Capital Adequacy and Other Information Subject to Disclosure

The Group of PKO Bank Polski SA

as at 31 December 2014

Introduction

The Report "Capital Adequacy and Other Information Subject to Disclosure of the Group of Powszechna Kasa Oszczędności Bank Polski SA as at 31 December 2014" (hereinafter referred to as "the Report") was prepared in accordance with the provisions of Article 111a clause 1 of the Act of 29 August 1997 – Banking Law[1] and the 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 (hereinafter referred to as "CRR"), implementing acts under the CRR as well as 4) Recommendation M of the Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego*, hereinafter referred to as "PFSA" or "KNF") on the operational risk management in banks.

Pursuant to Article 13 par. 1 of the CRR, Powszechna Kasa Oszczędności Bank Polski SA ("PKO Bank Polski SA", "the Bank") being a European parent institution, discloses information on its capital adequacy in a separate document annually, as referred to in Part Eight of the CRR.

This Report was prepared in accordance with the principles of information policy of PKO Bank Polski SA regarding capital adequacy[2], as adopted by the Bank, which contain detailed information related to disclosures concerning capital adequacy, rules of their verification and publication.

The Report covers year 2014 and present data as of 31 December 2014 and was prepared in accordance with the principles described in the first paragraph as of 31 December 2014. Unless otherwise stated, the Report includes consolidated data[3] of the PKO Bank Polski SA Group (hereinafter referred to as the "Bank Group" or the "Group"). Since the risk profile of the Group is predominantly affected by PKO Bank Polski SA (92.2%[4] of the Group's consolidated balance sheet total and 92.3%[5] of its consolidated profit/loss on banking activities), some of the information contained in the Report refers specifically to individual data of PKO Bank Polski SA.

Unless otherwise stated, the figures presented in the Report have been expressed in PLN million. Any differences in the totals and proportions result from the rounding to PLN million and to one decimal place respectively.

The scope of information contained in the Report, due to changes is regulatory environment, new reporting standards pursuant to the CRR, organisational changes, ongoing integration process with Nordea Bank Polska SA and legal merger that took part on 31 October 2014, has been prepared taking into account all of the data available on 31 December 2014.

This Report has been subject to internal verification by the Bank's internal audit.

[1] Uniform text, Journal of Laws 2015, No. 128.
[2] The principles of information policy of PKO Bank Polski SA regarding capital adequacy are available on the Bank's website (www.pkobp.pl).
[3] Data provided only for entities subject to prudential consolidation.
[4] The share PKO Bank Polski SA was calculated in relation in the consolidated balance sheet total of companies subject to prudential consolidation before consolidation adjustments and exclusions for the year ended 31 December 2014.
[5] The share of PKO Bank Polski SA was calculated in relation to the consolidated profit/loss on banking activities of the Group companies subject to prudential consolidation before consolidation adjustments and exclusions for the year ended 31 December 2014.

TABLE OF CONTENTS

1. INFORMATION ON THE BANK AND THE GROUP ... 4
2. RISK MANAGEMENT ... 6
2.1. IDENTIFYING SIGNIFICANT TYPES OF RISKS ... 8
2.2. CREDIT RISK ... 9
2.3. INTEREST RATE RISK ... 17
2.4. FOREIGN EXCHANGE RISK ... 20
2.5. LIQUIDITY RISK ... 20
2.6. PRICE RISK OF EQUITY SECURITIES AND COMMODITY PRICE RISK ... 22
2.7. OPERATIONAL RISK ... 23
2.8. COMPLIANCE RISK ... 27
2.9. BUSINESS RISK ... 27
2.10. LOSS OF REPUTATION RISK ... 28
3. OWN FUNDS ... 32
4. OWN FUNDS REQUIREMENTS ... 36
4.1. CREDIT RISK ... 37
4.2. MARKET RISK ... 39
4.3. OPERATIONAL RISK ... 39
5. UNENCUMBERED ASSETS ... 40
6. INTERNAL CAPITAL (PILLAR II) ... 41
7. CAPITAL ADEQUACY ... 43
8. PRINCIPLES OF DETERMINATION OF VARIABLE COMPONENTS OF REMUNERATION OF THE MANAGEMENT (MATERIAL RISK TAKERS) ... 45
8.1. THE PROCESS OF DETERMINATION OF VARIABLE COMPONENTS OF REMUNERATION ... 45
8.2. REMUNERATION COMMITTEE ... 45
8.3. MOST SIGNIFICANT INFORMATION ON CHARACTERISTICS OF VARIABLE COMPONENTS OF REMUNERATION SYSTEM ... 45
8.4. ASSESMENT OF MEMBERS OF THE MANAGEMENT BODY ... 46
8.5. THE NUMBER OF DIRECTORSHIPS HELD BY MEMBERS OF THE MANAGEMENT BODY ... 47
9. GLOSSARY OF TERMS AND ABBREVIATION ... 48

1. INFORMATION ON THE BANK AND THE GROUP

Pursuant to the CRR, prudential consolidation is used for the purposes of capital adequacy, which unlike IAS-compliant consolidation, encompasses subordinated entities that can be defined as institutions or financial institutions only. Non-financial and insurance entities are not subject to prudential consolidation.

As of 31st December 2014, the Bank Group comprised:

1) PKO Bank Polski SA,
2) PKO Leasing SA group (leasing services),
3) KREDOBANK group (banking and financial services),
4) PKO Towarzystwo Funduszy Inwestycyjnych SA (investment funds management),
5) PKO BP BANKOWY PTE SA (pension funds management) ,
6) PKO BP Faktoring SA (factoring),
7) Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. (factoring),
8) PKO Finance AB (funds acquisition for PKO Bank Polski SA from the bonds issuance),
9) PKO Bank Hipoteczny SA (banking services)[6].

The aforementioned entities are subject to full consolidation.

The controlling entity of the Group is PKO Bank Polski SA, whose share in the consolidated balance sheet total amounts to 92.2%[4], and 92.3%[5] in the consolidated profit/loss on banking activities.

The PKO Leasing SA Group (i.e. PKO Leasing SA together with its subsidiaries: PKO Bankowy Leasing Sp. z o.o. and PKO Leasing Sverige AB) operates in the leasing area in the territory of the Republic of Poland and Sweden. In 2014 PKO Leasing SA took over Nordea Finance Polska SA – a new company purchased by PKO Bank Polski SA. The share of PKO Leasing SA Group in the consolidated balance sheet total is 2.2%[4], and 1.6%[5] in the consolidated profit/loss on banking activities.

KREDOBANK SA pursues banking operations in the territory of Ukraine and is subject to Ukrainian banking supervision. In March 2012 KREDOBANK SA become the sole shareholder of Finansowa Kompania "Idea Kapitał" Sp. z o.o. (which subject of business includes rendering of financial services) and established the capital group. The share of KREDOBANK SA Group in the consolidated balance sheet total is 0.5%[4], and 0.8%[5] in the consolidated profit/loss on banking activities.

The rest of the aforementioned companies operate almost exclusively on the territory of the Republic of Poland, Ukraine (Finansowa Kompania „Prywatne Inwestycje" Sp. z o.o.) and Sweden (PKO Finance AB).
Additionally, in order to highlight the differences between consolidation prepared for accounting purposes and CRR-compliant consolidation, subordinated entities that were not included in prudential consolidation have been enumerated below:

1) PKO Życie Towarzystwo Ubezpieczeń SA group, comprising: PKO Życie Towarzystwo Ubezpieczeń SA (life insurance) and its subordinated entity Ubezpieczeniowe Usługi Finansowe Sp. z o.o. (service activities),
2) PKO BP Finat Sp. z o.o. (transfer agent services)[7],
3) „Inter-Risk Ukraina" Spółka z dodatkową odpowiedzialnością (debt recovery),
4) "CENTRUM HAFFNERA" capital group, comprising: "CENTRUM HAFFNERA" Sp. z o.o. and its subject entities (management of properties constructed as a part of revitalisation of Sopot city centre)
5) Bankowe Towarzystwo Kapitałowe SA (service activities),
6) Qualia Development Sp. z o.o. capital group, i.e.: Qualia Development Sp. z o.o. and its subject entities[8],
7) Merkury – a non-public assets closed-end investment fund (allocation of funds provided by its members) and its 8 subordinated entities (purchase, sale and management of properties)[9].

PKO Bank Polski includes the aforementioned companies in its capital requirements calculated according to the CRR using the equity method.

Detailed information on all entities of the Group, subject to the Bank's share in the equity capital of individual entities is contained in the consolidated financial statements of the Group for the year ended 31 December 2014, published on 16 March 2015.

In 2014 PKO Bank Polski S.A. purchased all shares of Nordea Bank Polska SA, Nordea Finance Polska SA and „Nordea Polska Towarzystwo Ubezpieczeń na Życie" SA (currently: PKO Życie Towarzystwo Ubezpieczeń SA), which is not subject to prudential consolidation.

The purpose behind this acquisition was to achieve improved results by increasing the client base and to strengthen the market position of the Bank.

On 31st October 2014 a legal merger of Nordea Bank Polska SA and PKO Bank Polski SA took place, resulting in transfer of all assets and liabilities of Nordea Bank Polska SA to PKO Bank Polski SA as an acquiring company. The merger was processed according to par. 515.1 of the Polish Code of Commercial Companies, i.e. the share capital of the Bank remained unchanged.

Between the purchase of majority shareholding (1 April 2014) and legal merger (31 October 2014) Nordea Bank Polska SA remained a separate entity in the Bank's Group, both legally and operationally.

Nordea Bank Polska SA ceased to exist as a separate entity as of the date of the legal merger with PKO Bank Polski SA acting as a legal successor, assuming all rights and obligations of the former company.

The integration process of both banks was finalised during the operational merger that took part in the 2nd half of April 2015.

Within the Bank Group, some limitations exist (described below) in regard to premature settlement of liabilities by subordinated companies as well as to the transfer of funds in the form of dividend payments:

[6] PKO Bank Hipoteczny was registered in the National Court Register on 24th October 2014 and did not undertake any operational activities in 2014.
[7] In 2014 PKO BP Finat Sp. z o.o. merged as an acquiring company with Inteligo Financial Services SA.

[8] In the 2014 Financial Report of PKO Bank Polski SA Group (together with its subordinated entities), the company is shown as non-current assets classified as held for sale.
[9] Pursuant to the regulations of IASs PKO Bank Polski SA remains a controlling entity of the Fund, through the ownership of its investment certificates. IAS-compliant consolidation of subordinated companies of the Fund takes place at the level of PKO Bank Polski SA group.

1) In view of a difficult political and economic situation in Ukraine, together with related volatilities on the foreign exchange market, a series of administrative limitations have been introduced, potentially influencing rapid transfer of funds and settlement of liabilities between Ukrainian entities of PKO Bank Polski SA Group and their parent company. Restrictions include a ban on premature repayment of FX liabilities and an obligation to exchange to UAH all of the funds received in other currencies.
2) In accordance with the resolution of the Extraordinary General Shareholders' Meeting of KREDOBANK SA commenced 29 January 2009 and continued 23 February 2009, a moratorium was introduced with respect to dividend payments. The moratorium is valid until revoked under an appropriate resolution. In 2014 the moratorium on dividend payment remained in force.

The strategy of PKO Bank Hipoteczny SA for 2015-2017 (approved by the Supervisory Board) assumes no dividend payments during those years. Moreover, in terms of dividend payments, PKO Bank Polski SA and its subordinated companies are bound by law and recommendations of the KNF. In December 2014 the criteria regulating the payment of dividends by financial institutions were tightened by the KNF.

According to KNF's recommendation, a dividend in the amount of up to 100% of profit generated for year 2014 could only be paid out by banks with substantial share of deposits from the non-financial sector, that meet all of the below criteria:

1) the bank is not subject to recovery proceeding;
2) common equity Tier 1 capital (CET1) ratio is higher than 12% (9% + 3% systemic risk buffer);
3) total capital ratio (TCR) is higher than 15.5% (12.5% + 3% systemic risk buffer);
4) general BION (Research and Supervisory Assessment) score is 1 (grade: good) or 2 (grade: satisfactory);
5) BION score related to capital risk is not lower than 2 (grade: satisfactory).

Banks with a significant share of deposits from the non-financial sector, with a total capital ratio of 12.5% to 15.5% can pay out up to 50% of profits generated for year 2014, providing they meet all of the above criteria.

2. RISK MANAGEMENT

Risk management is one the most substantial internal processes both in PKO Bank Polski SA and in other entities of the Bank Group. Risk management aims at ensuring profitability of business activity, with ensuring control of the risk level and maintaining it within the risk tolerance and limits applied by the Bank and the Group, in the changing macroeconomic and legal environment. The level of the risk is an important factor in the planning process.

In the Bank Group, the following types of risk have been identified, which are subject to management: credit, interest rate, foreign exchange, liquidity, commodity, price risk of equity securities, derivative instruments, operational, compliance, macroeconomic, model, business (including strategic risk), loss of reputation, capital and insurance risks[10].

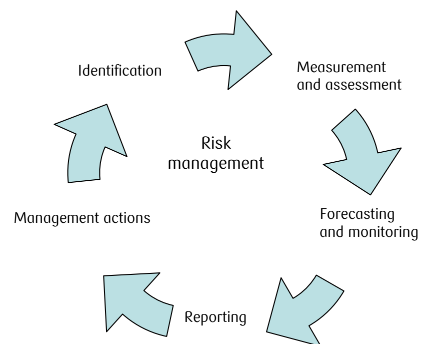
Risk management in the Group is based in particular on the following principles:

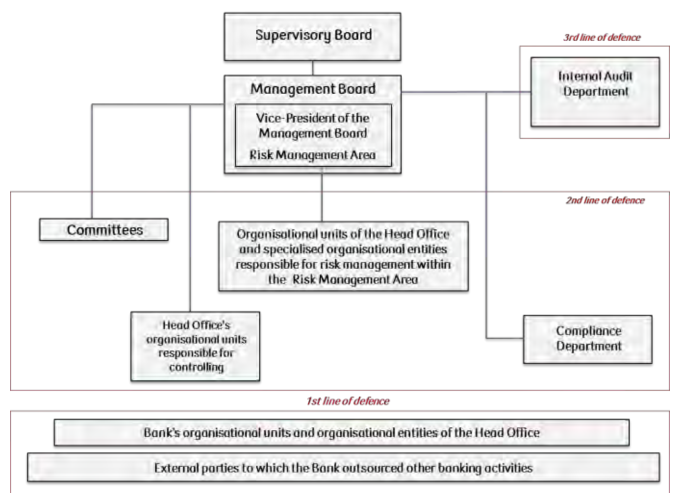
1) the Group manages all defined types of risk,
2) the risk management process corresponds to the volume of activities and to significance, level and complexity of the risk concerned and it is adjusted to new risk factors and sources on an ongoing basic,
3) risk management methods (in particular models and their assumptions) and risk measurement systems are adjusted to the volume and complexity of risk and they are verified and validated periodically,
4) organisational separation of the risk management process and debt recovery from business functions is maintained,
5) risk management is integrated with the planning and controlling systems,
6) the risk level is monitored and controlled on an ongoing basis,
7) the risk management process supports the pursuit of the Group's strategy while being compliant with the risk management strategy, in particular with regard to the risk tolerance level.

The risk management process in the Group includes:

1) risk identification which consists in recognition of both current and potential risk sources and assessment of significance of potential impact of such type of risk on the financial situation of the Group; risk identification includes defining of such types of risk that are considered to be significant in the activity of the Bank, an individual entity of the Group or the entire Group,
2) risk measurement and assessment – risk measurement includes determining risk measures adequate to the type, significance of risk and data availability, as well as quantitative measurement of risk by means of defined measures and risk assessment in a form of a determination of volume or scope of risks from the perspective of risk management objectives; the risk measurements include stress tests performed on the basis of assumptions ensuring reliable risk assessment,
3) risk forecasting and monitoring – consisting in preparation of risk level forecasts and monitoring differences between execution and forecasts or assumed references (e.g. limits, thresholds, plans, previous measurements, issued recommendations and suggestions). Risk monitoring is performed at a frequency appropriate for significance and volatility of a given type of risk,
4) risk reporting informing the Bank's Management on a cyclical basis on results of risk measurements, activities undertaken and recommendations of activities. The reporting scope, frequency and form are adjusted to the management level of addressees,
5) risk management actions including in particular, defining risk tolerance levels, defining limits and thresholds, issuing internal regulations, issuing recommendations, use of risk management tools. Management activities are aimed at designing risk management process and influencing the risk level.

Scheme 2.1





The risk management process takes place in all of the operational units of the Bank.

The risk management process is supervised by the Supervisory Board of the Bank, which regularly receives information on the risk profile of the Bank and of the Bank Group and on the most important activities undertaken within the risk management.

[10] Insurance risk has been identified in PKO Życie Towarzystwo Ubezpieczeń SA, which is not subject to prudential consolidation. In order for the description of the risk management process in the Bank Group to be complete and coherent, description of insurance risk has been included in Chapter 2 (p. 2.14).

The Management Board is responsible for the strategic risk management, which includes the supervision and monitoring of activities taken by the Bank within the risk management. The Management Board takes major decisions affecting the Bank's risk profile and approves internal regulations which define the risk management system.

The risk management process is executed in three mutually independent lines of defence:

1) first line of defence – internal functional control to ensure that the risk controls are used and actions comply with binding legal provisions; the function is performed in particular by the Bank's units, the Head Office units and entities of the Group and includes such aspects of activities of individual units and entities that may generate risk. The Group's units and entities are responsible for identification of risks, designing and implementing respective controls, if controls have not been implemented within the scope of activities undertaken in the second line of defence. At the same time the Bank Group's companies are obliged to comply with the principles of coherence and comparability of risk assessment and control in the Bank and Group entities, taking into account the specific nature of the company's business and market at which it operates,
2) second line of defence – the risk management system, including the risk management methods, tools, process and organisation; this function is performed in particular by the Risk Management Area, the Head Office unit managing compliance risk and loss of reputation risk, relevant committees and the Head Office units responsible for controlling,
3) third line of defence – internal audit; the function performed within the scope of internal audit, including audit on the efficiency of the risk management system.

The independence of the lines of defence means that they remain organisationally independent as follows:
1) the function of the second line of defence is independent from the first line of defence in regard to creation of system solutions,
2) the function of the third line of defence is independent from the first and second lines of defence,
3) the compliance function is reporting to the President of the Management Board.

The Bank's Head Office units that are responsible for risk management within the scope of their respective competencies were grouped in 2014 in the Bank Risk Division, Department of Risk Integration, Restructuring and Debt Collection of the Corporate Client Division and the Credit Risk Assessment and Analysis Centre, as well as in the Restructuring and Debt Collection Centre.

The purpose of the Banking Risk Division is to create and implement systemic solutions for managing risks that have been defined as significant, such as credit, operational, interest rate, foreign exchange, liquidity, business, macroeconomic risk as well as capital adequacy. The Bank Risk Division is responsible in particular for:

1) identification of risk factors and its sources,
2) risk measurement and assessment and cyclical monitoring and reporting of the risk level (significant risks),
3) measurement and assessment of capital adequacy,
4) preparing recommendations for the Management Board or committees as to the acceptable risk level,
5) developing internal regulations relating to risk and capital adequacy management,
6) developing IT systems to support risk and capital adequacy management.

The Department of Risk Integration is, in particular, responsible for:

1) validation of risk models,
2) management of risk models, including implementation of risk management standards in the Group,
3) coordination of the risk management system in the Group.

The Department of Restructuring and Debt Collection of the Corporate Client is responsible in particular for:

1) effective recovery (and / or restructuring) of nonperforming receivables,
2) protection of Bank's interests as a creditor during debt enforcement,
3) optimal sale of receivables and collateral foreclosure during recovery process,
4) reviewing and classifying of receivables and off-balance sheet liabilities managed by the Department and defining the amount of write-downs for impairment related to the risk in banking activity.

The Restructuring and Debt Collection Centre is responsible in particular for:

1) debt collection through restructuring or recovery, as well as improving effectiveness of those activities,
2) monitoring of delays in the collection of receivables from retail market clients,
3) management of collateral foreclosed as a result of recovering Bank's receivables,
4) efficient sale of non-performing debts.

The purpose of the Credit Risk Assessment and Analysis Centre is to mitigate credit risk of individual credit exposures of the Bank's retail, corporate market clients and financial institutions, which are particularly significant due to the volume of the exposure, client segment or risk level, as well as ensuring effective credit analyses in respect to mortgage credits granted to individual clients through the Bank's retail network and credits granted to rated SME clients, evaluated with rating methods, as well as taking respective credit decisions.

Risk management is supported by the following committees:

1) Risk Committee ('the RC'),
2) Assets & Liabilities Committee ('the ALCO'),
3) Bank's Credit Committee ('the BCC'),
4) Central Credit Committee ('the CCC'),
5) Operating Risk Committee ('the ORC').

RC monitors the integrity, adequacy and efficiency of the banking risk management system, capital adequacy and implementation of the risk management principles applied in the Bank, in compliance with the Bank's strategy, analyses and evaluates compliance with strategic risk tolerance limits defined in the Bank Risk Management Strategy in PKO Bank Polski SA. RC supports the Supervisory Board in the process of banking risk management through preparation of recommendations and making decision on capital adequacy and efficiency of the bank risk control system. Five sessions of the Risk Committee took place in 2014.

ALCO manages the Bank's assets and liabilities by influencing the structure of Bank's balance and off-balance positions in a way optimal in relation to profitability. The Committee supports the Bank's Management Board in the scope of both Bank and Group's activities related to the balance sheet structure, capital adequacy, profitability, as well as financial,

market, liquidity, business, credit (both settlement and pre-settlement) risk and wholesale market transactions.

BCC takes credit decisions in respect of individual significant credit exposures or issues recommendations in this respect to the Management Board of the Bank and makes decisions related to approval of credit risk models and results of their validation, with representatives from the Area of Finance and Accounting included in the decision making process.

CCC supports with its recommendations over a specified threshold the decision-taking by relevant directors of the Divisions and members of the Management Board.

ORC supports the Management Board in operational risk management through decision taking, issuing recommendations and opinions, for instance strategic tolerance limits and operational risk limits, key risk indicators (KRI), assumptions of stress tests, results of validation of operation risk measurement models, changes in AMA approach and by supporting all activities aimed at lowering of operational risk in all of the areas of the Group's activities.

The RC, ALCO, OCR, CCC as well as Management and Supervisory Boards receive cyclical reports concerning individual risk types.

The Bank supervises the functioning of the Bank Group entities. Within this supervisory function, the Bank defines and approves the subsidiaries' development strategies, also within the scope of risk level; oversees their risk management systems and supports the development of such systems; and also takes the risk level of the activity of individual subsidiaries into account as part of the risk monitoring and reporting system at the Group level.

Internal regulations on management of individual types of risk in the Bank Group entities are defined by internal regulations implemented by such companies upon consultation with the Bank and taking account of recommendations prepared by the Bank. Subsidiaries' internal regulations on risk management are implemented with coherence and comparability of assessment of individual types of risk in the Bank and the Bank Group entities, taking into account the scope and type of relationships between entities of the Group, specific nature and scale of the company's business and market at which it operates. Risk management in the companies of the Group involves in particular:

1) involvement of the units of Risk Management Area as well as relevant Committees of the Bank in a review process of significant transactions of the Group companies,
2) review (by relevant units from the Risk Management Area) of internal regulations related to risk management in respective companies of the Group,
3) Group companies' risk reporting to relevant Bank's Committees or Management Board,
4) monitoring of strategic limits for risk tolerance for the Group.

The priority of the Bank Group in 2014 was to keep its strong capital position and develop its funding to ensure the basis for stable development of business activities, having maintained at the same time the priorities related to business efficiency and efficient cost control and appropriate risk assessment.

As a consequence, in 2014 the Bank:

1) acquired EUR 500 mio. from issuance of bonds (as part of an EMTN programme) in January 2014 ,
2) in relation to the purchase of selected assets of Nordea Group, acquired a long-term financing in the amount of PLN 14 000 mio. from Nordea AB in April 2014
3) rolled forward short-term bonds in the amount of PLN 700 mio. in May and November 2014 (with current maturity of 3 months) as well as issued additional PLN 50 mio. worth of said instruments,
4) transferred the Bank's profit for 2013 and a part of the profit for 2014 to equity, at the value adjusted for expected charges and dividend payments, following the PFSA approval.

Neither the purchase of Nordea Bank Polska's companies on 1 April 2014 nor the legal merger that took part on 31 October 2014 had any effect on the profile risk of the Group.

In October 2014 PKO Bank Polski SA received the PFSA's approval for a significant extension of the AMA method, (used for the calculation of the own funds requirement for operational risk) by inclusion of the additional operations resulting from the merger with Nordea Bank Polska SA.

In the second half of 2014, in relation with the ongoing merger with Nordea Bank Polska SA, the Bank was engaged in a process of unification of solutions associated with the employment of the Recommendation M for the merged Bank.

The Bank monitors on a cyclical basis the level of banking risk and develops appropriate methods for its measurement.

The relevant units from the Bank Risk Division participate in risk management in the Group entities, since they prepare opinions on drafts of and periodically review internal regulations of these entities in relation to credit risk assessment and they prepare recommendations of changes in the draft procedures. The Bank supports implementation of recommended changes in the credit risk assessment principles in the Bank Group entities.

2.1. IDENTIFYING SIGNIFICANT TYPES OF RISKS

The significance of individual types of risk is defined at the level of the Bank and the Group entities.

The following type of risks was deemed to be significant in the Bank:

1) credit risk,
2) foreign exchange risk,
3) interest rate risk,
4) liquidity risk,
5) operational risk,
6) business risk,
7) macroeconomic risk,
8) model risk,
9) compliance risk.,
10) capital risk,
11) loss of reputation risk.

Moreover, operational and business risks have both been recognized as significant in the Bank Group, with compliance risk classified as such as of 31st of March 2014.

While determining the criteria of considering particular risk to be significant, an impact of such risk on the Bank's, the Group companies' and the whole Group's activities is taken into account, and there are three types of risk:

1) risks that are deemed permanently significant in advance – that are subject to active management,
2) potentially significant risks – in this case a periodical monitoring of significance is performed,

3) other undefined risks or kinds of risks that do not exist in the Bank or in the Group (insignificant or unmonitored).

In 2014 the following types of risks have been recognized as significant in the respective companies of the Bank Group:

1) credit risk: KREDOBANK SA Group, PKO Leasing SA, PKO BP Faktoring SA, Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o.,
2) foreign exchange risk: KREDOBANK SA Group, PKO Leasing SA Group, PKO BP Faktoring SA, Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o.,
3) interest rate risk: KREDOBANK SA Group, PKO Leasing SA Group,
4) liquidity risk: KREDOBANK SA Group, PKO Leasing SA, PKO BP Faktoring SA,
5) model risk: KREDOBANK SA Group, PKO Leasing SA Group, PKO BP Faktoring SA,
6) loss of reputation risk: PKO Leasing SA Group, PKO Towarzystwo Funduszy Inwestycyjnych SA.

On the basis of quantitative and qualitative information, a periodical assessment of level of potentially significant risks is performed in the Bank. In result of such assessment specific risks are defined as significant or insignificant. A similar assessment is periodically performed in relation to the Group entities'. The monitoring is performed in particular in case of a significant change of the scope or profile of activities of the Bank or the Group entities.

Pursuant to the Principles of Information Policy of PKO Bank Polski SA, the Management Board approves and the Supervisory Board acknowledges the report on capital adequacy and other information subject to disclosure. Consequently, by accepting the aforementioned Report, the Management Board takes responsibility for the design, implementation and maintenance of the risk management system (defined in the current chapter) as well as confirms that the utilised systems are congruent with respective risk profiles and the Bank's strategy.

2.2. CREDIT RISK

2.2.1. INTRODUCTION

Credit risk is understood as the risk of incurring losses as a result of client's default or the risk of decrease in the economic value of the Bank's receivables as a result of deterioration of the client's credibility.

The purpose of credit risk management is to limit losses arising from the credit portfolio and minimise risk of occurrence of credit exposures which may be subject to impairment, while maintaining the expected level of profitability and value of the credit portfolio.

The Bank and the companies of the Group apply the following credit risk management principles:

1) a credit transaction requires a comprehensive credit risk assessment, expressed as an internal rating or scoring,
2) credit risk transactions is measured at the application stage and on a cyclical basis as part of monitoring, and takes into account both the changing external conditions and changes in the financial standing of the borrowers,
3) the credit risk assessment of exposures significant for their risk level or value is additionally verified by credit risk assessment units, irrespective of business units,
4) the terms and conditions of credit transactions offered to clients depend on the assessment of credit risk level generated by the transaction concerned,
5) credit decisions may be taken only by authorised persons,
6) credit risk is diversified by geographical areas, industries, products and clients,
7) the expected level of credit risk is mitigated by legal collateral accepted by the Bank, credit spreads charged to clients as well as by impairment allowance for credit exposures.

2.2.1.1. Derivatives risk

The derivatives risk is the risk of loss as a result of the Bank's position in financial instruments that satisfy all of the following conditions:

1) the value of an instrument changes together with a change of underlying instrument,
2) they do not require any net initial investments or they require only minor net initial investments, as compared to other types of agreements that respond to changes of market conditions in a similar way,
3) their settlement will take place in the future.

The derivatives risk management process is integrated in the Bank with the management of interest rate risk, foreign exchange risk, liquidity risk and credit risk, but due to the specific nature of derivatives, it is subject to particular monitoring defined in the Bank's internal regulations.

Within the scope of its activities the Bank uses various types of financial derivatives for the purposes of management of the risks related to the activities performed.

As of 31st December 2014, PKO Leasing SA was the only Group company (except for the Bank) utilizing derivatives as part of their (core-business related) risk management activities. PKO Życie Towarzystwo Ubezpieczeń SA[11] executes derivative transactions for the purpose other than risk management. The company offers insurance products with built-in derivative instruments to their customers, having backed those transactions with banking institutions.

The majority of derivatives used by the Group for the purpose of risk management and offered to clients are: IRS, FRA, FX Swap, CIRS, FX Forward, Options.

2.2.2. CREDIT RISK MEASUREMENT AND ASSESSMENT

2.2.2.1. Credit risk measurement methods

In order to assess the level of credit risk and credit portfolio profitability, the Bank uses various credit risk measurement and assessment methods, including the following:
1) probability of default (PD),
2) expected loss (EL),
3) credit value at risk (CVaR),
4) accuracy ratio,
5) share and structure of loans with recognized impairment (according to IASs),
6) coverage ratio for impaired loans (according to IAS) with write-downs,
7) cost of risk.

[11] PKO Życie Towarzystwo Ubezpieczeń SA is not subject to prudential consolidation, however, in order for the description of the risk management process in the Bank Group to be complete and coherent, company's description has been included in Chapter 2 (p. 2.14).

PKO Bank Polski SA systematically extends the scope of its credit risk measures, taking into account the requirements of the IRB approach, as well as the scope of application of risk measures so as to fully cover the Bank's credit portfolio with those methods.

The portfolio credit risk measurement methods allow, among other things, to include credit risk in the price of products; to determine the optimum conditions of financing availability; and to determine level for making impairment write-downs.

The Bank performs analysis and stress-tests regarding the influence of potential changes in macroeconomic environment on the quality of Bank's loan portfolio. The test results are reported to the Bank's authorities. The above mentioned information enables the Bank to identify and take measures to limit the negative influence of unfavourable market changes on the Bank's performance.

2.2.2.2. Rating and scoring methods

Risk assessment of individual credit transactions is made by the Bank using scoring and rating methods developed, enhanced and supervised by the Banking Risk Division. The functioning of those methods is supported by specialised IT applications. The manner of credit risk assessment is defined in the Bank's internal regulations whose main purpose is to ensure uniform and objective credit risk assessment in the process of granting credit facilities.

The Bank assesses credit risk for individual clients at two levels: client's borrowing capacity and creditworthiness. Client's borrowing capacity assessment consists in verifying the financial standing of a prospective borrower, while creditworthiness assessment covers the client score and credit history obtained from the Bank's internal databases and from external databases.

Credit risk assessment for institutional clients is conducted at two levels: the level of the client and of the transaction. The assessment is expressed in the following ratings: of the client and of the transaction. The synthetic measure of credit risk, reflecting both risk factors, is the joint rating.

In case of corporate customers from the small and medium enterprise segment, that meet certain criteria, the Bank assesses credit risk using the scoring method. Such assessment is dedicated to the low-value, plain vanilla loans and is performed in two dimensions: customers' borrowing capacity and creditworthiness. The borrowing capacity assessment involves examination of the customer's economic and financial situation, whereas the creditworthiness assessment involves scoring and evaluation of the customer's credit history obtained from internal databases of the Bank as well as external databases.

In other cases, the credit rating method is used.

In 2014, the Bank introduced a scoring method to assess the credit risk associated with the financing of housing communities.

The rating and scoring information is used widely by the Bank in the process of credit risk management, within the system of competencies in the area of credit decisions, when determining the criteria for activation of the credit risk assessment units, and within the system for credit risk measurement and reporting.

In order to reduce the response time to the observed warning signs indicating an increase of the credit risk level, the Bank uses and develops IT application of the Early Warning System (EWS).

2.2.3. CREDIT RISK MONITORING

2.2.3.1. Exposure amount

Table 2.1 shows the classification of the exposures taken into account in the calculation of capital adequacy of the Bank Group as at 31 December 2014.

Table 2.1

Exposure class	The Bank Group 2014 Total exposure*	The Bank Group 2014 % of total exposure
Exposures to central governments or central banks	34 826	13,5%
Exposures to regional governments or local authorities	10 025	3,9%
Exposures to public sector entities	641	0,2%
Exposures to multilateral development banks	0	0,0%
Exposures to international organisations	0	0,0%
Exposures to institutions	5 878	2,3%
Exposures to corporates	59 193	22,9%
Retail exposures	76 421	29,6%
Exposures secured by mortgages on immovable property	44 322	17,2%
Exposures in default	8 799	3,4%
Exposures associated with particularly high risk	496	0,2%
Exposures in the form of covered bonds	0	0,0%
Items representing securitisation positions	0	0,0%
Exposures to institutions and corporates with a short-term credit assessment	0	0,0%
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	18	0,0%
Equity exposures	1 160	0,4%
Other items	16 437	6,4%
Total	258 216	100,0%

* The value of balance sheet exposures and balance sheet equivalents of liabilities and off-balance sheet transactions prior to the application of credit risk mitigation techniques

In 2014, the greatest proportion of the exposure structure of the Group was related to retail exposures (29.6%) and exposures to corporates (22.9%). The proportions of other exposure classes range between 0.2% and 17.2% (Table 2.1).

A considerable proportion of the Bank Group's exposures with defined maturity date (79.9%) are exposures with the maturity of over 1 year; for over 69.8% of exposures with fixed maturity date, such period exceeds 5 years (Table 2.2).

Table 2.2
EXPOSURE STRUCTURE* BY ORIGINAL MATURITY

The Bank Group
2014

Exposure class	PKO Bank Polski SA						Other Group companies**	Adjustments and exclusions	Total
	0 - 1 month	1 - 3 months	3 - 12 months	1 - 5 Years	Over 5 years	Other***			
Exposures to central governments or central banks	8 802	0	0	1	25 572	51	394	6	34 826
Exposures to regional governments or local authorities	7	1	810	178	8 948	7	75	0	10 025
Exposures to public sector entities	0	3	314	14	308	2	0	0	641
Exposures to multilateral development banks	0	0	0	0	0	0	0	0	0
Exposures to international organisations	0	0	0	0	0	0	0	0	0
Exposures to institutions	97	2 219	2 246	101	1 253	171	12 968	-13 177	5 878
Exposures to corporates	722	557	14 541	13 337	28 809	286	5 538	-4 599	59 193
Retail exposures	5	20	8 226	8 973	59 116	-180	261	0	76 421
Exposures secured by mortgages on immovable property	9	37	4 457	367	39 634	-233	59	-8	44 322
Exposures in default	14	52	1 248	1 555	5 578	242	184	-74	8 799
Exposures associated with particularly high risk	0	0	0	0	0	443	14	39	496
Exposures in the form of covered bonds	0	0	0	0	0	0	0	0	0
Items representing securitisation positions	0	0	0	0	0	0	0	0	0
Exposures to institutions and corporates with a short-term credit assessment	0	0	0	0	0	0	0	0	0
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	0	0	0	0	0	0	18	0	18
Equity exposures	0	0	0	0	0	1 802	408	-1 050	1 160
Other items	4 419	0	0	0	23	11 263	656	77	16 437
Total	14 073	2 890	31 842	24 527	169 242	13 853	20 574	-18 784	258 216

* The value of balance sheet exposures and balance sheet equivalents of liabilities and off-balance sheet transactions prior to the application of credit risk mitigation techniques
** The Group Companies subject to prudential consolidation
*** Includes items with unspecified maturity (e.g. fixed assets, stocks)

2.2.3.2. Impairment of credit exposures

The Bank Group reviews each month the credit exposures to identify impaired credit exposures; measures the impairment of its credit exposures; and establishes write-downs and provisions. The process of establishing write-downs and provisions comprises the following stages:

1) identification of the conditions of impairment and of events significant for such identification,
2) recording in the Group's IT systems the events significant for identification of the conditions of impairment of credit exposures,
3) defining the method for impairment measurement,
4) measuring the impairment and deciding on a write-down or provision,
5) verification and aggregation of the impairment measurement results,
6) recording of the impairment measurement results.

The method for defining the amount of the write-downs depends on the type of impairment sources identified and the individual significance of the credit exposure concerned. The following events are specifically treated as the conditions of individual impairment:

1) delay in repayment of principal or interest longer than 90 days,
2) significant financial difficulties of the customer (small probability of full repayment of debt towards the Bank without such actions as collateral foreclosure by the Bank),
3) entering into restructuring agreement or granting a discount concerning debt repayment (the indication of impairment is recognized, if the convenience granted to the consumer is a result of its difficult legal or economic position).

In determining the past due period of the credit, the outstanding amounts of interest or principal instalments above defined thresholds are taken into account.

The Bank Group uses three methods for impairment assessment:

1) the individual method for individually significant loans which meet the condition of individual impairment or require individual assessment due to the specific nature of a transaction and events that condition their repayment,
2) the portfolio method, applied in the case of individually insignificant loans for which the condition of individual impairment has been identified,
3) the collective method (IBNR), used in the case of loans where no conditions of individual impairment have been identified, but there is the possibility of occurrence of incurred but not identified losses.

The write-down for impairment of the balance sheet value of a credit exposure is the difference between the balance sheet value of that exposure and the current value of the expected future cash flows from that exposure:

1) when defining the write-down under the individual method, the expected future cash flows are assessed for each credit exposure individually, the possible scenarios of performance of the agreement taken into account and weighed with the probability of their fulfillment,
2) the write-down for credit exposure impairment defined under the portfolio or collective method equals the difference between the balance sheet value of those exposures and the current value of the expected future cash flows, assessed with statistical methods on the basis of historical monitoring of exposures from homogeneous portfolios.

The provision for off-balance sheet credit exposures is established in the amount equal to the expected (assessable) loss of economic benefits resulting from such exposures.

The provision is set as the difference between the expected value of the balance sheet exposure to arise from the off-balance sheet liability (from the date as at which the assessment is made to the date of occurrence of the overdue debt that is identified as the condition of individual impairment)

and the current value of the expected future cash flows generated from the balance sheet exposure arising from the off-balance liability.

When determining the provision under the individualised method, the expected future cash flows are assessed for each credit exposure individually.

When determining the provision under the portfolio or collective method, portfolio parameters are used that are assessed by means of statistical methods on the basis of historical exposures of the same characteristics.

The structure of the credit portfolio, value adjustments and provisions related to original exposures of the Group is shown in Table 2.3.

Table 2.3

Exposure class	The Bank Group 2014 Exposure*	Value adjustments and provisions related to original exposures
Exposures to central governments or central banks	34 826	0
Exposures to regional governments or local authorities	10 025	-6
Exposures to public sector entities	641	-3
Exposures to multilateral development banks	0	0
Exposures to international organisations	0	0
Exposures to institutions	5 878	-1
Exposures to corporates	59 193	-444
Retail exposures	76 421	-345
Exposures secured by mortgages on immovable property	44 322	-179
Exposures in default	8 799	-5 214
Exposures associated with particularly high risk	496	0
Exposures in the form of covered bonds	0	0
Items representing securitisation positions	0	0
Exposures to institutions and corporates with a short-term credit assessment	0	0
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	18	0
Equity exposures	1 160	-2
Other items	16 437	-1 242
Total	258 216	-7 436

* The value of balance sheet exposures and balance sheet equivalents of liabilities and off-balance sheet transactions prior to the application of credit risk mitigation techniques

The coverage ratio, calculated as the share of total impairment write-downs to gross balance sheet value of credits with recognised impairment, amounted to 51.7% as at 31 December 2013 and to 50.5% as at 31 December 2012 (Table 2.8).

Specific credit risk adjustment is part of the write-down for impaired assets, which has been used to reduce common equity Tier 1 capital in order to reflect losses related to credit risk in accordance with the applicable accounting standards.

Below are presented credits and loans and revaluation write-downs by geographical (Table 2.4) and industry (Table 2.5) structure.

Table 2.4

Geographical structure of credits and loans* and revaluation write-downs **

Region	PKO Bank Polski SA 2014 Balance sheet exposure	Impairment write-downs	Off balance exposure	Off balance related reserves
Poland (PKO Bank Polski), including:	12 271	6 817	297	22
Mazovia***	2 967	1 569	166	3
Opole-Silesia	981	588	6	1
Łódzkie	919	491	8	1
Lesser Poland / Świętokrzyskie	911	494	7	1
Greater Poland	759	409	4	1
Lower Silesia	697	384	9	2
Western Pomerania	661	397	7	1
Kujawsko-Pomorskie	655	385	5	1
Pomerania	622	348	6	1
Podlaskie	500	292	7	1
Central Macroregion	481	201	37	3
Western Macroregion	425	272	1	0
Lubelsko-Podkarpackie	372	212	5	1
Northern Macroregion	325	157	6	1
North Eastern Macroregion	304	197	14	2
Southern Macroregion	303	152	9	2
other****	276	220	0	0
South Eastern Macroregion	75	29	0	0
South Western Macroregion	39	21	1	0

* Including financial lease receivables

**Applies to exposures with identified condition of individual impairment (without IBNR and exposures assessed on individual basis with write-off equal to zero) as of 31st Dec 2014

*** Includes the region of Warsaw and the "Head Office"

**** Unallocated portfolio

Table 2.5

Structure of credits and loans* and revaluation write-downs by industry ** with recognized impairment write-downs***

	Type of client / branch	PKO Bank Polski SA 2014 Balance sheet exposure	Impairment write-downs	Off balance exposure	Off balance related reserves
Institutional clients, of which:		8 048	4 169	293	21
F	Construction	2 073	1 226	94	12
G	Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	1 586	904	13	2
C	Industrial processing	1 171	640	19	4
I	Accomodation and food service activities	873	262	4	1
L	Real estate activities	735	323	0	0
M	Professional, scientific and technical activities	402	198	2	0
H	Transportation and storage	23	22	0	0
	Other exposures	1 185	594	162	2
Banks		0	0	0	0
Governments		7	7	0	0
Individuals		4 216	2 641	4	1
Other****		0	0	0	0
Total		12 271	6 817	297	22

* Including financial lease receivables

** Detailed information regarding revaluation write-downs can be found in relevant standalone and consolidated financial statements

*** Applies to exposures with identified condition of individual impairment (without IBNR) as of 31st Dec 2014

**** Exposures managed at the Head Office level, include e.g.: securities, other assets

2.2.3.3. Risk concentration

The Group monitors the credit risk concentration in respect of:

1) exposures to individual clients or groups of related clients,
2) exposures to groups of clients or credit portfolios exposed to a single risk factor.

The Group analyses the concentration in relation to:

1) geographical region,
2) currencies,
3) industries,
4) mortgage-backed exposure,
5) largest entities,
6) largest capital groups.

The risk of concentration of exposures to individual clients or groups of related clients is monitored pursuant to Article 71 of the Banking Law. The exposure concentration limit relates to the total amount of individual exposure which may not exceed 25% of consolidated own funds (according to CRR's definition of eligible own funds) or equivalent of EUR 150 mio. translated into PLN using the average rate published by the National Bank of Poland prevailing as at the last reporting date.

As at 31 December 2014 and 31 December 2013 the concentration limits were not exceeded. As at 31 December 2014 the level of concentration risk of the Bank Group for individual exposures was low, the largest exposure to an individual entity amounted to 12.9% of consolidated own funds. The group of the 10 biggest borrowers of the Group consist of clients of PKO Bank Polski SA only.

Table 2.6

EXPOSURE TOWARDS THE 10 BIGGEST CLIENTS*

	The Bank Group			
	2014		2013	
No.	exposure	%** of own funds	exposure	% of own funds
1	3 194	12,9%	2 080	9,8%
2	2 474	10,0%	2 074	9,7%
3	2 267	9,2%	2 035	9,6%
4	2 173	8,8%	1 436	6,7%
5	2 080	8,4%	1 085	5,1%
6	1 643	6,6%	1 079	5,1%
7	1 266	5,1%	794	3,7%
8	1 178	4,8%	777	3,6%
9	1 131	4,6%	690	3,2%
10	1 008	4,1%	674	3,2%
Total	18 414	74,4%	12 724	59,7%

* Total (balance sheet and off-balance sheet) exposure to non-banking sector clients for comparison to the exposure concentration limit

**Own funds of The Bank Group as of 31st Dec 2014 have been calculated in accordance with provisions of the Regulation (EU) 575/2013 (CRR)

As at 31 December 2014 the level of concentration risk of the Bank Group towards any group of entities was small and amounted to 14.1% of the consolidated own funds.

Table 2.7

EXPOSURE TOWARD THE 5 BIGGEST CAPITAL GROUPS*

The Bank Group

No.	2014 exposure	2014 %** of own funds	2013 exposure	2013 % of own funds
1	3 498	14,1%	3 537	16,6%
2	3 194	12,9%	2 791	13,1%
3	2 972	12,0%	2 056	9,7%
4	2 315	9,3%	1 961	9,2%
5	2 190	8,8%	1 446	6,8%
Total	14 170	57,2%	11 791	55,3%

* Total (balance sheet and off-balance sheet) exposure to non-banking sector clients for comparison to the exposure concentration limit

**Own funds of The Bank Group as of 31st Dec 2014 have been calculated in accordance with provisions of the Regulation (EU) 575/2013 (CRR)

As at 31 December 2014, the sum of large exposures of the Group amounted to 39.0% of consolidated own funds.

The credit concentration risk in respect of geographical regions is monitored in relation to:

1) financial institutions – by the country of origin of the counterparty's head office,
2) other clients – by regional division of the Bank's organisational units extending the loan.

In order to ensure geographical diversification of the Bank's exposures to financial institutions, the Bank applies limits of total exposure for individual countries.

As at 31 December 2014, there was no significant geographical concentration level in the Group's credit portfolio (Table 2.8).

Table 2.8

GEOGRAPHICAL STRUCTURE OF EXPOSURES*

The Bank Group

2014

Country / region	No. of exposure class**														Total
	A	B	C	D	E	F	G	H	I	J	K	O	P	Q	
Poland, including:	34 426	9 949	641	0	0	4 801	56 302	75 997	44 057	8 602	443	0	1 802	15 704	252 724
Mazovia***	0	414	6	0	0	2	5 494	12 464	4 975	372	0	0	0	0	23 728
Opole-Silesia	0	661	5	0	0	0	3 365	9 876	3 332	195	0	0	0	0	17 433
Greater Poland	0	331	0	0	0	0	2 162	7 793	3 486	41	0	0	0	0	13 813
Lesser Poland / Świętokrzyskie	0	941	43	0	0	0	2 848	7 214	2 432	98	0	0	0	0	13 576
Lower Silesia	0	261	0	0	0	0	1 476	6 021	2 395	71	0	0	0	0	10 225
Lubelsko-Podkarpackie	0	664	7	0	0	0	1 548	6 479	1 867	47	0	0	0	0	10 613
West Pomerania	0	500	1	0	0	0	1 801	4 027	2 141	158	0	0	0	0	8 628
Łódzkie	1	825	3	0	0	0	2 475	4 924	1 201	220	0	0	0	0	9 650
Pomerania	0	175	0	0	0	0	2 510	4 693	1 742	45	0	0	0	0	9 164
Kujawsko-Pomorskie	0	694	5	0	0	0	1 378	4 130	1 168	102	0	0	0	0	7 477
Warmińsko-Mazurskie	0	124	0	0	0	0	935	3 119	950	47	0	0	0	0	5 175
Podlaskie	0	93	1	0	0	0	927	2 221	683	49	0	0	0	0	3 974
Other***	34 425	4 267	570	0	0	4 799	29 381	3 035	17 686	7 156	443	0	1 802	15 704	119 267
Norway	0	0	0	0	0	384	536	10	4	0	0	0	0	0	934
Ukraine	0	0	0	0	0	379	61	1	0	76	0	0	0	0	516
Liberia	0	0	0	0	0	0	491	0	0	0	0	0	0	0	491
Luxembourg	0	0	0	0	0	0	337	0	0	0	0	0	0	0	337
United Kingdom	0	0	0	0	0	190	0	72	49	4	0	0	0	0	315
Sweden	0	0	0	0	0	0	140	0	0	0	0	0	0	0	140
Cyprus	0	0	0	0	0	0	110	2	1	0	0	0	0	0	113
Spain	0	0	0	0	0	95	0	2	0	0	0	0	0	0	97
Germany	0	0	0	0	0	0	87	1	0	0	0	0	0	0	89
Canada	0	0	0	0	0	64	0	2	2	0	0	0	0	0	67
Ireland	0	0	0	0	0	1	0	0	64	0	0	0	0	0	65
France	0	0	0	0	0	43	0	2	5	0	0	0	0	0	50
Belgium	0	0	0	0	0	0	44	0	0	0	0	0	0	0	44
Other	0	0	0	0	0	131	145	71	88	7	0	0	0	0	444
Total (PKO BP SA)	34 426	9 949	641	0	0	6 087	58 253	76 160	44 272	8 689	443	0	1 802	15 704	256 427
Group subsidiaries	394	75	0	0	0	12 968	5 538	261	59	184	14	18	408	656	20 574
Adjustments and exclusions	6	0	0	0	0	-13 177	-4 599	0	-8	-74	39	0	-1 050	77	-18 784
Total	34 826	10 025	641	0	0	5 878	59 193	76 421	44 322	8 799	496	18	1 160	16 437	258 216

* The value of balance sheet exposures and the balance sheet equivalent of liabilities and off-balance sheet transactions prior to application of credit risk mitigation techniques

** Classification of exposures according to Regulation (EU) 575/2013 (CRR)

A - Exposures to central governments or central banks
B - Exposures to regional governments or local authorities
C - Exposures to public sector entities
D - Exposures to multilateral development banks
E - Exposures to international organisations
F - Exposures to institutions
G - Exposures to corporates
H - Retail exposures
I - Exposures secured by mortgages on immovable property
J - Exposures in default
K - Exposures associated with particularly high risk
L - Exposures in the form of covered bonds - non-occuring in the Bank Group and / or the Bank
M - Items representing securitisation positions - non-occuring in the Bank Group and / or the Bank
N - Exposures to institutions and corporates with short-term credit rating - non-occuring in the Bank Group and / or the Bank
O - Exposures in the form of units or shares in collective investment undertakings ('CIUs')
P - Equity exposures
Q - Other items

*** Exposures managed at the Head Office level including the following, among other items: cash, tangible fixed assets, intangible assets, assets from securities valuation, securities

The credit concentration risk is monitored also with respect to industry sectors determined based on the PCBA (Polish Classification of Business Activity), maintained for institutional clients. In the case of industry sectors with higher risk levels, the Bank applies limits restricting its exposure to those sectors.

As at 31 December 2014, there was no significant concentration level in any industry sector (Table 2.9).

Table 2.9

EXPOSURE STRUCTURE BY INDUSTRY*

The Bank Group 2014

Type of client / branch	No. of exposure class **														Total
	A	B	C	D	E	F	G	H	I	J	K	O	P	Q	
Corporate clients, including:	0	6 232	155	0	0	0	49 032	5 520	1 126	5 417	0	0	0	0	67 482
Industrial processing	0	0	0	0	0	0	2 372	165	29	167	0	0	0	0	2 732
Wholesale and retail trade, repair of motor vehicles, motorcycles	0	0	0	0	0	0	548	40	29	41	0	0	0	0	659
Activities related to real property management	0	13	0	0	0	0	6	6	1	1	0	0	0	0	26
Construction	0	0	0	0	0	0	570	278	35	122	0	0	0	0	1 005
Public administration and national defence, obligatory social security	0	2	3	0	0	0	402	20	4	40	0	0	0	0	472
Generation and supply of power, gas, water steam, hot water and air for air-conditioning systems	0	0	0	0	0	0	13 156	760	82	656	0	0	0	0	14 654
Other exposures	0	6 217	152	0	0	0	31 977	4 251	946	4 390	0	0	0	0	47 933
Banks	0	0	0	0	0	6 087	0	0	0	0	0	0	0	0	6 087
Governments	34 426	0	0	0	0	0	0	0	0	0	0	0	0	0	34 426
Individuals	0	0	0	0	0	0	6 133	70 890	25 987	2 641	0	0	0	0	105 650
Other****	0	3 718	486	0	0	0	3 089	-249	17 158	631	443	0	1 802	15 704	42 781
Total (PKO BP SA)	34 426	9 949	641	0	0	6 087	58 253	76 160	44 272	8 689	443	0	1 802	15 704	256 427
Group subsidiaries	394	75	0	0	0	12 968	5 538	261	59	184	14	18	408	656	20 574
Adjustments and exclusions	6	0	0	0	0	-13 177	-4 599	0	-8	-74	39	0	-1 050	77	-18 784
Total	34 826	10 025	641	0	0	5 878	59 193	76 421	44 322	8 799	496	18	1 160	16 437	258 216

* The value of balance sheet exposures and the balance sheet equivalent of liabilities and off-balance sheet transactions prior to application of credit risk mitigation techniques

** Classification of exposures according to Regulation (EU) 575/2013 (CRR)

A - Exposures to central governments or central banks
B - Exposures to regional governments or local authorities
C - Exposures to public sector entities
D - Exposures to multilateral development banks
E - Exposures to international organisations
F - Exposures to institutions
G - Exposures to corporates
H - Retail exposures
I - Exposures secured by mortgages on immovable property
J - Exposures in default
K - Exposures associated with particularly high risk
L - Exposures in the form of covered bonds - non-occuring in the Bank Group and / or the Bank
M - Items representing securitisation positions - non-occuring in the Bank Group and / or the Bank
N - Exposures to institutions and corporates with short-term credit rating - non-occuring in the Bank Group and / or the Bank
O - Exposures in the form of units or shares in collective investment undertakings ('CIUs')
P - Equity exposures
Q - Other items

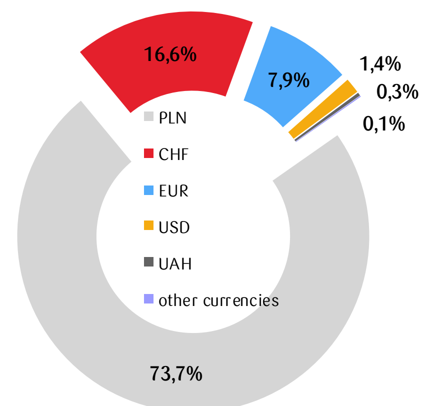
*** Exposures managed at the Head Office level including the following, among other items: securities, other assets

As at 31 December 2014, the share of exposures in convertible currencies other than PLN in the Group's total portfolio amounted to 26.2%. An increase by 5.8 p.p. in comparison to 31 December 2013 is a result of legal merger between PKO Bank Polski SA and Nordea Bank Polska SA., which incorporated Nordea Bank Polska's portfolio into the credit portfolio of the Bank.

The biggest portion of the Group's currency exposure is the exposure in CHF pertaining to the Bank's credit portfolio (Chart 2.1). In consequence of the aforementioned merger, share of credits denominated in CHF has increased by 4.0 p.p. In the case of the companies of the Group, i.e. exposures in EUR prevail in the currency portfolio of the PKO Leasing SA Group and the PKO BP Faktoring SA (respectively 94% and 93% of the foreign currency portfolio of the Groups). While portfolios of the Group of KREDOBANK SA and Finansowa Kompania „Prywatne Inwestycje" Sp. z o.o. (i.e. entities pursuing activity in the territory of Ukraine) are dominated by loans extended in USD (respectively 63% and 81% of the foreign currency portfolio of the entities).

Chart 2.1

CURRENCY STRUCTURE
OF THE CREDIT PORTFOLIO
THE BANK GROUP



2.2.3.4. Monitoring of derivatives

The Bank monitors contracts with embedded derivatives. Separated embedded derivatives are subject to periodical valuation.

Separated embedded derivatives were not a significant risk factor for the Bank in 2014.

As at 31 December 2014 the Bank had signed general agreements in ISDA/PBA standard with 24 Polish banks and 57 foreign banks and credit institutions as well as collateral agreements in CSA/PBA (Credit Support Annexes/PBA) standard with 21 Polish banks and 45 foreign banks and credit institutions. Moreover the Bank was a signing party of 12 ISMA (International Securities Market Association) agreements.

The coverage ratio of the nominal value of transactions on derivatives with general agreements and PBA collateral agreements and CSA was 99.6% and 99.1% respectively.

The positive gross fair value of contracts with financial institutions as at 31 December 2014 was PLN 5,042 million. The above amount was calculated as the total of positive market values of all open transactions. The net credit exposure, after taking into account the netting of transactions, for counterparties with framework agreements was ca. PLN 806 million. Netting benefits amounted to approx. PLN 4,236 million. The value of collateral accepted from the counterparties within the CSA and PBA collateral agreements was ca. PLN 762 million.

As at 31 December 2014, the Bank had no credit derivatives.

As at 31 December 2014, the Bank recognized credit value adjustments in the valuation of financial derivatives concluded with non-financial business entities based on a performed analysis of recoverability of the exposures. The Bank's adjustment included the market value of credit risk as assessed by the Bank. The analysis covered all significant exposures with the positive valuation of financial derivatives contracted with non-financial business entities. In particular, the adjustment included the risk of nonperformance of agreements executed with the counterparty, based e.g. on analyses of the business and financial standing of entities, the probability of repayment of specific contracts, and the recoverable value of collateral.

The financial institutions – the Bank's business partners on an interbank market – have high external ratings – between A and CCC (Table 2.10).

Table 2.10

THE QUALITY OF EXPOSURES*
TO FINANCIAL INSTITUTIONS**

Rating	PKO Bank Polski SA 2014
A	76,0%
BBB	12,0%
BB	5,0%
CCC	5,0%
No rating	2,0%
Total	100,0%

* Exposure is the total of the nominal exposure on account of bank deposits and securities and the total of derivatives valuations after netting them for counterparties with whom there have been concluded currently binding framework agreements for set-off

** Exposures to institutions from outside the Group

The above listing is based on external rating granted by Moody's, Standard & Poor's and Fitch rating agencies, mapped to a uniform rating scale.

2.2.4. CREDIT RISK REPORTING

The Bank prepares monthly and quarterly credit risk reports. Credit risk reporting comprises periodical information on the exposure level to the credit portfolio risk. Beside information on the Bank, the reports also include the credit risk data for the Group entities in which significant credit risk level was identified (for instance the KREDOBANK SA Group).

Moreover, the Bank prepares daily, weekly, monthly and quarterly reports on credit exposures related to derivatives risk, and the quarterly reports refer to the whole Bank Group. The reports comprise information on the risk exposure of derivatives and information on the use of risk limits. The recipients of the reports are mainly: BCC, ALCO, RC the Management Board and the Supervisory Board.

2.2.5. CREDIT RISK RELATED MANAGEMENT ACTIONS

2.2.5.1. Collateral policy

The credit risk collateral policy plays particular role in determination of minimum conditions of transactions. The purpose of the collateral policy followed by the Bank and the Group entities is to appropriately secure the credit risk to which the Group is exposed, and in the first place to establish collateral that offers the best possible level of recovery if the recovery procedure proves necessary. The policy concerning debt collateral is defined in the internal regulations of the Bank Group entities.

The specific types of collateral that are actually established depend on the product and client type.

In granting housing loans, collateral is obligatorily established mainly in the form of a mortgage on the real estate property. Until the mortgage is perfected (depending on the loan type and amount), a raised credit spread is applied or a collateral is accepted in the form of a transfer of receivables under the apartment construction agreement, transfer of receivables under the development agreement and open or closed escrow or a bill or guarantee.

When granting retail loans to individual clients, the Bank usually accepts personal collateral (a guarantee under civil law or a bill of exchange) or establishes pledge on the client's bank account, car or securities.

Collateral on loans financing small and medium enterprises as well as corporate clients is established, among other things, on business liabilities, bank accounts, movables, immovables or securities.

The basis of the value assessment of the collateral established on tangible assets is its market value. The market value is determined based on the assessment made by the Bank or the valuation prepared by an independent valuer in accordance with separate provisions on collateral assessment, including the assessment of property.

During the assessment of the collateral, the following are taken into account:

1) property, economic and financial or social and financial situation of entities providing personal collateral,
2) the state and the market value of the collateral objects and their susceptibility to the depreciation during of the life of

collateral (the impact of technological wear of the collateral on its value),
3) the potential economic benefits of the Bank arising from a particular method of securing debts, in particular, the ability to deduct write-downs related to impairment losses,
4) method of collateral establishment, including: the typical duration and complexity of formal operations, as well as necessary costs (cost of upholding the collateral and debt enforcement from the collateral), using the Bank's internal regulations relating to collateral evaluation,
5) complexity, time-intensity as well as economic and legal conditions related to the effective enforcement from the collateral, in the context of limitations and existing rules of execution related to distribution of amounts received from individual execution and/or bankruptcy proceedings, debt seniority.

Established collateral is subject to periodic monitoring in order to determine their current value. The following factors are monitored:

1) property/financial standing of the entity that issues personal collateral,
2) the condition and value of the object serving as property collateral,
3) other circumstances affecting the possibility of debt recovery by the Bank.

Collateral in the form of a mortgage is subject to special assessment. The Bank performs periodic monitoring of real properties accepted as collateral (LtV ratio), and monitors the prices on the real estate market. If the analysis shows a significant drop in prices on the real estate market, the Bank is prepared to activate emergency procedures.

In case of deterioration of property, economic and financial, social and financial situation of a debtor, significant decrease of collateral value or other threats to timely repayment of secured debts, the Bank insists on establishment of additional collateral.

In the Bank's Capital Group companies (Group KREDOBANK SA Group, the PKO Leasing SA, PKO BP Factoring SA) similar security policy is conducted, consistent with the Bank's policy, taking into account the specific nature of the activities of the relative company. The type of collateral depends on the product offered by the company, customer segment to which the product is offered and, in particular, the credit risk's level. Collaterals are assessed both before the credit transaction, as well as in the monitoring period (interim evaluation).

2.2.5.2. Credit risk management tools

The main credit risk management tools used by the Bank are as follows:

1) minimum transaction conditions (risk parameters) defined for a given type of transaction (e.g. the maximum value of the LtV rate, the maximum loan amount, the required collateral),
2) the principles to determine crediting availability, including cut-off points – the minimum number of points awarded during the creditworthiness assessment made using the scoring system (for individual clients and institutional clients evaluated using the scoring system) or the rating class and joint rating (for institutional clients evaluated using the scoring system), from which the loan transaction can be made with a given client,
3) concentration limits – limits defined in Article 71 of the Banking Law and the CRR,
4) industry limits – limits defining the risk level related to financing of institutional clients that conduct their businesses in industries characterized by a high level of credit risk,
5) limits related to the credit exposures of the Bank's clients – limits defining credit risk appetite resulting for instance from Recommendations S and T,
6) credit limits – defining the maximum Bank's concentration in case of a specific counterparty or country in relation to wholesale market transactions, settlement limits and tenor limits,
7) competence limits – defining the maximum level of powers required to take credit decisions with respect to the Bank's clients; the limits depend mainly on the Bank's credit exposure amount to a given client (or a group of related clients) and the period of credit transaction; the competence limits depend on the credit decision-making level (within the Bank's organisational structure),
8) minimum credit spreads – credit risk spreads related to a specific credit transaction executed by the Bank with a given corporate client, and the interest rates offered to a client may not be lower than the reference rate plus credit risk spread.

2.2.5.3. Credit risk management in the Bank Group

The Bank Group entities with significant credit risk level (the KREDOBANK SA Group, the PKO Leasing SA Group, PKO BP Faktoring SA and Finansowa Kompania „Prywatne Inwestycje" Sp. z o.o.) manage credit risk individually, with the provision that the applied methods for credit risk assessment and measurement are aligned with the method used by PKO Bank Polski SA, while observing the specific nature of the business activity conducted by those entities.

Change in the solutions applied by the Bank Group entities is each time agreed with units responsible for risk management within the Bank.

The KREDOBANK SA Group, PKO Leasing SA Group, PKO BP Faktoring SA and Finansowa Kompania „Prywatne Inwestycje" Sp. z o.o. measure credit risk and report the results of that measurement to the Bank on a cyclical basis.

The credit decision limits depend in those companies specifically on the following factors: the amount of the credit exposure to a client, the amount of a single credit transaction, and the term of such transaction.

The credit decision-making process in the KREDOBANK SA Group, the PKO Leasing Group SA and PKO Faktoring SA is supported by credit committees activated in the case of credit transactions generating an higher credit risk level.

In the case of loan transactions generating increased credit risk, the Bank supports the Group companies in the process of credit risk assessment and decision-making, by issuing an opinion by the Credit Risk Assessment and Analysis Centre and the credit committees at the Head Office of the Bank.

2.2.5.4. Management actions related to derivatives

In order to limit credit risk relating to derivative transactions, the Bank enters into framework agreements with its counterparties. Those agreements enable off-setting of due liabilities (mitigation of settlement risk) and non-due liabilities (mitigation of pre-settlement risk), arising from derivative transactions as well as utilisation of close-out netting at the moment of termination of the agreement due to infringement or event warranting termination in relation to one or both parties.

Framework agreements related to forward/future transactions with foreign counterparties are made on a basis of standards developed by ISDA (International Swaps and Derivatives Association) and on the basis of the standards developed by PBA in case of Polish counterparties. Framework agreements with foreign counterparties for transactions involving debt securities are made based on the GMRA (Global Master Repurpose Agreement) standard developed by ICMA (International Capital Market Association) and on the basis of PBA standard in case of Polish counterparties. Additionally, the Bank enters into collateral agreements (CSA – Credit Support Annex – standard developed by ISDA or PBA collateral agreement) with its counterparties, on the basis of which, each of the parties, after meeting certain criteria specified in the agreement, undertakes to establish appropriate collateral along with the right to set it off.

Collateral agreements signed by the Bank contain provisions on the allowed difference between credit exposure and collateral value. Collateral agreements may allow to forms of collateral: cash and securities.

The Bank has developed a standard for signing framework agreements, which defines the manner of activities during the course of negotiations and during the course of signing and administering framework agreements and collateral agreements made with banks and financial institutions.

Entering into a framework agreement with counterparty is the basis for verification of internal limit per counterparty and of the length of period of the Bank's exposures to forward or repurchase agreement transactions. The client limit is based on the internal (in case of Polish banks) or external (prepared by one of major credit rating agencies) rating (in case of foreign banks) as well as on the amount of own funds of the Bank and the client.

In case of credit transactions with financial institutions having their registered office outside the territory of the Republic of Poland, the international standards of loan agreements of the Loan Market Association are applied.

If a client (counterparty) did not meet its liability under such instrument, the settlement amount would be recorded as a receivable valued at the nominal value adjusted by the interest due and reduced by the amount of impairment write-downs.

Every month the Bank reviews derivative transactions concluded with counterparties in order to identify impaired transactions and includes recognized impairment in the valuation of such transactions.

The identification of impaired transactions consists in recognition of events that indicate a threat to payments under such transactions, in particular:

1) delays in making payments under such transactions,
2) no cover of a transaction from foreseeable cash flows from client's economic activities or accepted transaction collateral,
3) significant deterioration of client's internal rating or missing information on current rating.

On a monthly basis the Bank conducts adjustment of the valuation of derivatives reflecting counterparty credit risk (CVA) and the Bank's own credit risk (DVA).

CVA adjustment for particular counterparties is calculated as an amount of products of: discounted expected positive exposure and a probability of counterparty's insolvency including calculated recovery rates.

The derivatives risk management methods in the Bank Group entities are defined in the internal regulations implemented by such entities that have positions in derivatives or expect to have such positions in such instruments. These provisions are worked out on the basis of opinions prepared by the Bank and include the Bank's recommendations prepared for the subsidiaries.

Positions taken by other entities in the Bank Group in specific derivatives shall be determined analogically, like the positions in derivatives taken by the Bank, taking account of the specific nature of those activities.

2.3. Interest rate risk

2.3.1. Introduction

Interest rate risk is the risk of loss on the Bank's balance sheet and off-balance sheet items sensitive to interest rate changes, resulting from unfavourable interest rate changes on the market.

The purpose of interest rate risk management is to mitigate the possible losses due to changes in the market interest rates to an acceptable level through appropriate shaping of the structure of the balance sheet and off-balance sheet items.

2.3.2. Interest rate risk measurement and assessment

In order to determine the level of interest rate risk, the Bank uses the value at risk model (VaR), price sensitivity measure (BPV), interest income sensitivity measure, stress tests and repricing gaps.

The value at risk (VaR) is the potential loss resulting from maintained structure of balance sheet and off-balance sheet items and changes in interest rates or as potential value of loss on the maintained currency positions due to changes in interest rates or foreign exchange rates, with an assumed probability level and taking account of a correlation between risk factors.

VaR for market risk management purposes is calculated with the 99% confidence level and 10-day holding. For interest rate risk management purposes, the following, among other things, are applied: the VaR value determined for individual financial instruments and for the Bank's portfolios, and by individual types of business activity of the Bank.

Price sensitivity measure (Basis Point Value – BPV) is defined as change of the financial instrument fair value caused by parallel upward movement of the profitability curves by one basis point.

The interest income sensitivity is a measure defining a change in the interest income resulting from stepwise interest rate changes. The measure takes into account the different repricing dates of individual interest items in each of selected time horizons.

The repricing gap is the difference between the current value of assets and liabilities positions exposed to interest rate risk, repriced in a given time interval, with the items shown as at the transaction date.

Stress tests for interest rate risk are used to assess potential losses resulting from the maintained structure of the balance sheet and off-balance sheet items where market situation

occurs that is not described in a standard manner using the statistical measures.

The following scenarios are applied at the Bank:

1) hypothetical scenarios – within which fluctuations in interest rates are assumed arbitrarily: parallel movement of the interest rate curves for the individual currencies by ±50 bps, by ±100 bps and by ±200 bps and deflection scenarios (nonparallel peak- and twist- type deflections) of profitability curves.
2) historical scenarios – within which fluctuations in interest rates are assumed on the basis of fluctuations in interest rates observed in the past, including: the biggest historical change, deflection of the interest rate curve, the biggest historical nonparallel movement of interest rate curves for securities and for derivatives hedging those securities.

In the process of interest rate risk measurement, in relation to credit and deposit balances with indefinite repricing, the Bank assumed the approach based on replicated interest rate profiles, while taking account of instability of balances of this products (defined on the basis of their past structure).

2.3.3. MONITORING THE INTEREST RATE RISK

In 2014, interest rate risk of the Bank Group was determined mainly by the risk of mismatch of dates of repricing of assets and liabilities.

As at 31 December 2014 the mismatch of reassessment dates of the Bank Group in case of PLN interest rate and also for EUR and CHF interest rates comprised mainly the Bank's mismatch. The mismatch of interest rate repricing dates for these currencies that was generated by the other Group entities had no significant impact on the interest rate risk for the entire Group and consequently, it did not change its risk profile significantly. The mismatch of the Group's USD repricing dates comprised mainly the Bank's exposures and the mismatch of the Group entities. The mismatch of the Bank Group entities reduced the mismatch of the Group in USD in the range of 3 up to 6 months and over 5 years. As far as the other ranges are concerned, the mismatch of the Group entities increased the mismatch of the Group.

The Tables 2.11 – 2.14 present the repricing gaps of the Bank and the Group as at 31 December 2014 by currencies.

Table 2.11

PLN repricing gap (in PLN million)

2014	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	51 930	37 535	-11 183	-24 671	-16 298	-17 380	-38	19 894
Cumulative gap	51 930	89 464	78 281	53 610	37 313	19 933	19 894	-
Group subsidiaries								
Periodic gap	-2 157	-737	22	71	7	10	27	-2 757
Cumulative gap	-2 157	-2 893	-2 871	-2 800	-2 794	-2 784	-2 757	-
TOTAL - Periodic gap	49 773	36 798	-11 161	-24 600	-16 291	-17 370	-11	17 137
TOTAL - Cumulative gap	49 773	86 571	75 410	50 810	34 519	17 149	17 137	-

Table 2.12

USD repricing gap (in USD million)

2014	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	36	32	-225	87	166	8	-121	-18
Cumulative gap	36	68	-158	-71	95	103	-18	-
Group subsidiaries								
Periodic gap	-126	17	2	11	33	9	9	-44
Cumulative gap	-126	-109	-106	-95	-62	-53	-44	-
TOTAL - Periodic gap	-90	49	-223	98	199	17	-112	-62
TOTAL - Cumulative gap	-90	-41	-264	-166	33	50	-62	-

Table 2.13

EUR repricing gap (in EUR million)

2014	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	-970	1 405	165	-262	50	-614	48	-177
Cumulative gap	-970	435	600	339	389	-225	-177	-
Group subsidiaries								
Periodic gap	355	-118	0	-29	7	3	7	225
Cumulative gap	355	237	237	208	215	217	225	-
TOTAL - Periodic gap	-615	1 287	165	-291	57	-611	55	48
TOTAL - Cumulative gap	-615	673	837	546	603	-8	48	-

Table 2.14

CHF repricing gap (in CHF million)

2014	0-1 month						Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	-2 271	2 949	265	-504	-11	-4	-7	417
Cumulative gap	-2 271	679	943	439	428	424	417	-
Group subsidiaries								
Periodic gap	5	-7	0	0	0	0	0	-2
Cumulative gap	5	-2	-2	-2	-2	-2	-2	-
TOTAL - Periodic gap	-2 266	2 942	265	-504	-11	-4	-7	415
TOTAL - Cumulative gap	-2 266	677	941	437	426	422	415	-

The VaR and analysis of stress test scenarios of the Group's exposure to the interest rate risk as at 31 December 2014 and 31 December 2013 respectively are presented below:

Table 2.15

Sensitivity of financial assets Exposed to interest rate risk

	2014*		2013**	
	10-day VaR	Stress-test ±200 base	10-day VaR	Stress-test ±200 base
PKO Bank Polski SA	282	-2 370	55	-523
Group subsidiaries	-	-21	-	-27
Total	282	-2 391	55	-496

* Data presented in accordance with provisions of the Regulation (EU) 575/2013 (CRR) (Group subsidiaries subject to prudential consolidation)
** Data presented in accordance with provisions of the resolution 76/2010 of the Polish Financial Supervisory Authority (KNF) as amended
***The table presents the value of most adverse stress test among all scenarios: shift of FX rates in particular currencies by 200 BPS up and by 200 BPS down, both separately and jointly for the Bank and Group subisidiares

As at 31 December 2014, the 10-day VaR on the interest rate was PLN 282.2 million for the Bank, which accounted for ca. 1.1% of the Bank's own funds. As of 31 December 2013, the Bank's VaR was 54.9 PLN, which accounted for approx. 0.3% of the Bank's own funds.

The results of stress tests showing changes in the market value resulting from shifts of the yield curves by individual currencies are presented in Table 2.16:

Table 2.16

Stress tests results* - parallel shift of interest rate curves by ±200 base points

	Bank		Group subsidiaries		Total	
Currency	2014**	2013***	2014**	2013***	2014**	2013***
PLN	-1 877	-413	-3	0	-1 880	-413
EUR	-236	-49	-6	-9	-242	-58
USD	-2	-59	-12	-18	-14	-77
CHF	-266	-2	0	0	-266	-2
GBP	-1	-1	0	0	-1	-1

* Main foreign currency values have been shown in PLN equivalents
** Data presented in accordance with provisions of the Regulation (EU) 575/2013 (CRR) (Group subsidiaries subject to prudential consolidation)
*** Data presented in accordance with provisions of the resolution 76/2010 of the Polish Financial Supervisory Authority (KNF) as amended

Given the nature of business activity of the other entities of the Group generating significant interest rate risk and the specific nature of the market on which they operate, the Group does not determine the consolidated VaR. The companies use their own risk measures to manage interest rate risk. The 10-day VaR measure for interest rate for main currencies is used by KREDOBANK SA, its value as at 31 December 2014 was PLN 9.5 million, while as at 31 December 2013 – ca. PLN 10.7 million.

2.3.4. INTEREST RATE RISK REPORTING

The Bank prepares daily, weekly, monthly and quarterly interest rate risk reports, but the quarterly reports refer also to the Group. The reports contain information on interest rate risk exposure and on the risk limits utilisation. The recipients of such reports are mainly ALCO, RC, the Management Board and Supervisory Board.

2.3.5. MANAGEMENT ACTIONS RELATED TO INTEREST RATE RISK

The basic interest rate management tools used in the Group are as follows:

1) interest rate risk management procedures,
2) limits and threshold values by individual market risk types,
3) defining characteristics and level of exposure for the interest rate risk for particular types of products,
4) defining the allowed types of transactions exposed to interest rate risk.

The Group defined limits and thresholds for interest rate risk, that is among other, price sensitivity, interest income sensitivity, as well as limits and thresholds of losses, and limits for instruments sensitive to interest rate fluctuations.

The methods of interest rate management in the Group entities are defined by internal regulations that are implemented by companies in which the interest rate risk is significant. Such provisions are developed with consultations with the Bank and taking account of the recommendations of the Bank.

2.4. FOREIGN EXCHANGE RISK

2.4.1. INTRODUCTION

FX risk is the risk of loss due to changes in the foreign exchange rates, generated through maintaining open currency positions in individual currencies.

The purpose of FX risk management is to mitigate possible losses resulting from changes of FX rates to an acceptable level through appropriate structuring of balance sheet and off-balance sheet items.

2.4.2. FOREIGN EXCHANGE RISK MEASUREMENT AND ASSESSMENT

In order to determine the level of FX rate risk, the Bank uses the value at risk model (VaR) and stress tests.

Stress tests and crash tests for FX risk are used to assess potential losses on taken currency positions where extraordinary market situation occurs that is not described in a standard manner using the statistical measures.

The following two scenarios are applied at the Bank:

1) hypothetical scenarios – within which the historical appreciation or depreciation of foreign exchange rates is assumed (by 20% and 50%),
2) historical scenarios – scenarios of fluctuations in exchange rates observed in the past.

2.4.3. MONITORING OF THE FOREIGN EXCHANGE RISK

In 2014, the FX risk of the Bank Group was low as it is the Bank's policy to close currency positions in the main currencies, that is EUR, USD, CHF and GBP. 10-day VaR for FX position of the Bank at the end of 2014 amounted to PLN 6.2 million, which accounted for approx. 0.03% of the Bank's own funds. The VaR and stress-test analysis in respect of the Bank's and the Group's financial assets (total for all currencies) exposed to FX risk as at 31 December 2014 and 31 December 2013 respectively was as follows:

Table 2.17

Sensitivity of financial assets exposed to FX risk	2014*		2013**	
	10-day VaR	Stress-test ±20%	10-day VaR	Stress-test ±20%
PKO Bank Polski SA	6	-16	2	-21
Group subsidiaries	-	-7	-	-43
Total	6	-24	2	-14

* Data presented in accordance with provisions of the Regulation (EU) 575/2013 (CRR) (Group subsidiaries subject to prudential consolidation)
** Data presented in accordance with provisions of the resolution 76/2010 of the Polish Financial Supervisory Authority (KNF) as amended
*** The table presents the value of most adverse stress test among all scenarios: PLN appreciation by 20% and PLN depreciation by 20%

As in the case of interest rate risk, given the nature of business activity of the Bank Group entities generating significant FX risk and the specific nature of the market on which they operate, the Bank does not determine the consolidated VaR sensitivity measure. The companies use their own risk measures to manage FX risk. The 10-day VaR measure is used by KREDOBANK SA, as at 31 December 2014 its value was ca. PLN 3.7 million while as at 31 December 2013 – ca. PLN 0.9 million.

2.4.4. REPORTING OF THE FOREIGN EXCHANGE RISK

The Bank prepares daily, weekly, monthly and quarterly FX risk reports, but the quarterly reports refer also to the Group. The reports contain information on FX risk exposure and on the use of these risk limits. The recipients of such reports are mainly ALCO, RC, the Management Board and Supervisory Board.

2.4.5. MANAGEMENT ACTIONS RELATED TO FOREIGN EXCHANGE RISK

The basic FX risk management tools used in the Group are as follows:

1) FX risk management procedures,
2) limits and thresholds for FX risk,
3) defining the allowed types of FX transactions and FX rates used in such transactions.

The Bank Group defined limits and thresholds for FX risk, that is among others, FX positions, 10-day VaR and daily losses on the FX market.

The methods of FX risk management in the Group entities are defined by internal regulations implemented by companies in which FX risk measures are significant. Such regulations are prepared after consultation with the Bank and taking into account recommendations of the Bank.

2.5. LIQUIDITY RISK

2.5.1. INTRODUCTION

Liquidity risk is the risk of inability of timely discharge of liabilities due to absence of liquid cash and equivalents. The lack of liquidity may result from an improper balance sheet structure, cash flows mismatch, non-payment by contractors, and sudden withdrawal of funds by the clients or other market events.

The purpose of liquidity risk management is to secure necessary means to discharge the current and future (also potential) liabilities to the nature of business activity and any needs that may result from a changing market environment, through structuring of balance sheet and off-balance sheet items.

2.5.2. LIQUIDITY RISK MEASUREMENT AND ASSESSMENT

The Bank Group's liquidity policy is based on maintenance of liquid securities portfolio and growth of stable financing sources (in particular stable deposit base). Moreover, money market instruments, including operations of the open market of the National Bank of Poland are used for liquidity risk management.

The Bank Group uses, for instance the following liquidity risk measures:

1) contractual liquidity gap – listing of all balance sheet items by their maturity,
2) adjusted liquidity gap – listing of individual balance sheet categories by their adjusted maturity,
3) liquidity reserve – the difference between the most liquid assets and expected and potential liabilities that mature in a given period,
4) stability measures of deposit and loan portfolio,
5) liquidity stress tests.

Stress tests for liquidity risk are used to assess the number of business days over which the Bank could fully pay funds to non-financial entities and to verify if the Bank's funds would be enough to cover the liabilities should the shock scenario be materialised.

The following three scenarios are applied at the Bank:
1) scenarios of mass withdrawal of deposits by non-financial clients,
2) scenarios of sensitivity of in- and outflows to changing market conditions,
3) scenarios of forecasted liquidity risk in shock conditions.

2.5.3. MONITORING THE LIQUIDITY RISK

The adjusted liquidity gaps presented below include a list of matured assets, payable liabilities, and additionally selected balance sheet items for a proper presentation of the liquidity status of the Bank and the companies of the Bank Group.

Subject to adjustment were the following:

1) the core deposits (interbank market excluded) and their payability - clients' deposits (current accounts, savings accounts and fixed term deposits) have been classified to appropriate tenors according to their stability (maintenance of an appropriate balance or revolving after payability),
2) the core deposits on the current accounts of non-financial entities and their maturity - overdrafts have been classified to appropriate tenors according to their possibility of revolving,
3) liquid securities and their maturity – liquid securities have been classified into the tenor of up to 7 days according to the possible date of their liquidation (pledging, sale).

The table below presents data concerning periodic gap and cumulative periodic gap of the Bank and of the companies of the Group as at 31 December 2014 and 31 December 2013 respectively.

Table 2.18

ADJUSTED LIQUIDITY GAP* - ASSETS AND LIABILITIES

2014**	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
PKO Bank Polski SA								
Periodic gap	12 717	11 081	1 212	1 328	1 405	11 330	12 837	-51 909
Cumulative gap	12 717	23 798	25 009	26 337	27 742	39 072	51 909	-
Group subsidiaries								
Periodic gap	-71	-6	-600	-50	-306	703	565	-234
Cumulative gap	-71	-77	-677	-728	-1 034	-331	234	-
TOTAL - Periodic gap	12 647	11 074	611	1 278	1 099	12 033	13 402	-52 143
TOTAL - Cumulative gap	12 647	23 721	24 332	25 610	26 708	38 741	52 143	0

2013***	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
PKO Bank Polski SA								
Periodic gap	7 014	13 167	-9 759	-769	1 985	5 272	18 082	-34 990
Cumulative gap	7 014	20 180	10 421	9 652	11 637	16 909	34 990	-
Group subsidiaries								
Periodic gap	-33	157	-502	-75	-274	340	525	-138
Cumulative gap	-33	124	-378	-453	-727	-387	138	-
TOTAL - Periodic gap	6 981	13 324	-10 261	-843	1 711	5 612	18 606	-35 128
TOTAL - Cumulative gap	6 981	20 304	10 043	9 200	10 910	16 522	35 128	0

* Set as a sum of real-terms liquidity gap of PKO Bank Polski SA and contractual liquidity gaps of the other companies of the Group
** Data presented in accordance with provisions of the Regulation (EU) 575/2013 (CRR) (Group subsidiaries subject to prudential consolidation)
*** Data presented in accordance with provisions of the resolution 76/2010 of the Polish Financial Supervisory Authority (KNF) as amended

In all tenors, the cumulative adjusted liquidity gap of the Group showed positive values. This means a surplus of matured assets over matured liabilities.

Table 2.19 presents data concerning contractual off-balance sheet liquidity gap of derivatives of the Group.

Table 2.19

CONTRACTUAL OFF-BALANCE SHEET LIQUIDITY GAP FOR DERIVATIVES

The Bank Group

2014*	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
TOTAL - Periodic gap	94	191	-140	25	201	383	368	1 124
TOTAL - Cumulative gap	94	286	146	171	372	756	1 124	-

2013**	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
TOTAL - Periodic gap	74	-48	63	85	227	325	28	755
TOTAL - Cumulative gap	74	26	89	175	402	727	755	-

* Data presented in accordance with provisions of the Regulation (EU) 575/2013 (CRR) (Group subsidiaries subject to prudential consolidation)
** Data presented in accordance with provisions of the resolution 76/2010 of the Polish Financial Supervisory Authority (KNF) as amended

The table below presents the Bank's liquidity reserve as at 31 December 2014 and 31 December 2013:

Table 2.20

LIQUIDITY RESERVE UP TO 1 MONTH

	2014*	2013**
PKO Bank Polski SA	21 075	17 816

* Data presented in accordance with provisions of the Regulation (EU) 575/2013
** Data presented in accordance with provisions of the resolution 76/2010 of the Polish Financial Supervisory Authority (KNF) as amended

The structure of the Bank's funding has been described in the Financial Statement for 2014 (51.2 "Forecasting and monitoring of liquidity risk").

2.5.4. LIQUIDITY RISK REPORTING

The Bank prepares daily, weekly, monthly and quarterly liquidity risk reports, but the quarterly reports refer also to the Group. The reports contain information on liquidity risk exposure and on the risk limits utilisation. The recipients of such reports are mainly ALCO, RC, the Management Board and the Supervisory Board.

2.5.5. MANAGEMENT ACTIONS RELATED TO LIQUIDITY RISK

The basic liquidity risk management tools used by the Bank Group are as follows:

1) liquidity risk management procedures including contingency plans,
2) limits and threshold values for liquidity risk,
3) deposit, investment, derivative transactions, including structured FX transactions and security sell and buy transactions,
4) transactions ensuring long-term financing of credit activities.

In order to ensure proper liquidity level in the Bank and the Bank Group entities, limits and thresholds were adopted for measures of the current as well as mid- and long-term liquidity.

Liquidity risk management methods in the Group's entities are defined in the internal regulations introduced by the companies when the risk measures achieve significant values.

These regulations have been developed after consultations with the Bank and after considering the recommendations of the Bank.

2.6. PRICE RISK OF EQUITY SECURITIES AND COMMODITY PRICE RISK

2.6.1. INTRODUCTION

The price risk of equity securities is defined as a risk of loss related to changes in prices of equity securities on the public market or stock exchange indices that is generated through open positions in the instruments that are sensitive to changes of such market parameters.

The price risk of equity securities is generated as a result of operations conducted in respect to trading (Dom Maklerski PKO Bank Polski SA), investment activities and in result of other operations in the banking activity that generate positions in equity securities.

The aim of equity securities risk management is to reduce possible losses related to changes in prices of equity securities in the public market or exchange market indices through an optimisation of positions in instruments that are sensitive to changes of such market parameters.

Commodity price risk is defined as the risk of incurring losses due to changes in commodity prices, generated by maintaining open positions on particular types of goods.

The aim of commodity price risk management is to reduce potential losses resulting from changes in commodity prices to the acceptable level by influencing the structure of balance sheet and off-balance sheet commodity positions.

Taking account of other price risks, as of the end of 2014 the Bank was exposed to the price risk of participation units in collective investment funds. Influence of this risk to the Bank's financial situation is immaterial – an own funds capital requirement, pursuant to the CRR, to cover the above mentioned risk amounted to approximately PLN 1.5 million at the end of the 2014.

2.6.2. MEASUREMENT AND ASSESSMENT OF PRICE RISK OF EQUITY SECURITIES AND COMMODITY PRICE RISK

The impact of the price risk of equity securities and other price risk on the Bank's financial conditions was defined as insignificant. Positions in equity securities and indexed instruments reduced and their significant increase is not expected.

In 2014 positions in transactions generating commodity price risk were closed as at end of the day.

The Bank Group's banking book equity exposures are qualified into following groups depending on their type and purpose of their acquisition:

1) equity exposures in strategic and financial market infrastructure companies – investments in entities which provide services supplementary to the Bank's basic financial offer (e.g. in terms of insurance), provide support to the Bank and other Group's companies and contribute to the development of financial market (financial market operators included),
2) other exposures – investments which are mostly intended for sale, made by the Bank and its subsidiaries subject to prudential consolidation. This group includes i.a. assets acquired during debt restructuring process,
3) participation units in collective investment undertakings – covering investments of PKO Towarzystwo Funduszy Inwestycyjnych SA in participation units of the new investment funds under its management. Assets are acquired in accordance with the Statutes of PKO TFI SA, with the purpose of providing financing required for establishment of said investment funds.

Table 2.21

CAPITAL EXPOSURES - BANKING BOOK

	The Bank Group	
	2014	
	carrying amount	fair value*
Total	1 281	1 286
Investments valued under the equity method**	793	798
Shares in other entities	169	169
Equity securities	319	319
Shares in entities listed on regular market***	31	31
Shares in entities not listed on regular market****	271	271
Participation units in collective investment undertakings	18	18

* Assessed fair value

** Equity investments in subsidiaries not subject to prudential consolidation, joint-ventures and associated entities

*** Fair value of listed securities equals their balance sheet value

**** This line includes also shares that are not listed on the regular market of public companies

2.6.3. MONITORING OF PRICE RISK OF EQUITY SECURITIES AND COMMODITY PRICE RISK

Stocks and shares in other entities are subject to periodic valuation.

Investments in subsidiaries not subject to prudential consolidation, joint-ventures and associates are valued using equity method.

At the end of each reporting period, an assessment of impairment for investments in subsidiaries not subject to prudential consolidation, joint-ventures and associates is made. If impairment is identified, an assessment is made of the higher of the investment's value in use and fair value less selling expenses (impairment test). The forecast of the value in use is assessed using the discounted cash flow method under the assumption that the stocks or shares will continue to be held. Forecasts concerning cash flows are developed on the basis of financial plans of entities using varied discount rates adjusted to the specific nature of business activity of individual companies.

Additionally, impairment tests are performed at the end of every year regardless of whether impairment conditions exist for those investments.

Stocks and shares in other companies are valued at fair value (market value for those stocks, for which there is an active market, according to an external valuation or based on the purchase price offered) or at acquisition cost reduced by an impairment allowance.

In 2014, the Bank Group realised a cumulative loss on the sale of securities representing banking book equity exposures in the amount of 25.8 million.

The Group's unrealised cumulative loss resulting from revaluation of the banking book equity exposures (shown in the profit and loss account and the revaluation reserve) amounted to 153.8 million as of the end of 2014. The aforementioned value includes unrealised profit of the Group in the amount of PLN 178.5 million related to revaluation to fair value of the purchase price of the shares of one of the companies. In 2014, PKO Polish Bank SA received a dividend related to shares held and shares representing equity exposures in the total gross amount of 44.2 million.

2.6.4. REPORTING PRICE RISK OF EQUITY SECURITIES AND COMMODITY PRICE RISK

The Bank prepares monthly and quarterly reports including price risk of equity securities and commodity prices. The reports contain information on exposure and on the use of these risk limits. The recipients of such reports are mainly ALCO, RC, the Management Board and Supervisory Board.

2.6.5. MANAGEMENT ACTIONS RELATED TO PRICE RISK OF EQUITY SECURITIES AND COMMODITY PRICE RISK

The equity securities risk is managed through limits imposed on the activities of Brokerage House of PKO Bank Polski, monitoring of their use and reporting risk levels.

Commodity price risk is managed by imposing limits on the Treasury Department's activity, monitoring their use and reporting the risk level.

2.7. OPERATIONAL RISK

2.7.1. INTRODUCTION

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events; includes legal risk and does not include reputation risk and business risk.

The purpose of operational risk management is to increase the security of Bank's operational activity through improvement of effective, adjusted to the profile and volume of activity, mechanisms of identification, assessment and measurement, mitigation, as well as monitoring and reporting on operational risk.

Operational risk profile of the Bank and of the Bank Group is defined as the volume and structure of exposure to operational risk, determined by strategic limits for operational risk tolerance.

The Bank's internal regulations clearly define the distribution of duties and competencies in the area of operational risk management. In accordance with these regulations, all issues related to operational risk management are supervised by the Management Board that:

1) sets the objectives of operational risk management,
2) shapes operational risk management policy,
3) adopts resolutions on operational risk management principles, strategic limits for operational risk tolerance and the extensions and changes for the AMA
4) accepts the value of the management adjustment of the own funds requirement for operational risk according to the AMA,
5) accepts reports and information related to operational risk.

The Bank Group entities manage operational risk in accordance with the principles of managing operational risk of the Bank, taking into account the scope and type of connections between entities belonging to the Bank Group as well as the specific nature and scale of activity these entities.

2.7.2. OPERATIONAL RISK MEASUREMENT AND ASSESSMENT

2.7.2.1. Methods of operational risk measurement and assessment

Operational risk measurement in the Bank is aimed to define the scale of threats related to the operational risk by using defined risk measures.

Operational risk measurement includes:

1) calculation of key operational risk indicators (KRI),
2) calculation of own funds requirement for operational risk according to the AMA,
3) stress tests,
4) calculation of internal capital.

For the purpose of operational risk management, the Bank gathers internal and external data on operational events together with causes and results of their occurrence, data on business environment factors, KRI and data on the quality of functional internal control.

Operational risk self-assessment includes identification and assessment of operational risk arising in the products, processes and IT applications of the Bank, as well as resulting from organisational changes. Self-assessment is conducted periodically before the introduction of new or changed products, processes and applications of the Bank by using collected data on operational events and information obtained during the measurement, monitoring, reporting of this risk (including internal audit and audit security reports) or through cooperation with the Bank Group's entities,

The Bank assesses parameters of distributions used for measurement of the operational risk on the basis of internal and external information on operational events. The estimating algorithm of these parameters takes account of existing thresholds of losses for which information on operational events are gathered. The value of a threshold for internal events was established by taking into account the economic costs related to gathering information on operational events and their added-value for operational risk measurement. Used external data on operational events come for instance from the consortium database (called ZORO)maintained by the Polish Bank Association. Moreover, the operational risk measurements include macroeconomic data and data related to the volume of the Bank's operational and business activities.

Own funds requirement for operational risk according to the AMA corresponds to the VaR in respect to operational risk plus the result of scenario analysis and corrected by the value of adjustments related to changes in quality of internal functional audit and management adjustment according to the following formula:

$$AMA = (LDA+SbAMA) * (1+IC) + MA$$

where:

AMA	-	own funds requirement for operational risk according to the AMA,
LDA	-	value at risk,
SbAMA	-	scenario based AMA,
IC	-	adjustment related to changes in quality of internal control,
MA	-	management adjustment.

The AMA captures potentially severe tail events, achieving a soundness standard comparable to a 99,9% confidence interval over a one year period.

Calculations of value at risk are made under a loss distribution approach (LDA) framework. On the basis of historical internal and external information on operational events and about business environment, this approach measures potential loss that is not to be exceeded within coming year.

The purpose of the scenario based AMA is to extend the AMA calculation to capture operational risk related to operational events that have not been covered with the LDA.

Adjustment related to the changes in quality of internal control allows to assess the potential deterioration of the quality of Bank's internal control that would result in an increase of the frequency or severity of operational risk events.

The purpose of management adjustment is to cover the requirement of extraordinary events in the AMA calculation, if due to their specific nature such events were not included into LDA or AMA calculation..

In October 2014 PKO Bank Polski SA received the permission from the PFSA to introduce an extension of the AMA, needed as a result of the business due to the merger with Nordea Bank Polska SA.

Risk measurement includes stress tests referring to potential consequences of extremely unfavourable, yet possible, scenarios. Its aim is to define the sensitivity of the Bank's results to the fulfillment of a test scenario and to determine if the AMA covers the total amount of losses resulting from the accomplishment of such scenarios.

The previous results of stress tests do not challenge the sufficient conservatism of the AMA.

Moreover, the Bank performs backtesting of the AMA calculation. Backtest results confirm the sufficient conservatism of the AMA.

Furthermore, the AMA is validated by an independent organisational unit of the Head Office (Risk Integration Department). The validation is aimed to ensure that the operational risk measurement and management systems in the Bank with their essential components comply with the assumptions. Validation include the verification of accuracy, objectivity, correctness and conservatism of the AMA model applied by the Bank.

2.7.2.2. The Bank's insurance policy

To minimize negative financial impact of operational events, PKO Bank Polski SA has an insurance policy that requires that

a continuing and effective insurance cover is granted in return for an acceptable cost.

PKO Bank Polski SA endeavours to apply uniform insurance principles to the whole Bank Group, in order to optimise the scope of the cover and make use of effects of scale.

The Bank's insurance programme is regularly monitored in order to identify needs of essential changes.

2.7.2.3. Impact of insurance

While calculating the own funds requirement for operational risk, the Bank includes the impact of insurance.

The insurance policies used by the Bank to reduce own funds requirement for operational risk, fulfill the criteria defined in Article 323 of CRR and also comply with internal regulations regarding calculation of own funds requirement reduction due to insurance. The Bank's insurance policies refer mainly to all risk property insurance and the Bank's civil liability insurance.

While calculating deductions related to purchased insurance policies, the Bank takes account of deductibles.

In compliance with Article 323 of CRR the reduction in own funds requirements from the recognition of insurances shall not exceed the maximum value equal to 20% of the own funds requirement for operational risk before the recognition of risk mitigation techniques are taken into account.

2.7.3. Monitoring of operational risk

The purpose of operational risk monitoring is to control operational risk and diagnose areas for management actions.

The Bank regularly monitors in particular:

1) utilisation of strategic limits of risk tolerance and operational risk limits,
2) operational events and their consequences,
3) results of operational risk self - assessment,
4) own funds requirement for operational risk according to the AMA for the Bank and own funds requirement for operational risk according to the BIA (basic indicator approach) for other Group's financial entities,
5) results of stress tests,
6) KRI values against threshold and critical values,
7) efficiency and timeliness of the activities undertaken in relation to operational risk reduction or transfer,
8) management activities undertaken because of increased or high level of operational risk and their effectiveness in reducing the operational risk level.

2.7.4. Operational risk reporting

Reporting on operational risk is carried out for the purpose of:
1) of fulfillment of Bank's internal needs, in particular senior management, ORC, RC, Management Board, Audit Committee of the Supervisory Board and Supervisory Board,
2) regulators.

Reporting for the Bank's internal need, of risk-related information concerning the Bank and the companies of the Group is conducted on monthly and quarterly basis.

The recipients of monthly information are members of the Management Board, the Head Office units and specialised organisational units responsible for systemic operational risk management. Monthly information includes in particular information about:
1) the number and results of operational events,
2) structure of operational events,
3) KRI values.

The recipients of quarterly reports are ORC, RC, Management Board, Audit Committee of the Supervisory Board and Supervisory Board. Quarterly reports contain in particular information on:
1) results of operational risk measurements and monitoring,
2) the Bank's operational risk profile resulting from its process of identification and assessment of threats for products, processes and applications of the Bank,
3) activities undertaken to mitigate the operational risk and assessment of efficiency of activities undertaken in order to reduce the operational risk level,
4) opinions, recommendations and decisions of ORC or the Management Board.

The scope of information varies and is adjusted to the scope of responsibility of individual recipients of the information.

2.7.5. Management actions related to operational risk

Operational risk management process is conducted at the Bank's level as well as at the particular areas of systemic operational risk management.

Systemic operational risk management consists in developing solutions, which enable the Bank to exercise control in order to achieve its objectives. Main areas of systemic operational risk management are:

1) security,
2) IT,
3) settlements,
4) human resources,
5) business processes,
6) administration,
7) support (in particular: insurance management, outsourcing, creation and implementation of internal operational risk models and systems of identification, assessment, monitoring and limiting of operational risk, etc.).

Current operational risk management is carried out by each employee of the Bank in the scope of their duties and obligations and consist in preventing the materialisation of operational events arising in servicing products, conducting processes, using IT applications and reacting on operational events occurrence. Reacting includes:

1) identifying operational events and explaining reasons for their occurrence,
2) defining consequences of operational events,
3) recording data on operational risk events and their consequences,
4) monitoring information on operational events and their consequences,
5) minimizing the negative consequences of operational risk events,
6) implementation of corrective and preventive actions.

A significant role in operational risk management is performed by the Banking Risk Division, which coordinates the identification, measurement, monitoring and reporting of operational risk in the entire Bank Group.

The Risk Integration Department is providing support for the Bank Group entities in the field of operational risk management by supervising them in the process of creation and development

of the risk management system in accordance with the solutions adopted in the Bank.

In 2014 a dominant influence on the operational risk profile of the Bank Group have had PKO Bank Polski SA (including merged Nordea Bank Polska SA), the PKO Leasing SA Group and the KREDOBANK SA Group. Other companies of the Bank Group, due to a considerably lower scale and specific type of their businesses, generate only limited operational risk.

In order to mitigate operational risk exposure of the Bank, various solutions are applied. These include, among other things, the following:

1) control instruments (authorization, internal control, separation of functions),
2) human resources management instruments (personnel selection and recruitment, employee qualifications enhancement systems and incentive systems),
3) threshold and critical values (KRI),
4) strategic operational risk tolerance limits for the Bank and the Bank's Group and loss limits for the Bank,
5) contingency plans,
6) insurance,
7) outsourcing.

Securing and transfer of operational risk include:

1) the use of operational risk management tools, including operational risk limits, KRI, stress tests in order to identify areas which require special attention in terms of the size of the operational risk,
2) taking activities to maintain or reduce the operational risk level of the Bank

Management activities are taken in the following cases:

1) as a response to the initiative of ORC,
2) as a response to the initiative of Bank's organisational units responsible for managing operational risk,
3) when there is high probability that risk will exceed moderate or it already has exceeded theselevels.

In particular, if the operational risk level is considered as increased or high, the Bank uses the following approaches:

1) risk reduction – mitigating impact of risk factors or results of risk materialisation,
2) risk transfer – a transfer of responsibility for coverage of potential losses to an external party,
3) risk avoidance – resignation from a risk generating activity or elimination of a possibility that a risk factor occurs.

Operational risk management process is subject to internal control including the following:

1) reviewing strategy and operational risk management process,
2) self– assessment of compliance with the AMA requirements,
3) validation of the AMA,
4) internal audit.

2.7.6. INCURRED LOSSES AND OPERATIONAL RISK MANAGEMENT ACTIONS

In the 2014 events related to operational risk, excluding losses from credit process, were disclosed in the Bank and amounted to PLN 40,7 mio. (Table 2.27).

Table 2.22

GROSS LOSSES* RELATED TO DISCLOSURED EVENTS
PKO Bank Polski SA
2014

General cathegory	Specific cathegory	Gross losses**
Internal frauds	Non-legitimated activities	1,92
	Thefts and frauds	1,28
Regulations of employment and work safety	Labour issues	2,12
	Work environment safety	3,91
	Diversity and discrimination	0,06
Clients, products and operational practises	Customer service, disclosure of information about clients, responsibilities to clients	0,03
	Improper business or market practises	11,04
Disruptions of bank activity and systems breakdowns	Systems	0,36
Making transactions, providing and managing operational processes	Recording in the system, making, calculating and servicing transactions	2,56
	Monitoring and reporting	0,39
	Inflow and registering clients	0,07
	Managing clients' bank accounts	0,17
	Counterparties who are not Bank's client	0,03
	Sellers and suppliers	0,02
Losses related to fixed assets	Natural disasters and other events	0,91
External frauds	Thefts and frauds	15,83
Total		40,72

* According to the Recommendation M of the Polish Financial Supervision Authority gross losses include realised losses (e.g. provisions, write-downs, expenses) as well as unrealised (potential) losses. Gross losses does not include direct recoveries and recoveries from the risk transfer mechanisms.

** Gross losses as at 10 March 2015, does not include losses from operational risk related to credit risk, which are recognised as losses from credit risk and are used to calculate minimum capital requirements.

In the 2014 the most substantial operational events, not related to credit risk, were disclosed in the following categories:

1) „Clients, products and business practice" – according to the Office of Competition and Consumer Protection, Bank used illegal terms in patterns credit agreements according to consumer credits. appealed against the decision pointing to making appropriate changes in pattern agreements. The proceeding is not legally valid.
2) „Regulations of employment and work safety" – The Bank established a reserve for potential losses related to the necessity of relocation of employees of one of the branches.

The Bank takes systemic and current management actions in order to limit losses from operational risk. Current actions include reacting on identified risks, eliminating irregularities when it is possible as well as recovering financial losses. Systemic actions consist of, among others, securing IT systems, improving processes, optimisation of functional control, staff trainings as well as risk transfer (insurance policies, outsourcing). In particular, the Bank continues to raise the level of security used by the Bank's customers applications, improves the credit processes by centralizing activities related to servicing customers' contracts and improves the security of IT systems in the area of customers' settlements. In order to prevent frauds, on the Bank's main website as well as on the websites to log in are placed announcement warning against false sms and e-mails send by people impersonating the Bank.

2.8. COMPLIANCE RISK

2.8.1. INTRODUCTION

Compliance risk is the risk of incurring legal sanctions or occurrence of financial losses or a loss of reputation or credibility as a result of failure on the part of the Group, the Group's employees or entities operating on its behalf to comply with legal regulations, internal regulations and the standards of procedure adopted by the Bank, the ethical standards included.

The objective of the compliance risk management in Group is to:

1) prevent from the occurrence of cases of improper application of the provisions of the law, internal regulations and standards adopted by the Bank, including ethical standards,
2) prevent from the possibility of losing reputation or reliability as well as incurring financial losses or legal sanctions, which may result from breach of above mentioned regulations and standards of conduct,
3) prevent occurrence of noncompliance events and to establish among shareholders, customers, employees, business partners and other market participants, the Bank's image as an institution acting in accordance with the law and accepted standards of conduct and reliable, fair and honest.

2.8.2. COMPLIANCE RISK IDENTIFICATION AND ASSESSMENT

Identification and assessment of compliance risk includes compliance risk existing in the Bank's internal processes.

Compliance risk assessment includes assessment of acuteness of results of potential materialisation of such risk.

Identification and assessment of compliance risk is performed periodically, but every internal process is assessed at least once a year.

Results of identification and assessment of compliance risk are used for compliance risk monitoring and reporting.

2.8.3. COMPLIANCE RISK MONITORING

Compliance risk is monitored by means of information provided by organisational units of the Bank and the Group companies and it includes in particular:

1) analysis of cases of noncompliance in the Group and the banking industry, their reasons and consequences,
2) assessment of changes of the key legal regulations that have impact on the Bank's and Group's activities,
3) assessment of activities undertaken by the Bank and the Group's companies within the scope of compliance risk management,
4) assessment of efficiency of control mechanisms related to limitation of compliance risk.

2.8.4. COMPLIANCE RISK REPORTING

Reporting information on compliance risk refers to the Bank and the companies of the Bank Group. Quarterly reports contain information provided by the Group companies, also on cases of incompliance. The recipients of such reports are RC, the Management and Supervisory Boards and the Supervisory Board Audit Committee.

The reports contain i.a. synthetic information concerning:

1) results of compliance risk identification and assessment,
2) observed cases of noncompliance,
3) letters of external auditing and regulatory authorities received by the Bank,
4) external audits conducted in the Bank, major activities undertaken within the scope of systemic compliance risk management and fulfillment of recommendations after external audits.

2.8.5. MANAGEMENT ACTIONS RELATED TO COMPLIANCE RISK

Compliance risk management covers specifically the following issues:

1) prevention of the Group's involvement in illegal activities,
2) ensuring data protection,
3) propagation of the ethical standards and monitoring of their functioning,
4) management of conflicts of interests,
5) prevention of situations, in which professional behaviour of the Group employees could seem as care for personal interests,
6) professional, reliable and clear formulation of the product offer and the advertising and marketing messages,
7) immediate, honest and professional consideration of the clients' complaints, applications and suggestions.

In 2014 the Bank Group maintained zero tolerance approach to compliance risk which means that the Bank Group focuses its activities on prevention from compliance risk materialisation.

The Bank gathers data on noncompliance events, their causes and results of their occurrence. Mentioned data are collected in central database. Information about noncompliance events is reported by Bank's organisational units and organisational units of Head Office and individually by particular employees of the Bank. Every report is examined with diligence and due care.

Respective organisational entities or appointed employees of such entities are responsible for establishment of systemic solutions within the scope of compliance of the operations of individual Bank Group's entities with applicable legislations and standards of conduct. The Compliance Department is responsible in the Bank for creation of such solutions and development of compliance risk assessment, monitoring and reporting methods that is independent and in case of issues related to compliance risk management it reports directly to the President of the Management Board.

In all entities of the Bank Group the consistent compliance risk management principles are functioning.

2.9. BUSINESS RISK

2.9.1. INTRODUCTION

Business risk is the risk of losses resulting from unfavourable changes in the business environment, unfavourable decisions, improper implementation of decisions or a failure to take appropriate action in response to changes in the business environment; it specifically includes the strategic risk.

Managing the business risk is aimed at maintaining, on an acceptable level, the potential negative financial consequences resulting from: adverse changes in the business environment, making adverse decisions, improper implementation of adopted decisions or lack of appropriate actions, which would be a response to changes in the business environment.

2.9.2. BUSINESS RISK MEASUREMENT AND ASSESSMENT

Business risk identification is to recognize and determine factors both current and potential, resulting from current and planned activities of the Bank and which may significantly affect the financial position of the Bank, generating or change in the Bank's income and expense. Business risk identification involves identification and analysis of factors, which significantly affected the level of deviation of costs and revenues from their projected values.

The purpose of measurement of business risk is to determine, using existing risk measures, the scale of hazards related to existence of business risk. Business risk is measured quarterly and involves:

1) conducting of stress test,
2) calculation of internal capital.

Assessment of the business risk level is performed quarterly on the basis of:

1) calculated levels of strategic limits of tolerance,
2) results of the annual survey conducted among Bank's senior management,
3) results of internal capital for business risk measurements.

2.9.3. BUSINESS RISK MONITORING

Monitoring of business risk includes in particular:

1) strategic levels of business risk tolerance – on a quarterly basis,
2) stress-tests results – on an annual basis,
3) internal capital level – on a quarterly basis,
4) deviation of business risk realisation from its projected values – on a quarterly basis,
5) results of the annual survey conducted among Bank's senior management.

2.9.4. BUSINESS RISK REPORTING

Business risk reporting of the Group is conducted quarterly. Reports on business risk are prepared for the ALCO, the RC, the Management Board and since first quarter of 2014 also for the Supervisory Board. Reports contain among others information on the internal capital level, stress-tests results, results of an annual survey conducted among senior management of the Bank, utilisation of limits of risk tolerance on business risk, business risk forecast and its backtesting, business risk level, information on business risk related to the Bank Group entities.

2.9.5. BUSINESS RISK RELATED MANAGEMENT ACTIONS

Management activities involve in particular:

1) issuing of internal regulations,
2) determining acceptable risk tolerance levels,
3) verification and updating of quarterly financial forecasts, including efforts to reduce business risk level in line with the approved limits,
4) monitoring of the strategic limit of business risk tolerance.

2.10. LOSS OF REPUTATION RISK

2.10.1. INTRODUCTION

Loss of reputation risk is defined as a risk of reputation loss among customers, counterparties, investors, supervisors and public opinion, due to business decisions, operational events, noncompliance or other events.

The purpose of loss of reputation risk management is to protect the Bank's reputation by reducing the negative impact of brand-related events and preventing reputation losses.

2.10.2. REPUTATION RISK MEASUREMENT AND ASSESSMENT

Identification of loss of reputation risk involves events observed both in internal processes of the Bank and in the external environment, in particular:

1) brand-related events,
2) business environment factors, affecting the loss of reputation risk.

Each identified, negative information related to the Bank is taken into account during the brand-related information gathering process, i.a. in the form of:

1) information broadcasted in the media,
2) information disclosed by the Group according to the principles of information policy of the Bank,
3) evaluations prepared by auditing companies, analytical agencies and external supervisory institutions.

Additionally, identification of loss of reputation risk involves analysis of factors and their sources, related to loss of reputation and which may affect the future loss of reputation risk profile.

2.10.3. REPUTATION RISK MONITORING

Evaluation and monitoring of loss of reputation risk involves:

1) non-financial losses – amount and severity of reputational losses including i.a. the tone and spread of information constituting the brand-related event,
2) financial losses – direct costs related to protective measures taken.

2.10.4. REPUTATION RISK REPORTING

Reporting of information related to loss of reputation risk is done in the form of:

1) semi-annual management report, prepared for the Risk Committee, the Management Board and the Supervisory Board,
2) information related to the current events that significantly affect the Bank's reputation, prepared for the Head of the CEO Division and Chairman of the Board,
3) information disclosed in the financial reports for the Bank and the Group as well as made available on the request of external supervisory institutions.

Semi-annual management report includes in particular information on:

1) scale and profile of the loss of reputation risk for the Bank,
2) most severe reputational losses and protective measures undertaken to protect the Bank's reputation,
3) factors affecting the future profile of loss of reputation risk and their sources.

2.11. MODEL RISK

2.11.1. INTRODUCTION

Model risk is the risk of incurring negative financial or reputation effects as a result of making incorrect business decisions on the basis of the models operating within the Bank. The model risk in the Group is managed both on the level of particular company of the Group (owner of the model) and on the Bank's level, acting as a controlling entity of the Group.

The objective of models management and model risk management is to mitigate the level of model risk in the Group. Companies, whose model risk is deemed as significant, introduce relevant internal regulations and model risk management process, after consultations with the Bank. Solutions used in the Group can be customized to the specifics of individual companies.

In 2014, pursuant to amended model risk management regulations, the scope of models pursuant to independent validation has been extended. The validation unit of the Bank has begun the process of issuing opinions regarding models that have been deemed significant for the Group and are utilised by the Group companies,

2.11.2. MODEL RISK MEASUREMENT AND ASSESSMENT

Identification of model risk in the Bank mainly consists of:

1) gathering information on existing, under development and planned to be build models,
2) cyclical determining the relevance of models,
3) determining potential threats that may occur during the life cycle of the model.

The model risk evaluation is aimed at determining the scale of threats associated with the occurrence of the model risk. Assessment of the risk level is made annually. Ratings are aggregated mainly at the level of the Bank, the individual entity or the Group.

2.11.3. MODEL RISK MONITORING AND REPORTING

The purpose of model risk monitoring is to control model risk and diagnose areas for management actions. Model risk monitoring process contains, in particular: updates on the level of model risk, verification of the status of implementation of the proposed recommendations and the assessment of effectiveness of implementation of the recommendations on mitigation of model risk. The results are cyclically reported to the RC, Management Board and contain a comprehensive assessment of model risk, in particular:

1) information on the level of model risk (solo and consolidated),
2) model risk map,
3) Information on the validation process as well as the status of post-validation recommendations,
4) evaluation of effectiveness of the recommendations made to reduce the model risk level,
5) potential proposed management actions reducing the model risk.

2.11.4. MANAGEMENT ACTIONS CONCERNING MODEL RISK

The purpose of management actions is to form a model risk management process and a level of this risk.

Management actions consist in particular of:

1) issuing internal regulations,
2) determining acceptable risk levels,
3) issuing recommendations,
4) making decisions about the use of tools supporting model risk management.

2.12. MACROECONOMIC RISK

2.12.1. INTRODUCTION

Macroeconomic risk is a risk of deterioration of the Bank's financial situation as a result of the adverse impact of changes in macroeconomic conditions.

The purpose of macroeconomic risk management is to identify macroeconomic factors having a significant impact on the Bank's activities and taking actions to reduce the adverse impact of potential changes in the macroeconomic situation on the financial situation of the Bank.

2.12.2. MACROECONOMIC RISK IDENTIFICATION AND ASSESSMENT

Identification of macroeconomic risk is to determine scenarios of the potential macroeconomic changes and to determine risk factors having the greatest impact on the financial situation of the Bank. Macroeconomic risk results from interaction of factors dependent and independent of the Bank's activities. The Bank identifies the factors affecting the level of macroeconomic risk during carrying out comprehensive stress-tests.

The macroeconomic risk materialises indirectly through other risks affecting the Bank's operations by:

1) credit losses,
2) losses arising from adverse changes in market situation (changes in exchange rates, changes in interest rates),
3) a decrease in the liquidity of the Bank,
4) losses arising from the operational risk realisation,
5) other losses.

For the purpose of measuring the macroeconomic risk the Bank uses risk measures based on the results of comprehensive stress-tests, in particular:

1) financial result and its components,
2) capital adequacy measures and their components,
3) selected liquidity measures.

2.12.3. MACROECONOMIC RISK MONITORING

A process of macroeconomic risk monitoring includes monitoring of:

1) macroeconomics factors to which the Bank is sensitive,
2) changes in the macroeconomic situation,
3) results of stress-tests,
4) level of macroeconomic risk .

2.12.4. MACROECONOMIC RISK REPORTING

Macroeconomic risk reporting is realised in the form of:

1) reports summarizing the results of each stress-tests, presented to ALCO,
2) information on macroeconomic risk described in the „Capital Adequacy in PKO Bank Polski SA" report, related to stress tests which were conducted in a quarter subject to reporting to ALCO, RC, Management Board and Supervisory Board.
3) reports presented to ALCO and prepared in case of elevated or high level of macroeconomic risk : an analysis of reasons which led to an increase in the risk level, assessment of the potential consequences of this situation for the Bank, prediction of possible outcomes, proposals of:
   a. actions aimed at reduction of the risk level,
   b. initial assessment of effectiveness of said actions,
   c. specialised units of the Head Office, specialised units of the Bank or divisions responsible for corrective actions,
   d. deadlines for said actions, together with an assessment of required resources or justification for the lack of necessity for any actions to be taken.

2.12.5. MANAGEMENT ACTIONS CONCERNING MACROECONOMIC RISK

Management actions in particular consist of:

1) issuing internal regulations of the Bank,
2) determining acceptable levels of risk,
3) proposals of actions aimed at reducing the level of risk in the event of elevated or high macroeconomic risk occurrence.

2.13. CAPITAL RISK

Capital risk is defined as the risk of inadequate, and thus insufficient in relation to the scale of PKO Bank Polski SA activities, level and structure of own funds for absorption of unexpected losses (taking into account both development plans and borderline cases).

The purpose of capital risk management is to ensure an adequate level and structure of own funds, in relation to the scale of PKO Bank Polski SA activities and its risk exposure, taking into account the dividend payout policy of the Bank and recommendations from the supervisory institutions, related to capital adequacy.

The level of capital risk for the Bank and the Group is determined on the basis of capital adequacy measures, i.a. total capital ratio and common equity Tier 1 capital ratio. Additional thresholds in the form of a surplus over minimal values constituting strategic tolerance limits for capital adequacy measures are established.

The bank regularly monitors the capital adequacy measures in order to determine the degree of compliance with regulatory norms, internal strategic limits and to identify events requiring utilisation of capital contingency measures.

The level of capital adequacy measures and the level and structure of own funds of the Bank are presented in Chapter 3 'Own Funds' and Chapter 7 'Capital adequacy'.

2.14. INSURANCE RISK MANAGEMENT

Insurance risk means the risk of loss or unfavourable change of value of insurance liabilities due to inadequate assumptions regarding valuation and creation of provisions (technical and settlement reserves in particular).

2.14.1. INSURANCE RISK IDENTIFICATION AND ASSESSMENT

The purpose of insurance risk management is to maintain the level of the insurance risk on acceptable level and to reduce potential losses arising from unfavourable changes of insurance liabilities.

Exposure to insurance risk exists in PKO Życie Towarzystwo Ubezpieczeń SA (PKO Życie) and is related to the following sub-types of risk:

1) mortality,
2) morbidity,
3) contracts withdrawal,
4) cost increase,
5) catastrophic.

Assessment of insurance risk exposures is as follows:

1) mortality and morbidity risk (in a current solvency regime risk of claims) is assessed at a low level due to the small share of insurance policies relating to this risk in the whole Company's insurance portfolio and reinsurance applied,
2) the catastrophic risk is limited by i.a. regional diversity,
3) the contracts withdrawal risk relates primarily to insurance products with Insurance Capital Funds. Based on data from 2014 the level of contracts withdrawal is assessed as stable.

Insurance risk measurement in PKO Życie is carried out as a part of contracts withdrawal analysis, claims analysis, analysis of assets covering technical reserves (APR) and annual analysis of shock scenarios – stress-tests, on the basis of methodology required by the PFSA Office. In preparation for implementation of the new Solvency II system, PKO Życie performs analyses of exposure to insurance risks in the process of Quantitative Impact Studies (QIS) supervised by the PFSA Office.

2.14.2. INSURANCE RISK MONITORING

Test results for insurance risks subject to stress tests are presented below:

Table 2.23

INSURANCE RISK STRESS TESTS RESULTS IN RELATION TO CAPITAL ADEQUACY RATIO

	31.12.2013
Capital adequacy ratio	
prior to stress tests	177%
after stress tests, related to the risk of incurred costs	172%
after stress tests, related to lapse risk	171%

Assets covering technical reserves (APR) were at a sufficient level (above 100%), as well as had the appropriate structure (in line with regulatory requirements). The total reserves cover ratio amounted to 101% at the end of 2014. For insurance products with Insurance Capital Funds and for structured products, which comprise the greater part of the portfolio of PKO Życie, surplus of assets is not required, hence the total level of ratios remains at the level slightly above 100%.

2.14.3. INSURANCE RISK REPORTING

Insurance risk reporting is performed in PKO Życie in the form of monthly report for the Management Board and the quarterly report for the Assets & Liabilities Management Committee and for Risk Committee.

2.14.4. MANAGEMENT ACTIONS COVERING INSURANCE RISK

In order to mitigate the insurance risk exposure, PKO Życie uses among others:

1) reinsurance of risks (mortality, morbidity),
2) grace periods,
3) exemptions,
4) retention activities.

Passive reinsurance of PKO Życie is performed on the basis of:

1) obligatory-facultative, quota share - surplus treaties, on the basis of risk-premium,
2) facultative reinsurance agreements, on the basis of risk–premium,
3) obligatory, proportional reinsurance agreements, on the basis of risk–premium.

Facultative reinsurance is applied for all insurance agreements and risks not covered by obligatory – facultative reinsurance agreements, in which the sum on the gross risk exceeds agreed amount.

In case of the new products and the risks, PKO Życie choses reinsurer, level of protection, conditions of the reinsurance, changes in concluded reinsurance contracts and concluding new reinsurance contracts in relation to the newly introduced to offer or modified insurance products and new risks.

2.15. COMPLEX STRESS – TESTS

Complex stress-tests are an integral part of the PKO Bank Polski SA Group's risk management and are complementary for stress-test-specific to particular types of risks.

Complex stress-tests collectively include the following risks considered to be relevant by the Bank, including:

1) credit risk,
2) market risk,
3) liquidity risk,
4) operational risk,
5) business risk.

Complex stress-tests include an analysis of the impact of changes in the environment and the functioning of the Bank on the financial position of the PKO Bank Polski SA Group, in particular on:

1) income statement,
2) statement of financial position,
3) own funds,
4) the capital adequacy, including capital requirements, internal capital, measures of capital adequacy,
5) selected liquidity measures.

Complex stress-tests for the own use of the Group are carried out at least once a year in the three-year horizon for the Group and at least twice a year in the three-year horizon for the Bank, taking into account changes in the value and structure of the statement of financial position and income statement items (dynamic tests). Supervisory tests are carried out at the request of the supervisory authorities in accordance with the assumptions provided by supervisory authorities.

3. Own funds

For the purpose of capital adequacy, own funds are calculated according to the regulations of the Banking Law and Part Two of the CRR together with executive acts related to the CRR.

Own funds of the Group include Common Equity Tier 1 capital and Tier 2 capital. No items classified as Additional Tier 1 capital are identified in the Group.

Included in the Common Equity Tier 1 capital are the following:

1) share capital – presented according to the Bank's Statutes and entry in the Trade Registry, at nominal value,
2) supplementary capital – established from the annual net profits, assigned to absorb balance sheet losses that may arise within the Bank's activities,
3) other reserve capital – established independently from the supplementary capital, created from the annual net profits in the amount defined by the General Meeting (hereinafter referred to as "GM"), assigned to absorb balance sheet losses exclusively,
4) other accumulated total income (except for profits and losses related to cash flow), with the unrealised profits and losses on instruments classified as AFS (available for sale) recognized under the transition period (until the end of 2017) in the amount accepted by the PFSA,
5) general banking risk reserve created from the annual net profits in the amount defined by the GM, assigned to absorb unidentified losses may arise within the Bank's activities,
6) retained earnings,
7) net financial result prior to approval and net result for the current reporting period – calculated based on applicable accounting standards, decreased by any expected charges and dividends, in amounts not exceeding amounts audited by a certified public accountant; net financial result can be included in own funds under the condition of GM's approval or, prior to the aforementioned approval, consent of the PSFA.

Common Equity Tier 1 capital is reduced by the following items:

1) losses for the current financial year,
2) intangible assets valued at their carrying amount, after deduction of the related provisions for deferred tax. The deducted amount includes goodwill included in the valuation of significant investments,
3) additional adjustments for assets valued at their fair value, subject to requirements for prudent valuation, which are deducted from Common Equity Tier 1 capital,
4) deferred tax assets related to future profitability, not resulting from temporary differences,
5) deferred tax assets related to future profitability arising from temporary differences, not exceeding 10% of Common Equity Tier 1 capital (after deductions described in p. 1-4 and 6),
6) direct and indirect equity exposures of the Bank in financial sector entities in which it doesn't have any significant investments, in the form of shares or other instruments of Common Equity Tier 1 or Tier 2 capital of said entities, not exceeding 10% of Common Equity Tier 1 capital of the Bank (after deductions described in p. 1-4),
7) direct and indirect capital exposure in financial sector entities in which the institution has significant investments, in the form of shares or other instruments of Common Equity Tier 1 of said entities, exceeding 10% of Common Equity Tier 1 capital of the institution (after deductions described in p. 1-4 and 6),
8) amount by which the sum of:
    a. deferred tax assets related to future profitability arising from temporary differences, not exceeding 10% of Common Equity Tier 1 capital (after deductions described in p. 1-4 and 6) and
    b. direct and indirect capital exposure in financial sector entities in which the institution has significant investments, in the form of shares or other instruments of Common Equity Tier 1 of said entities, not exceeding 10% of Common Equity Tier 1 capital of the institution (after deductions described in p. 1-4 and 6),

   exceeds 17.65% of Common Equity Tier 1 capital of the institution (after deductions described in p. 1-6). The amount below the aforementioned threshold is included in risk weighted exposures,
9) during the transitional period described in the CRR (end of 2017), Common Equity Tier 1 capital is reduced by the amount, by which the sum of:
    a. deferred tax assets related to future profitability arising from temporary differences, not exceeding 10% of Common Equity Tier 1 capital (after deductions described in p. 1-4 and 6) and,
    b. direct and indirect capital exposure in financial sector entities in which the institution has significant investments, in the form of shares or other instruments of Common Equity Tier 1 of said entities, not exceeding 10% of Common Equity Tier 1 capital of the institution (after deductions described in p. 1-4 and 6),

   exceeds 15% of Common Equity Tier 1 Capital of the institution. The amount below the aforementioned threshold is included in risk weighted exposures.

The Tier 2 capital comprises subordinated liabilities i.e. funds acquired by the Bank - in the amount and based on the consent of the PFSA issued in response to the Bank's request – conforming to the principles laid out in par. 127.3 p. 2.b of the Banking Law and conforming to the CRR.

The Tier 2 capital is reduced by the following items:

1) direct and indirect capital exposure in financial sector entities in which the institution has significant investments, in the form of instruments of Tier 2 capital of said entities,
2) direct and indirect capital exposure in financial sector entities in which the institution doesn't have any significant investments, in the form of shares or other instruments of Tier 2 capital of said entities,
3) if the deductions described in points 1 and 2 above would result in a negative value of Tier 2 capital, the remaining value of said deductions is used to reduce Common Equity Tier 1 capital.

By way of derogation, during the transitional period described in the CRR, the residual amounts specified by the PFSA are deducted from the Common Equity Tier 1 and Tier 2 capital on the 50/50 basis.

Conforming to the Executive Order 1423/2014, the Table 3.1 presents information on the outline of differences regarding consolidation for accounting purposes and prudential regulations as at 31 December 2014.

Table 3.1

	Reconciliation of items of own funds and equity reported in the audited financial report				
	The Bank Group				
	2014				
	IFRS compliant financial report	De-consolidation of entities not subject to prudential consolidation	Prudential consolidation / CRR compliant financial report	items not recognized in the regulatory own funds	items recognized in the regulatory own funds
ASSETS					
Intangible assets	3 380	181	3 199	263	**2 936**
LIABILITIES					
Subordinated liabilities	2 414	0	2 414	19	**2 395**
KAPITAŁY					
Share capital	1 250	0	1 250	0	**1 250**
Supplementary capital	18 802	99	18 704	0	**18 704**
Other reserves	3 474	51	3 423	0	**3 423**
General banking risk reserve	1 070	0	1 070	0	**1 070**
Other income	-164	8	-172	118	**-290**
revaluation capital related to assets avalable for sale	31	0	31	113	**-82**
revaluation capital related to cash flow hedging instruments	5	0	5	5	**0**
exchange differences	-193	8	-201	0	**-201**
actuarial gains / losses	-9	0	-9	0	**-9**
share in other comprehensive income of an associated entity	1	0	1	0	**1**
Net profit for the current period	3 254	46	3 208	2 204	**1 004**
Previous years' result	-61	-232	171	0	**171**
Total own funds	**27 626**	**-28**	**27 654**	**2 322**	**25 332**
ADDITIONAL DEDUCTIONS					**0**
Additional adjustments of assets measured at fair value					**-36**
Deferred tax assets reliant on future profitability excluding those arising from temporary differences					**-12**
OWN FUNDS TOTAL USED FOR CALCULATION OF CAPITAL ADEQUACY RATIO					**24 743**

Conforming to the Executive Order 1423/2014, the Table 3.2 presents information on the type and value of key items of own funds utilised in the calculation of Total Capital Ratio as at 31 December 2014.

Table 3.2

Own funds used for calculation of capital adequacy ratio (consolidated basis)

	Common Equity Tier 1 capital: instruments and reserves	The Bank Group AMOUNT AS OF DISCLOSURE DATE
	Capital instruments and the related share premium accounts	1 250,0
	of which: A-SERIES REGISTERED SHARES	312,5
	of which: A-SERIES COMMON BEARER SHARES	197,5
	of which: B-SERIES COMMON BEARER SHARES	105,0
	of which: C-SERIES COMMON BEARER SHARES	385,0
	of which: D-SERIES COMMON BEARER SHARES	250,0
2	Retained earnings	1 175,7
3	Accumulated other comprehensive income	21 954,2
3a	Funds for general banking risk	1 070,0
6	Common Equity Tier 1 prior to regulatory adjustments	25 449,9
	Common Equity Tier 1 capital: regulatory adjustments	
7	Additional value adjustment (negative value)	-35,7
8	Intangible assets (net of related deferred tax liabilities) (negative value)	-2 936,0
10	Deferred tax assets reliant on future profitability excluding those arising from temporary differences (net of related income tax liabilities providing the conditions in Article 38 (3) are met) (negative value)	-11,6
11	Fair value reserves related to gains or losses resulting from cash flow headging instruments	-5,2
26	Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment	-113,0
26a	Regulatory adjustments relating to unrealised gains and losses pursuant to Article 467 and 468	-81,6
	of which: ...filter for unrealized losses 1 (*debt*)	-48,3
	of which: ...filter for unrealized losses 2 (*equity*)	-33,3
28	**Total regulatory adjustments to Common equity Tier 1**	-3 101,4
29	**Common Equity Tier 1 capital**	22 348,5
45	**Tier 1 capital (Tier 1 = Common Equity Tier 1 + Additional Tier 1 capital)**	22 348,5
	Tier II capital: instruments and provisions	
46	Capital instruments and the related share premium accounts	2 394,7
51	**Tier 2 capital before regulatory adjustments**	2 394,7
58	**Tier 2 capital**	2 394,7
59	**Total capital (Tier 1 + Tier 2 capital)**	24 743,2
60	**Total risk weighted assets**	190 870,0
	Capital ratios and buffers	
61	**Common Equity Tier 1 (as a percentage of risk weighted assets)**	11,71%
62	**Tier 1 (as a percentage of risk weighted assets)**	11,71%
63	**Total capital (as a percentage of risk weighted assets)**	12,96%

As at 31 December 2014, conforming to par. 48 of the CRR, capital exposure in financial sector entities didn't exceed 10% of Common Equity Tier 1 capital, and therefore do not constitute an impairment to own funds of the Bank and the Group and have been included in risk weighted assets.

The main features of instruments issued by the Bank and included in the Common Equity Tier 1 and instruments of Tier 2 capital are presented in Table 3.3.

Table 3.3

Capital instruments' main features (PLN)

	Capital instruments	I	II	III	IV	V	VI	VII
1	Issuer	PKO BP	PKO BP	PKO BP	PKO BP	PKO BP	PKO BP	Nordea AB
2	Unique identifier (eg. CUSIP or Bloomberg identifier for private placement)	PLPKO0000016	PLPKO0000016	PLPKO0000016	PLPKO0000016	PLPKO0000016	PLPKO0000081	
3	Governing law(s) of the instrument	Polish law	Polish law	Polish law	Polish law	Polish law	Polish law	Polish law
4	Transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Common Equity Tier 1	Common Equity Tier 1	Common Equity Tier 1	Tier 2	Tier 2
5	Post-transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Common Equity Tier 1	Common Equity Tier 1	Common Equity Tier 1	Tier 2	Tier 2
6	Eligible at solo/(sub-)consolidated / solo and (sub-)consolidated	Solo and consolidated	Solo and consolidated	Solo and consolidated	Solo and consolidated	Solo and consolidated	Solo and consolidated	Solo and consolidated
7	Instrument type (types to be specified by each jurisdiction)	common stock	common stock	common stock	common stock	common stock	bonds	subordinated debt
8	Amount recognised in regulatory capital (PLN, as of most recent reporting date)	312 500 000	197 500 000	105 000 000	385 000 000	250 000 000	1 600 700 000	794 012 800
9	Nominal amount of instrument	312 500 000	197 500 000	105 000 000	385 000 000	250 000 000	1 600 700 000	780 013 000 PLN 224 000 000 CHF
9a	Issue price	312 500 000	197 500 000	105 000 000	385 000 000	250 000 000	-	-
12	Perpetual or dated	perpetual	perpetual	perpetual	perpetual	perpetual	dated	dated
13	Original maturity date	no maturity	no maturity	no maturity	no maturity	no maturity	14.09.2022	24.04.2022
17	Fixed or floating dividend / coupon	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating coupon	Floating coupon
30	Write-down features	No	No	No	No	No	No	No
36	Non-compliant transitional features	No	No	No	No	No	No	No

At 30 June 2014 the profit of the Bank for 2013 (PLN 2,025.0 million), after deductions related to approved dividend payments, has been included in the own funds of the Bank calculated for capital adequacy purposes. The net profit has been presented in supplementary and reserve capital of the Bank (Table 3.1 "other reserves"), pursuant to Resolution 7/2014 of the General Meeting of Powszechna Kasa Oszczędności Bank Polski SA of 26 June 2014, regarding distribution of profits of PKO Bank Polski SA for year 2013 and settlement of remaining uncovered loss from previous years.

At 31 December 2014 the net profit of the Bank for the period from 1 January 2014 to 30 June 2014 (PLN 1,004.3 million), after deductions related to expected deductions and approved dividend payments, has been included in the own funds of the Group, based on the decision of the PFSA from 29 September 2014. Aforementioned profit has been included in the Common Equity Tier 1 capital.

Moreover, on the 26 March 2015, the Bank received the approval of the PFSA for inclusion of part of the profit for the period from 1 July 2014 to 30 September 2014 (PLN 439.1 million) to own funds.

4. OWN FUNDS REQUIREMENTS

Pursuant to the CRR, the Group calculates own funds requirement for the following types of risk:

1) the credit risk – using the standardized approach,
2) the operational risk – using the Advanced Method Approach (AMA) for the Bank and Basic Indicator Approach (BIA) for the Group companies conducting financial activities,
3) the market risk – using the basic methods.

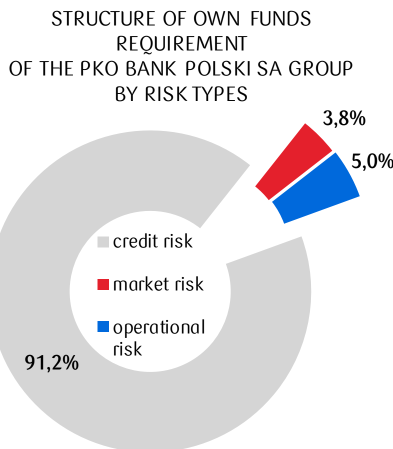
Information on the structure of own funds requirements of the Bank and the Group is presented in Table 4.1.

Table 4.1

	Grupa Kapitałowa	Bank
	2014	2014
Total own funds requirement	15 270	14 891
Credit risk	13 883	13 590
Settlement / delivery risk	0	0
Market risk	585	602
Risk related to credit valuation adjustment	42	42
Operational risk	759	655

As at 31 December 2014, the biggest part of the Group's total own funds requirements was the own funds requirement for credit risk (91.2%) – Chart 4.1. Credit risk showed on the chart includes risk of credit valuation adjustment. Settlement risk is presented as part of market risk.

Chart 4.1



As at 31 December 2014:

1) own funds requirement for credit risk and counterparty credit risk was calculated under the standardized approach (pertaining to the CRR, Part III, Title II, Chapters 2 and 6),
2) own funds requirement for market risk (including foreign exchange risk, commodities risk, equity risk, specific risk of debt securities, general risk of debt securities) was calculated under the basic methods, pursuant to the CRR, Part III, Title IV, Chapters 2-4),
3) own funds requirement for credit valuation adjustments of derivatives (pursuant to the CRR, Part III, Title VI),
4) own funds requirement for operational risk is calculated using AMA for the Bank and BIA for the Group companies, pursuant to the CRR, Part III, Chapter III,
5) own funds requirement for:
    a) the settlement and delivery risk was calculated according to the CRR, Part III, Title V
    b) the risk of exceeding the significant investments limit – was calculated according to the CRR (par. 395 – 401).

Total own funds requirement for the Group comprises capital requirements for:

1) credit risk, including credit risk for banking book instruments, counterparty credit risk,
2) market risk,
3) credit value adjustment (CVA) risk,
4) settlement and delivery risk,
5) operational risk,
6) risk of exceeding the limit for significant investments,

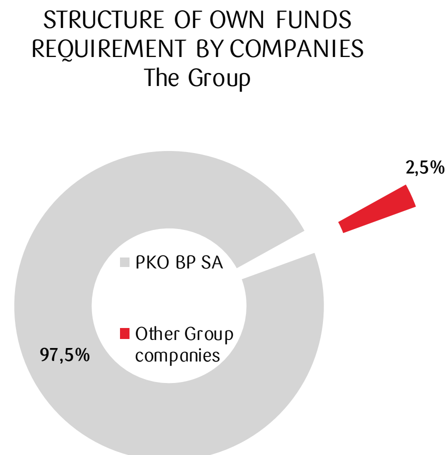
Increased value of the credit portfolio and acquisition of portfolio of Nordea Bank Polska SA resulted in an increase of own funds requirement by ca. PLN 2,288.8 million in comparison to 2013.

The increase of own funds requirement for market risk by ca. 78.8% (up to PLN 585.3 million) in comparison to 2013 results primarily from acquisition of corporate bonds portfolio and exposures tied to corporate bonds underwriting of the Nordea Bank Polska SA portfolio.

The increase of own funds requirement for operational risk for the Group by ca. 20.3% results from the merger of the Bank and Nordea Bank Polska SA.

Own funds requirement for the Bank constitutes a significant part (97.5%) of the total own funds requirement for the Group (Chart 4.2).

Chart 4.2



4.1. Credit risk

The own funds requirement for credit risk and the counterparty credit risk as at 31 December 2014 is shown (by exposure classes) in Table 4.2.

Table 4.2

STRUCTURE OF OWN FUNDS REQUIREMENT FOR CREDIT RISK

The Bank Group

2014

TOTAL	13 883	100,0%
Exposures to central governments or central banks	219	1,6%
Exposures to regional governments or local authorities	172	1,2%
Exposures to public sector entities	14	0,1%
Exposures to multilateral development banks	0	0,0%
Exposures to international organisations	0	0,0%
Exposures to institutions	158	1,1%
Exposures to corporates	4 414	31,8%
Retail exposures	4 446	32,0%
Exposures secured by mortgages on immovable property	3 083	22,2%
Exposures in default	824	5,9%
Exposures associated with particularly high risk	60	0,4%
Exposures in the form of covered bonds	0	0,0%
Exposures to institutions and corporates with a short-term credit assessment	0	0,0%
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	1	0,0%
Equity exposures	199	1,4%
Other items	293	2,1%
Items representing securitisation positions	0	0,0%

The Group is obliged to maintain the highest own funds requirement for the risk related to corporate exposures (31.8%), retail exposures (32.0%) and exposures secured on real property (22.2%), which results from the Bank's high exposure to such types of segments.

The value of exposures secured with collateral types, which permit a reduction of the own funds requirement, amounted to PLN 5,164.8 million as at 31 December 2014 (Tables 4.3 and 4.4).

Table 4.3

EXPOSURES COLLATERALISED WITH GUARANTEES

The Bank Group

2014

TOTAL	3 546
Exposures to central governments or central banks	0
Exposures to regional governments or local authorities	0
Exposures to public sector entities	343
Exposures to multilateral development banks	0
Exposures to international organisations	0
Exposures to institutions	0
Exposures to corporates	1 493
Retail exposures	1 400
Exposures secured by mortgages on immovable property	102
Exposures in default	209
Exposures associated with particularly high risk	0
Exposures in the form of covered bonds	0
Exposures to institutions and corporates with a short-term credit assessment	0
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	0
Equity exposures	0
Other items	0
Items representing securitisation positions	0

Table 4.4

EXPOSURES COLLATERALISED WITH RECOGNIZED FINANCIAL COLLATERAL

The Bank Group

2014

TOTAL	1 620
Exposures to central governments or central banks	0
Exposures to regional governments or local authorities	0
Exposures to public sector entities	0
Exposures to multilateral development banks	0
Exposures to international organisations	0
Exposures to institutions	0
Exposures to corporates	998
Retail exposures	50
Exposures secured by mortgages on immovable property	27
Exposures in default	545
Exposures associated with particularly high risk	0
Exposures in the form of covered bonds	0
Exposures to institutions and corporates with a short-term credit assessment	0
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	0
Equity exposures	0
Other items	0
Items representing securitisation positions	0

As part of the credit risk mitigation techniques, the Bank uses guarantees and financial collateral as funded credit protection (mainly registered pledges on securities, irrevocably blocked funds on a bank account or a deposit account at the Bank or payment of cash to the account of the Bank). The Bank applies the Financial Collateral Comprehensive Method, which makes use of collateral haircuts. Apart from financial collateral and guarantees, the Bank uses mortgages to classify its exposures as belonging to the class of exposures secured by mortgages on immovable property.

The Bank did not securitize its assets, it did however conduct package sales of on- and off-balance sheet receivables in 2014:

1) in the first quarter, over 10 thousand retail loans classified as 'loss' in relation to individuals who do not conduct business activities (credit card loans included), with a total debt of PLN 191.6 million, EUR 0.5 million and CHF 10.7 million, over 890 corporate loans classified as 'loss' with a total debt of PLN 107.9 million, EUR 0.03 million and CHF 0.4 million;
2) in the second quarter 182 mortgage-secured retail loans, classified as 'loss' in relation to individuals who do not conduct business activities with a total debt of PLN 26.7 million, EUR 0.2 million and CHF 4.7 million and close to 830 corporate loans classified as 'loss' with a total debt of PLN 80.2 million, EUR 0.1 million, CHF 0.1 million and USD 0.6 thousand as well as 83 loans from institutional clients classified as 'loss', with a total debt of PLN 80.2 million and CHF 0.6 million,
3) in the third quarter nearly 7.2 thousand retail loans classified as 'loss' in relation to individuals who do not conduct business activities, with a total debt of PLN 159 million, EUR 0.04 million, CHF 4.8 million and USD 0.3 million;
4) in the fourth quarter, over 10.5 thousand retail loans (including credit cards loans) classified as 'loss' in relation to individuals who do not conduct business activities, with a total debt of PLN 146.8 million, EUR 0.1 million, CHF 3.8 million and USD 0.4 million over 1.1 thousand corporate loans classified as 'loss' with a total debt of PLN 224 million,

EUR 0.1 thousand, CHF 3.1 million and USD 0.2 thousand and 54 loans from institutional clients classified as 'loss', with a total debt of PLN 115.5 million and USD 2.2 million.

The total carrying value of provisions for potential claims from the sale of receivables amounted to PLN 1.8 million as at 31 December 2014 (in comparison to PLN 2.1 million as at 31 December 2013). As a result of the sale of receivables, all the risks and benefits have been transferred, and as a result, the Group ceased to recognize the related assets. The Bank did not receive any securities related to the aforementioned transactions.

The tables below (4.5 and 4.6) show the value of exposures (before and after the application of the credit risk mitigation techniques) by exposure classes and the counterparty credit quality rating as at 31 December 2014. Over 86.1% of the exposures lack the credit quality rating. This results from the small number of entities operating on the Polish market that have not been awarded the creditworthiness rating by recognized rating agencies. The exposures that involve the credit quality rating are mainly: securities of and receivables to the State Treasury of Poland and the National Bank of Poland as well as transactions with other banks.

Table 4.5

VALUE OF EXPOSURES* BEFORE APPLICATION OF THE CREDIT RISK MITIGATION TECHNIQUES

The Bank Group

2014

	Counterparty's credit quality rating							Other Group companies	Adjustments and exclusions	Total
	1	2	3	4	5	6	none			
Exposures to central governments or central banks	0	33 377	0	0	0	0	1 049	394	6	34 826
Exposures to regional governments or local authorities	0	71	661	0	0	0	9 218	75	0	10 025
Exposures to public sector entities	0	0	0	0	0	0	641	0	0	641
Exposures to multilateral development banks	0	0	0	0	0	0	0	0	0	0
Exposures to international organisations	0	0	0	0	0	0	0	0	0	0
Exposures to institutions	876	1 826	669	76	0	289	2 353	12 968	-13 177	5 878
Exposures to corporates	0	7	2 189	0	0	0	56 057	5 538	-4 599	59 193
Retail exposures	0	0	0	0	0	0	76 160	261	0	76 421
Exposures secured by mortgages on immovable property	0	0	0	0	0	0	44 272	59	-8	44 322
Exposures in default	0	0	0	0	0	0	8 689	184	-74	8 799
Exposures associated with particularly high risk	0	0	0	0	0	0	443	14	39	496
Exposures in the form of covered bonds	0	0	0	0	0	0	0	0	0	0
Items representing securitisation positions	0	0	0	0	0	0	0	0	0	0
Exposures to institutions and corporates with a short-term credit assessment	0	0	0	0	0	0	0	0	0	0
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	0	0	0	0	0	0	0	18	0	18
Equity exposures	0	0	0	0	0	0	1 802	408	-1 050	1 160
Other items	0	0	0	0	0	0	15 704	656	77	16 437
Total	876	35 281	3 519	76	0	289	216 386	20 574	-18 784	258 216

* The value of balance sheet exposures and balance sheet equivalent of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques.

Table 4.6

VALUE OF EXPOSURES* AFTER APPLICATION OF THE CREDIT RISK MITIGATION TECHNIQUES

The Bank Group

2014

	PKO Bank Polski SA							Other Group companies	Adjustments and exclusions	Total
	Counterparty's credit quality rating									
	1	2	3	4	5	6	none			
Exposures to central governments or central banks	0	33 377	0	0	0	0	3 831	394	6	37 608
Exposures to regional governments or local authorities	0	71	661	0	0	0	9 756	75	0	10 563
Exposures to public sector entities	0	0	0	0	0	0	298	0	0	298
Exposures to multilateral development banks	0	0	0	0	0	0	0	0	0	0
Exposures to international organisations	0	0	0	0	0	0	0	0	0	0
Exposures to institutions	876	1 826	669	76	0	289	1 782	12 968	-13 177	5 308
Exposures to corporates	0	7	2 189	0	0	0	53 999	5 392	-4 599	56 989
Retail exposures	0	0	0	0	0	0	74 833	257	0	75 090
Exposures secured by mortgages on immovable property	0	0	0	0	0	0	44 148	59	-8	44 198
Exposures in default	0	0	0	0	0	0	8 167	175	-74	8 268
Exposures associated with particularly high risk	0	0	0	0	0	0	443	14	39	496
Exposures in the form of covered bonds	0	0	0	0	0	0	0	0	0	0
Items representing securitisation positions	0	0	0	0	0	0	0	0	0	0
Exposures to institutions and corporates with a short-term credit assessment	0	0	0	0	0	0	0	0	0	0
Exposures in the form of units or shares in collective investment undertakings ('CIUs')	0	0	0	0	0	0	0	18	0	18
Equity exposures	0	0	0	0	0	0	1 802	408	-1 050	1 160
Other items	0	0	0	0	0	0	15 704	656	77	16 437
Total	876	35 281	3 519	76	0	289	214 763	20 415	-18 784	256 433

* The value of balance sheet exposures and balance sheet equivalent of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques.

Within the calculation of its own funds requirements, the Bank uses the credit assessments assigned by the following external credit assessment institutions (rating agencies):

1) Moody's Investors Service,
2) Standard and Poor's Ratings Services,
3) Fitch Ratings.

The Bank implemented the process of carrying the issuer's and issue's rating to off-trading book items for the purposes of calculation of the own funds requirements functions in accordance with the CRR, Part III, Title II, Chapter 2. Pursuant to the CRR (par. 295-298) contractual netting is used by the Bank during the calculation of the capital requirement from counterparty credit risk.

4.2. MARKET RISK

The market risk of the Bank Group is determined primarily by the Bank. The Group's own funds requirement for its market risk is calculated in accordance with the CRR. To calculate the own funds requirement for FX risk and specific risk of debt instruments, the Bank uses basic methods. To calculate the own funds requirement for the commodities risk and risk of equity instruments the Bank uses simplified methods. To calculate the own funds requirements for debt instruments, the Bank uses the duration method.

The largest share in the value of requirement for market risk in the Group for 2014 was related to the specific risk of debt instruments (approx. 74.8%), which results from growth of liabilities for underwriting of the corporate bonds. Another type of capital requirement that is significant in terms of value is the own funds requirement for the general debt instruments risk (approx. 24.9%) (table 4.7).

Table 4.7

OWN FUNDS REQUIREMENT FOR MARKET RISK
2014

	the Group	Bank
Specific risk related to debt instuments	438	453
General risk related to debt instruments	146	148
General risk related to capital securities	0	0
Specific risk related to capital securities	0	0
Position risk related to exposures in CIUs	1	1
Total	585	602

The own funds requirement for FX risk was zero due to the fact that the total currency position did not exceed 2% of the Bank's own funds. As at the end of 2014 the Bank did not have an open position for commodity price risk, so the respective own funds requirement was zero.

4.3. OPERATIONAL RISK

Having obtained approval from PFSA to use the advanced approach to calculate own funds requirement for operational risk, since 31 December 2012 the Bank calculates the requirement under a AMA framework.. In October 2014, the Bank obtained approval from PFSA for a significant increase of scope of the advanced method approach (AMA), used in the calculation of own funds requirement, by including the additional activities resulting from the merger with Nordea Bank Polska SA. In case of the Group's financial companies, the basic index approach (BIA) applies.

The value of the Group's capital requirement for operational risk was ca. PLN 759.2 million (including PLN 655.4 million of the own funds requirement for the Bank's operational risk). As compared to 2013 this amount was higher by ca. PLN 28.3 million for the Group, mainly due to the merger of the Bank with Nordea Bank Polska SA.

Table 4.8

CAPITAL REQUIREMENT
FOR OPERATIONAL RISK
2014

	Bank	Companies	Group
Total	655	104	759
Basic Index Approach - BIA	0	104	104
Advanced approach - AMA	655	0	655

5. UNENCUMBERED ASSETS

Information regarding unencumbered assets of the Group can be found in the table below. Respective assets are considered encumbered, if they have been pledged or are subject to any form of agreement aimed at securing or increasing a credit rating of any on- or off-balance sheet transaction, and cannot be freely withdrawn (for instance to be pledged for financing purposes).

Table 5.1

ENCUMBERED AND UNENCUMBERED ASSESTS

	2014 The Bank Group			
	Balance amount of encumbered assets	Fair value of encumbered assets	Balance amount of unencumbered assets	Fair value of unencumbered assets
Total	15 643	-	231 685	-
Capital instruments	0	0	328	308
Debt securities	2 258	2 258	40 078	34 873
Other assets	13 385	-	191 279	-

6. INTERNAL CAPITAL (PILLAR II)

The Group determines the internal capital in compliance with the CRR, CRD IV and the PFSA's Resolution no 258/2011 of 4 October 2011 on detailed principles of operation of the risk management system and internal audit system and detailed conditions of internal capital estimation by banks, and reviews of the process of internal capital estimation and maintenance and the principles for determining the variable salary components policy for persons holding managerial positions in the Bank.

Internal capital is the amount of capital that is required to cover all identified significant types of risk present in the business activity of the Group and the effect of changes in the business environment, taken into account the anticipated risk level.

The purpose of internal capital assessment is to define the minimum level of own funds ensuring the safety of operations, taking account of changes in the profile and volume of conducted activities and unfavourable stress conditions.

The internal capital of the Bank Group in 2014 was estimated to cover each significant risk type:

1) credit risk, including default risk, concentration risk and dilution risk,
2) FX risk,
3) interest rate risk,
4) liquidity risk,
5) operational risk,
6) business risk (including strategic risk).

Materialisation of macroeconomic risk, model risk, compliance risk and loss of reputation risk is reflected in the estimates of internal capital for covering the types of risk: credit, interest rate, currency, operational and business.

The Bank monitors on a cyclical basis the significance of individual types of risk related to the business activity of the Bank and the Bank Group entities.

The total internal capital of the Bank Group is the sum of internal capital required to cover all significant risk types that occur in the companies of the Bank Group. A conservative approach to risk aggregation is adopted and the diversification effect is not used.

The amount of internal capital for credit default risk is determined for exposures subject to credit risk at the level of unexpected loss for the portfolio of exposures, covered by the portfolio risk measures and is calculated pertaining to the VaR model. The unexpected credit loss (UL) is the difference between the credit value at risk (CVaR) and the amount of the expected loss (EL). For credit portfolios not covered by the portfolio risk measures, it is assumed that internal capital for credit risk equals own funds requirement for credit risk, calculated under the approaches defined in the CRR and CRD IV.

The internal capital to cover the credit risk of concentration is determined as the product of:

1) the multipliers of the internal capital surcharge for each material risk concentration type and
2) the internal capital to cover the credit default risk.

The value of exposure to a counterparty being a financial institution, sovereign or a central bank is determined on the basis of the balance sheet equivalent of an on- or off-balance sheet transaction. Depending on its rating, the exposure is given a credit quality step and appropriate risk weight calculated on the basis of internal methods.

Internal capital for credit dilution risk is equal to the internal capital charge for clients affected by the dilution risk, divided by internal capital for credit default risk. Value of the internal capital charge is calculated on the basis of loan portfolio's rating of the dilution risk affected client.

To calculate the internal capital for interest rate risk and FX risk, the Bank uses the VaR methodology, taken into account the results of stress tests.

The internal capital to cover the liquidity risk comprises the total estimated cost of an accelerated sale of securities covering the stress-test related outflow of funds and the cost of acquisition of additional financing for intangible assets necessary to meet the required level of intangible assets.

The internal capital for the Bank's operational risk is equal to the Bank's capital requirement fr operational risk calculated using AMA. The internal capital for the operational risk of the Group entities is adopted as follows:

1) for the Bank Group financial entities – as the additional own funds requirement for operational risk, calculated under the basic indicator approach,
2) for the Group entities not engaged in financial operations – as equal to the maximum amount of the annual losses related to operational risk for the last 3 years, as suffered by a given entity.

The internal capital to cover business risk of the Bank is determined on the basis of analysis of historical volatility of deviations of realised net revenue from its expected values, in accordance with the earnings at risk concept (Earnings at Risk).

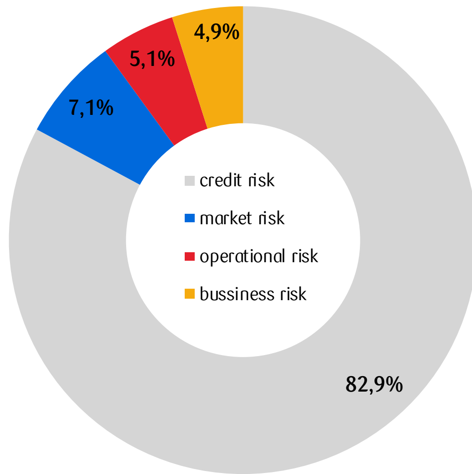
The internal capital for covering business risk of the Group entities is determined as the product of ratio of internal capital calculation for covering business risk and total internal capital of said entity reduced by its internal capital for business risk.

The internal capital ratio for business risk of the Group entities is a product of the internal capital of the Bank for business risk and total internal capital of the Bank excluding the internal capital for business risk.

The internal capital calculation approaches are defined in internal regulations. To assess internal capital based when using the statistical models, the time horizon of one year and 99.9% confidence level is applied.

The Chart below presents the structure of internal capital by risk type, as estimated as at 31 December 2014 for the Group.

Chart 6.1



The total internal capital is allocated by business areas, client segments and by the companies of the Group.

In order to assess the amount of capital required to safely conduct business activity in unfavourable economic conditions, the Bank carries out stress tests.

7. CAPITAL ADEQUACY

Capital adequacy is a process aiming to ensure, for a given risk tolerance, that the risk level assumed by the Bank and the Group for the development of business operations can be covered by available capital within specified time horizon. Capital adequacy management process involves, in particular, adherence to applicable supervisory standards and risk tolerance levels set in the Bank and the Group, capital planning process, including policies related to sources of capital.

The objective of capital adequacy management is to maintain, on an ongoing basis, the level of capital that is adequate to the scale and risk profile of business activity of the Group.

Capital adequacy management at the Bank comprises:

1) identifying and monitoring significant types of risk,
2) assessing the amount of internal capital for individual significant types of risk and of total internal capital,
3) monitoring, reporting, forecasting and limiting of capital adequacy,
4) allocating internal capital to business areas, client segments and companies of the Group for the purpose of profitability analyses,
5) using tools influencing the capital adequacy level (including: tools changing the level of own funds, the scale of deductions of own funds and the amount of credit portfolio).

The main measures of capital adequacy are as follows:

1) the total capital ratio (TCR) of at least 8% as required by the CRR,
2) Tier 1 capital ratio of at least 6% as required by the CRR,
3) Common Equity Tier 1 capital ratio of at least 4.5% as required by the CRR,
4) the own funds to internal capital ratio of at least 1.0 pursuant to the Banking Law.

According to the recommendation of the PFSA, total capital ratio should not be lower than 12% and Tier 1 capital ratio should not be lower than 9%.

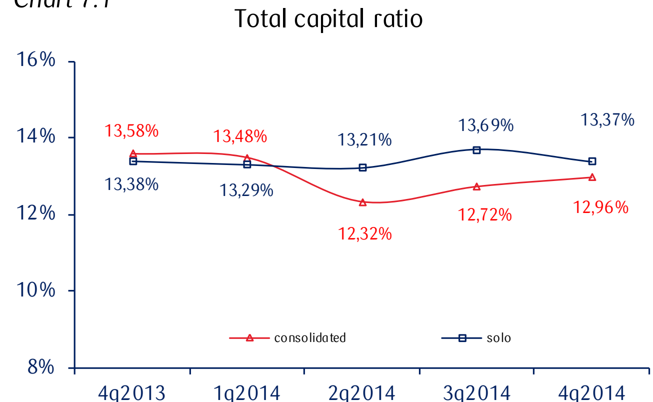
Due to the expectations of the PFSA (2 December 2014 as well as a letter from 5 December 2014) for the banks (with a significant market share of deposits from the non-financial sector) to qualify for dividend payment up to 50% of net profit for 2014 must fulfill of the following conditions:

1) bank is not included in the programme of corporate recovery proceedings,
2) Common Equity Tier 1 (CET1) Ratio is at a level higher than 12%,
3) Total Capital Ratio (TCR) is at a level higher than 12.5%,
4) general BION score is equal to 1 or 2,
5) equity risk BION is no worse than 2.

In 2014 PKO Bank Polski SA continued activities aimed at ensuring proper capital buffer, and maintaining and enhancing its liquidity position. As at the end of 2014 the Bank met all PFSA's expectations entitling to dividend payment for up to 50% profit for 2014.

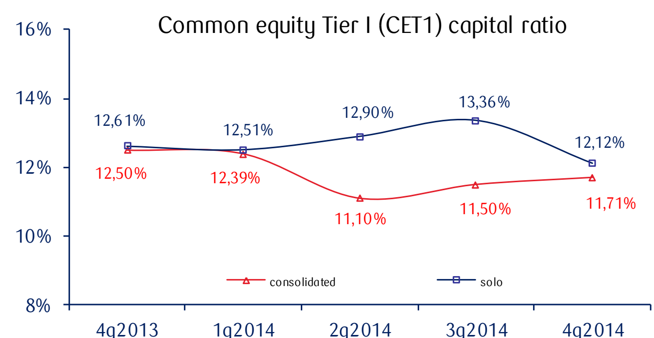
The chart below presents changes in the Total Capital Ratio calculated for the Bank and the Bank Group

Chart 7.1



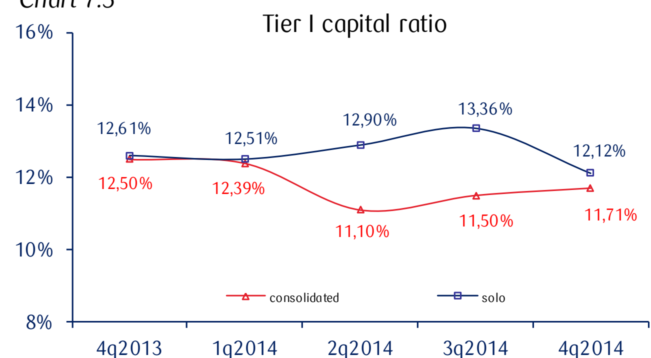
The chart below presents changes in the Common Equity Tier 1 Ratio for the Bank and the Bank Group.

Chart 7.2



The chart below presents changes in the Tier 1 Ratio for the Bank and the Bank Group.

Chart 7.3



In 2014 the measures of capital adequacy remained at above internal and external limits, and above the minimum values recommended by the PFSA.

As at 31 December 2014, as compared to the state as of 31 December 2013, the Group's total capital ratio fell by 0.6 percentage points, to the level of 12.96%, which resulted mainly from increase of own funds requirement for credit risk by ca. PLN 2.3 billion (resulting mainly from incorporation of Nordea Bank Polska SA's portfolio and a significant increase of the credit portfolio). As at 31 December 2014 the capital ratio was equal to 13.37%.

In 2014 the Bank participated, among other banks, in European stress tests conducted by European Banking Authority (EBA) in

close collaboration with Polish Financial Supervision Authority. Stress test results were published by EBA on October 2014. In all of the scenarios (even the most adverse one), the Bank's results significantly outperformed the required capital adequacy measures.

PKO Bank Polski implemented requirements of so-called Basel III, which were implemented in European legislation with CRD IV/CRR package comprising of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending the Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Capital Requirements Directive IV, CRD IV) and 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 (Capital Requirements Regulation, CRR).

8. Principles of determination of variable components of remuneration of the management (material risk takers)

Pertaining to the CRD IV and regulation 604/2014 of 4 March 2014[12], the Bank implemented principles of determination of variable components of remuneration in the following resolutions:

1) Resolution of the Supervisory Board – policy on variable components of remuneration entitled "Principles of variable components of remuneration for the Bank's management" (on the basis of which further regulations have been issued) and the Regulation on variable components of remuneration for the Management Board Members,
2) Resolution of the Management Board – the Regulation on variable components of remuneration for the Management,
3) The principles of determination of variable components of remuneration of the Management Board have also been implemented by Supervisory Boards of selected subsidiaries of PKO Bank Polski SA – PKO Leasing SA, PKO Towarzystwo Funduszy Inwestycyjnych SA, PKO BP BANKOWY PTE SA and PKO Życie Towarzystwo Ubezpieczeń. Additionally, selected managerial positions in PKO Życie Towarzystwo Ubezpieczeń SA have been included in said principles in 2014.

8.1. The process of determination of variable components of remuneration

The preparation the above mentioned documents, including the policy on variable components of remuneration involved the experts and the Bank's management from the following departments: the Human Resources and Performance Management Department (principles of bonus and remuneration payment), the Human Resources and Payroll Centre (labour), the Planning & Controlling Department (planning, imposing and checking financial objectives) and the Legal Department (legal compliance).

While preparing the policy, the Bank used external services rendered by a consulting company, PwC Polska. EY Polska provided support to the Bank during the update of aforementioned policy. The policy itself is modified by the Supervisory Board on the basis of Management Board's recommendation and Remuneration Committee's opinion.

8.2. Remuneration committee

The Remuneration Committee was appointed in the Bank to support the Supervisory Board in fulfillment of its statutory obligations and execution of tasks defined in the legal regulations. The Remuneration Committee prepares opinion on the policy on variable components of remuneration – its amount and components - of the Bank's management, including regular and variable components of remuneration of the Management Board Members.

The Remuneration Committee is responsible in particular for accomplishment of the following tasks:

1) preparing opinions on general principles of the policy on variable components of remuneration of the Bank's management that are subject to approval by the Supervisory Board,
2) performing periodical reviews of general principles of the policy on variable components of remuneration of the Bank's management on the basis of Internal Audit Department's report,
3) analysis and review of Management Board's remuneration principles and salary,
4) review and monitoring of variable components of remuneration of the Bank's management responsible for risk management and legal compliance (both with internal and external regulations),

Four meetings of the Remuneration Committee took place in 2014.

The following Members of the Bank's Supervisory Board were appointed to the Remuneration Committee:

1) Chairman – Tomasz Zganiacz,
2) Deputy Chairman – Jerzy Góra,
3) Members – Jarosław Klimont, Elżbieta Mączyńska-Ziemacka, Marek Mroczkowski.

8.3. Most significant information on characteristics of variable components of remuneration system

The Principles and Remuneration Regulations issued on the basis of such principles describe the manner in which management members and Management Board Members are granted variable components of remuneration bound to the results and effects of their work – including awards for exceptional achievements and bonuses.

The main principle of granting of variable components of remuneration is in particular bonus objectives assigned within the Management by Objectives System (MbO).

1) Assigned objectives shall take into account the economic cycle as well as risk related to the operations of the Bank. Aforementioned risk is taken into account by establishment of appropriate, risk-sensitive performance evaluation criteria, as well as reduction or absence of bonuses in case of worsened financial results, loss of the Bank or worsening of other variables (malus).
2) The objectives guarantee:
   a) an incentive to work and act in the way ensuring that the Bank achieves the best and stable financial results in a long time horizon,
   b) support for correct and effective risk management and discouraging from taking too excessive risk beyond level of risk acceptable by the Bank,
   c) support for fulfillment of business strategy and limiting conflict of interests.
3) Assessment criteria of a person holding managerial position, including member of Management Board should include in particular:
   a) impact on regulatory capital, capital adequacy ratio and equity of the Bank in such a way that payment of variable remuneration does not limit possibilities of their strengthening,
   b) effects of work of a person holding the position,

[12] Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

c) work performance of supervised area, units or organisational units of the Head Office,
d) Bank's result on the area of responsibility of a given person in respect to the results of the entire Bank.

The KPI structure combines different types of KPI, that is in particular quantitative and performance indicators resulting from possessed systemic data and coherent with specific nature of the organisation. All performance indicators are parameterised and of measurable nature. Due to nature of a given management position, different proportions of individual assessment levels and weights of the above mentioned KPI types are defined. Responsibilities for risk-adjusted long-term financial results and costs with different structure of objectives depending on a specific nature of accomplished tasks have been used.

Bonus ratios for the Management Board Members are defined in the Regulations, while in case of the Bank's management members – in a decision of the Bank's President of the Management Board.

Bonus amount:

1) of the Bank's Management Board Member may change up or down by an adjustment ratio according to the level of fulfillment of specified MbO objectives as compared to the level of fulfillment of objectives defined in annual Bank's Memorandum (list of the Bank's key management indicators) for a given calendar year,
2) of the Bank's management member may change up by an adjustment ratio according to the level of fulfillment of specified MbO objectives as compared to the level of fulfillment of objectives defined in annual Bank's Memorandum for a given calendar year,

Variable components of remuneration for a given period of time (a calendar year) are granted on the basis of Regulations, after bonus objectives have been settled, in the following forms:

1) non-deferred from – up to 60% of variable remuneration (in the first year after assessed period),
2) deferred from – up to 40% of variable remuneration (in equal instalments for the following three years after assessed period),

and both, non-deferred and deferred remuneration is granted in equal parts in cash and in form of financial instrument that is phantom shares (that are converted into cash according to updated prices of the Bank's shares after the retention period and in case of deferred remuneration – after deferment).

If the amount of variable remuneration for a given year is higher than PLN 1 million, PLN 400 million and 60% of the surplus over such PLN 1 million is to be deferred.

Variable remuneration, taking into account its raise by adjustment ratio, is subject to restrictions within the range of maximum amount that may be assigned – no higher than 100% of the fixed component of remuneration of managerial positions and 70% for Management Board members. At the request of the Supervisory Board, the aforementioned limit for variable remuneration for persons holding managerial positions outside of the Management Board can be raised up to 200% of the fixed component for remuneration for investment banking positions – if approved by the General Meeting of Shareholders, in compliance with the CRD IV.

Every calculated component of variable remuneration may be reduced in consequence of:

1) violation of professional obligations,
2) noncompliance with legal regulations or customer service standards,
3) incorrect fulfillment of assigned professional duties,
4) violation of principles of community life in relation to other employees.

In case of members of the Management Boards, variable components are granted and released on the condition of approval of the financial statement for the given period of assessment by the General Meeting of Shareholders.

In case of:

1) Significant deterioration of the Bank's/ Group company's results due to:
   a) existence or a threat of balance sheet loss,
   b) existence of insolvency threat or loss of liquidity,
2) finding that a significant adverse change in equity occurred,
3) violation of legal provisions, regulations, procedures or obligations resulting from employment relationship of a management members and Management Board Member or commitment of significant mistakes by such person, such as acting contradictory to internal code of conduct, guidelines on compliance or fundamental values, in particular in the fields of risk management,
4) adjustments of accomplishment and level of accomplishment of results or objectives of management members and Management Board Members,
5) deterioration of results of organisational units or sections supervised or managed by such persons,
6) the fact of granting variable remuneration on the basis of incorrect, misleading information or in result of fraud of a given management member or Management Board Member,

the Supervisory Board or the Management Board respectively may apply malus solutions that reduce amount of due deferred variable remuneration in upcoming settlement periods.

The respective Supervisory Board in relation the Bank's or Group company's Management Board and the Management Board in relation to management members may take a decision on possible pro rate reduction of funds for variable remuneration before every payment of such remuneration, taking into account:

1) impact on regulatory capital, capital adequacy ratio and the Bank's equity, so payment of variable compensation does not restrict possibilities of their strengthening,
2) impact on the capital cost, so payment of variable compensation does not restrict possibilities to maintain proper capital base,
3) required risk profile of the Bank,
4) financial results of the Bank in respect to long-term plans of development.

Quantitative data on variable components of remuneration will be published in May 2015.

8.4. ASSESMENT OF MEMBERS OF THE MANAGEMENT BODY

Assessment of members of the management body is carried out by the Supervisory Board during recreation process. Knowledge, experience, competences, skills and information on clean criminal record are verified.

Moreover, an annual assessment of members of the management body is performed by an external advisory company. Both individual and Management Board's competences are subject to assessment.

8.5. THE NUMBER OF DIRECTORSHIPS HELD BY MEMBERS OF THE MANAGEMENT BODY

„Members of the management body" shall mean members of the Management and Supervisory Boards. As of 31 December 2014 there were 9 members of the Supervisory Board and 7 Members of the Management Board.

9. GLOSSARY OF TERMS AND ABBREVIATION

AFS – available for sale – a securities portfolio type under IAS

AMA (Advanced Measurement Approach) – operational risk advanced measurement approach for the purpose of defining the own funds requirements for operational risk according to the CRR,

Application scoring method– a method for assessing the Bank's credit risk involved in the financing of clients on the basis of scores corresponding to information provided by the client

Banking book – contains operations not included in the trading book, specifically related to credit facilities and loans and deposits extended or accepted within the bank's basic business activity or for the purposes of liquidity and interest rate risk management

Basel III – a set of external regulations defining a new approach to the calculation of capital requirements and management of the risk in banks; in particular those defined 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 and amending Regulation (EU) No 648/2012 (hereinafter referred to as the "CRR"), executive acts to the CRR, national acts transposing Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (hereinafter referred to as the "CRD IV").

Basel III – set of amendments to Basel II regulations published in December 2010 entered into force in January 2014 and they implemented gradually until January 2019

Behavioural scoring system – a system for assessing the bank's credit risk involved in the financing of clients mainly on the basis of transactions on the current account, used for defining the revolving credit limits

Business risk – the risk of loss resulting from unfavourable changes in the business environment, unfavourable decisions, improper implementation of decisions or a failure to take appropriate action in response to changes in the business environment; it specifically includes the strategic risk

Total Capital Ratio (TCR) – the main measure of capital adequacy, calculated as the quotient of own funds and total own funds requirements multiplied by 12.5%

Capital risk - risk of inadequate, and thus insufficient in relation to the scale of the Bank's activities, level and structure of own funds for absorption of unexpected losses (taking into account both development plans and borderline cases)

CCF (Credit Conversion Factor) – credit conversion ratio for part of off-balance sheet exposures.

CET 1 Ratio (Common Equity Tier 1 Ratio) – Tier 1 funds (exclusive of hybrid instruments and total capital requirements) multiplied by 8%. According to the external guidelines (RBA) and the Bank Risk Management Strategy in PKO Bank Polski SA), the minimum admissible level of Common Equity Tier 1 Ratio is 9%.

CIRS (Currency Interest Rate Swap) – a currency interest rate swap transaction

Commodities risk – risk of loss related to negative changes in prices of commodities, generated by through the maintenance of open positions in respective commodities

Compliance risk – the risk of incurring legal sanctions or occurrence of financial losses or a loss of reputation or credibility as a result of failure on part of the bank, the bank's employees or entities operating on the Bank's behalf to observe legal provisions, internal regulations and the standards of procedure adopted by the bank, the ethical standards included

Concentration risk – the risk resulting from the Bank's significant exposure to individual entities or groups of entities, whose debt repayment ability depends on one and the same factor (e.g. the industry situation, geographical location, relations between business entities etc.)

Confidence level – the probability, expressed usually as a proportion, that the variable (bank's loss) under analysis will not exceed a specific value

Coverage ratio – a ratio of the credit and loan impairment write-downs to the value of credits and loans assessed by means of individual and portfolio approaches

CRD I (Capital Requirements Directive) – Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.

CRD II – Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC.

CRD III – Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies.

CRD IV - Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

Credit exposure –total assets constituting, awarded off-balance sheet liability or concluded off-balance sheet (derivative) transaction

Credit risk – the risk of incurring losses as a result of counterparty's default in settlement of liabilities towards the bank or the risk of decrease in the economic value of the bank's receivables as a result of deterioration of the counterparty's ability to service its debt

Credit Value-at-Risk (CVaR) – a potential loss that should not be exceeded in relation to credit risk on the maintained credit portfolio, on the assumption that a defined confidence level and holding period of the position are kept

CSA (Credit Support Annex) – a collateral agreement – annex to the framework agreement

Cumulated adjusted liquidity gap – the sum of all partial real-terms liquidity gaps from the first a'vista interval to the interval for which the cumulated real-terms liquidity gap is calculated

Cumulated contractual liquidity gap – the sum of all partial contractual liquidity gaps from the first a'vista interval to the interval for which the cumulated contractual liquidity gap is calculated

Cut-off point – the minimum number of points awarded as a result of client creditworthiness assessment made using the scoring system (for individual clients) or the client or joint rating class (for institutional clients), starting from which a loan transaction may be concluded with a specific client

CVA (Credit Value Adjustment) - adjustment of the valuation of derivatives reflecting counterparty credit risk

DVA (Debt Value Adjustment) - adjustment of the valuation of derivative reflecting the Bank's own credit risk

EaR (Earnings at risk) – defines maximum deviation of net business income from expected value with an assumed range of confidence in a specified time horizon

Price risk of equity securities – risk of loss related to changes in prices of equity securities on the public market or securities exchange indices, generated through the maintenance of open positions in instruments that are sensitive to changes in such market parameters

Expected Loss, EL – a statistically assessed value of the mean (expected) credit risk loss that the bank expects to incur on the portfolio within one year

Facultative reinsurance – an agreement concluded and negotiated individually for a particular insurance agreement or risk for which the insurance company decides on the eventual transfer of risk (and its amount) and the reinsurer decides whether to acquire said risk

Fair value – an amount for which a specific asset might be exchanged, and a liability discharged, within a market transaction between interested and informed unrelated parties

Foreign Exchange (FX risk) – risk of loss due to changes in the foreign exchange rates, generated through maintaining open currency positions in individual currencies

FRA (Forward Rate Agreement) – a forward agreement for the interest rate

Framework agreement – an agreement between parties regulating the principles of the Bank's co-operation with counterparties on the financial market with respect to forward financial transactions

Funded credit risk protection – a credit risk mitigation technique, where the bank's credit risk related to exposure is reduced by that bank's right - in the case of the counterparty's default in the discharge of its liabilities, insolvency, bankruptcy or another credit event affecting that counterparty and specified in the documentation of the transaction, and, if required for the depositary keeping the collateral – to liquidate, transfer, acquire, or retain specific assets or amounts

FX Swap – a foreign currency exchange swap

IAS – the International Accounting Standards

IBNR (incurred but not reported) – a collective method for assessment of the impairment of credit exposures

Individual position for a specific foreign currency (the currency position) – the difference between total assets in a currency, off-balance sheet liabilities received and assets indexed to that currency on the one hand, and total liabilities in that currency, off-balance sheet liabilities awarded and liabilities indexed to that currency on the other hand

Insurance risk - the risk of loss or unfavourable change of value of insurance liabilities due to inadequate assumptions regarding valuation and creation of provisions (technical and settlement provisions in particular)

Interest rate risk – risk of loss on the Bank's balance sheet and off-balance sheet items sensitive to interest rate changes, resulting from unfavourable interest rate changes on the market

Internal capital – an amount of capital, assessed by the Bank that is required to cover all identified significant types of risk present in the Bank's business activity and the effect of changes in its business environment, taking into account the anticipated risk level

IRB (Internal Ratings Based Approach) – an internal ratings method used to determine the capital requirement for credit risk

IRS (Interest Rate Swap) – a transaction involving a swap of interest rates

ISDA – the International Swap and Derivatives Association

ISMA – the International Securities Market Association

Key Performance Indicators, KPI – financial and nonfinancial indicators used as measures in the process of measurements of the level in which objectives of an organisation are achieved

Key Risk Indicators, KRI – simplified operational risk measure that is significant for a given area, application or process

Large exposure – Bank's exposure to a single borrower or a group of borrowers related by capital or organisational structure equal to or higher than 10% of Bank's own funds,

LDA (Loss Distribution Approach) – an approach in which historical data on internal and external events are used, as well as the information on the development of business environment factors for statistical measurement of operational risk.

LGD (Loss Given Default) – a loss suffered by the Bank in case of client's default

Liquidity reserve – the difference between the most liquid assets and expected and potential liabilities that mature in a given period for a given currency

Liquidity risk – the risk of inability to timely discharge of liabilities due to non-availability of liquid means

LMA – the Loan Market Association

LTV – ratio of the credit exposure amount to the value of the real property offered as collateral of that exposure

Macroeconomic risk – a risk of deterioration of the Bank's financial condition in result of adverse impact of changes in macroeconomic conditions

Model risk – possibility of suffering negative financial or reputation consequences in result of wrong business decisions taken on the basis of functioning models

NBP – the National Bank of Poland

Operational risk – the risk of losses resulting from inadequacy or unreliability of the internal processes, the human factor and systems, or from external events; it includes legal risk and does not include reputation risk and business risk

Outsourcing – use of external resources

Own funds requirements – total own funds requirements for particular risk types and own funds requirements for exceeded limits and other violations of norms described in the CRR and CRD IV

Partial adjusted liquidity gap – the difference between total assets and total liabilities, calculated for each maturity range; tells about a mismatch between matured assets and matured liabilities in a given tenor, their real-terms maturity date taken into account

Partial contractual liquidity gap – the difference between total assets and total liabilities, calculated for each maturity range; tells about a mismatch between matured assets and matured liabilities in a given tenor

Passive reinsurance – an agreement in which the insurance/reinsurance company cedes whole or a part of the insured risk to another insurance/reinsurance company

PBA – the Polish Bank Association

PCBA – the Polish Classification of Business Activity

PFSA – the Polish Financial Supervision Authority

Pre-settlement risk – the risk of the counterparty's losing creditworthiness while its transaction with the bank is pending

Probability of Default, PD – a statistical assessment of the probability of a borrower's insolvency on the annual scale (defines the portfolio-related credit risk to become materialised in the future)

Rating method – a method for assessing the bank's credit risk involved in the financing of institutional clients, incurred when awarding or changing the essential terms of a loan transaction and in the period of performance of such transaction

Recommendation – a document prepared by the Polish Financial Supervision Authority defining the list of best practices and suggestions for banks

Reinsurer – insurance or reinsurance company which acquires risk from insurance company

Reputation risk – risk of reputation loss among customers, counterparties, investors, supervisors and public opinion, due to business decisions, operational events, noncompliance or other events

Settlement risk – the risk resulting from the counterparty's default in the discharge of its liabilities at the moment of settlement of the contract

Strategic tolerance limit – acceptable risk level defined by the Management Board

Stress test (shock analysis) – a risk management tool used for assessment of the potential impact on the bank's situation of a specific event and/or changes in the market parameters not described in the standard manner with statistical measures

Trading book – all positions in financial instruments and commodities held by an institution either with trading intent, or in order to hedge positions held with trading intent

Unexpected Loss, UL – the difference between the value affected by credit risk and the expected loss

Value at risk (VaR) – a potential loss resulting from changes in the present value of cash flows from financial instruments, or a potential loss on the maintained currency positions due to changes in the foreign exchange rates, on the assumption that a defined confidence level and holding period of the position are kept