



Bank Polski

**CAPITAL ADEQUACY
AND OTHER INFORMATION SUBJECT TO
DISCLOSURE**

(PILLAR III)

THE GROUP OF PKO BANK POLSKI SA

AS AT 31 DECEMBER 2013

Introduction

The Report “Capital Adequacy and Other Information Subject to Disclosure (Pillar III) (the “Report”) of the Group of Powszechna Kasa Oszczędności Bank Polski SA (the “Bank Group” or the “Group”) as at 31 December 2013” was prepared in accordance with the provisions of Article 111a clause 1 of the Act of 29 August 1997 – Banking Law¹ and the requirements set forth in Resolution No. 385/2008 of the Polish Financial Supervision Authority of 17 December 2008 concerning the detailed principles and rules of publication by banks of qualitative and quantitative information relating to capital adequacy and the scope of required disclosure as amended²).

Pursuant to § 6 item 1 of Resolution No. 385/2008 of the Polish Financial Supervision Authority, Powszechna Kasa Oszczędności Bank Polski SA (“PKO Bank Polski SA”, “the Bank”) which is the controlling entity, discloses annually information on its capital adequacy and other information subject to disclosure in a separate document, which is published no later than within 30 days of the approval of annual financial statements by the General Meeting.

This Report was prepared in accordance with the principles of information policy of PKO Bank Polski SA regarding capital adequacy³, as adopted by the Bank, which contain detailed information on the scope of disclosures concerning capital adequacy, rules of their verification and publication.

The Report covers year 2013 and present data as of 31 December 2013 and was prepared in accordance with the external principles^{1,2} as of 31 December 2013. Unless otherwise stated, the Report includes consolidated data of the PKO Bank Polski SA Group. Since the risk profile of the Group is predominantly affected by PKO Bank Polski SA (91.9%⁴ of the Group’s consolidated balance sheet total and 93.8%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.

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

¹ Journal of Laws 2012, No. 1376 as amended.

² Amendments to PFSA’s resolution no 385/2008 dated 17 December 2008 were implemented with the following PFSA’s resolutions: resolution no 368/2010 of 12 October 2012, resolution no 259/2011 of 4 October and resolution no 326/2011 of 20 December 2011

³ The principles of information policy of PKO Bank Polski SA regarding capital adequacy are available on the Bank’s website (www.pkobp.pl).

⁴ The share of companies in the consolidated balance sheet total was calculated in relation to the consolidated balance sheet total before consolidation adjustments and exclusions for the year ended 31 December 2013.

⁵ The share of companies in the consolidated profit/loss on banking activities was calculated in relation to the consolidated profit/loss on banking activities of the Bank Group before consolidation adjustments and exclusions for the year ended 31 December 2013.

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1. INFORMATION ON THE BANK AND THE GROUP

The controlling entity of the Group is PKO Bank Polski SA, whose share in the consolidated balance sheet total amounts to 91.9%⁴, and in the consolidated profit/loss on banking activities – 93.8%⁵.

Besides PKO Bank Polski SA, the Group includes also other entities described below, but the Group of PKO Leasing SA⁶ and Group of KREDOBANK SA were described in more detail due to their participation in the consolidated balance sum totals and consolidated result of the Group's banking activities.

The Group pursues activity mainly in the territory of the Republic of Poland and through its subsidiaries KREDOBANK SA, "Inter-Risk Ukraina" Spółka Additional Liability Company ("Inter-Risk Sp. z d.o."), Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. and Finansowa Kompania "Idea Kapitał" Sp. z o.o. acting in the territory of Ukraine and also through subsidiaries PKO Finance AB and PKO Leasing Sverige AB in the territory of Sweden.

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. The share of PKO Leasing SA Group in the consolidated balance sheet total is 2.3%⁴, and in the consolidated profit/loss on banking activities – 1.3%⁵.

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 0.7%⁴, and in the consolidated profit/loss on banking activities – 1.2%⁵.

Other entities which are part of the Group covered by the consolidation include:

- 1) PKO Towarzystwo Funduszy Inwestycyjnych SA (management of the investment funds),
- 2) PKO BP BANKOWY PTE SA (management of the pension funds),
- 3) Qualia Development Sp. z o.o. (property development activity) – together with its subsidiaries,
- 4) Inteligo Financial Services SA (development and maintenance of IT systems services),
- 5) Group of Bankowe Towarzystwo Kapitałowe SA ("BTK SA Group") including: Bankowe Towarzystwo Kapitałowe SA (service activities) and its subsidiary PKO BP Faktoring SA (factoring activities),
- 6) PKO Finance AB (generating funds for PKO Bank Polski SA from the issue of bonds),
- 7) PKO BP Finat Sp. z o.o. (transfer agent services),
- 8) Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. (factoring activities),
- 9) "Inter-Risk Ukraina" Sp. z d.o. (debt collection activities).

In 2013 consolidation Merkury – non-public asset closed-end investment fund („Merkury – fiz an”) was included, of which investment certificates were acquired by Bank and 8 subsidiaries of the “Merkury –fiz an”(which activity is to purchase, sell and manage property development).

What is more, on 12 June 2013 PKO Bank Polski SA and Nordea Bank AB signed an agreement setting out the terms of an acquisition from Nordea Bank AB and other entities from the Nordea Group (shares of Nordea Bank Polska SA, shares of Nordea Polska Towarzystwo Ubezpieczeń na Życie SA, shares of Nordea Finance Polska SA). As a result of executing this transaction, the Bank will significantly improve its position in the private banking segment, enhance its competences in the corporate banking segment and ensure growth in the area of bancassurance.

Detailed information on the entities of the Group, the method of consolidation, and the Bank's interest in the capital of individual entities is contained in the consolidated financial statements of the Bank Group for the year ended 31 December 2013, published 10 March 2014.

At the consolidation level, own funds of the Group are reduced by the Bank's capital exposure in the following entities:

- 1) Bank Pocztowy SA and Poznański Fundusz Poręczeń Kredytowych Sp. z o.o. (associated entities valued under the equity method i.e. not subject to consolidation under the full method) which amounted to the total of PLN 106.7 million as at 31 December 2013,
- 2) "2020 European Fund For Energy, Climate Change and Infrastructure" (investment securities available for sale and valued at fair value) which amounted to PLN 137.1 million as at 31 December 2013.

At the individual level, own funds of the Bank are reduced by the Bank's capital exposure directly in KREDOBANK SA, PKO BP BANKOWY PTE SA, PKO Towarzystwo Funduszy Inwestycyjnych SA (PKO TFI SA), PKO Leasing SA, PKO Finance AB, Finansowa Kompania „Prywatne Inwestycje” Sp. z o.o., Merkury – fiz an, “2020 European Fund For Energy, Climate Change and Infrastructure”, Bank Pocztowy SA and Poznański Fundusz Poręczeń Kredytowych Sp. z o.o. as well as directly and through a non-financial entity in PKO BP Faktoring SA amounting to the total of PLN 1,265.8 million as at 31 December 2013. The revaluation write-down of the Bank's credit exposure in KREDOBANK SA amounted to PLN 745.7 million as at 31 December 2013.

Within the Bank Group, there are limitations on the transfer of funds (dividends) to the investor between KREDOBANK SA and the Bank. 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 2013 the moratorium on dividend payment remained in force.

⁶ Until March 2013 – Bankowy Fundusz Leasingowy SAGroup (the change of name of this Company was registered in the National Court Register on 27 March 2013).

2. RISK MANAGEMENT

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

In the PKO Bank Polski SA Group, the following types of risk have been identified, which are subject to management: credit, interest rate, foreign exchange, liquidity, commodity, equity risk, derivative instruments, operational, compliance, macroeconomic changes, model, business (including strategic risk) and reputation.

Risk management at 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, volume and complexity of the risk concerned and it is adjusted to new risk factors and sources on an ongoing basis,
- 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 from business functions is maintained,
- 5) risk management is integrated with the planning and controlling systems,
- 6) the risk level is monitored 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.

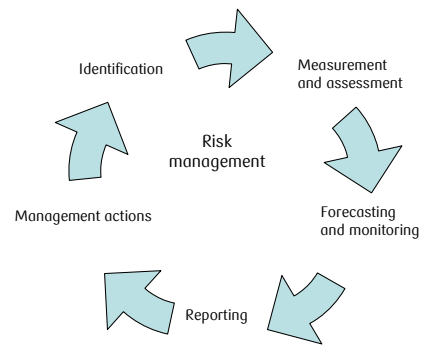
The risk management process in the Group includes:

- 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 Bank and the Group; risk identification includes defining of such types of risk that are considered to be significant in the activity of the Bank, an 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 volumes 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, threshold values, 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 within which the Bank's Management are informed 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 values, issuing internal regulations, issuing recommendations, use of risk management tools; management activities are aimed at designing risk management process and influencing on risk level.

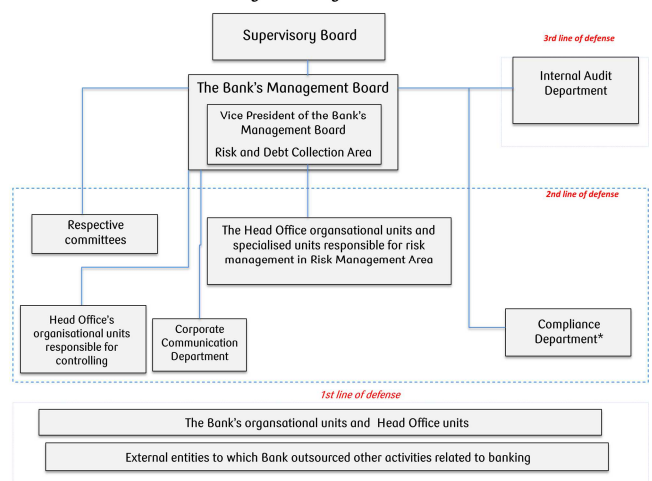
Scheme 2.1



The risk management process takes place in the environment that comprises the following:

- 1) the applied methods and methodologies forming a system of internal regulations,
- 2) the Bank's IT environment, which permits the flow of information required for risk assessment and control (including central IT systems which support risk assessment, and central databases),
- 3) internal organisation which includes organisational units, their tasks, scope of responsibilities and mutual relations.

Scheme 2.2 Risk management organisational chart



As of 17 December 2013 Compliance Department is responsible for reputational risk management and supervision of reputational risk management instead of Corporate Communication Department

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

The Management Board is responsible for the strategic risk management, which includes the supervision and monitoring of activities taken by the Bank within 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 defense:

- 1) first line of defense – internal functional control to ensure that the risk control mechanisms 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 control mechanism, if control mechanisms have not been implemented within the scope of activities undertaken in the second line of defense. At the same time the Group's entities are obliged to comply with the principles of coherence and comparability of risk assessment and control in the Bank and Group subsidiaries, taking account of the specific nature of the company's business and market at which it operates,
- 2) second line of defense – 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, reputation risk, relevant committees and the Head Office units responsible for controlling,
- 3) third line of defense – internal audit; the function performed within the scope of internal audit, including audit on the efficiency of the risk management system related to the Bank's activity.

The independence of the lines of defense means that they remain organisationally independent as follows:

- 1) the function of the second line of defense is independent from the first line of defense in regard to creation of system solutions,
- 2) the function of the third line of defense is independent from the first and second lines of defense,
- 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 2013 in the Bank Risk Division, Model Validation Office, 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.

On 1 January 2014 while establishing the Risk Integrating Department, the Model Validation Office was included into its structure and transformed into the Model Validation Team. One of the purposes of establishing new Department is to ensure more standardized and integrated methods for model risk management in Group.

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

- 1) identification of risk factors and 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 aim of the Model Validation Office is, in particular, validation of risk measurement models, creating an effective system of the model risk management at the Bank, measurement and reporting of risk of the models, as well as supporting risk management.

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

- 1) recovering receivables from difficult institutional clients,
- 2) developing solutions in recovering or selling bad debts,
- 3) foreclosing collaterals as a result of recovering process, reviewing and classifying receivables managed by the Department and off-balance sheet liabilities and defining the amount of write-downs for impairment related to the risk in banking activity.

The purposes of Restructuring and Debt Collection Centre are in particular:

- 1) development of systematical solutions (including procedures and IT applications), supporting process of collecting debt and monitoring delays in payments of receivables,
- 2) development of methodologies of calculating indices of: effectiveness of restructuring and debt collection processes, effectiveness of systems monitoring delays in payment of receivables and recoveries from collaterals indices,
- 3) creation, development and validation of models used in processes of monitoring of delays in payments and collecting debts.
- 4) debts collection from difficult clients through restructuring and collecting debts, as well as improving effectiveness of those activities,
- 5) effective intervention activities within the early monitoring of delays in the collection of receivables from retail market clients,
- 6) management of collateral foreclosed as a result of recovering Bank's receivables,
- 7) calculation of an amount of non-performing debts impairment,
- 8) 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 important due to the volume of the exposure, client segment or risk lever, 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'),
- 6) credit committees which operate in the regional retail and macro-regional corporate branch offices.

RC monitors the integrity, adequacy and efficiency of the 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 risk management through preparation of recommendations and making decision on capital adequacy and efficiency of the bank risk control system.

ALCO takes decisions within the scope of limits and thresholds in relation to individual types of risk, issues related to transfer prices as well as model risks and its parameters and it also issues recommendations to the Management Board, for instances, in respect of structuring of the Bank's assets and liabilities, management of individual risk types, capital and price policy.

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 since second quarter of 2014 BCC is making decisions related to among others: credit models risk and results of validation of significant models of credit risk. BCC is also presenting opinions regarding among others: credit transactions of the Group entities, loan bundle sale, and significant models of credit risk used in entities of the Group.

CCC supports with its recommendations over a specified threshold the decision-taking by relevant directors of the Divisions and members of the Management Board, while the credit committees operating in the regional retail and macro-regional corporate branches, support directors of branches and directors of macro-regional corporate branches in relation to issues involving higher risk level

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 and changes in AMA approach.

The Bank supervises the functioning of individual subsidiaries of the Bank Group. 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 subsidiaries of the Bank Group 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 on the basis of the principle coherence and comparability of assessment of individual types of risk in the Bank and Group subsidiaries, taking account of the specific nature of the company's business and market at which it operates.

The priority of the Bank Group in 2013 was to keep its strong capital position and increase its financing sources that 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 2013 the Bank:

- 1) announced the strategy "PKO Bank Polski. Daily the Best" for the years 2013-2015, aiming at strengthening the leader position of the Polish banking market,
- 2) took into consideration conclusions from the financial crisis while using risk measurement methods (among others regarding risk parameters and stress tests scenarios),
- 3) rolled forward short-term bonds in the amount from PLN 500 to 850 million, while extending the maturity date of the securities from three to six months,
- 4) contracted credits in September 2013, in the amount of EUR 75 million and in November ca. CHF 185 million,
- 5) transferred a part of the Bank's profit for 2012 to equity.

Moreover, on 12 June 2013, the Bank signed an agreement to acquire Nordea Bank Polska SA, Nordea Finance Polska SA, Nordea Polska Towarzystwo Ubezpieczeń na Życie SA, and the corporate loan portfolio serviced directly by the seller - the Scandinavian financial group Nordea. The above mentioned acquisition shall have no impact on the change in the risks identified in the business of PKO Bank Polski SA or Nordea Bank Polska SA.

In the first half of 2013 the Bank endeavored to adapt to the requirements of Recommendation M of the Polish Financial Supervision Authority amended in January 2013 relating to operational risk management in banks. The Bank complied with all the recommendations by 30 June 2013, except from the recommendation relating to disclosure of information on operational losses which was complied, in accordance with Recommendation M, in the third quarter of 2013.

In the second half of 2013, the Bank implemented the process of including counterparty credit risk in the valuation of financial instruments in accordance with the best practices in the market and internal conditions.

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

The competent units from the Bank Risk Division participate in risk management in the Group companies, since they prepare opinions on drafts of and periodically review internal regulations of these subsidiaries 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 subsidiaries.

In 2013 KREDOBANK SA conducted works related to optimization and improvement of the lending process through improvement of the management information system (MIS), optimization of the credit process for individuals, small and medium-size enterprises (SME) and corporate clients. Moreover, the Bank amended internal regulations concerning basic principles of organization of the credit process and regulations related to the credit process for individual clients and legal entities.

In 2013 the PKO Leasing SA Group focused mainly on creation of safe leasing portfolio that guarantees positive consolidated

results of the PKO Leasing SA Group, capital security and reduction of the share of bad debts in the portfolio.

The General Meeting of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna in its resolution no 8/2012 dated 20 June 2013 decided that the dividend for 2012 would amount to PLN 2,250,000,587,500 thousand, that is 1.80 gross per share (details are presented in the consolidated financial statement of the Group of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna for year ended 31 December 2013 on page 52 in section 14 entitled "Paid Dividends (the Total Amount or Per One Share) as Divided into Ordinary and Other Shares").

2.1. IDENTIFYING SIGNIFICANT TYPES OF RISKS

The significance of individual types of risk is defined in the level of the Bank and the Group subsidiaries.

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 changes risk,
- 8) model risk,
- 9) compliance risk.

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 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).

As of 31 December 2013 significant banking risk level was identified in PKO Bank Polski SA, PKO Leasing SA Group, KREDOBANK SA Group, the BTK SA Group and in Finansowa Kompania „Prywatne Inwestycje” Sp. z o.o.

Moreover, operational risk and business risk were considered as key risks in all companies of the Bank Group, as well as compliance risk since 31 March 2014

A periodical assessment of level of potentially significant risks is performed in the Bank on the basis of quantitative and qualitative information. In result of such assessment specific risks are defined as significant or insignificant. A similar assessment is periodically performed in relation to the Bank 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.

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 ability to service the debt.

The purpose of credit risk management is to limit losses arising from the credit portfolio and minimize 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 in the internal rating or scoring,
- 2) credit risk transactions is measured when considering the loan application 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 reasons of 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 provisions for impairment of credit exposures.

2.2.1.1. Credit risk of financial institutions

PKO Bank Polski SA cooperates on the wholesale market with financial institutions having their registered offices in the territory of more than 40 countries. The Bank may enter within the limits into transactions with over 280 counterparties, including Polish and foreign banks, insurance companies, pension funds, investment funds companies and investment funds. Transactions include loans and deposit, securities transactions, foreign exchange operations and derivative transactions.

The Bank monitors the financial standing of its counterparties on an ongoing basis and sets exposure limits adequate to the risk incurred for pre-settlement and settlement exposures of individual counterparties. The integral tools for the management of credit risk of financial institutions are framework agreements signed with counterparties on the basis of ISDA (foreign banks, credit institutions) and the PBA (domestic banks) standards. The exposure to financial institutions on the wholesale market is of high quality and low credit risk, as confirmed by external ratings granted by rating agencies and also by internal ratings granted to the counterparties by the Bank.

2.2.1.2. Derivatives risk

The derivatives risk is the risk of loss in result of the Bank's position in financial instruments that fulfill 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 risks, 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.

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 (Table 2.1). The remaining Group's subsidiaries, i.e. entities other than Bank, may enter into transactions in derivatives exclusively for the purpose of hedging against the risk resulting from their core activities.

Table 2.1

FINANCIAL DERIVATIVES*

	The Bank Group			
	2013			
	Nominal value		Fair value	
	Purchase	Sale	Negative	Positive
Currency transactions (over-the-counter market)	34 038	34 488	824	393
FX Swap	6 010	6 139	156	40
FX Forward	4 023	4 077	60	25
Options	3 852	3 955	62	75
Cross Currency IRS	20 152	20 317	545	253
Interest rate transactions	207 400	205 288	2 502	2 604
Interest Rate Swap (IRS)	180 237	180 237	2 491	2 591
Forward Rate Agreement (FRA)	27 163	25 051	11	14
Credit derivatives	0	0	0	0
Other (including stock market index derivatives)	3 614	3 868	2	4
Total derivatives	245 052	243 644	3 328	3 001

*Nominal values of underlying instruments and fair value of derivative financial instruments.

Derivatives are recognized at their fair value starting from the date of a transaction. A derivative becomes an item of assets if its fair value is positive and it becomes liability if its fair value is negative.

The value of derivatives that are traded on the exchange market and embedded options in structured products that are closed back-to-back is the market price. In case of other derivatives it is - the applied models of derivative pricing that are common models at the market, to which data are fed from the active market. Such models base on the discounted cash flow approach, taking into account also the variability parameter and probability function in case of option pricing models.

For the purpose of calculation of a balance sheet equivalent of off-balance sheet transactions, in order to take account of counterparty (credit risk and counterparty credit risk) the Bank applies the market pricing method.

The Bank recognises embedded derivatives. An embedded derivative is an element of hybrid (combined) instrument that also contains the principal agreement that is not a derivative (of both financial and non-financial nature) resulting in the fact that some cash flows resulting from a combined instrument change in the way similar to cash flows resulting from a separate derivative. An embedded derivative results in the fact that some or all cash flows resulting from the principal agreement are modified on the basis of a specific interest rate, price of a financial instrument, price of goods, foreign exchange rate or another variable, provided that a non-financial variable is not specific for any of the parties of a contract.

An assessment if an agreement contains an embedded instrument is made at the moment of accession to an agreement. A reassessment is made only if changes are introduced to an agreement that have a significant impact on resulting financial flows.

Embedded derivatives are elements of concluded financial and non-financial agreements and the whole or part of cash flows related to such agreements changes in a way similar to an independent derivative.

A derivative is recognized separately if all the following conditions are fulfilled:

- 1) a hybrid (combined) instrument is not priced at fair value, with the result recorded in the profit and loss account,
- 2) the economic nature of an embedded instrument and related risks are not closely connected with the economic nature of the principal agreement and the risks resulting from it,
- 3) a separate instrument with characteristics corresponding to the features of embedded derivatives would fulfill the function of a derivative.

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 IAS),
- 6) coverage ratio of credits with impairment recognized with write downs,
- 7) risk cost.

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.

In 2013 the Bank implemented new rating methods to assess credit risk of institutional clients, including those granted as specialized financing.

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 unfavorable 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.

In the first half of 2013 in respect of credit risk, the Bank endeavored to adapt to the requirements of Recommendation T of the Polish Financial Supervision Authority amended in February 2013, relating to best practice in respect of management of risk arising from retail loan exposures. All recommendations have been implemented in the Bank in accordance with the expected date, i.e. to 31 July 2013. In the second half of 2013, the Bank endeavoured to adapt to the requirements of Recommendation S of the PFSA amended in June 2013, relating to best practice in respect of management of mortgage-secured loan exposures. A part of the

recommendations have been implemented in the end of 2013, in accordance with the PFSA's expectations, the work on the full adaptation of the Bank to the provisions of this Recommendation will also be continued in the first half of 2014 (a part of recommendations should be implemented no later than to 1 July 2014).

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. This method is available besides the rating method. Such assessment is dedicated to the low-value, uncomplicated loan transactions and it is performed in two dimensions: customers' borrowing capacity and his 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 records of the Bank and external databases.

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 signaling 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 2.2 shows the balance sheet and off-balance sheet items taken into account in the calculation of capital adequacy of the Bank Group as at 31 December 2013 and 31 December 2012.

Table 2.2

	The Bank Capital Group		
	2013	2012	Average
ASSETS	199 231	193 151	196 191
Net credits and loans*	149 623	143 483	146 553
Securities	29 796	25 159	27 478
Receivables from banks	1 893	3 392	2 643
Financial fixed assets	310	119	214
Other assets**	17 609	20 997	19 303
OFF-BALANCE SHEET LIABILITIES	44 598	42 891	43 744
Financial	34 211	32 513	33 362
Guarantees granted	10 387	10 377	10 382
DERIVATIVES***	488 696	512 197	500 446

* Including financial lease receivables

** Including: cash, funds at the National Bank of Poland, valuation of financial derivatives, fixed assets for sale, inventories, intangible assets, tangible fixed assets, current and deferred tax receivables and assets, other assets

*** Nominal value

The instruments that generate the biggest credit risk for the Bank Group include credits and loans granted as well as off-balance sheet financial liabilities (for instance limits and credit facilities).

Table 2.3

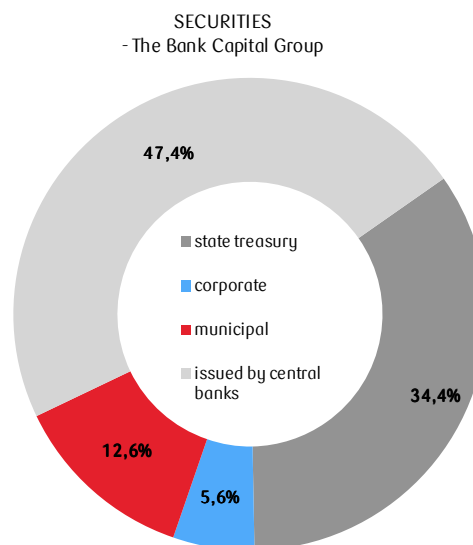
CREDITS AND LOANS* - STRUCTURE BY PORTFOLIO

	The Bank Group	
	2013	2012
Net credits and loans	149 623	143 483
consumer loans	19 214	20 336
housing loans	74 900	70 419
commercial loans	51 576	50 654
debt securities	1 789	2 074
repurchase agreements	2 144	0

* Including financial lease receivables

A much smaller credit risk level of the Bank Group is related to derivatives, interbank deposits and the Group's holdings of securities (of which 81.8% are securities issued by the Treasury or the central banks) (Chart 2.1).

Chart 2.1



In 2013, the greatest proportion of the exposure structure of the Group was related to exposures and exposures secured on real estate property (59.1% in total). The proportions of other exposure classes range between 0.1% and 13.45% (Table 2.4).

Table 2.4

Exposure class*	The Bank Group 2013	
	Total exposure**	Average exposure**
Secured on real estate property	64 480	62 586
Corporate	62 152	62 830
Central governments and central banks	28 986	28 183
Retail	24 651	25 232
Other exposures	13 827	12 895
Institutions (banks)	7 669	8 511
Regional governments and local authorities	7 029	7 501
Past due	4 003	4 274
Public sector and non-commercial undertakings	1 195	1 185
Other classes***	163	177
Total	214 155	213 374

* Pursuant to § 20 of Appendix no 4 to Resolution no 76/2010 of PFSA on the scope and detailed principles of determination of capital requirements for individual types of risk, as amended

** The value of balance sheet exposures and balance sheet equivalents of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques. The average amount of exposure has been calculated as the arithmetic mean of exposures from individual quarters of 2013

*** Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings

A considerable proportion of the Bank Group's exposures with defined maturity date (76.7%) are exposures with the maturity of over 1 year; for over 52.9% of exposures with fixed maturity date, such period exceeds 5 years (Table 2.5).

Table 2.5
EXPOSURE STRUCTURE* BY ORIGINAL MATURITY

The Bank Group 2013									
Exposure class	PKO Bank Polski SA, KREDOBANK SA Group and PKO Leasing SA Group						Other Group companies**	Adjustments and exclusions	Total
	0 - 1 month	1 - 3 months	3 - 12 months	1 - 5 Years	Over 5 years	Other****			
Secured on real estate property	8	2	111	1 466	62 979	0	0	-86	64 480
Corporate	601	202	13 326	25 034	25 740	374	767	-3 893	62 152
Retail	11	1	6 045	8 431	10 053	109	0	0	24 651
Central governments and central banks	18 808	18	544	7 720	1 877	5	14	0	28 986
Other exposures	4 365	0	0	0	74	8 451	993	-56	13 827
Institutions (banks)	575	802	605	3 684	1 002	1 961	9 378	-10 338	7 669
Regional governments and local authorities	4	2	276	1 223	5 524	0	0	0	7 029
Past due	86	54	655	1 235	1 972	0	82	-82	4 003
Public sector and non-commercial undertakings	1	0	1 048	53	93	0	0	0	1 195
Other classes***	0	0	0	0	0	904	18	-759	163
Total	24 459	1 084	22 609	48 847	109 314	11 805	11 252	-15 214	214 155

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

** The Group Companies other than the PKO Leasing SA Group and KREDOBANK Group

*** Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings

**** Includes items with unspecified maturity (e.g. fixed assets, stocks)

2.2.3.2. Impairment of credit exposures

The Bank Group reviews each month its credit exposures to identify credit exposures threatened with impairment; 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) definition of 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 findings,
- 6) recording of the impairment measurement findings.

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

- 1) past due of exposure by minimum 3 months,
- 2) considerable deterioration of debtor's internal rating,
- 3) entering into restructuring agreement or granting a discount concerning debt repayment (the indication of impairment is recognised, if the convenience granted to the consumer is a result of its difficult legal or economic position).

In determining the past due period of credit exposures, the outstanding amounts of interest or principal installments above defined threshold values 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 from which they result 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 individualised 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 awarded (from the date as at which 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 awarded 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 and of established write-downs for credit exposure impairment of the Group is shown in Table 2.6. In 2013, the gross value of loans granted by the Group valued under the individualised method decreased by ca. PLN 749 million, while valued using the portfolio method increased by PLN 417 million.

As of 31 December 2013 the share of credits with recognized impairment amounted to 8.2% (as of 31 December 2012: 8.9%). A decrease of the value of credits assessed with the individualised method by 9.3% as of 31 December 2013 resulted mainly from conversion from balance sheet evidence into off-balance sheet evidence (of exposures, which were subject to loss of control over the assets in the meaning of International Accounting Standards and International Financial Reporting Standards).

The increase in the value of loans valued under the portfolio method by 6.0% in 2013 resulted mainly from deteriorating delays in repayment of corporate credits (in the portfolio of small and medium size enterprises) and consumer credits, as well as from rise in value of restructuring agreements related to mortgage loans.

Table 2.6

CREDITS AND LOANS*

The Bank Group		
	2013	2012
Gross credits and loans	156 274	150 259
individualised method	7 337	8 086
portfolio method	7 329	6 912
collective method (IBNR)	141 608	135 261
Write-offs (balance)	-6 651	-6 776
individualised method	-2 292	-2 708
portfolio method	-3 773	-3 517
collective method (IBNR)	-586	-552
Net credits and loans (gross-write-down)	149 623	143 483

* Including financial lease receivables

The result of impairment write-downs is a consequence of the conservative policy of PKO Bank Polski SA in regard of credit risk recognition and assessment and of an increase of the credit base. The drop of the impairment write-downs in 2013 in the amount of PLN 125 million in line "Credit and loans" was influenced mainly by a change of write-downs in commercial credits in the amount of PLN 148 million and in housing loans in the amount of PLN 18 million. The result of write-downs decreased as a consequence of conducted non-performing loans package sales as well as excluding from balance sheet receivables, over which the Bank lost control (Table 2.7).

Table 2.7

IMPAIRMENT WRITE-DOWNS

The Bank Group

	Balance as at		Change in 2013	Additional write-downs	Release of write-downs	Depreciation charged to write-downs	Other changes, including FX differences	Cost of write-downs input to profit and loss
	2013	2012						
Credits and loans*	6 651	6 776	-125	6 435	-4 407	-1 776	-378	-2 028
consumer loans	1 413	1 432	-18	1 561	-1 149	-425	-6	-412
housing loans	1 731	1 715	17	1 300	-1 031	-196	-56	-269
corporate loans	3 478	3 626	-148	3 548	-2 225	-1 154	-316	-1 323
debt securities	28	4	24	25	-1	0	0	-24
Receivables from banks	29	29	-1	0	0	0	-1	0
Financial instruments	150	136	14	24	-4	-6	0	-19
Other	902	581	320	388	-398	-29	359	10
Total	7 731	7 523	207	6 847	-4 809	-1 810	-20	-2 038

*Including financial lease receivables

The coverage ratio, calculated as the share of impairment write-downs to total credits and loans to gross credit with recognized impairment balance sheet value, amounted to

51.7% as at 31 December 2013 and to 50.5% as at 31 December 2012 (Table 2.8).

Table 2.8

EXPOSURES WITH RECOGNISED IMPAIRMENTS AND TOTAL WRITE-DOWNS

The Bank Group		
	2013	2012
Exposures with recognised impairment	12 961	13 524
receivables from banks	29	29
credits and loans*	12 861	13 417
debt securities (AFS)	6	6
other financial assets	65	73
Write-offs (balance)**	-6 746	-6 879
receivables from banks	-29	-29
credits and loans*	-6 651	-6 776
debt securities (AFS)	-3	-6
other financial assets	-64	-68

* Including financial lease receivables

** Apply to exposures with recognised impairment. For credits and loans with respect to which the IBNR method has been applied, the write-downs pertain also to exposures without recognised impairment

Below are presented credits and loans and revaluation write-downs by geographical (Table 2.9) and industry (Table 2.10) structure.

Tabela 2.9

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

The Bank Group		
2013		
Region	With recognised impairment **	
	Exposure	Impairment write-downs
Poland (PKO Bank Polski), including:	12 192 ***	5 771 ***
mazowiecki****	2 975	1 365
śląsko-opolski	1 090	561
małopolsko-świętokrzyski	1 030	465
łódzki	958	454
wielkopolski	795	355
dolnośląski	743	354
zachodniopomorski	695	362
kujawsko-pomorski	662	335
pomorski	605	309
podlaski	559	261
lubelsko-podkarpacki	406	196
southern macroregion	382	203
western macroregion	316	152
central macroregion	283	114
northern macroregion	256	72
northern-eastern macroregion	207	105
southern-eastern macroregion	145	91
southern-western macroregion	26	8
other*****	60	8
Securities classified as credits	105	23
Bancassurance adjustment	-31	0
Poland (other companies)	251	123
Ukraine	345	121
Adjustments, exclusions	0	11
Total	12 861	6 048

* 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)

*** The totals include IAS income in the amount of PLN 632 million

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

***** Unallocated portfolio

Capital adequacy and Other Information Subject to Disclosure (Pillar III)

Tabela 2.10

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

The Bank Group		
2013		
Type of client/branch	Z rozpoznanej utraty wartości**	
	Exposure	Impairment write-downs
Institutional clients, of which:	7 843 ***	3 393
Construction	2 324	1 095
Industrial processing	1 097	461
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household appliances	1 510	739
Activities related to real property management	755	249
Generation and supply of power, gas, water steam, hot water and air for air-conditioning systems	116	80
Public administration and national defence and obligatory social security	0	0
Other exposures	2 040	769
Banks	0	0
Governments	6	6
Individuals	4 343	2 371
Securities classified as credits	105	23
Bancassurance adjustment	-31	
Poland (other Group companies)	251	123
Ukraine	345	121
Adjustment and exclusions	0	11
Total	12 861	6 048

* Including financial lease receivables

** Applies to exposures with identified condition of individual impairment (without IBNR)

*** The total includes IAS income in the amount of PLN 632 million

**** 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 or equivalent of EUR 150 mln translated into PLN using to the average rate announced by the National Bank of Poland prevailing as at the last reporting date.

As at 31 December 2013 and 31 December 2012 concentration limits were not exceeded. As at 31 December 2013 the level of concentration risk of the Bank Group for individual exposures was low, the largest exposure to an individual entity amounted to 5.1% of consolidated own funds. The group of the 10 biggest borrowers of the Group consist of clients of PKO Bank Polski SA only.

Table 2.11

EXPOSURE TOWARDS THE 10 BIGGEST CLIENTS*

No	The Bank Group			
	2013		2012	
	exposure	% of own funds	exposure	% of own funds
1	2 080	9,8%	2 229	10,9%
2	2 074	9,7%	2 080	10,2%
3	2 035	9,6%	1 933	9,4%
4	1 396	6,6%	1 404	6,9%
5	1 084	5,1%	1 206	5,9%
6	1 079	5,1%	1 121	5,5%
7	794	3,7%	810	4,0%
8	752	3,5%	725	3,5%
9	690	3,2%	600	2,9%
10	674	3,2%	596	2,9%
Total	12 658	59,4%	12 705	62,0%

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

As at 31 December 2013 the biggest concentration of exposure of the Bank Group in the group of subsidiaries amounted to 16.6% of its consolidated own funds (entities not exempted from the exposure concentration limit).

Table 2.12

EXPOSURE TOWARD THE 5 BIGGEST CAPITAL GROUPS*

No	The Bank Group			
	2013		2012	
	exposure	% of own funds	exposure	% of own funds
1	3 537	16,6%	4 021	19,6%
2	2 791	13,1%	2 993	14,6%
3	2 056	9,7%	1 957	9,6%
4	1 961	9,2%	1 639	8,0%
5	1 446	6,8%	1 590	7,3%
Total	11 791	55,3%	12 200	36,5%

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

As at 31 December 2013, the sum of large exposures of the Group amounted to 29.3% 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 joint exposure for individual countries.

As at 31 December 2013, there was no significant geographical concentration level in the Group's credit portfolio (Table 2.13). The KREDOBANK SA portfolio of loans extended to Ukrainian clients accounted for approx 0.6% of the Group's total portfolio.

Table 2.13
 GEOGRAPHICAL STRUCTURE OF EXPOSURES*

Country/region	The Bank Group 2013										Total
	No. of exposure class**										
	A	B	C	D	E	F	G	H	I	Other***	
Poland, of which:	24 394	63 255	28 712	64 272	12 170	4 927	7 029	3 847	1 195	904	210 705
mazowiecki	4 233	7 442	0	10 699	1	27	419	35	1 047	0	23 904
śląsko-opolski	3 455	5 002	90	8 203	3	0	587	47	13	0	17 400
wielkopolski	2 465	3 067	20	7 454	1	0	310	20	17	0	13 354
małopolsko-świętokrzyski	2 255	3 806	11	6 263	4	0	1 011	10	37	0	13 397
dolnośląski	2 032	2 148	1	5 264	2	0	409	21	0	0	9 877
lubelsko-podkarpacki	1 752	2 458	0	5 628	11	0	531	22	8	0	10 410
zachodniopomorski	1 356	2 505	0	4 265	2	0	399	57	0	0	8 586
łódzki	1 718	3 494	1	3 513	1	0	752	16	1	0	9 496
pomorski	1 485	2 499	0	4 109	1	0	168	18	0	0	8 280
kujawsko-pomorski	1 386	1 943	216	3 271	2	0	485	19	3	0	7 324
warmińsko-mazurski	985	1 340	96	2 519	3	0	51	12	0	0	5 006
podlaski	728	1 587	21	1 754	0	0	65	11	2	0	4 167
other****	544	25 963	28 257	1 331	12 139	4 899	1 843	3 558	66	904	79 505
Norway	2	591	0	11	0	1	0	0	0	0	605
Ukraine	231	525	255	102	243	454	0	151	0	0	1 960
Liberia	0	334	0	0	0	0	0	0	0	0	334
Luxembourg	0	300	0	0	0	0	0	0	0	0	300
United Kingdom	11	0	0	122	0	1 069	0	2	0	0	1 204
Switzerland	0	159	0	2	0	12	0	0	0	0	173
Cyprus	0	50	0	0	0	0	0	0	0	0	50
Spain	0	40	0	0	0	0	0	0	0	0	41
Germany	4	4	0	17	0	406	0	1	0	0	432
Canada	0	15	0	1	0	0	0	0	0	0	16
Ireland	2	0	0	12	0	0	0	1	0	0	15
France	2	0	0	6	0	524	0	0	0	0	532
Belgium	1	0	0	5	0	30	0	0	0	0	36
Other	3	4	4	19	476	1 207	0	1	0	0	1 714
Total (PKO Bank Polski SA, KREDOBANK SA Group and PKO Leasing SA Group)	24 651	65 278	28 972	64 567	12 890	8 629	7 029	4 003	1 195	904	218 117
Other companies of the Group	0	767	14	0	993	9 378	0	82	0	18	11 252
Adjustments and exclusions	0	-3 893	0	-86	-56	-10 338	0	-82	0	-759	-15 214
Total	24 651	62 152	28 986	64 480	13 827	7 669	7 029	4 003	1 195	163	214 155

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

** A - retail exposures,

B - corporate exposures,

C - exposures to central governments and central banks,

D - exposures secured on real estate property,

E - other exposures,

F - exposures to institutions,

G - exposures to regional governments and local authorities,

H - past due exposures,

I - exposures to public sector and non-commercial undertakings

***Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.

****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 2013, there was no significant credit concentration level with respect to industry sectors (Table 2.14).

Table 2.14
 EXPOSURE STRUCTURE BY INDUSTRY*

Type of client/branch	The Bank Group 2013										Total
	No. of exposure class **										
	A	B	C	D	E	F	G	H	I	Other***	
Institutional clients, of which:	0	56 036	0	1 448	0	7	5 801	2 406	1 195	0	66 893
Industrial processing	0	13 824	0	171	0	0	0	516	0	0	14 510
Wholesale and retail trade, repair of motor vehicles, motorcycles	0	9 674	0	254	0	0	0	616	0	0	10 543
Activities related to real property management	0	5 008	0	211	0	0	0	177	0	0	5 396
Construction	0	5 148	0	384	0	0	0	366	0	0	5 898
Public administration and national defence, obligatory social security	0	35	0	0	0	0	5 773	0	1 195	0	7 002
Generation and supply of power, gas, water steam, hot water and air for air-conditioning systems	0	2 353	0	9	0	0	0	45	0	0	2 408
Other exposures	0	19 994	0	419	0	7	29	686	0	0	21 135
Banks	0	2	0	0	0	8 355	0	0	0	0	8 357
Governments	0	0	28 967	0	0	0	0	0	0	0	28 967
Individuals	24 574	6 964	0	63 118	0	0	0	1 588	0	0	96 245
Other***	76	2 276	5	0	12 890	267	1 228	9	0	904	17 656
Total (PKO BP SA, KREDOBANK SA Group and PKO Leasing SA Group)	24 651	65 278	28 972	64 567	12 890	8 629	7 029	4 003	1 195	904	218 117
Other companies of the Group	0	767	14	0	993	9 378	0	82	0	18	11 252
Adjustments and exclusions	0	-3 893	0	-86	-56	-10 338	0	-82	0	-759	-15 214
Total	24 651	62 152	28 986	64 480	13 827	7 669	7 029	4 003	1 195	163	214 155

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

** A - retail exposures,

B - corporate exposures,

C - exposures to central governments and central banks,

D - exposures secured on real estate property,

E - other exposures,

F - exposures to institutions,

G - exposures to regional governments and local authorities,

H - past due exposures,

I - exposures to administration bodies and non-commercial undertakings,

***Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings

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

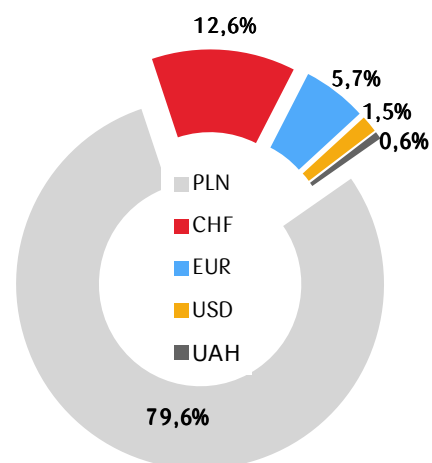
As at 31 December 2013, the share of exposures in convertible currencies other than PLN in the Group's total portfolio amounted to 20.4%. The biggest portion of the Group's currency exposure is the exposure in CHF pertaining to the Bank's credit portfolio (Chart 2.2).

The situation is different 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 BTK SA Group (respectively 96% and 91% 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 54% and 80% of the foreign currency portfolio of the entities).

The 2013 decrease in the share of loans denominated in foreign currencies resulted mainly from the drop of the USD and CHF rate compared to the 2012. What is more, there can be observed a rise of sales of new credits offered to the Bank's institutional clients granted in foreign currencies with simultaneous drop of the individual clients' engagements in the foreign currency portfolio resulted from the lack of mentioned type of credits in Bank's portfolio for individual client segment.

Chart 2.2

CURRENCY STRUCTURE OF THE CREDIT PORTFOLIO THE BANK GROUP



2.2.3.4. Monitoring of derivatives

Contracts with embedded derivatives are monitored by the Bank and separated embedded derivatives are subject to periodical valuation.

Derivatives subject to separation from main contracts and separate recognition are valued at their fair value. Their valuation is presented in the financial statement in the line entitled "Financial derivatives". Changes in valuation of the fair value of derivatives are referred to in the profit and loss account in the line entitled "Result of financial instruments valued at fair value" or "Result of foreign exchange position". Separated embedded derivatives were not a significant risk factor for the Bank in 2013.

As at 31 December 2013 the Bank had signed general agreements in ISDA/PBA standard with 26 Polish banks and 56 foreign banks and credit institutions. Moreover, the Bank was a party of 63 CSA (Credit Support Annexes/PBA collateral agreements) and 7 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 98.8% respectively.

The positive gross fair value of contracts with financial institutions as at 31 December 2013 was PLN 2,638 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 437 million. Netting benefits amounted to approx. PLN 2,201 million (these were not accounted for in the calculation of capital requirements for credit risk, as presented in Chapter 4 "Capital requirements (Pillar I)"). The value of collateral accepted from the counterparties within the CSA and PBA collateral agreements was ca. PLN 524 million.

As at 31 December 2013, the Bank had no derivative credit transactions.

As at 31 December 2013, the Bank recognized adjustments for credit valuation in the valuation of financial derivatives concluded with non-financial business entities based on a performed analysis of recoverability of its exposures. The Bank's adjustment included the market value of credit risk as assessed by the Bank. Analyse covered all significant exposures on account of the Bank's positive valuation of financial derivatives contracted with non-financial business entities. In particular, the adjustment included the risk of non-performance 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 prevailing numbers of financial institutions – the Bank's business partners on an interbank market – were awarded high external ratings – between AAA and BB (Table 2.15).

Table 2.15

THE QUALITY OF EXPOSURES* TO FINANCIAL INSTITUTIONS**

Rating	PKO Bank Polski SA	
	2013	
AAA		0,1%
AA		3,0%
A		77,5%
BBB		8,8%
BB		2,0%
No rating		8,6%
Total		100%

* 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 into 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 companies for the Bank Group in which significant credit risk level was identified (for instance the KREDOBANK SA Group and the PKO Leasing 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.

Because the Bank implements the internal rating based (IRB) approach to calculate capital requirement for credit default risk, since 2011 quarterly reports include also information on credit risk parameters for commercial credits (similar to existing analogical information for consumer credits), in particular in respect of PD parameter as divided by the results of rating assessment

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 subsidiaries of the Bank Group 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 subsidiaries of the Bank Group.

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-sized enterprises as well as corporate clients is established, among other things, on business liabilities, bank accounts, movables, immovables or securities.

In accepting legal collateral for loans, the Bank applies the following principles:

- 1) in case of large loans, the Bank establishes several types of collateral, combining personal and tangible collateral whenever possible,
- 2) liquid collateral is preferred, that is such collateral that may be sold without significant reduction of its price in time and does not expose the Bank to changes in collateral value due to price fluctuation typical for a given collateral subject,
- 3) in case of acceptance of property collateral, as an additional security the Bank accepts transfer of cash receivables under insurance policy for the subject of collateral, or insurance policy issued in favor of the Bank,
- 4) collateral is assessed in terms of the actual possibility of their use as a potential source of the Bank's claim. The basis of the value assessment of the collateral established on tangible assets is the market value,
- 5) effective establishment of collateral in accordance with clauses of the agreement is a prerequisite to release of the loan funds.

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 (the Loan to value (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 activates emergency procedures.

Concluding the lease agreements, the PKO Leasing SA Group as the owner of the leased assets treats them as collateral for the transaction.

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.

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 course of creditworthiness assessment made using the scoring system (for individual clients) or the rating class and joint rating (for institutional clients), from which the loan transaction can be made with a given client,
- 3) concentration limits – limits defined in Article 71 of the Banking Law,
- 4) branch limits – limits defining the risk level related to financing of institutional clients that conduct their businesses in branches characterised 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 limits for a period of concentration,
- 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 subsidiaries of the Bank Group

The subsidiaries of the Bank Group with significant credit risk level (the KREDOBANK SA Group, the PKO Leasing SA Group, the BTK SA Group, and subsidiary - 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 adjusted to 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 subsidiaries of the Bank Group is each time agreed with units responsible for risk management within the Bank.

The PKO Leasing SA Group, the BTK SA Group and the KREDOBANK SA Group and subsidiary: 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 organization structures of the KREDOBANK SA Group, the PKO Leasing SA Group and the BTK SA Group include risk units that are specifically in charge of the following:

- 1) development of the methods of credit risk assessment and establishing provisions and write-downs,
- 2) credit risk control and monitoring in the credit process,
- 3) the quality and efficiency of restructuring and the debt collection process.

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 in the BTK Group is supported by credit committees activated in the case of credit transactions generating an enhanced credit risk level.

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 by setting off due and payable liabilities (mitigation of settlement risk) and liabilities which are not due and payable (mitigation of pre-settlement risk), which is aimed at collateralising the Bank's claims towards counterparties, resulting from derivative transactions.

Framework agreements with foreign counterparties are made in accordance with standards developed by ISDA (International Swaps and Derivatives Association) and ISMA (International Securities Market Association), while those made with Polish counterparties – in accordance with the standards developed by PBA. Framework agreements with Polish financial institutions for transactions involving debt securities are made based on the Bank's internal standard. To mitigate credit risk, in the case of a planned increase in the scale of operations with a financial institution under a framework agreement, the parties enter into a collateral CSA (Credit Support Annex) agreement or on the basis of PBA's standard. Based on the collateral agreement, 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. In occasional cases, the provisions of collateral agreements require additional collateral of creditworthiness of any of the parties' decreases.

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 requires that its counterparty establishes additional collateral, for example in the form of blocked securities account, where the planned scope of cooperation with that given counterparty exceeds the level of the limit granted.

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 Polish banks and financial institutions as well as framework agreements and credit support annexes with foreign banks and credit 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 assessment (internal rating) 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.

Due to the specific nature of derivatives, the derivatives management process is subject to particular control defined in the internal regulations.

The derivatives risk management methods in the entities of the Bank Group 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 subsidiaries 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 subsidiaries' activities.

In 2013, the only companies of the Bank Group beside the Bank to use derivatives within market risk management (to hedge the risk resulting from their major activities) were companies of the PKO Leasing SA Group and KREDOBANK SA Group (which obtained short term financing by FX swap transactions).

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 the interest rate changes, resulting from unfavorable interest rate changes on the market.

The purpose of interest rate risk management is to mitigate the possible losses of changes in the market interest rates to an acceptable level through 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.

In order to determine VaR for market risk management purposes, the variance-covariance method is applied 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 movement of the profitability curves by one basis point up.

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 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 2013, interest rate risk of the Bank Group was determined mainly by the risk of mismatch of dates of reassessment of assets and liabilities.

As at 31 December 2013 the mismatch of reassessment dates of 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 Companies 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 reassessment dates comprised mainly the Bank's exposures and the mismatch of the Group's companies. The mismatch of the Bank Group's companies reduced the mismatch of the Group in USD in the range up to 1 month. As far as the other ranges are concerned, the mismatch of the Group's companies increased the mismatch of the Group.

The Tables 2.16 – 2.19 present the repricing gaps of the Group as at 31 December 2013 by currencies.

Table 2.16

PLN repricing gap (in PLN million)								
2013	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	33 491	65 625	-21 546	-58 315	-3 496	4 730	361	20 851
Cumulative gap	33 491	99 116	77 571	19 256	15 760	20 490	20 851	
Group subsidiaries								
Periodic gap	-91	-480	58	27	18	-77	25	-519
Cumulative gap	-91	-571	-513	-485	-467	-544	-519	
TOTAL - Periodic gap	33 400	65 145	-21 487	-58 288	-3 477	4 653	386	20 332
TOTAL - Cumulative gap	33 400	98 545	77 058	18 770	15 293	19 946	20 332	

Table 2.17

USD repricing gap (in USD million)

2013	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	34	423	-1	-432	1	0	-199	-175
Cumulative gap	34	457	456	24	24	24	-175	
Group subsidiaries								
Periodic gap	-99	0	-2	-7	42	33	11	-22
Cumulative gap	-99	-100	-101	-108	-66	-33	-22	
TOTAL - Periodic gap	-65	423	-3	-439	42	33	-187	-196
TOTAL - Cumulative gap	-65	357	355	-84	-42	-9	-196	

Table 2.18

EUR repricing gap (in EUR million)

2013	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	178	757	-96	-681	-475	117	-13	-213
Cumulative gap	178	935	839	158	-317	-200	-213	
Group subsidiaries								
Periodic gap	-84	1	0	0	6	13	5	-58
Cumulative gap	-84	-83	-83	-83	-77	-63	-58	
TOTAL - Periodic gap	94	758	-96	-681	-468	130	-9	-272
TOTAL - Cumulative gap	94	852	756	75	-393	-263	-272	

Table 2.19

CHF repricing gap (in CHF million)

2013	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	-740	1 194	-2	-40	-500	-8	18	-78
Cumulative gap	-740	454	452	412	-88	-96	-78	
Group subsidiaries								
Periodic gap	-6	1	0	0	0	0	0	-5
Cumulative gap	-6	-5	-5	-5	-5	-5	-5	
TOTAL - Periodic gap	-746	1 194	-2	-40	-500	-8	18	-83
TOTAL - Cumulative gap	-746	449	447	407	-93	-101	-83	

The VaR and analysis of stress test scenarios of the Group's exposure to the interest rate risk as at 31 December 2013 and 31 December 2012 respectively are presented below:

Table 2.20

	Sensitivity of financial assets Exposed to interest rate risk			
	2013		2012	
	10-day VaR	Stress-test ±200 base points*	10-day VaR	Stress-test ±200 base points*
PKO Bank Polski SA	54,9	-523,1	64,5	-299,0
Group subsidiaries	-	-27,3	-	-42,9
Total	54,9	-495,9	64,5	-271,0

*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, separately for the Bank and Group subsidiaries and together for them

As at 31 December 2013, the 10-day VaR on the interest rate was PLN 54.9 million for the Bank, which accounted for ca. 0.27% of the Bank's own funds. As of 31 December 2012, the Bank's VaR was 64.5 PLN, which accounted for approx. 0.33% 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 the table below:

Table 2.21

Currency	Stress tests results* - parallel shift of interest rate curves by ±200 base points					
	Bank		Group Subsidiaries		Total	
	2013	2012	2013	2012	2013	2012
PLN	-412,8	-260,4	-0,3	-11,0	-412,5	-271,4
EUR	-48,9	-49,1	-8,9	-5,1	-40,0	-44,0
USD	-58,8	16,3	-18,1	-26,7	-40,7	43,0
CHF	-2,2	-4,4	0,0	-0,1	-2,2	-4,5
GBP	-0,8	-0,6	0,0	0,0	-0,8	-0,6

* Main foreign currency values have been shown in PLN equivalents

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 2013 was PLN 10.7 million, while as at 31 December 2012 - ca. PLN 14.3 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 use of these risk limits. 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 threshold values for interest rate risk, that is among other, price sensitivity, interest income sensitivity, as well as limits and threshold values of losses, and limits for instruments sensitive to interest rate fluctuations.

The methods of interest rate management in the Group's subsidiaries are defined by internal regulations that are implemented by companies in which the interest rate risk is significant. Such provisions are worked out consultations with the Bank and taking account of the recommendations sent to companies by 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 and it is 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 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 2013, 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 2013 amounted to PLN 2.4 million, which accounted for approx. 0.012% of the Bank's own funds. The VaR and stress-test analysis in respect of the Bank's and the Group's financial assets (jointly for all currencies) exposed to FX risk as at 31 December 2013 and 31 December 2012 respectively was as follows:

Table 2.22

 Sensitivity of financial assets
exposed to FX risk

	2013		2012	
	10-day VaR	Stress-test ±20%	10-day VaR	Stress-test ±20%
PKO Bank Polski SA	2,4	-21,4	0,6	-3,9
Group subsidiaries	-	-43,1	-	-28,7
Total	2,4	-14,2	0,6	-32,6

*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 other companies of the Bank Group 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 2013 its value was ca. PLN 0.9 million while as at 31 December 2012 – ca. PLN 0.6 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 threshold values for FX risk,
- 3) defining the allowed types of FX transactions and FX rates used in such transactions.

The Bank Group defined limits and threshold values 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's subsidiaries are defined by internal regulations implemented by companies in which FX risk measures reach significant value. Such regulations are prepared after consultation with the Bank and taking into account recommendation sent by the Bank to companies.

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 with due account 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) real-terms liquidity gap – listing of individual balance sheet categories by their real-terms 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 credit 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 fulfilled.

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 with due account 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 with due account 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 2013 and 31 December 2012 respectively.

Table 2.23

ADJUSTED LIQUIDITY GAP* - ASSETS AND LIABILITIES

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	0
Group subsidiaries								
Periodic gap	-33	157	-502	-75	-274	340	525	-138
Cumulative gap	-33	124	-378	-453	-727	-387	138	0
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
2012	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	10 223	6 748	402	3 133	2 174	9 249	11 556	-43 486
Cumulative gap	10 223	16 971	17 373	20 506	22 680	31 930	43 486	0
Group subsidiaries								
Periodic gap	163	110	-377	-88	-169	-90	295	156
Cumulative gap	163	273	-104	-192	-362	-451	-156	0
TOTAL - Periodic gap	10 386	6 858	25	3 045	2 005	9 159	11 851	-43 329
TOTAL - Cumulative gap	10 386	17 244	17 269	20 314	22 319	31 478	43 329	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

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

Table 2.24 presents data concerning contractual off-balance sheet liquidity gap of derivatives of the Group.

Table 2.24

CONTRACTUAL OFF-BALANCE SHEET LIQUIDITY GAP FOR DERIVATIVES

The Bank Group

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	0
2012	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Razem
TOTAL - Periodic gap	-112	-145	48	347	351	348	259	1 096
TOTAL - Cumulative gap	-112	-257	-209	139	489	838	1 096	0

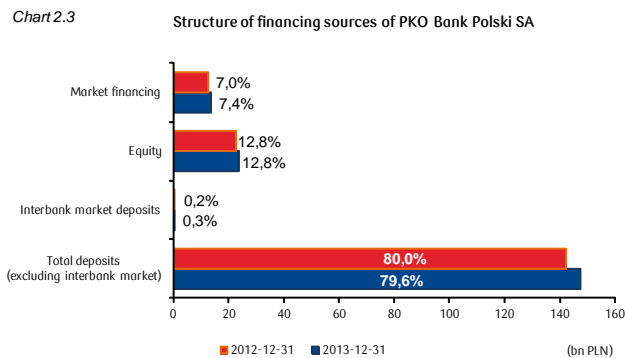
The table below presents the Bank's liquidity reserve as at 31 December 2013 and 31 December 2012:

Table 2.25

LIQUIDITY RESERVE PKO Bank Polski SA		
Sensitivity measure	2013	2012
Liquidity reserve for up to 1 month	17 816	13 568

As at 31 December 2013, core deposits amounted to approx. 95.9% of all deposits held by the Bank (the interbank market excluded), which was an increase of approx. 2.6 percentage points compared to 31 December 2012.

The following chart presents the structure of the Bank's financing sources as of 31 December 2013 and 31 December 2012.



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 use of these risk limits. 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 other companies of Bank Group limits and threshold values 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 directed to the entities of the Group.

2.6. EQUITY RISK 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 2013 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 – a capital requirement, pursuant to the Resolution No. 76/2010 (with subsequent amendments), to cover the above mentioned risk amounted to approximately PLN 60 thousand at the end of the 2013.

2.6.2. MEASUREMENT AND ASSESSMENT OF EQUITY RISK 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 2013 positions in transactions generating commodity price risk were closed as at end of the day.

The Bank Group's capital exposures in the banking book are divided into two groups depending on the purpose of their acquisition:

- 1) stocks and shares – exposures to subsidiaries and associated companies and to other companies with the minority interest of PKO Bank Polski SA and the Group's companies in their share capital (except for stocks and shares reducing own funds of the Group). The reason behind acquisition of these assets is to obtain capital gains (dividend) and return on investment following the disposal of stocks and shares (including recovery of capital in result of sales of shares or stock acquired in restructuring of credit receivables) as well as the share of PKO Bank Polski SA in the development of the financial market;
- 2) participation units in collective investment undertakings – covering investments of PKO TFI SA in participation units of the new investment funds under its management. The reason behind the acquisition of those assets is to obtain,

in accordance with the Statutes of PKO TFI SA, the means required to create such fund.

Table 2.26

CAPITAL EXPOSURES - BANKING BOOK

	The Bank Group			
	2013		2012	
	Carrying amount	fair value*	Carrying amount	fair value
Total	271 472	271 869	98 428	98 87
Shares in other entities	204 689	204 689	13 760	13 76
Equity securities	66 783	67 180	84 668	85 11
Shares in entities listed on regular market **	43 242	43 242	31 513	31 51
Shares in entities not listed on regular market ***	5 938	6 335	36 006	36 45
Participation units in collective investment undertakings	17 603	17 603	17 149	17 14

* Assessed fair value

** Fair value of listed securities equals their market value

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

Stocks and shares in co-subidiaries and associated companies are valued using the equity method (acquisition cost adjusted by a change in the net assets of the company for the period from the acquisition to valuation date) less impairment write-downs.

The co-subidiaries and associated companies' share in the financial result from the acquisition date is shown in the profit and loss account, and their share in the changes of other overall revenues from the acquisition date - under other overall revenues.

2.6.3. MONITORING OF EQUITY RISK AND COMMODITY PRICE RISK

At the end of each reporting period, an assessment of impairment for investments in associated entities and subsidiaries 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 and cover the period from 3 to 5 years 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 stock and shares in associated companies and co-subidiaries.

Stocks and shares in other companies are valued as follows:

- 1) at fair value determined in the following manner:
 - a) at market value for those stocks, for which there is an active market,
 - b) as a received current offer of purchase or by way of valuation performed by specialised external entity providing this type of service, for stocks and shares, for which there is no active market;
- 2) at the acquisition cost less impairment write-down for those stocks and shares, for which reliable determination of fair value is not possible.

The effects of changes in the fair value of stocks and shares are taken to revaluation reserve, except for impairment write-downs, which are taken to the profit and loss account. The revaluation reserve item is taken to the profit and loss account

at the time the asset is disposed of or impaired. In the case of impairment of a given asset, the amounts recognised previously as an increase in the value due to reassessment to fair value decrease revaluation reserve. If the amount of previously recognised increases is not sufficient to cover the impairment, the difference is taken to the profit and loss account.

Impairment write-downs for the stocks and shares in other entities are not reversed through profit and loss account, i.e. any subsequent increases in their fair value are recognised in the revaluation reserve.

Participation units in collective investment undertakings are valued at fair value with an effect carried to the revaluation reserve.

Dividends on capital exposures are recognised in the profit and loss account at the time the entity's right to receive payment has been established.

As at 31 December 2013, the unrealised loss of the Bank Group relating to evaluation of capital exposures (presented in the profit and loss account and in revaluation) and foreign exchange amounted together to PLN 4.5million, and realised gains from selling capital exposure held in the stocks amounted to PLN 5.9 mln. Simultaneously in the 2013 the Group presented profit from revaluation to the fair value shares of Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o in the amount PLN 178.7 mln. Additionally, on account of its capital exposure in the stocks held, the Bank Group received a gross dividend in 2013 in the total amount of PLN 5.1 million.

2.6.4. REPORTING EQUITY RISK 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 EQUITY RISK AND COMMODITY PRICE RISK

The equity securities 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 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.

Target operational risk profile is defined as a volume and a structure of exposure to operational risk, determined by strategic limits for operational risk tolerance.

Bank complies with the Recommendation M requirements during the operational risk management process.

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 the issues relating to operational risk management are supervised by the Management Board that:

- 1) sets the objectives for operational risk management,
- 2) shapes operational risk management policy,
- 3) adopts resolutions on operational risk management principles, strategic limits for operational risk tolerance and changes and extensions of the AMA method,
- 4) accepts the value of the management adjustment of the capital requirements for operational risk by means of AMA method,
- 5) accepts reports and information relating to operational risk.

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 means of defined risk measures.

Operational risk measurement includes:

- 1) calculation of key operational risk indicators (KRI),
- 2) calculation of capital requirement in compliance with the method,
- 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 and results of their occurrence, data on operational environment 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 in the organisational changes and is conducted using the following:

- 1) collected data on operational risk events,
- 2) results of inspections, proceedings and internal functional control,
- 3) the key operational risk indicators.

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 with an account of the economic costs related to gathering information on operational events and their value added in operational risk measurement. Used external data on operational events come for instance from the system of information exchange in respect to events within the scope of operational risk that is maintained by the Polish Bank Association (ZORO). Moreover, the operational risk measurements include macroeconomic data and data

presenting the volume of the Bank's operational and business activities.

According to the AMA approach, the capital requirement for operational risk corresponds to the VaR in respect to operational risk plus the result of complementary method and adjusted by the value of adjustments related to changes in quality of internal functional audit and management adjustment pertaining to the following formula:

$$AMA = (LDA_{99,9\%} + CMR) * (1 + IA) + MA$$

Where:

AMA - capital requirement for operational risk (AMA requirement),

LDA_{99,9%} - value at risk,

CMR - complementary method result,

IA - adjustment related to changes in quality of internal functional audit,

MA - management adjustment.

Calculations of value at risk are made by means of the loss distribution approach (LDA). On the basis of historical internal and external information on operational events and about operational environment, this approach measures potential loss that is not to be exceeded within coming year with the probability equal to 99.9%.

Complementary method is an analysis of scenarios concerning selected types of operational events. The purpose of the complementary method is to extend the AMA requirement to cover operational risk related to operational events that have not been covered with LDA approach.

Adjustment related to the changes in audit quality makes it possible to include possibilities of deterioration of the internal functional audit quality in the Bank that would result in an increase of the frequency or severity of operating events.

The purpose of management adjustment is to cover the requirement of extraordinary events in AMA calculation, if due to their specific nature such events were not included on AMA's requirement under LDA approach or under complementary method.

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 AMA's requirement 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 requirements.

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

Furthermore, applied AMA method is validated by an independent organisational unit of the Head Office at least once a year. The validation is aimed to ensure that the operational risk measurement and management systems in the Bank with their essential components functioned in compliance with the assumptions. The subject of validation is verification of accuracy, objectivity and conservatism of the operational risk measurement and management system 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 the insurance policy that requires that a continuing and effective insurance cover is granted in return of acceptable cost level.

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 capital requirement for operational risk, the Bank includes the impact of insurance.

The insurance policies used by the Bank to reduce capital requirement, fulfill the criteria defined in § 63-64 of Appendix no 14 to the Resolution of the Polish Financial Supervision Authority no 76/2010 (as amended) and they also comply with internal regulations as regards calculation of capital 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 calculation deductions related to maintained insurance, the Bank takes account of deductibles. Every reduction of the operational risk result in relation to maintained insurance is subject to verification.

In compliance with § 65 of Appendix no 14 to the Resolution of the Polish Financial Supervision Authority no 76/2010 (as amended) a reduction of the capital requirements due to recognition of insurance shall not exceed the maximum value equal to 20% of the capital requirements for operational risk before risk reduction 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:

- 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) results of AMA and stress tests,
- 5) KRI values against threshold and critical values,
- 6) efficiency and timeliness of the activities undertaken in relation to operational risk reduction or transfer.

2.7.4. OPERATIONAL RISK REPORTING

Reporting on operational risk is made for:

- 1) the Bank's internal needs, in particular senior management, ORC, RC, Management Board and Supervisory Board,
- 2) regulators,
- 3) shareholders and the financial market.

Report for the Bank's internal need of risk-related information concerning the Bank and the companies of the Group are 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) number and results of operational events,
- 2) structure of operational events,
- 3) KRI values.

The recipients of quarterly reports are ORC, RC, Management 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 operational risk level,
- 4) 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 central Bank level as well as at the particular areas of systemic operational risk management.

Systemic operational risk management consists in developing solutions, which enable Bank to exercise control in order to realize its aims. 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 PKO Bank Polski and consist in preventing from materialisation of operational events arising in servicing products, conducting processes, exploiting IT applications and reacting on occurring operational events. Reacting consists in the following:

- 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) liquidating the negative consequences of operational risk events.

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.

Three entities, i.e. PKO Bank Polski SA, the PKO Leasing SA Group and the KREDOBANK SA Group have a decisive impact on the operational risk profile of the Bank 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 at the Bank, various solutions are applied. These include, among other things, the following:

- 1) control instruments,
- 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 and loss limits,
- 5) contingency plans,
- 6) insurance,
- 7) outsourcing.

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 high level or it already exceeded one of this levels.

If the operational risk level is higher 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 AMA requirements,
- 3) validation of AMA approach,
- 4) internal audit.

The companies of the Bank Group manage operational risk in accordance with the operational risk principles binding in PKO Bank Polski SA, taking into account the specific nature and scale of their business activity.

2.7.6. INCURRED LOSSES AND OPERATIONAL RISK MANAGEMENT ACTIONS

In the 2013 events related to operational risk, excluding losses from credit process, were disclosed in the Bank and amounted to PLN 17 mln (Table 2.27).

Table 2.27

 GROSS LOSSES* RELATED TO DISCLOSED EVENTS
 PKO Bank Polski SA
 2013

General category	Specific category	Gross losses**
Internal frauds	Non-legitimated activities	0,03
	Thefts and frauds	1,64
Regulations of employment and work safety	Labour issues	2,91
Clients, products and operational practises	Customer service, disclosure of information about clients, responsibilities to clients	0,08
	Improper business or market practises	2,85
	Product malfunctions	0,08
Disruptions of bank activity and systems breakdowns	Systems	0,45
Making transactions, providing and managing operational processes	Recording in the system, making, calculating and servicing transactions	1,43
	Monitoring and reporting	0,47
	Inflow and registering clients	0,24
	Managing clients' bank accounts	0,04
	Counterparties who are not Bank's clients	0,01
	Sellers and suppliers	0,04
Losses related to fixed assets	Natural disasters and other events	0,55
External frauds	Thefts and frauds	6,11
Total		16,93

* 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 15 April 2014, 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 2013 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, terms of granting credits presented in the Bank's advertisements were unclear for an average consumer. The Bank appealed the Office's decision. The proceeding is not legally valid.
- 2) „External frauds” – the suspicions of making non-licensed actions by entities providing outsourcing. In the Bank were taken actions aiming at implementing additional monitoring of outsourcing services.

The Bank takes systemic and current management actions in order to limit losses from operational risk. Current actions include reacting on identified risks, eliminating incorrectnesses when it is possible as well as recovering financial losses. Systemic actions contain, among others, IT security systems, improving processes, optimisation of functional control, staff trainings as well as risk transfer (insurance policies, outsourcing). Taking into account, in particular, events of inaccessibility of cards systems and the Bank's transactional websites, the Bank revised and optimised cards' systems architecture and is adjusting its website service hours in respect to minimise the risk of interrupting website services accessibility to the clients. Aiming at preventing frauds, on the Bank's main website as well on the websites to log in on the announcement warning against false sms and e-mails send by people impersonating the Bank was placed. What is more, the process of credit risk assessment analysing was centralised and the whistleblowing mechanism was intensified.

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) 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 non-compliance 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 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 CC, the Management and Supervisory Boards and the Audit Committee.

The reports contain synthetic information concerning:

- 1) results of compliance risk identification and assessment,
- 2) observed cases of non compliance,
- 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 defense,
- 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 2013 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 non – compliance events, their causes and results of their occurrence. Mentioned data are collected in central database. Information about non-compliance events are 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 perspicacity.

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 function consistent compliance risk management principles.

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 recognise 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 is made through the analysis of selected items from the income statement related to the Bank's income and expense.

Measurement of business risk is aimed at defining the scale of threats related to the existence of business risk with the use of defined risk measures. The measurement of business risk is conducted quarterly and comprises:

- 1) calculation of selected business risk indicators,
- 2) conducting stress-tests,
- 3) calculation of internal capital.

Business risk assessment is conducted quarterly on the basis of the following:

- 1) results of business risk measurements,
- 2) level of calculated strategic limits of risk tolerance
- 3) results of the survey conducted among Bank's senior management.

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) deviations from the implementation of business risk forecast – on a quarterly basis.

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 a survey conducted among senior management of the Bank, utilisation of strategic risk limits on business risk, business risk forecast and forecast backtesting.

2.9.5. BUSINESS RISK - RELATED MANAGEMENT ACTIONS

Management activities include in particular:

- 1) verification and updating of quarterly financial forecasts,
- 2) monitoring of the strategic limit of risk tolerance.

2.10. REPUTATION RISK

2.10.1. INTRODUCTION

Reputation risk is related to the possibility of occurrence of negative deviations from the Bank's planned financial result due to deterioration of the Bank's image.

The purpose of reputation risk management is to protect the Bank's image and reduce the risk of occurrence and the amount of losses of reputation.

2.10.2. REPUTATION RISK MEASUREMENT AND ASSESSMENT

Reputation risk ratios are calculated on the basis of an annual assessment of effects of image-related events identified in a given year for individual categories of image-related events.

The main tools used to define the Bank's reputation risk level are:

- 1) catalogue of categories of image-related events that includes a specification of categories of image-related events together with weights assigned to them,
- 2) register of image-related events effects used to recording identified image-related events effects – media monitoring result and complaints and requests.

2.10.3. REPUTATION RISK MONITORING

Monitoring of image-related events is performed on an ongoing basis and it includes:

- 1) monitoring the external channels of communication in respect to identification of effects of image-related events that have taken place and distribution of respective information,
- 2) gathering and analysing information on the occurrence or potential occurrence of an image-related event,
- 3) recording data on identified negative effects of image-related events.

2.10.4. REPUTATION RISK REPORTING

Reputation risk reporting is performed in the Bank on an annual basis. Report presents in particular: description of reputation risk measurement method, results of mentioned risk measurement, and results of image – related events identification as well as recommendations of activities mitigating reputation risk level. Information on reputation risk is submitted to the Management Board and the Supervisory Board units of the Banking Risk Division.

2.10.5. REPUTATION RISK-RELATED MANAGEMENT ACTIONS

Reputation risk management in the Bank comprises in conducting preventive activities aimed at reducing the scale of image-related events. What is more, reputation risk management decisions within the scope of selection of effective tools for protective actions in order to eliminate, mitigate or reduce negative impact of image-related events on the Bank's image.

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 objective of models management and model risk management is to mitigate the level of model risk in the Group.

Within the Group, model risk is managed both in a given company (an owner of a model) and in the Bank. In December 2013, a new department was appointed by a resolution of the Management Board. One of its tasks is to ensure greater standardisation and integration of management methods of model risk within the Group.

2.11.2. MODEL RISK MEASUREMENT AND ASSESSMENT

Identification of model risk in the Bank mainly consists of:

- 1) gathering information on all existing, built 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.

All models relevant to the Bank are covered by the regular independent validation process.

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 of particular elements important from the model's point of view, risk assessment on the level of a single model and aggregate assessment of the model risk level is carried out in the Bank.

Ratings may be aggregated mainly at the level of the Bank, particular risk types or classes of models, particular processes of model life-cycle. The model risk assessment is performed at least once a year and at the moment of appearing of new models, change the scale or business profile of the Bank.

2.11.3. MODEL RISK MONITORING

The purpose of model risk monitoring is to control model risk and diagnose areas for management actions. Model risk monitoring process contains, in particular: the level of model risk, the status of implementation of the proposed recommendations and the effectiveness of implementation of the recommendations on mitigation of model risk.

2.11.4. MODEL RISK REPORTING

Model risk reporting is conducted in the Bank on a quarterly and annual basis. Reports contain, in particular:

- 1) results of model risk monitoring,
- 2) information on the level of model risk and model risk map,
- 3) potential proposed management actions reducing the model risk,
- 4) evaluation of effectiveness of the recommendations made to reduce the model risk level,
- 5) conclusions, reports or summaries resulting from the model management process.

2.11.5. MANAGEMENT ACTIONS CONCERNING MODEL RISK

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

Management actions in particular consist 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 CHANGES RISK

2.12.1. INTRODUCTION

Risk of macroeconomic changes 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 risk of macroeconomic changes 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 CHANGES RISK IDENTIFICATION AND ASSESSMENT

Identification of macroeconomic changes 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. Risk of macroeconomic changes results from interaction of factors dependent and independent of the Bank's activities. The Bank identifies the factors affecting the level of macroeconomic changes risk during carrying out comprehensive stress-tests.

The risk of macroeconomic changes 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 risk of macroeconomic changes the Bank uses risk measures based on the results of comprehensive stress-tests, in particular:

- 1) level of own funds and its structure,
- 2) financial result and its components,
- 3) capital adequacy measures and their components,
- 4) selected liquidity measures.

2.12.3. MACROECONOMIC CHANGES RISK MONITORING

A process of risk of macroeconomic changes monitoring includes monitoring of:

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

2.12.4. MACROECONOMIC CHANGES RISK REPORTING

Risk of macroeconomic changes reporting is realised in the form of reports summarising the results of each stress-tests. Reports are addressed to ALCO and the Management Board. Reports include information i.e.:

- 1) summary of the results of stress-tests,
- 2) in case of elevated or high level of risk of macroeconomic changes: 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 actions aimed at reducing the level of risk, an initial assessment of their effectiveness.

2.12.5. MANAGEMENT ACTIONS CONCERNING MACROECONOMIC CHANGES 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 risk of macroeconomic changes occurrence.

2.13. 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 by the PKO Bank Polski SA Group to be relevant, 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, 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 Resolution no 325/2011⁷ of the Polish Financial Supervision Authority dated 20 December 2011 concerning decreases of basic funds, (Official Journal of PFSA no 13 item 49).

Included in the basic funds (so called Tier 1) are the following:

- 1) core funds comprising:
 - a) share capital – in the amount defined in the Bank's Statutes and entry in the Register of Entrepreneurs, at nominal value,
 - b) reserve capital – established in accordance with the Bank's Statutes from the net profits and premiums on the issue of shares, assigned to absorb balance sheet losses that may arise within the Bank's activities; decisions concerning utilisation of the reserve capital are taken by the General Meeting,
 - c) other reserve capital – to be utilised for the purposes defined in the Statutes, created from of the net profits in the amount defined by the General Meeting,
- 2) general banking risk reserve for unidentified banking activities risk – created in accordance with the Banking Law from the net profit,
- 3) retained earnings,
- 4) 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 pertaining to article 127 item 2 point 2 letter c of the Banking Law.

In addition, the basic funds are reduced by the following items:

- 1) intangible assets valued at their carrying amount,
- 2) equity exposures⁸ of the Bank to financial institutions, lending institutions, Polish and foreign banks and insurance companies, in the form of:
 - a) shares or stocks held,
 - b) amounts classified as subordinated liabilities,
 - c) other equity exposure in items classified as own funds or capital of those entities, including additional contributions in favour of a limited liability company, in the amount of 50% of carrying amounts of such exposures,
- 3) unrealised losses on debt and equity instruments and on other liabilities classified as available for sale,
- 4) negative amounts from revaluation adjustments of the value of assets held in the trading book,
- 5) negative differences from conversion of stock abroad.

Supplementary funds (so called Tier 2) comprise the following:

- 1) subordinated liabilities– in the amount and based on the principles defined by the Polish Financial Supervision Authority –which together meet in accordance with the contract the following criteria:
 - a) the funds have been accepted for a period of at least 5 years (term of contract),
 - b) the funds may not be withdrawn from the bank prior to expiration of contract,
 - c) the funds are to be returned as the last item in the case of the bank's bankruptcy or liquidation,
 - d) the refund is not guaranteed by the Bank, either directly or indirectly,
- 2) unrealised gains on debt and equity instruments classified as available for sale – in the amount of 80% of their pre-tax value,
- 3) positive exchange rate differences from conversion of stock abroad.

In addition, supplementary funds are reduced by 50% of the value of the Bank's equity exposures⁸ in financial or lending institutions, Polish and foreign banks and insurance companies. Where the value of those reductions decreases the amount of supplementary funds to below zero, the surplus amount over the value of supplementary funds is deducted from the basic funds.

In addition, the following is included in the balance of consolidated own funds:

- 1) goodwill of the subsidiaries (acts to reduce own basic funds),
- 2) non-controlling interest (have an impact on the value of basic funds).

The value of short-term capital (so called Tier 3) reflects the total of daily market profits for the reporting year.

Information on the structure of the Bank's and the Group's own funds is presented in Table 3.1.

Table 3.1

	OWN FUNDS			
	Group		Bank	
	2013	2012	2013	2012
OWN FUNDS	21 305	20 178	20 524	19 562
Basic funds (Tier 1)	19 611	18 475	19 347	18 345
core funds	21 480	20 053	21 265	19 834
general risk funds	1 070	1 070	1 070	1 070
retained profit/loss	-306	-417	-271	-225
intangible assets	-2 230	-1 934	-1 944	-1 681
capital exposures	-122	-98	-633	-580
unrealised losses on instruments available for sale	-142	-77	-134	-72
revaluations of assets in the portfolio	-6	-1	-6	-1
currency translation differences	-134	-121	0	0
minority interest	2	-0	0	0
Supplementary funds (Tier 2)	1 540	1 573	1 023	1 087
subordinated liabilities	1 601	1 601	1 601	1 601
unrealised profits on instruments available for sale	56	70	55	67
currency translation differences	5	1	0	0
capital exposures	-122	-98	-633	-580
Short-term equity (Tier 3)	154	130	154	130

As of 31 December 2013 the Group's own funds grew ca. PLN 1,127 million, which was mainly due to the fact that the Bank's net profit for 2012 minus disbursed dividend (in the amount of PLN 2,250 million) was recorded as funds. As compared to the end of 2012, the result from previous years decreased by PLN 111 million, while the value of unrealised losses on debt and capital instruments and other receivables in the portfolio of investment securities available for sale rose by the amount of ca. PLN 65 million, and capital investments – by PLN 48 million with simultaneous increase of the value of the negative exchange rate differences by the amount of PLN 13 million and intangible assets by PLN 296 million.

⁷ Resolution No. 325/2011 of the Polish Financial Supervision Authority dated 20 December 2011 concerning other decreases to basic funds, their amount, scope and terms and conditions of decreasing the bank's basic funds by those amounts, other bank's balance sheet items included in supplementary funds, their amount, scope and terms and conditions of including them in the bank's supplementary funds, decreases to supplementary funds, their amount, scope and terms and conditions of decreasing the bank's basic funds by those amounts as well as the scope and manner of accounting for banks' activities in holdings in calculation of own funds.

⁸ Exposures in financial institutions meeting the requirements set forth in § 5.1 of Resolution No. 325/2011 of the Polish Financial Supervision Authority dated 20 December 2011 concerning other decreases to basic funds, their amount, scope and terms and conditions of decreasing the bank's basic funds by those amounts, other bank's balance sheet items included in supplementary funds, their amount, scope and terms and conditions of including them in the bank's supplementary funds, decreases to supplementary funds, their amount, scope and terms and conditions of decreasing the bank's basic funds by those amounts as well as the scope and manner of accounting for banks' activities in holdings in calculation of own funds.

According to resolution no 8/2013 of the Ordinary General Meeting of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna dated 20 June 2013, the dividend for 2012 was agreed to be PLN 2,250,000 thousand that is PLN 1.80 per share.

The list of shareholders eligible to receive dividend for the year 2012 was defined as at 19 September 2013, and the payment was made on 4 October 2013.

The Management Board placed proposal on paying dividends from the profit for 2013 in the amount of PLN 937.5 mln. In

accordance with the Bank's policy on paying dividends, the Management Board of the Bank, while making decisions on paying dividends, took into consideration the necessity to ensure an appropriate level of the capital adequacy ratio and the capital necessary to the Bank's development.

4. CAPITAL REQUIREMENTS (PILLAR I)

Information on the structure of capital requirements of the Bank and the Group is presented in Table 4.1

Table 4.1

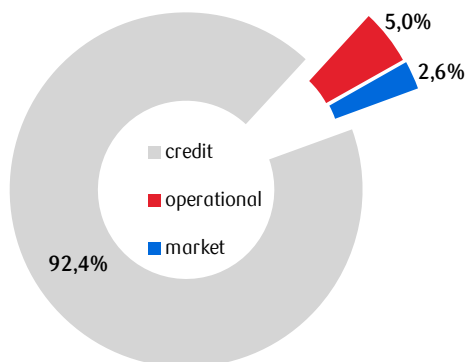
	CAPITAL REQUIREMENT			
	Group		Bank	
	2013	2012	2013	2012
Total capital requirement	12 552	12 525	12 272	12 283
Credit risk	11 594	11 371	11 392	11 190
credit risk (banking book)	11 439	11 207	11 237	11 025
Counterparty risk (trading book)	155	164	155	165
Market risk	327	495	340	527
FX risk	0	0	0	0
commodities risk	0	0	0	0
equity risk	18	1	18	1
specific interest rate risk	214	412	227	441
general interest rate risk	96	82	96	85
Operational risk	631	660	540	567
Other types of risk*	0	0	0	0

* Includes requirements in regard to the settlement and delivery risk, exposure concentration limit and capital concentration threshold

As at 31 December 2013, the biggest part of the Group's total capital requirement was the requirement for credit risk (92%) – Chart 4.1.

Chart 4.1

STRUCTURE OF CAPITAL REQUIREMENT OF THE PKO BANK POLSKI SA GROUP BY RISK TYPES



As at 31 December 2013:

- 1) the capital requirement for credit risk and counterparty credit risk was calculated under the standardised approach (pertaining to Appendices no. 4, 11, 16 and 17 to Resolution of PSFA No. 76/2010 as amended⁹ (Official Journal of PSFA no 2 item 11 of)),
- 2) the capital requirement for market risk was calculated under the basic methods (Appendices No. 6 to 10 to Resolution No. 76/2010 of PSFA as amended),
- 3) the capital requirement for operational risk was calculated for the Bank under the advanced approach (AMA) and under basic indicator approach (BIA) for the rest of the Group (Appendix No. 14 to Resolution No. 76/2010 of PSFA as amended),
- 4) the capital requirement for:

- a) the settlement and delivery risk – was calculated under the method defined in Appendix No. 11 to Resolution No. 76/2010 of PSFA as amended,
- b) the risk of exceeding the exposure concentration limit – was calculated under the method defined in Appendix No. 12 to Resolution No. 76/2010 of PSFA as amended,
- c) the risk of exceeding the capital concentration threshold – was calculated under the method defined in Appendix No. 13 to Resolution No. 76/2010 of PSFA as amended.

The scale of trading activities of the Bank and the Group is considerable and hence the total capital requirement for market risk is the total of capital requirements for the following risks:

- 1) FX risk,
- 2) commodities risk,
- 3) equity risk,
- 4) specific interest rate risk,
- 5) general interest rate risk.

The increase in the credit portfolio (balance sheet and off-balance sheet exposures) contributed to the increased capital requirement for credit risk in 2013 by 4%.

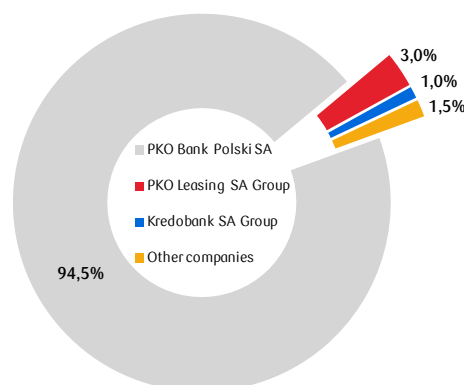
The decreased capital requirement for market risk by c. a. 34% to the amount of PLN 327 million results mainly from decrease of the value of liabilities due for guarantees of issues of corporate bonds with a simultaneous increase of the value of corporate bonds (total increase of the requirement for bonds by ca. 57%).

The Bank's capital requirement in respect of operational risk was calculated under the advanced measurement approach (AMA), while a requirement for operational risk of the Group entities was calculated under the basic index approach (BIA). A slight decrease of the requirement in respect of operating risk by 4% occurred.

A significant portion (95%) of the total capital requirement of the Group represented capital requirements of the Bank (Chart 4.2).

Chart 4.2

STRUCTURE OF CAPITAL REQUIREMENT BY COMPANIES The Group



⁹ Amendments to PSFA's Resolution 76/2010 were implemented with the following PSFA's resolutions: PSFA's Resolution no 369/2010 of 12 October 2010, PSFA's Resolution no 153/2011 of 7 June 2011, PSFA's Resolution no 206/2011 of 22 August 2011, PSFA's Resolution no 324/2011 of 20 December 2011, PSFA's Resolution no 172/2012 of 19 June 2012 and PSFA's Resolution no 307/2012 of 20 November 2012.

A considerable proportion of the capital requirement of both the Group (Table 4.2) and the Bank (Table 4.3) results from exposure in the banking book especially within the requirement

established for balance sheet exposures (respectively for the Bank 86.0% and for the Group – 86.7%).

Table 4.2

	The Bank Group		
	2013		
	Book		
	banking	trading	total
Capital requirement*	11 439	386	11 825
Balance sheet exposures	10 248	147	10 395
Off-balance sheet liabilities	1 140	84	1 223
Derivatives	52	155	206

* Covers credit risk, counterparty credit risk, specific interest rate risk and equity risk. It does not cover general interest rate risk, operational risk, FX risk and settlement and delivery risk.

Table 4.3

	PKO Bank Polski SA		
	2013		
	Book		
	banking	trading	total
Capital requirement*	11 237	399	11 636
Balance sheet exposures	10 006	150	10 156
Off-balance sheet liabilities	1 179	94	1 273
Derivatives	52	155	207

* Covers credit risk, counterparty credit risk, specific interest rate risk and equity risk. It does not cover general interest rate risk, operational risk, FX risk and settlement and delivery risk.

4.1. CREDIT RISK

The capital requirement for credit risk and the counterparty credit risk as at 31 December 2013 was calculated under the standardised approach in accordance with Appendices No. 4, 11, 16 and 17 to Resolution No. 76/2010 of PFSA as amended. The value of that capital requirement of the Bank's Group by exposure classes is shown in Table 4.4.

Table 4.4

STRUCTURE OF CAPITAL REQUIREMENT FOR CREDIT RISK

	The Bank Group
	2013
TOTAL	11 594
Corporate	4 867
Secured on real estate property	4 024
Retail	1 515
Central governments and central banks	20
Other exposures	403
Institutions (banks)	243
Regional governments and local authorities	118
Past dues	353
Public sector entities and non-commercial undertakings	47
Other*	2

* Includes exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.

In 2013, the capital requirement of the Group for credit risk (the counterparty credit risk included) increased by PLN 223 million compared to 2012. The Group is obliged to maintain the highest capital requirement for the risk related to corporate exposures and exposures secured on real property, which results from the Bank's high exposure to such types of segments. The low

capital requirement for exposures to central governments and central banks, despite the high value of such exposures, results from the low risk weights attached to such entities (a considerable proportion of such exposures is accounted for by securities of the State Treasury of Poland and the National Bank of Poland, for which the risk weight is 0%).

The value of exposures secured with collateral types, which permit a reduction of the capital requirement, amounted to PLN 1,852 million as at 31 December 2013 (Tables 4.5 and 4.6).

Table 4.5

EXPOSURES COLLATERALISED WITH GUARANTEES

	The Bank Group
	2013
TOTAL	981
Corporate	912
Secured on real estate property	0
Central governments and central banks	0
Retail	0
Other exposures	22
Institutions (banks)	0
Regional governments and local authorities	18
Past dues	16
Public sector entities and non-commercial undertakings	13
Other*	0

* Includes exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.

Table 4.6

EXPOSURES COLLATERALISED WITH RECOGNIZED FINANCIAL COLLATERAL*

	The Bank Group
	2013
TOTAL	871
Corporate	729
Secured on real estate property	1
Central governments and central banks	0
Retail	51
Other exposures	0
Institutions (banks)	0
Regional governments and local authorities	0
Past dues	88
Public sector entities and non-commercial undertakings	4
Other**	0

* After volatility haircuts.

** Includes exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.

As part of the credit risk mitigation techniques, the Bank uses guarantees (78% of the guarantees accepted by the Bank are guarantees issued by the State Treasury of Poland) 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 on real properties. The value of the portfolio of those exposures was PLN 65 billion as at 31 December 2013.

In 2013 and in the previous years, the Group did not conclude any securitisation transaction within the meaning of the Banking Law and Appendix no 18 to the Resolution of PSFA no 76/2010 (as amended).

In 2013 the Bank conducted package sales:

- 1) in the first quarter, over 3 thousand retail loans classified as 'loss' in relation to individuals who do not conduct business activities, with a total debt of PLN 61 million, over 580 corporate loans classified as 'loss' with a total debt of PLN 47 million and 53 loans from institutional clients classified as 'loss', with a total debt of PLN 89 million,
- 2) in the second quarter over 8 thousand retail loans classified as 'loss' in relation to individuals who do not conduct business activities with a total debt of PLN 212 million and over 116 corporate loans (mortgage-secured) classified as 'loss'. The sale covered a portfolio with a total debt of PLN 118 million,
- 3) in the third quarter nearly 15 thousand retail loans (including mortgage-secured loans, credit cards loans and loans in which debtors were convicted for an offence as a result of a valid criminal court judgment) classified as

'loss' in relation to individuals who do not conduct business activities, with a total debt of PLN 322 million, CHF 14 million and EUR 298 thousand, over 3 thousand corporate loans classified as 'loss' with a total debt of PLN 296 million, EUR 2 million, CHF 6 million, and 75 loans from institutional clients classified as 'loss', with a total debt of PLN 270 million,

- 4) in the fourth quarter, over 10 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 155 million, over 730 corporate loans classified as 'loss' with a total debt of PLN 64 million, and 90 loans from institutional clients classified as 'loss', with a total debt of PLN 272 million and USD 5 million.

The tables below 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 2013. Over 84% 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 recognised 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 4.7

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

	The Bank Group 2013							Other Group companies	Adjustments and exclusions	Total
	PKO Bank Polski SA, KREDOBANK SA Group and PKO Leasing SA Group									
	Counterparty's credit quality rating									
	1	2	3	4	5	6	none			
Corporate	0	11	2 380	0	0	0	62 887	767	-3 893	62 152
Secured on real estate property	0	0	0	0	0	0	64 567	0	-86	64 480
Central governments and central banks	0	27 466	0	0	254	0	1 252	14	0	28 986
Retail	0	0	0	0	0	0	24 651	0	0	24 651
Other exposures	0	0	34	0	0	0	12 856	993	-56	13 827
Institutions (banks)	555	2 977	2 225	113	357	17	2 385	9 378	-10 338	7 669
Regional governments and local authorities	0	1 299	684	0	0	0	5 047	0	0	7 029
Past dues	0	0	0	0	0	0	4 003	82	-82	4 003
Public sector entities and non-commercial undertakings	0	0	0	0	0	0	1 195	0	0	1 195
Other**	0	0	0	0	0	0	904	18	-759	163
Total	555	31 752	5 322	113	612	17	179 747	11 252	-15 214	214 155

* 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.

** Includes exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.

Table 4.8

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

	The Bank Group 2013							Other Group companies	Adjustments and exclusions	Total
	PKO Bank Polski SA, KREDOBANK SA Group and PKO Leasing SA Group									
	Counterparty's credit quality rating									
	1	2	3	4	5	6	none			
Corporate	0	11	2 380	0	0	0	61 583	767	-3 893	60 847
Secured on real estate property	0	0	0	0	0	0	64 566	0	-86	64 480
Retail	0	0	0	0	0	0	24 619	0	0	24 620
Central governments and central banks	0	27 466	0	0	254	0	2 182	14	0	29 915
Other exposures	0	0	34	0	0	0	12 630	993	-56	13 601
Institutions (banks)	555	2 977	2 225	113	357	17	2 385	9 378	-10 338	7 669
Regional governments and local authorities	0	1 299	684	0	0	0	5 165	0	0	7 147
Past dues	0	0	0	0	0	0	3 898	82	-82	3 898
Public sector entities and non-commercial undertakings	0	0	0	0	0	0	1 181	0	0	1 181
Other**	0	0	0	0	0	0	904	18	-759	163
Total	555	31 752	5 322	113	612	17	179 113	11 252	-15 214	213 521

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

** Includes exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.

In 2013, the transactions that had the greatest influence on the amount of the Group's capital requirement for derivatives were the IRS and CIRS transactions (Table 4.9).

Table 4.9

**CAPITAL REQUIREMENT
FOR DERIVATIVES ***

2013

The Bank Group

	Book		
	banking	trading	Total
Derivatives	52	155	206
IRS	21	122	143
CIRS	28	21	50
Forward	0	7	7
SWAP	2	1	3
Options	0	2	2
FRA	0	1	1
Revers Repo	0	0	0
BSB	0	0	0

* Credit risk and counterparty credit risk.

In 2013, within the calculation of capital requirement for derivatives, no netting of the balance sheet and off-balance sheet items was used.

Within the calculation of its capital 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 capital requirements in accordance with the regulations of Annexes No. 4 and No. 15 to Resolution No. 76/2010 of PFSA of 10 March 2010 as amended and Resolution No. 387/2008 of PFSA of 17 December 2008¹⁰.

4.2. MARKET RISK

The market risk of the Bank Group is determined primarily by the Bank. The Group's capital requirement for its market risk is calculated in accordance with the regulations of Resolution No. 76/2010 of PFSA as amended. To calculate the capital requirement for FX risk and specific risk of debt instruments, the Bank uses basic methods. To calculate the capital requirement for the commodities risk and price risk of equity securities the Bank uses simplified methods. To calculate the

capital requirements for general interest rate risk, the Bank uses the duration method.

The largest share in the value of requirement for market risk in this period fell to the specific risk of debt instruments (approx. 65%), 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 capital requirement for the general interest rate risk (approx. 29%).

The change in the amount of the capital requirement for interest rate risk in the consolidated statements for 2013 resulted from exclusions of the mutual transactions in the capital requirement calculations.

The capital requirement for all other types of market risk was PLN 18 million. The capital 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 2013 the Bank did not have an open position for commodity price risk, so the respective capital requirement was zero.

4.3. OPERATIONAL RISK

PKO Bank Polski SA has a decisive influence on the operational risk profile of the Bank Group. Other companies of the Bank Group, due to considerably lower scale of their business activity, only generate limited operational risk.

Having obtained approval from PFSA to use the advanced approach to calculate capital requirement for operational risk, since 31 December 2012 the Bank calculates the requirement by means of AMA approach. In case of the Group's companies, the basic index approach (BIA) applies.

The value of the Group's capital requirement for operational risk was ca. PLN 631 million (including PLN 540 million of the capital requirement for the Bank's operational risk). As compared to 2012 this amount was lower by ca. PLN 29 million for the Group.

Table 4.10

**CAPITAL REQUIREMENT
FOR OPERATIONAL RISK**

2013

The Bank Group

	Bank	Companies	Group
Total	540	91	631
Basic Index Approach - BIA	n.a.	91	91
Advanced approach - AMA	540	n.a.	540

¹⁰ Resolution No. 387/2008 of the Polish Financial Supervision Authority of 17 December 2008 defining the creditworthiness ratings awarded by external rating agencies that may be used by a bank to determine the capital requirements, the scope of utilization of such ratings and their relation to the credit quality ratings (Official Journal of the Polish Financial Supervision Authority of 2008 No. 8, item 41).

5. INTERNAL CAPITAL (PILLAR II)

The Group determines the internal capital in compliance with 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 (PFSA's Official Journal no 11, item 42 of 23 November 2011 as amended).

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, the anticipated risk level taken into account.

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 2013 was estimated to cover each significant risk type:

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

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

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 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 capital requirement for credit risk, calculated under the approaches defined in resolution no 76/2010 of PFSA as amended.

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 risk.

In 2013, PD, LGD and CCF parameters (LGD for retail portfolios only) based on the models developed during the implementation of the IRB method.

The value of exposure to a counterparty being a financial institution is determined on the basis of the market value of

balance sheet transactions (deposits and bonds) and of the balance sheet equivalent understood as the sum of the cost of replacement and the future potential credit exposure, for off-balance sheet transactions, less the recovery rate. The value of the recovery rate and probability of default for exposures to financial institutions is calculated from data of the Moody's rating agency. The internal capital to cover the counterparty credit risk is assessed on the basis of CVAR approach, but in case of derivatives the volume of credit exposures adopted for the purpose of the approach is defined on the basis of the appendix no 11 to resolution on 76/2010 of PSFA as amended.

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

The internal capital to cover the liquidity risk is equal to the sum of the internal capital to cover the shortage of liquid assets as compared to the required amount defined by the Bank, and the internal capital to cover the risk of spread related to a sale of the entire securities portfolio.

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

- 1) for the Bank Group's financial subsidiaries - as the additional capital requirement for operational risk, calculated under the basic indicator approach,
- 2) for non-financial subsidiaries - as equal to the maximum amount of the annual losses related to operational risk for the last 3 years, as suffered by a given subsidiary.

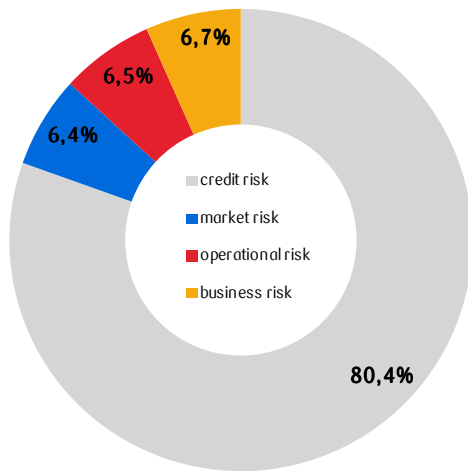
The internal capital to cover business risk of the Bank is determined on the basis of analysis of historical volatility of selected items of the income statement, related to the Bank's income and expense in accordance with the earnings at risk concept (Earnings at Risk). The internal capital for covering business risk of the Group entities is determined as the product of ratio of internal capital calculation for covering business risk and results on banking activities.

The internal capital calculation approaches are defined in internal regulations. To assess internal capital based on 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 assessed as at 31 December 2013 for the Group.

Chart 5.1

INTERNAL CAPITAL STRUCTURE
OF THE GROUP



Allocation of the total internal capital is made by business lines 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.

6. CAPITAL ADEQUACY

Capital adequacy is the condition under which the amount of own funds of the Bank and the Group is higher than total capital requirements (the so-called Pillar I) and total internal capital (the so-called Pillar II). 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.

The process of 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 capital adequacy ratio (CAR) of at least 8% as required by the Banking Law,
- 2) the own funds to internal capital ratio of at least 1.0 pursuant to the Banking Law,
- 3) Common Equity Tier 1 Ratio - CET1 Ratio - with the minimum level equal to 9%.

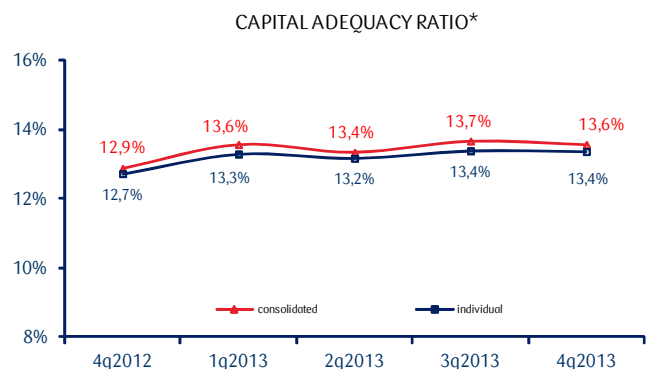
Due to the expectations of the Polish Financial Supervisions Authority (letter of 10 December 2013) for the banks to may pay dividend to the amount 100% of net profit for 2013 must fulfill the following conditions:

- 1) bank is not included in the programme of corporate recovery proceedings,
- 2) capital adequacy ratio is at a higher level than 12%,
- 3) Common Equity Tier 1 Ratio is at a higher level than 9%,
- 4) forecasts of capital adequacy for scenarios of stress tests higher than 12% at the end of 2014,
- 5) forecasts of Common Equity Tier 1 Ratio for scenarios of stress tests higher than 9% at the end of 2014,
- 6) General BION assessment and BION assessment in respect to capital at level not lower than 2.5.

In 2013 PKO Bank Polski SA continued activities aimed at ensuring proper capital buffer, and maintaining and enhancing its liquidity position. As at the end of 2013 the Bank met all PFSA's expectations entitling to dividend payment for 2013. The Management Board placed proposal on paying dividends from the profit for 2013 in the amount of PLN 937.5 mln.

The chart below presents changes in the capital adequacy ratio calculated for the Bank and the Bank Group

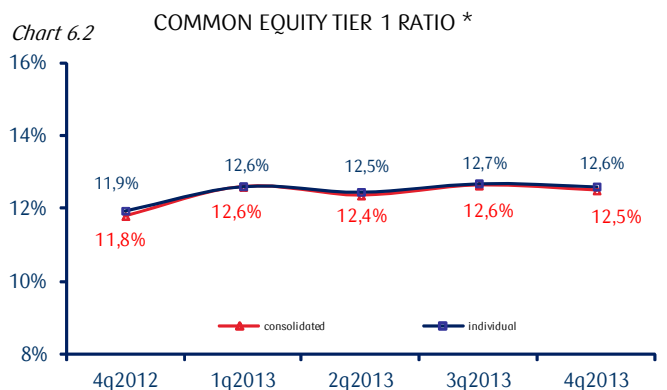
Chart 6.1



*Data are converted due to implementation retrospective changes of accounting principles by Bank, referring to recognition of revenues and costs from selling insurance products connected to other products offered by Bank (bancassurance adjustment)

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

Chart 6.2



*Data are converted due to implementation retrospective changes of accounting principles by Bank, referring to recognition of revenues and costs from selling insurance products connected to other products offered by Bank (bancassurance adjustment)

In 2013 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 2013, as compared to the state as of 31 December 2012, the Group's capital adequacy ratio grew by 0.7 percentage points, to the level of 13.6%, which resulted mainly from increase of own funds of the Bank Group for the needs of capital adequacy (resulting mainly from the fact that PLN 1,431 million were allocated to the basic funds) and an increase of the capital requirement for credit risk (growth of the credit portfolio). PKO Bank Polski SA participates semiannually in the quantitative studies (QIS) of Basel III's impact on the banking sector.

In 2013 the Bank conducted internal stress tests for Bank's own use (internal TWS) and participated in stress tests organised by the PFSA (PFSA TWS).

The purpose of conducting stress test in the first half of the year was to define a prospective influence of the variable macroeconomic environment on the Bank's and the Group's

financial and capital condition. The TWS regulatory stress tests conducted in the second half of the year were aimed at presenting the general resistance of the banking sector and ability of banks to absorb potential shocks that have an impact on the growth of credit and market risks. The results of the tests confirm the strong capital position of PKO Bank Polski SA and the Bank's considerable resistance to macroeconomic shocks, fulfillment of negative market scenarios. The Bank records net profit in every scenario and the value of capital adequacy remains above internal and external limits. Obtained results did not point out to a need to undertake non-standard activities in response to the macroeconomic situation.

In 2014 the Bank will participate, among other banks, in European stress tests conducted by European Banking Authority (EBA) in close collaboration with Polish Financial Supervision Authority. The date of publication of stress test results by EBA is planned for October 2014. In 2013 PKO Bank Polski SA successfully passed another capital adequacy examination conducted by the European Banking Authority (EBA) in close cooperation with the Polish Financial Supervision Authority.

PKO Bank Polski conducted preparations to implement 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). The provisions of the CRD IV/CRR package entered into force on 1 January 2014.

7. PRINCIPLES OF DETERMINATION OF VARIABLE COMPONENTS OF REMUNERATION OF THE MANAGEMENT

Pertaining to the regulations of PFSA's Resolution no 258/2011¹¹ the Group implemented principles of determination of variable components of remuneration in the following resolutions:

- 1) Resolution of the Bank's 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 Bank's Management Board – the Regulation on variable components of remuneration for the Management,
- 3) Resolution of the Supervisory Boards of selected subsidiaries of the Bank Group – PKO Leasing SA, PKO Towarzystwo Funduszy Inwestycyjnych SA and PKO BP BANKOWY PTE SA (“the Group Companies”) – the “Regulation on variable components of remuneration for the Management Board Members”.

7.1. 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 legislation and operational risk issues in the process), the Controlling Department (planning, imposing and checking financial objectives) and the Legal Department (legal compliance, including the requirements defined in the PFSA's resolution).

While preparing the policy, the Bank used external services rendered by a consulting company, PricewaterhouseCoopers (PwC) Polska.

7.2. 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 and presenting results of such reviews to the Supervisory Board,
- 3) proposing remuneration principles, policy on variable components of remuneration of the Bank's management and salary payment to the Supervisory Board.

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

- 1) Chairman – Tomasz Zganiacz,
- 2) Deputy Chairman – Zofia Dzik,
- 3) Members – Cezary Banasiński, Elżbieta Mączyńska - Ziemacka, Marek Mroczkowski.

7.3. MOST SIGNIFICANT INFORMATION ON REMUNERATION DEPENDING ON RESULTS AND CRITERIA OF RESULT ASSESSMENTS

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.

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

According to the Regulations, such objective should ensure:

- 1) an incentive to work and act in the way ensuring that the Bank/ Group Company achieves the best and stable financial results in a long time horizon,
- 2) support for correct and effective risk management and discouraging from taking too excessive risk beyond acceptable level of risk seeking,
- 3) support for fulfillment of business strategy and limiting conflict of interests.

Assessment criteria of such objectives should include in particular:

- 1) impact on regulatory capital, capital adequacy ratio and equity in such a way that payment of variable remuneration does not limit possibilities of their strengthening,
- 2) effects of work of a given person and effects of work of supervised units,
- 3) result on the area of responsibility of a given person in respect to the results of the entire Bank and Group Company.

When the assessment criteria, so called key performance indicators (KPI) for the variable component of remuneration of the management members/ Management Board members have been defined, the multidimensionality of the assessment was taken into account in compliance with the regulations of the PFSA's resolution.

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.

¹¹ The PFSA's Resolution no 285/2011 of 4 October 2011 on detailed principles of operation of the risk management system and internal audit system, detailed conditions of internal capital assessment by banks, reviews of the process of internal capital assessment and maintenance and definition of policy on variable components of remuneration for bank managements.

7.4. MAJOR INFORMATION ON THE KEY PARAMETERS OF REMUNERATION DEPENDING ON RESULTS

Pertaining to the requirements of PFSA's Resolution no 258/2011 KNF and proportions defined therein, 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 (for the next 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 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.

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,
- 3) of a Management Board Member of the Group company may change up by an adjustment ratio according to the level of fulfillment of specified MbO objectives as compared to the level of fulfillment planned for the periods of net profit assessment in the Group.

Variable remuneration, taking into account its raise by adjustment ratio, is subject to restrictions within the range of maximum amount that may be assigned – as a percentage of the regular remuneration for a given period under assessment.

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

- 1) violation of professional obligations,
- 2) non-compliance 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 the Members of the Management Boards of the Bank and Group company, variable components are granted and released on the condition of approval of the financial statement for the given period of assessment.

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/ Group company'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 and Group company,
- 4) financial results of the Bank and Group company in respect to long-term plans of development.

Remuneration in compliance with the policy on variable components of remuneration for management members by business lines in PKO Bank Polski for 2013 and 2012 were as follows (note: variable remuneration of the Management Board Members as of the data publication date depends also on the approval of the annual financial statement) (Table 7.1):

Table 7.1

REMUNERATION BY BUSINESS LINES 2013

PKO Bank Polski SA

Areas	Retail market area	Corporate market area	Investment banking area	Other areas	Including Management Board Members	Total
Amount of remuneration (regular and variable remuneration subject to CRD III principles) in mln PLN	7,03	8,80	6,44	27,18	16,35	49,44

REMUNERATION BY BUSINESS LINES 2012

PKO Bank Polski SA

Areas	Retail market area	Corporate market area	Investment banking area	Other areas	Including Management Board Members	Total
Amount of remuneration (regular and variable remuneration subject to CRD III principles) in mln PLN	5,70	8,79	7,09	21,59	12,85	43,17

Regular and variable remuneration in 2013 and 2012 for management members in PKO Bank Polski SA who are Management Board Members, persons reporting directly to the

Management Board Members and other persons on key positions is presented in table 7.2

Table 7.2

REMUNERATION DIVIDED INTO REGULAR AND VARIABLE PART 2013

Specification	PKO Bank Polski SA			
	Management Board Members	Persons reporting directly to Management Board members (including chief accountant) and directors of corporate regions	Other persons	Total
Number of persons	7	37	17	61
Paid regular remuneration (in mln PLN)	9,88	14,78	5,33	29,99
Variable remuneration subject to CRD III principles for 2013 (in mln PLN)	6,47	9,71	3,28	19,46
granted non-deferred component of the amount subject to CRD III principles, including (in mln PLN):	3,83	5,82	1,97	11,62
<i>cash (50% of non-deferred component)</i>	1,92	2,91	0,98	5,81
<i>financial instrument - number of shares - 50% of non-deferred component converted into a number of phantom shares at the price in Q4 2013</i>	48 382	73 536	24 817	146 735
calculated but not yet granted deferred component (for the period of three upcoming years) of the amount subject to CRD III principles, including (in mln PLN):	2,64	3,88	1,31	7,83
<i>cash (50% of deferred component)</i>	1,32	1,94	0,66	3,92
<i>financial instrument - number of shares - 50% of deferred component converted into a number of phantom shares at the rate in force in Q4 2013</i>	33 345	49 030	16 549	98 924
value of deferred remuneration granted in the given financial year, paid and reduced due to an adjustment related to results	n.a.	n.a.	n.a.	n.a.
payments related to commencement and termination of an employment relationship (w mln PLN)			0,27	0,27
number of persons who receive such payments the highest payment			1	1
			0,27	0,27

* Paid variable remuneration in 2014

REMUNERATION DIVIDED INTO REGULAR AND VARIABLE PART 2012

PKO Bank Polski SA

Specification	Management Board Members	Persons reporting directly to Management Board members (including chief accountant) and directors of corporate regions	Other persons	Total
Number of persons	6	34	16	56
Paid regular remuneration (in mln PLN)	7,59	14,55	5,01	27,15
Variable remuneration subject to CRD III principles for 2013 (in mln PLN)	5,26	8,08	2,68	16,02
granted non-deferred component of the amount subject to CRD III principles, including (in mln PLN):	3,15	4,87	1,62	9,64
<i>cash (50% of non-deferred component)</i>	1,55	2,40	0,80	4,75
<i>financial instrument - number of shares - 50% of deferred component converted into a number of phantom shares at the price in Q4 2012</i>	43 290	66 821	22 231	132 342
<i>financial instrument - number of shares - converted into cash at the rate in force in Q3 2013</i>	1,60	2,47	0,82	4,89
calculated and partly granted deferred component (for the period of three upcoming years) of the amount subject to CRD III principles, including (in mln PLN):	2,11	3,21	1,06	6,38
granted deferred component cash - I instalment for 2012	0,36	0,54 *	0,18 *	1,08
<i>calculated but not yet granted deferred component - cash</i>	0,70	1,07	0,35	2,12
<i>calculated but not yet granted deferred component - financial instrument - number of shares</i>	29 309	44 548	14 820	88 677
value of deferred remuneration granted in the given financial year and reduced due to an adjustment related to results	n.a.	n.a.	n.a.	n.a.
payments related to commencement and termination of an employment relationship	n.a.	n.a.	n.a.	n.a.

* Paid variable remuneration in 2014

8. 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 capital requirements for operational risk

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 – operations not included in the trading book, specifically credit facilities and loans and deposits extended or accepted within the bank's business activity or for the purposes of liquidity management

Basel II – a set of external regulations defining a new approach to the calculation of capital requirements and management of the risk in banks; in Poland, Basel II was implemented by way of amendment of the Banking Law and adoption of Resolutions No. 1-6/2007 of PFSA of March 2007, which became binding upon Polish banks as of 1 January 2008 (with the assumption of exercise of the option contained in § 14 clause 1 of Resolution No. 1/2007 of PFSA) amended with resolutions no 380-385/2008 of PFSA and resolution no 76/2010 of PFSA as amended.

Basel III/CRD IV – 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

Capital adequacy ratio – the main measure of capital adequacy, calculated as the quotient of own funds and total capital requirements multiplied by 8%

Capital requirement – the minimum amount of capital that the bank is obliged, pursuant to Article 128 of the Banking Law and Resolution No. 76/2010 of the Polish Financial Supervision Authority, to maintain as coverage of the credit, interest rate, FX, liquidity and operational risks (an element of the so-called Pillar I of Basel II Accord)

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.

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 individualizes 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.

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

Equity risk - 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

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) - the risk of loss due to unfavourable changes of foreign exchange rates or their volatility

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

Interest rate risk - the risk of loss due to unfavourable changes of interest rates or their volatility

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 (an element of the so-called Pillar II)

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

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 operational 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

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

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

PBA - the Polish Bank Association

PCBA - the Polish Classification of Business Activity

PFSA - the Polish Financial Supervision Authority

Pillar I - a part of the Basel II requirements containing regulations on the minimum capital requirements for credit, interest rate, FX, liquidity and operational risks

Pillar II - a part of the Basel II requirements containing regulations on a bank's internal risk management and risk mitigation processes

Pillar III - a part of the Basel II requirements containing regulations on obligatory disclosures of risk profile information and the banks' capital adequacy

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

Reputation risk – the risk relating to the possibility of occurrence of negative deviations from the planned financial result of the bank due to deterioration of the bank's image

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

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 – operations carried out on the bank's own account for trading purposes, i.e. with the intention of generating financial profit, usually within short periods, from the actual or expected differences between the market purchase and sale prices or from other price or price parameters deviations, including specifically interest rates, foreign exchange rates, and share indices, as well as operations carried out for hedging a risk of operations included in the trading book

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