kart S.A.	-	-	-	90	24 172	-	9 700
Pekao Financial Services Sp. z o. o.	-	-	-	4	13 373	-	-
Pekao Bank Hipoteczny S.A.	67 155	-	3 262	136	11 108	6 854	-
Pekao Property S.A.	6 230	-	-	-	33 402	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	16	-	-	-	5 225	-	6 666
FPB – Media Sp. z o. o.	9 144	-	-	-	643	-	-
Dom Inwestycyjny Xelion Sp. z o.o.	-	-	-	3	34 087	-	-
Pekao Investment Management S.A.	-	-	-	13 220	197 118	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	-	-	-	-	126 952	-	-
Total of Bank Pekao S.A. Group entieties	**4 109 821**	**8 911**	**3 429**	**44 999**	**1 591 997**	**6 854**	**33 714**
Key management personnel of the Bank Pekao S.A.	458	-	-	-	8 111	-	-
Total	**4 111 289**	**8 911**	**3 918**	**45 892**	**2 566 650**	**11 916**	**33 714**

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

31.12.2017	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank 's parent entity	-	-	-	-	-	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	900	110	-	-	-	-	1 010
Bank Pekao S.A. Group entities							
Subsidiaries	249 748	60 468	173 454	2 057 393	1 511 056	57 702	4 109 821
Key management personnel of the Bank Pekao S.A.	-	-	-	6	28	424	458
Total	**250 648**	**60 578**	**173 454**	**2 057 399**	**1 511 084**	**58 126**	**4 111 289**

(*) Current receivables include Nostro account and cash collaterals

Liabilities due to loans and deposits by contractual maturity

31.12.2017	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank 's Pekao S.A. parent entity	3 978	473 507	-	-	-	-	477 485
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	6 249	482 808	-	-	-	-	489 057
Bank Pekao S.A. Group entities							
Subsidiaries	983 072	161 815	409 884	9 413	27 813	-	1 591 997
Key management personnel of the Bank Pekao S.A.	5 504	-	2 607	-	-	-	8 111
Total	**998 803**	**1 118 130**	**412 491**	**9 413**	**27 813**	**-**	**2 566 650**

(*) Current receivables include Loro account and cash collaterals

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2017	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank ‘s parent entity	-	-	-	-	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	1 010	-	1 010
Bank Pekao S.A. Group entities						
Subsidiaries	621 173	16 817	479	3 465 140	6 212	4 109 821
Key management personnel of the Bank Pekao S.A.	-	-	387	71	-	458
Total	**621 173**	**16 817**	**866**	**3 466 221**	**6 212**	**4 111 289**

Liabilities due to loans and deposits by currency

31.12.2017	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank ‘s parent entity	301	-	-	477 184	-	477 485
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	93	1	247	488 716	-	489 057
Bank Pekao S.A. Group entities						
Subsidiaries	44 457	39 171	6 073	1 499 756	2 540	1 591 997
Key management personnel of the Bank Pekao S.A.	3 483	185	5	4 435	3	8 111
Total	**48 334**	**39 357**	**6 325**	**2 470 091**	**2 543**	**2 566 650**

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions as at 31 December 2016

NAME OF ENTITY	RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
UniCredit S.p.A. – the Bank's parent entity	187 357	-	-	433	9 261	-	1 180
Entities of UniCredit Group excluding of Pekao S.A. Group entities	682 836	-	32 072	55	191 779	620 819	-
Bank Pekao S.A. Group entities							
Subsidiaries							
Pekao Investment Banking S.A.	-	-	-	241	265 345	-	1 027
Pekao Leasing Sp. z o.o.	2 504 735	-	313	16 021	19 353	-	13 382
Pekao Faktoring Sp. z o.o.	929 105	-	-	2	3 987	-	-
Centralny Dom Maklerski Pekao S.A.	-	-	-	167	812 350	-	71
Pekao Fundusz Kapitałowy Sp. z o.o.	-	-	-	-	51 799	-	36
Pekao Powszechne Towarzystwo Emerytalne S.A.	-	-	-	93	15 256	-	-
Centrum Kart S.A.	-	-	-	224	25 698	-	5 702
Pekao Financial Services Sp. z o. o.	-	-	-	4	15 965	-	-
Pekao Bank Hipoteczny S.A.	138 051	60 700	42 894	-	29 109	6 461	34
Pekao Leasing Holding S.A. (in liquidation)	-	-	-	-	-	-	-
Pekao Property S.A.	10 362	-	-	-	2 112	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	-	-	-	61	3 569	-	4 844
FPB – Media Sp. z o. o.	10 265	-	-	-	501	-	-
Associates							
Dom Inwestycyjny Xelion Sp. z o.o.	-	-	-	45	28 682	-	-
Pekao Investment Management S.A.	-	-	-	-	137 850	-	-
Pekao TFI S.A. (PIM S.A subsidiary)	-	-	-	12 481	112 949	-	-
Total of Bank Pekao S.A. Group entities	**3 592 518**	**60 700**	**43 207**	**29 339**	**1 524 525**	**6 461**	**25 096**
Key management personnel of the Bank and UniCredit S.p.A.	7 948	-	-	-	28 022	-	-
Total	**4 470 659**	**60 700**	**75 279**	**29 827**	**1 753 587**	**627 280**	**26 276**

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

31.12.2016	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	12 342	175 015	-	-	-	-	187 357
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	597 829	85 007	-	-	-	-	682 836
Bank Pekao S.A. Group entities							
Subsidiaries	241 049	27 005	134 416	1 019 467	2 104 257	66 324	3 592 518
Associates	-	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	5 506	-	-	202	2 240	7 948
Total	**851 220**	**292 533**	**134 416**	**1 019 467**	**2 104 459**	**68 564**	**4 470 659**

(*) Current receivables include Nostro account and cash collaterals

Liabilities due to loans and deposits by contractual maturity

31.12.2016	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
UniCredit S.p.A. – the Bank's parent entity	9 261	-	-	-	-	-	9 261
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	65 821	125 958	-	-	-	-	191 779
Bank Pekao S.A. Group entities							
Subsidiaries	1 046 943	129 157	52 378	5 089	11 477	-	1 245 044
Associates	17 348	91 256	170 877	-	-	-	279 481
Key management personnel of the Bank and UniCredit S.p.A.	8 066	3 226	15 748	982	-	-	28 022
Total	**1 147 439**	**349 597**	**239 003**	**6 071**	**11 477**	**-**	**1 753 587**

(*) Current receivables include Loro account and cash collaterals

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	2 160	10 180	-	175 017	-	187 357
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	561 564	113	7	99 082	22 070	682 836
Bank Pekao S.A. Group entities						
Subsidiaries	656 490	761	1 415	2 933 851	1	3 592 518
Associates	-	-	-	-	-	-
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	7 948	-	7 948
Total	**1 220 214**	**11 054**	**1 422**	**3 215 898**	**22 071**	**4 470 659**

Liabilities due to loans and deposits by currency

31.12.2016	EUR	USD	CHF	PLN	OTHER	TOTAL
UniCredit S.p.A. – the Bank's parent entity	543	-	-	8 718	-	9 261
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	20 989	-	-	167 723	3 067	191 779
Bank Pekao S.A. Group entities						
Subsidiaries	39 361	60 047	19 943	1 121 661	4 032	1 245 044
Associates	-	-	-	279 481	-	279 481
Key management personnel of the Bank and UniCredit S.p.A.	6 818	247	-	20 946	11	28 022
Total	**67 711**	**60 294**	**19 943**	**1 598 529**	**7 110**	**1 753 587**

Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2017 to 31 December 2017

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSION EXPENSE	OTHER INCOME	OTHER EXPENSES
PZU S.A. – the Bank ‘s Pekao S.A. parent entity (*)	49	(88)	1 239	-	48	(182)
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities (*)	436	(255)	1 307	(79)	788	(52)
UniCredit S.p.A. – the Bank's Pekao S.A. parent entity (**)	154	(153)	391	(1 197)	1 510	(3 825)
Entities of UniCredit Group excluding the Bank Pekao S.A. Group entities (**)	3 275	(1 253)	3 321	(62)	14 472	(1 725)
Bank Pekao S.A. Group entities						
Subsidiaries						
Pekao Investment Banking S.A.	1	(2 815)	157	(5 966)	71	-
Centralny Dom Maklerski Pekao S.A.	-	(4 003)	1 347	(2 043)	2 950	(2 793)
Pekao Leasing Sp. z o.o.	67 918	(8 106)	2 418	-	2 067	(30)
Pekao Faktoring Sp. z o.o.	20 156	-	154	-	292	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	-	(175)	1 341	-	6	-
Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation)	-	(596)	6	-	31	-
Centrum Kart S.A.	-	(198)	1 006	-	1 023	(48 606)
Pekao Financial Services Sp. z o.o.	-	(130)	43	-	39	-
Pekao Bank Hipoteczny S.A.	1 057	55	1 016	-	1 123	(7 709)
Centrum Bankowości Bezpośredniej Sp. z o.o.	-	(5)	5	(21 685)	1 625	(38 942)
Pekao Property S.A.	107	(14)	3	-	18	-
FPB - Media Sp. z o.o.	325	(5)	2	-	-	-
Dom Inwestycyjny Xelion Sp. z o.o. (***)	-	(33)	4	-	2	-
Pekao Investment Management S.A. (***)	-	(241)	1	-	-	-
Pekao TFI S.A. (jednostka zależna PIM S.A.) (***)	-	(123)	14 184	-	-	-
Associates						
Dom Inwestycyjny Xelion Sp. z o.o. (****)	-	(366)	39	-	163	-
Pekao Investment Management S.A. (****)	-	(1 800)	9	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary) (****)	-	(1 189)	152 509	-	-	-
Total of Bank Pekao S.A. Group entities	**89 564**	**(19 744)**	**174 244**	**(29 694)**	**9 410**	**(98 080)**
Key management personnel of the Bank Pekao S.A.	108	(198)	2	-	-	-
Total	**93 586**	**(21 691)**	**180 504**	**(31 032)**	**26 228**	**(103 864)**

(*) data from the date of taking control by PZU S.A.
(**) data until the day of loss of control by UniCredit S.p.A.
(***) data from the date when the Group has taken control over the entities (discontinuation of the eguity method valuation)
(****) data till the date when the Group has taken control over the entities (discontinuation of the equity method valuation)

Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2016 to 31 December 2016

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSION EXPENSE	OTHER INCOME	OTHER EXPENSES
UniCredit S.p.A. – the Bank's parent entity	(137)	(375)	1 239	(2 723)	2 901	(13 150)
Entities of UniCredit Group excluding of Pekao S.A. Group entities	13 416	(2 521)	8 602	(192)	17 372	(55 709)
Pekao S.A. Group entities						
Subsidiaries						
Pekao Investment Banking S.A.	-	(3 613)	244	(6 219)	195	(326)
Centralny Dom Maklerski Pekao S.A.	-	(3 043)	1 439	(42)	2 916	(3 034)
Pekao Leasing Sp. z o.o.	56 863	(7 456)	4 190	(7)	2 224	(82)
Pekao Faktoring Sp. z o.o.	14 334	-	1 051	-	284	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	-	(449)	809	-	6	-
Pekao Fundusz Kapitałowy Sp. z o.o.	-	(584)	6	-	31	-
Centrum Kart S.A.	-	(217)	39	-	1 025	(54 103)
Pekao Financial Services Sp. z o.o.	-	(137)	44	-	40	-
Pekao Bank Hipoteczny S.A.	2 250	(329)	827	-	787	(11 750)
Pekao Leasing Holding S.A. (in liquidation)	-	(573)	3	-	1	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	1	(3)	18	(17 621)	1 691	(36 661)
Pekao Property S.A.	141	(4)	14	-	17	-
FPB - Media Sp .z o.o.	421	(2)	2	-	-	-
Associates						
Pekao Investment Management S.A.	-	(1 862)	24	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	-	(1 370)	157 183	-	-	-
Dom Inwestycyjny Xelion Sp. z o.o.	-	(323)	45	-	171	-
Total of Pekao S.A. Group entities	**74 010**	**(19 965)**	**165 938**	**(23 889)**	**9 388**	**(105 956)**
Key management personnel of the Bank and UniCredit S.p.A.	237	(318)	17	-	-	-
Total	**87 526**	**(23 179)**	**175 796**	**(26 804)**	**29 661**	**(174 815)**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees as at 31 December 2017

NAME OF ENTITY	GRANTED		RECEIVED	
	FINANCIAL	GUARANTEES	FINANCIAL	GUARANTEES
PZU S.A. – the Bank ‘s Pekao S.A. parent entity	2 509	-	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	599	-	-	-
Bank Pekao S.A. Group entities				
Subsidiaries				
Pekao Investment Banking S.A.	122	-	-	-
Pekao Leasing Sp. z o.o.	767 159	1 822 737	-	-
Pekao Faktoring Sp. z o.o.	588 420	-	-	-
Centralny Dom Maklerski Pekao S.A.	80	-	-	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	60	-	-	-
Centrum Kart S.A.	64	3 000	-	-
Pekao Financial Services Sp. z o. o.	45	790	-	-
Pekao Bank Hipoteczny S.A.	432 875	356 720	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	34	-	-	-
Pekao Investment Management S.A.	15	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	98	-	-	-
Total of Bank Pekao S.A. Group entities	**1 788 972**	**2 183 247**	**-**	**-**
Key management personnel of the Bank Pekao S.A.	553	-	-	-
Total	**1 792 633**	**2 183 247**	**-**	**-**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees granted by contractual maturity

31.12.2017	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Financial commitments granted							
PZU S.A. – the Bank ‘s Pekao S.A. parent entity	-	-	-	-	2 509	-	2 509
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	20	-	-	579	-	599
Bank Pekao S.A. Group entities							
Subsidiaries	-	-	432 849	1 271 946	84 177	-	1 788 972
Key management personnel of the Bank Pekao S.A.	10	-	-	24	126	393	553
Total	**10**	**20**	**432 849**	**1 271 970**	**87 391**	**393**	**1 792 633**
Guarantees issued							
Bank Pekao S.A. Group entities							
Subsidiaries	-	-	1 719	112 621	492 198	1 576 709	2 183 247
Total	**-**	**-**	**1 719**	**112 621**	**492 198**	**1 576 709**	**2 183 247**

Off-balance sheet financial commitments and guarantees granted by currency

31.12.2017	EUR	USD	CHF	PLN	INNE	TOTAL
Financial commitments granted						
PZU S.A. – the Bank ‘s Pekao S.A. parent entity	-	-	-	2 509	-	2 509
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	599	-	599
Bank Pekao S.A. Group entities						
Subsidiaries	6 673	13 125		1 759 868	9 306	1 788 972
Key management personnel of the Bank Pekao S.A.	-	-	-	553	-	553
Total	**6 673**	**13 125**	**-**	**1 763 529**	**9 306**	**1 792 633**
Guarantees issued						
Bank Pekao S.A. Group entities						
Subsidiaries	1 712 455	-	356 720	114 072	-	2 183 247
Total	**1 712 455**	**-**	**356 720**	**114 072**	**-**	**2 183 247**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees as at 31 December 2016

NAME OF ENTITY	GRANTED		RECEIVED	
	FINANCIAL	GUARANTEES	FINANCIAL	GUARANTEES
UniCredit S.p.A. – the Bank's parent entity	50 162	246 519	-	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group	202 191	599 604	5 192	192 481
Bank Pekao S.A. Group entities				
Subsidiaries				
Pekao Investment Banking S.A.	150	-	-	-
Pekao Leasing Sp. z o.o.	255 377	1 306 054	-	-
Pekao Faktoring Sp. z o.o.	405 208	-	-	-
Centralny Dom Maklerski Pekao S.A.	97	132	-	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	60	-	-	-
Centrum Kart S.A.	63	3 000	-	-
Pekao Financial Services Sp. z o. o.	45	838	-	-
Pekao Bank Hipoteczny S.A.	361 984	411 730	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	3 029	-	-	-
Pekao Property Sp. z o. o.	-	-	-	-
Associates				
Pekao Investment Management S.A.	15	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	96	-	-	-
Total of Pekao S.A. Group entities	**1 026 124**	**1 721 754**	**-**	**-**
Key management personnel of the Bank and UniCredit S.p.A.	217	-	-	-
Total	**1 278 694**	**2 567 877**	**5 192**	**246 444**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by contractual maturity

31.12.2016	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
FINANCIAL COMMITMENTS GRANTED							
UniCredit S.p.A. – Bank's parent entity	-	-	-	-	-	50 162	50 162
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	-	-	-	202 191	202 191
Bank Pekao S.A. Group entities							
Subsidiaries	-	-	362 581	257 719	405 713	-	1 026 013
Associates	-	-	-	-	111	-	111
Key management personnel of the Bank and UniCredit S.p.A.	30	-	5	-	182	-	217
Total	**30**	**-**	**362 586**	**257 719**	**406 006**	**252 353**	**1 278 694**
GUARANTEES ISSUED							
UniCredit S.p.A. – Bank's parent entity	-	2 624	-	50 190	81 659	112 046	246 519
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	9 343	24 475	113 978	293 599	158 209	599 604
Bank Pekao S.A. Group entities							
Subsidiaries	-	-	-	2 269	2 232	1 717 253	1 721 754
Total	**-**	**11 967**	**24 475**	**166 437**	**377 490**	**1 987 508**	**2 567 877**
FINANCIAL COMMITMENTS RECEIVED							
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	5 192	-	-	-	-	5 192
Total	**-**	**5 192**	**-**	**-**	**-**	**-**	**5 192**
GUARANTEES RECEIVED							
UniCredit S.p.A. – the Bank's parent entity	-	4 645	752	33 619	13 399	1 548	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	3 322	75 122	11 062	102 975	192 481
Total	**-**	**4 645**	**4 074**	**108 741**	**24 461**	**104 523**	**246 444**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by currency

31.12.2016	EUR	USD	CHF	PLN	OHTER	TOTAL
FINANCIAL COMMITMENTS GRANTED						
UniCredit S.p.A. – Bank's parent entity	30 164	-	-	19 998	-	50 162
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	98 535	41 716	-	61 580	360	202 191
Bank Pekao S.A. Group entities						
Subsidiaries	31 853	17 595	-	964 733	11 832	1 026 013
Associates	-	-	-	111	-	111
Key management personnel of the Bank and UniCredit S.p.A.	-	-	-	217	-	217
Total	**160 552**	**59 311**	**-**	**1 046 639**	**12 192**	**1 278 694**
GUARANTEES ISSUED						
UniCredit S.p.A. – Bank's parent entity	12 167	-	-	234 352	-	246 519
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	53 077	-	-	546 527	-	599 604
Bank Pekao S.A. Group entities						
Subsidiaries	1 306 492	-	411 730	3 532	-	1 721 754
Total	**1 371 736**	**-**	**411 730**	**784 411**	**-**	**2 567 877**
FINANCIAL COMMITMENTS RECEIVED						
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	-	-	-	-	5 192	5 192
Total	**-**	**-**	**-**	**-**	**5 192**	**5 192**
GUARANTEES RECEIVED						
UniCredit S.p.A. – the Bank's parent entity	29 130	-	-	24 833	-	53 963
Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities	109 606	-	-	82 090	785	192 481
Total	**138 736**	**-**	**-**	**106 923**	**785**	**246 444**

Notes to the financial statements (cont.)

(In PLN thousand)

Remuneration of Bank's Management Board and Supervisory Board Members

	VALUE OF BENEFITS	
	2017	**2016**
Management Board of the Bank		
Short-term employee benefits (*)	15 072	19 120
Post-employment benefits	448	-
Long-term benefits (**)	2 266	2 083
Paid termination benefits	6 642	-
Share-based payments (***)	7 050	5 393
Total	**31 478**	**26 596**
Supervisory Board of the Bank		
Short-term employee benefits (*)	1 225	1 069
Total	**1 225**	**1 069**

(*) Short-term employee benefits include: base salary, bonuses and other benefits due in next 12 months from the date of the balance sheet.
(**) The item 'Other long - term benefit' includes provisions for deferred bonus payments.
(***) The value of share - based payments is a part of Personnel Expenses, recognized according to IFRS 2 during the reporting period in the income statement, representing the settlement of fair value of share options and shares, including phantom shares, granted to the Members of the Bank's Management Board.

(In PLN thousand)

52. Repo and reverse repo transactions

The Bank increases its funds through the sale of financial instruments with the repurchase promise granted (repo and sell-buy back) at the same price increased by interest.

Securities composing the balance sheet portfolio of the Bank as well as securities with obligation of resale (reverse repo and buy-sell back transactions) may be a subject to repo and sell-buy back transactions.

Securities composing the balance sheet portfolio of the Bank and treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Bank holds all benefits and risk deriving from these assets.

	31.12.2017		31.12.2016	
	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RELATED LIABILITIES	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RELATED LIABILITIES
Financial assets available for sale				
up to 1 month	915 423	916 637	1 599 015	1 599 789
from 1 to 3 months	49 425	49 427	-	-
Total financial assets available for sale	**964 848**	**966 064**	**1 599 015**	**1 599 789**
Financial assets held for trading				
up to 1 month	123 797	123 812	175 732	176 019
Total financial assets held for trading	**123 797**	**123 812**	**175 732**	**176 019**
Total	**1 088 645**	**1 089 876**	**1 774 747**	**1 775 808**

The Bank purchases financial instruments with the obligations of repurchase or resale (reverse-repo and buy-sell back) at the same price increased by interest.

Securities treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Bank holds all the benefits and the risk deriving from these assets.

	31.12.2017		31.12.2016	
	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGING ASSETS	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGING ASSETS
Loans and advances from banks				
up to 1 month	494 706	492 418	703 635	700 960
Total loans and advances from banks	**494 706**	**492 418**	**703 635**	**700 960**
Total	**494 706**	**492 418**	**703 635**	**700 960**

Financial assets which are subject to reverse repo and buy-sell back transactions constitute collateral accepted by the Bank, which the Bank has the right to sell or pledge.

	31.12.2017	31.12.2016
Fair value of assets pledged as collaterals, in this:	492 418	700 960
Short sale	469 448	673 165
Reverse repo transactions/ buy-sell-back	-	-

(In PLN thousand)

53. Company Social Benefits Fund ('ZFŚS')

The Social Benefits Fund Act of 4 March 1994 with subsequent amendments introduced the requirement to create a Company's Social Benefits Fund by all employers employing over 20 employees. The Bank has created the ZFŚS Fund and is making periodic charges to the ZFŚS Fund in amounts required by the Act. The basic aim of the ZFŚS Fund is to subsidize social assistance in benefit of the employees, former employees (pensioners and the retired) and entitled members of their families.

The liabilities of the ZFŚS Fund represent the accumulated value of charges made by the Company towards the ZFŚS Fund decreased by the amount of non-returnable expenditures of the ZFŚS Fund.

In the statement of financial position, the Bank netted the ZFŚS Fund assets against the ZFŚS Fund value, due to the fact that the assets of the ZFŚS Fund do not represent the assets of the Bank. For this reason the amount pertaining to the ZFŚS Fund in the unconsolidated statement of financial position as at 31 December 2017 and 31 December 2016 was nil.

The table below presents the assets according to type and book value, the balance of the Fund and costs related to ZFŚS.

	31.12.2017	31.12.2016
Loans granted to employees	33 027	38 606
Cash at ZFŚS account	1 561	3 116
ZFŚS assets	**34 588**	**41 722**
ZFŚS value	**34 588**	**41 722**
	2017	**2016**
Deductions made to ZFŚS during fiscal period	24 614	23 522

54. Subsequent events

There have been no significant subsequent events.

Signatures of all Management Board Members

Date	Name/Surname	Position/Function	Signature
26.02.2018	Michał Krupiński	President of the Management Board	
26.02.2018	Roksana Ciurysek-Gedir	Vice President of the Management Board	
26.02.2018	Andrzej Kopyrski	Vice President of the Management Board	
26.02.2018	Tomasz Kubiak	Vice President of the Management Board	
26.02.2018	Michał Lehmann	Vice President of the Management Board	
26.02.2018	Marek Lusztyn	Vice President of the Management Board	
26.02.2018	Tomasz Styczyński	Vice President of the Management Board	
26.02.2018	Marek Tomczuk	Vice President of the Management Board	

Glossary

Glossary

IFRS – International Financial Reporting Standards – the standards, interpretations and their structure adopted by the International Accounting Standards Board (IASB.).

IAS – International Accounting Standards – previous name of the standards forming part of the current IFRS.

IFRIC – International Financial Reporting Interpretations Committee – the committee operating under the International Accounting Standards Board publishing interpretations of IFRS.

CIRS – Currency Interest Rate Swap – the transaction exchange of principal amounts and interest payments in different currencies between two counterparties.

IRS – Interest Rate Swap – the agreement between two counterparties, under which the counterparties pay each other (at specified intervals during the contract life) interest on contractual principal of the contract, charged at a different interest rate.

FRA – Forward Rate Agreement – the contract under which two counterparties fix the interest rate that will apply in the future for a specified amount expressed in currency of the transaction for a predetermined period.

CAP – the financial agreement, which limits the risk borne by lender on a variable interest rate, exposed to the potential loss as a result of increase in interest rates. Cap option is a series of call options on interest rates, in which the issuer guarantees the buyer the compensation of the additional interest costs, that the buyer must pay if the interest rate on loan increases above the fixed interest rate.

FLOOR –the financial agreement, which limits the risk of incurring losses resulting from decrease in interest rates by the lender providing the loan at a variable interest rate. Floor option is a series of put options on interest rates, in which the issuer guarantees the interest to be paid on the loan if the interest rate on the loan decreases below the fixed interest rate.

IBNR – Incurred but Not Reported losses.

PD – Probability Default – the parameter used in Internal Ratings-Based Approach which determines the likelihood that the debtor will be unable to meet its obligation. PD is a financial term describing the likelihood of a default over an one year time horizon.

LGD – Loss Given Default – the percentage of loss over the total exposure when bank's counterparty goes to default.

EAD – Exposure at Default.

EL – Expected Loss.

CCF – Credit Conversion Factor.

VaR – Value at Risk – the risk measure by which the market value of an asset or portfolio may be reduced for a given assumptions, probability and time horizon.

ICAAP – Internal Capital Adequacy Assessment Process – the process of assessing internal capital adequacy.