# CAPITAL ADEQUACY AND RISK MANAGEMENT

# (PILLAR III)

THE CAPITAL GROUP OF POWSZECHNA KASA OSZCZĘDNOŚCI BANK POLSKI SPÓŁKA AKCYJNA

AS AT 31 DECEMBER 2008

# INTRODUCTION

The Report "Capital Adequacy and Risk Management (Pillar III)" (hereinafter the "Report") of the Capital Group of Powszechna Kasa Oszczędności Bank Polski SA ("the PKO BP SA Group" or "the Group") as at 31 December 2008 was prepared in accordance with the provisions of article 111a clause 1 of the Act of 29 August 1997 – Banking Law[1] 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 manner of publication by banks of qualitative and quantitative information relating to capital adequacy and the scope of required disclosure* ("Resolution No. 385/2008 of PFSA").

Pursuant to § 6.1 of Resolution No. 385/2008 of PFSA, Powszechna Kasa Oszczędności Bank Polski SA ("PKO BP SA", "the Bank") which is the controlling entity within the meaning of § 3 of the Resolution, publishes annually information on its capital adequacy in a separate document, which is issued no later than within 30 days of the approval of annual financial statements by the General Meeting of Shareholders.

The Report covers the year ended 31 December 2008. Unless stated otherwise, the Report includes consolidated data of the PKO BP SA Capital Group. Since the risk profile of the PKO BP SA Capital Group is predominantly affected by PKO BP SA (96%[2] of the Group's consolidated balance sheet total and 98%[3] of its consolidated result), some of the information contained in the Report pertains specifically to individual data of PKO BP SA. Unless stated otherwise, the figures presented in the Report have been expressed in PLN million. Any differences in the totals and proportions result from the rounding off to PLN million and to one decimal place respectively.

From 1 January 2008, the Capital Group is bound by new provisions (so-called Basel II) on the calculation of capital requirements contained in Resolution No. 1/2007 of the Commission for Banking Supervision of 13 March 2007[4], and also on the process of assessment of the internal capital adequacy (Internal Capital Adequacy Assessment Process – ICAAP) – the so-called Pillar II of Basel II, defined in Resolution No. 4/2007 of the Commission for Banking Supervision of 13 March 2007[5]. The data on the 2007 capital requirement, presented in this Report for comparison, have been calculated in accordance with Basel I. Until 31 December 2007 (inclusive), the Capital Group exercised the option provided in § 14 point 1 of Resolution No. 1/2007 of the Commission for Banking Supervision of 13 March 2007, permitting a decrease of the capital requirement for operational risk by 100%, which reduced that requirement to zero. By way of supplementation, the Report also contains the Bank's assessments of the financial effects of implementation of the Basel II requirements.

Starting from 2008, the PKO BP SA Capital Group calculates the internal capital for each of the identified and significant risk types present in the activities of the Bank and companies of the Capital Group. Pursuant to Art. 128 clause 1 point 2 of the Banking Law, total own funds of the Group may not be lower than either total capital requirements for individual risk types, or the assessed internal capital.

This Report has been subject to internal verification by the Bank's organizational unit in charge of internal audit.

[1] Journal of Laws 2002, No. 72, item 665 with subsequent amendments.

[2] The share of subsidiaries in the consolidated total assets was calculated before consolidation adjustments and exclusions for the year ended 31 December 2008.

[3] The share of subsidiaries in the consolidated result was calculated in relation to the financial result of the Group before consolidation adjustments and exclusions for the year ended 31 December 2008.

[4] Resolution No. 1/2007 of the Commission for Banking Supervision dated 13 March 2007 concerning scope and detailed principles of determining capital requirements for individual risk types, including the scope and terms and conditions for use of statistical methods and the scope of information attached to applications for the use of those methods, terms and conditions of accounting for contracts for transfer of receivables, contracts for sub-participation and contracts for credit derivatives and contracts other than contracts for transfer of receivables and contracts for sub-participation, for the purpose of determining capital requirements, terms, scope and manner of use of ratings given by external rating agencies and agencies of export credits, the manner and detailed principles of calculation of bank capital adequacy ratio, scope and manner of accounting for activities of banks in holdings in the calculation of capital requirements and capital adequacy ratio as well as defining additional balance sheet items of banks recognised under own funds in the capital adequacy statement and the scope, manner and terms of their determining (Official Journal of the National Bank of Poland 2007, No. 2, item 3)

[5] Resolution No. 4/2007 of the Commission for Banking Supervision dated 13 March 2007 concerning detailed principles of functioning of risk management and internal control systems and detailed terms and conditions for the estimation by banks of internal capital and reviewing the process of estimating and maintaining internal capital (Official Journal of the National Bank of Poland 2007, No. 3, item 6).

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# 1. INFORMATION ABOUT THE BANK AND THE GROUP

The controlling entity of the Group is PKO BP SA whose share in the consolidated balance sheet total amounts to 96%[2], and in the consolidated net financial result – 98%[3]. PKO BP SA pursues activity in the territory of the Republic of Poland and is subject to Polish banking supervision authority.

Beside PKO BP SA, the PKO BP SA Capital Group comprises also other companies; in two of them – Bankowy Fundusz Leasingowy SA and KREDOBANK SA – a significant level of banking risk occurs.

Bankowy Fundusz Leasingowy SA ("BFL SA") – together with its subsidiaries – operates in the leasing area in the territory of the Republic of Poland. The share of Bankowy Fundusz Leasingowy SA (together with subsidiaries) in the consolidated balance sheet total is 1.8%[2], and in the consolidated net financial result – 0.3%[3].

KREDOBANK SA pursues business operations in Ukraine and is subject to the Ukrainian banking supervision. The share of KREDOBANK SA in the consolidated balance sheet total is 1.6%[2], and the net loss of KREDOBANK SA reduced the consolidated net financial result by 6.7%[3].

Other companies of the Capital Group covered by the consolidation include:

- Powszechne Towarzystwo Emerytalne BANKOWY SA (management of a pension fund),
- Centrum Finansowe Puławska Sp. z o.o. (management and operation of Centrum Finansowe Puławska),
- PKO Inwestycje Sp. z o.o. (a developer) – together with its subsidiaries,
- PKO Towarzystwo Funduszy Inwestycyjnych SA (investment funds' management),
- Inteligo Financial Services SA (technical servicing of Internet banking) – together with its subsidiary,
- Centrum Elektronicznych Usług Płatniczych eService SA (handling and settlement of transactions made with the use of cards),
- Bankowe Towarzystwo Kapitałowe SA (financial agency in the trade in stocks and shares),
- PKO Finance AB (generating funds for PKO BP SA from the issue of Eurobonds).

Detailed information on the Capital Group's subsidiaries, the method of consolidation, and the Bank's interest in the share capital of individual companies is contained in the consolidated financial statements of the Capital Group of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna for the year ended on 31 December 2008, published on 9 April 2009.

At the consolidation level, own funds of the Capital Group are reduced by the Bank's capital exposure in the following entities: 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 146.9 million as at 31 December 2008.

At the individual level, own funds of the Bank are reduced by the Bank's capital exposure in KREDOBANK SA, PTE BANKOWY SA, PKO TFI SA, BFL SA, Bankowe Towarzystwo Kapitałowe SA, PKO Finance AB, Bank Pocztowy SA and Poznański Fundusz Poręczeń Kredytowych Sp. z o.o., amounting to the total of PLN 612.4 million as at 31 December 2008.

Within the PKO BP SA Capital Group, there are limitations on the transfer of funds (dividends) to the investor between KREDOBANK SA and the Bank. In accordance with the decision of the Extraordinary General Meeting of Shareholders of KREDOBANK SA of 17 November 2005, a moratorium was introduced with respect to dividend payments in the years 2005-2008.

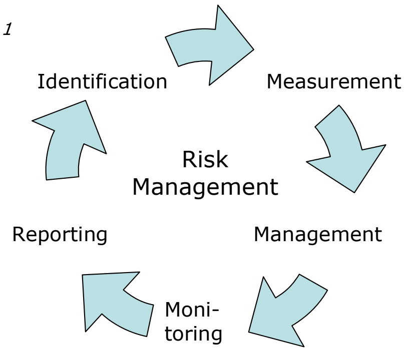
# 2. RISK MANAGEMENT

Banking activity is exposed to many types of risk, including such as credit, market, operational and business risk. Controlling the effect of those types of risk on the functioning of the PKO BP SA Capital Group is one of the main objectives of the Bank's and the Group's management, and the risk level is an important factor of the planning process.

Risk management at the Bank is based on the following principles:
- full organisational separation of the risk and debt collection functions from business functions is maintained,
- risk management is integrated with the planning and controlling systems,
- the area of risk and debt collection supports, on the ongoing basis, the achievement of business objectives while maintaining the acceptable risk level,
- the risk level is monitored on a regular basis,
- the risk management model is regularly updated to accommodate new risk factors and sources.

The risk management process in the Capital Group includes the following activities:
- risk identification which consists in defining both current and potential risk sources, which result from the Bank's current and planned activity,
- risk measurement,
- risk management which consists in taking decisions as to the acceptable risk level, planning of activities, issuing recommendations and guidance, and developing the procedures and ancillary tools,
- monitoring which consists in the ongoing monitoring of the risk level based on the adopted risk measurement methods,
- reporting within which the management are periodically informed on the scale of risk exposure and activities undertaken.

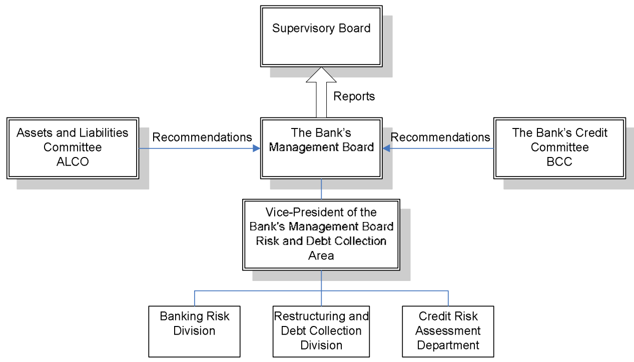
*Scheme 2.1*




The risk management process takes place in the environment that comprises the following:
- the applied methods and methodologies forming a system of internal regulations,
- 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),
- internal organisation which includes organisational units, their tasks, scope of responsibilities and mutual relations.

*Scheme 2.2*

Risk management organisation chart




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

The Management Board of the Bank is responsible for the risk management strategy, which includes the supervision and monitoring of activities taken by the Bank within risk management. The Management Board of the Bank approves major decisions affecting the Bank's risk profile and internal regulations which define the Bank's risk management system. Risk management at the level of operations is carried out – within the scope of their respective competencies – by organisational units of the Bank within the Banking Risk Division, Restructuring and Debt Collection Division and the Credit Risk Assessment Department.

The purpose of the Banking Risk Division is to prepare and implement systemic solutions for managing credit, operational, compliance, market and strategic risk as well as capital adequacy. The most important tasks of the Division consist in:
- identification of risk factors and sources,
- risk measurement and cyclical monitoring and reporting of the risk level,
- measurement and assessment of capital adequacy,
- taking decisions and developing recommendations for the Assets and Liabilities Committee and the Management Board of the Bank as to the acceptable risk level,
- developing internal regulations relating to risk and capital adequacy management,
- developing IT systems to support risk and capital adequacy management.

The purpose of the Restructuring and Debt Collection Division is to ensure effective and efficient collection and restructuring of bad debts. The most important tasks of the Division consist in:

- efficient collection of bad debts and increasing the efficiency of such activities,
- effective early monitoring of late payment of debts by retail clients using telephone contacts and other generally utilized means of communication as well as direct visits at the clients,
- effective sale of bad debts and outsourcing of its tasks realised, as well as effective management of the assets taken over as the result of Bank debt collection.

The purpose of the Credit Risk Assessment Department is to assess and verify the credit risk level of individual credit exposures, which require special attention due to the scale of exposure or the risk level involved.

The risk management at the Bank is supported by two committees, chaired by the Vice-president of the Management Board of the Bank in charge of the Risk and Debt Collection Area:

- the Assets and Liabilities Committee ("ALCO"),
- the Bank's Credit Committee ("BCC").

ALCO takes decisions and issues recommendations to the Management Board of the Bank as regards market and portfolio credit risk management, the Bank's assets and liabilities management, and capital adequacy management.

BCC takes credit decisions in respect of individual significant credit exposures of considerable value or issues recommendations in this respect to the Management Board of the Bank. Credit committees also operate at other levels of the Bank's organisational structure. Their task is to issue recommendations concerning credit decisions which are material due to the risk level or amount of exposure.

The Bank supervises the functioning of individual subsidiaries of the PKO BP SA Capital Group. Within this supervisory function, the Bank defines and approves the subsidiaries' development strategies, also within the scope of risk; 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 Capital Group level.

### FINANCIAL CRISIS

In the latter half of 2008, the financial crisis affecting the developed countries (mainly US and Western Europe) started to affect negatively also the economic situation in Poland and the rest of Central and Eastern Europe. Particularly affected by the financial crisis have been the economies of Hungary and Ukraine (considerable devaluation of UAH by about 50% to USD during the 3rd and 4th quarter of 2008). In Poland, the crisis raised the exchange and interest rates, and also affected the Polish financial sector and the mutual trust of the interbank market operators.

To counteract the negative effect of those factors on the financial standing of PKO BP SA, the Bank adjusted its risk management policies. It has become the Bank's priority to keep its strong capital position and a stable deposit base, which together condition a growth of its credit portfolio.

As a consequence, in the 4th quarter of 2008, the Bank:

- launched intense activities to obtain new deposits from individuals,
- prepared a recommendation as to retention of the whole of its 2008 profit,
- included in its banking risk measurement methods the financial crisis conditions (such as e.g. the stress test scenarios, contingency liquidity plans, the interest rate and FX risks, and implementation of the Early Warning System),
- broadened the scope and increased the frequency of management reports on risk prepared for the Bank's Management Board,
- adjusted its credit policies to the changed market conditions (among other things, requirements related to the award of loans in foreign currencies to individuals were made stricter; the minimum own contribution for mortgage loans was raised; the crediting of clients with high credit risk of transactions was limited; and credit spreads for newly granted facilities within corporate and retail banking were raised).

Additionally, to facilitate immediate response to the dynamically changing situation on the financial markets, the Bank appointed a special working group, which submits periodic reports to the Bank's Management Board.

Apart from the aforementioned activities resulting from the financial crisis, the Bank continued its periodic banking risk monitoring and, as previously assumed, development its banking risk measurement methods.

Besides, in the of the deterioration of the macroeconomic situation of Ukraine, the Bank extended the scope of its activities aimed at monitoring the economic and financial standing of KREDOBANK SA and made a revaluation write-off of its credit exposure in KREDOBANK SA to costs in 2008.

On 30 June 2009, the General Meeting of Shareholders of PKO BP SA resolved on payment of the dividend from the 2008 profit in the amount of PLN 1 billion, i.e. about 35% of the Bank's reviewed net profit for 2008.

The above activities resulted in a continuously safe level of the Bank's risk, evidenced e.g. by absence of the need to use the regulatory tools supporting the banking sector's liquidity (pawn credit, foreign currency financing operations).

## 2.1. CREDIT RISK

Credit risk is understood as the risk of incurring losses as a result of client default in the 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 liabilities.

The Bank and the Capital Group's subsidiaries apply the following credit risk management policies:

- a credit transaction requires a comprehensive credit risk assessment, expressed in the internal rating or scoring,
- credit risk measurement of potential and open credit transactions is made on a cyclical basis and takes into account both the changing external conditions and changes in the financial standing of the borrowers,
- 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,
- the terms and conditions of credit transactions offered to clients depend on the assessment of credit risk level generated by the transaction concerned,
- credit decisions may be taken only by authorised persons,
- credit risk is diversified by geographical areas, industries, products and clients,
- the expected level of credit risk is secured by credit spreads charged to clients as well as by provisions for impairment of credit exposures.

The application of the above policies is ensured by the fact that the Bank uses advanced methods of credit risk management both at the level of individual credit exposures and at the level of the entire credit portfolio of the Bank. The methods are verified and developed for compliance with the requirements of the internal rating based (IRB) methods.

## 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 central 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 awarding credit facilities. The internal regulations define the methods of assessment of the credit risk of individual credit exposures and its collateral, and also of taking credit decisions.

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

In 2008, the Bank continued to develop the aforementioned principles of credit risk assessment for individual clients, e.g. extending the behavioural scoring system by new revolving products within the Bank's offer for individual clients – credit cards and Inteligo revolving loans. In the discussed period, the Bank also updated the minimum values of the parameters used in the assessment of borrowing capacity of individual clients applying for consumer credits, housing loans, credit cards and revolving loans. The changes in the value of parameters involve e.g. an increase of the minimum regular household costs as well as the current consumption costs.

Credit risk assessment for institutional clients is conducted at two levels: the level of the client and of the transaction (except for certain types of transactions involving small and medium-sized enterprises which are assessed under the scoring approach). 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.

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

In February 2008, for earlier identification of potential threats related to the credit risk and collateral impairment risk within crediting of institutional clients, the Bank implemented an Early Warning System (EWS).

In view of the increased price fluctuations on financial markets (the foreign exchange market in particular), and also as a result of signals generated within the EWS, the Bank carried out an additional credit risk assessment with respect to its corporate clients who have concluded derivative transactions with both this Bank and other banks.

Noted in several cases was a deterioration of the client's standing due to conclusion of transactions hedging the same currency flows with several banks at the same time, or as a results of application of asymmetric option structures.

Verifying the client ratings as at the end of 2008 and until the present day, the Bank identified a group of clients who may suffer a deterioration of the business and financial standing as a result of treasury transactions or material negative valuations, as well as a group whose lowered rating or loss of current borrowing capacity could be confirmed.

## Collateral policy

The collateral policy followed by the Bank and the Capital Group's subsidiaries is to appropriately secure the interests of the Group, and in the first place to establish collateral that offers the best possible level of debt recovery if the recovery procedure proves necessary. The policy concerning legal collateral is defined in the Group's internal regulations.

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

In granting housing loans, collateral is obligatorily established on the financed real property. Until a mortgage can be established effectively (depending on the loan type and amount), a raised credit spread is applied or a temporary collateral is accepted in the form of a transfer of liabilities under the apartment construction agreement, a bill, guarantee or insurance of liabilities.

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 a collateral on the client's current account, car or securities.

The collateral on loans financing small and medium-sized enterprizes 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 policies:

- in the case of big loans, the Bank establishes several types of collateral, combining personal and tangible collateral whenever possible,
- liquid collateral is preferred, such as property collateral, for which there is a high probability that the Bank will quickly satisfy its debt achieving prices approximating the value of assets determined at the time of collateral acceptance,
- collateral exposed to a risk of significant unfavorable value fluctuations is treated as ancillary,
- in the case of acceptance of property collateral, as an additional security the Bank accepts transfer of rights from insurance policy for the subject of collateral, or insurance policy issued in favor of the Bank,
- 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 the current credit risk level of the transaction. The following factors are monitored:

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

Collateral in the form of mortgage is subject to special assessment. The Bank performs periodic monitoring of real properties accepted as collateral (the LtV ratio taken into account), 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, BFL SA as the owner of the leased assets treats them as a security for the transaction. Where the liquidity (demand for a given fixed asset on the secondary market), pace of loss of the market value of the asset or client financial standing are not acceptable according to internal procedures, an additional legal collateral is accepted in the form intended and used by banks. These include property collateral such as mortgages, registered pledges, transfer of ownership rights, repurchase agreements for repurchase of the leased goods concluded with suppliers, and financial collateral such as transfers of receivables, powers of attorney to access bank accounts, as well as security deposits.

## PORTFOLIO RISK MEASUREMENT

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:

- probability of default (PD),
- expected loss (EL),
- credit value at risk (CVaR),
- accuracy ratio,
- share and structure of irregular loans,
- share and structure of exposures meeting the criteria of individual loss of value.

The Bank 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 credit portfolio with those methods.

The portfolio credit risk measurement methods allow, among other things, to include the credit risk in the price of services; to determine the optimum amount of cut-off points; and to determine rates for making impairment write-offs.

In view of the crisis, PKO BP SA carries out additional analyses and stress tests of the impact of potential changes in its macroeconomic environment of the Bank's credit portfolio quality; besides, additional reporting to the Bank's Management has been introduced. The aforementioned information makes it possible to identify the negative effects of the crisis on the Bank's result and to undertake activities to limit such effects.

## EXPOSURE AMOUNT AS PER BALANCE SHEET VALUATION

Table 2.1 shows the balance sheet and off-balance sheet items taken into account in the calculation of capital adequacy of the PKO BP SA Capital Group as at 31 December 2007 and 31 December 2008.

*Table 2.1*

| | The PKO BP SA Group | | |
|---|---|---|---|
| | 2008 | 2007 | Average |
| ASSETS | 134 636 | 108 538 | 121 587 |
| Credits and loans* | 101 108 | 76 417 | 88 762 |
| Securities | 14 667 | 15 234 | 14 950 |
| Receivables from banks | 3 364 | 5 261 | 4 312 |
| Financial fixed assets | 247 | 179 | 213 |
| Other assets** | 15 251 | 11 447 | 13 349 |
| OFF-BALANCE SHEET LIABILITIES | 30 444 | 28 232 | 29 338 |
| Financial | 26 141 | 24 347 | 25 244 |
| Guarantees granted | 4 303 | 3 885 | 4 094 |
| DERIVATIVES | 423 628 | 416 803 | 420 216 |

* Including financial lease receivables.

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

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

*Table 2.2*

CREDITS AND LOANS* - STRUCTURE BY PORTFOLIO

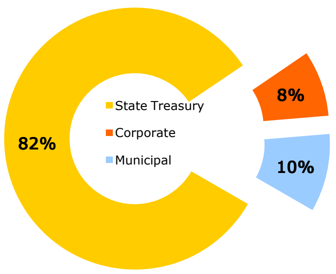
| | The PKO BP SA Group | |
|---|---|---|
| | 2008 | 2007 |
| Net credits and loans | 101 108 | 76 417 |
| consumer loans | 20 203 | 17 843 |
| housing loans | 45 402 | 32 887 |
| corporate loans | 35 503 | 25 688 |

* Including financial lease receivables.

A much smaller credit risk of the Group is related to derivatives, interbank deposits and the Group's holdings of securities (of which 82% are securities issued by the Treasury or the National Bank of Poland).

*Chart 2.1*

SECURITIES
THE PKO BP SA GROUP




In 2008, the greatest proportion of the exposure structure of the Bank's Capital Group (over 67%) was accounted for by retail and corporate exposures. The proportions of other exposure classes does not exceed 9.1% (Table 2.3).

*Table 2.3*

| | The PKO BP SA Group 2008 | |
|---|---|---|
| Exposure class* | Total exposure** | Average exposure** |
| Retail | 70 636 | 65 749 |
| Corporate | 41 649 | 37 461 |
| Secured on real estate property | 13 006 | 10 166 |
| Institutions (banks) | 8 766 | 8 349 |
| Past due | 955 | 1 751 |
| Regional governments and local authorities | 2 757 | 3 057 |
| Regulatory high risk categories | 73 | 140 |
| Central governments and central banks | 15 082 | 14 038 |
| Other exposures | 12 756 | 10 316 |
| Other classes*** | 21 | 827 |
| Total | 165 700 | 151 854 |

* Pursuant to § 20 of Appendix No. 4 to Resolution No. 1/2007 of the Commission for Banking Supervision.

** The value of balance sheet exposures and off-balance sheet liabilities granted (the product risk weight left out of account) before the 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 2008.

*** Includes: administrative bodies and non-commercial undertakings, short-term claims, claims in the form of collective investment undertakings.

A considerable proportion (over 70%) of the Capital Group's exposures are exposures with the original maturity of over 1 year; for over 50% of exposures with fixed maturity date the original maturity exceeds 5 years (Table 2.4).

*Table 2.4*

EXPOSURE* STRUCTURE BY ORIGINAL MATURITY

The PKO BP SA Group
2008

| | PKO BP, KREDOBANK i BFL | | | | | | Other Group companies | Adjustments and exclusions | Total |
|---|---|---|---|---|---|---|---|---|---|
| Exposure class | 0 - 1 month | 1 - 3 months | 3 - 12 months | 1 - 5 years | over 5 years | Other*** | | | |
| Retail | 20 | 10 | 9 320 | 12 510 | 39 231 | -328 | 9 | 0 | 60 772 |
| Corporate | 4 | 59 | 10 349 | 10 084 | 13 594 | -147 | 35 | -1 360 | 32 618 |
| Secured on real estate property | 1 | 3 | 180 | 628 | 12 138 | -76 | 0 | -8 | 12 865 |
| Institutions (banks) | 3 653 | 62 | 104 | 2 620 | 2 934 | 122 | 230 | -833 | 8 892 |
| Past due | 28 | 12 | 749 | 1 035 | 1 126 | -2 014 | 0 | 0 | 937 |
| Regional governments and local authorities | 5 | 0 | 41 | 673 | 1 882 | -16 | 0 | 0 | 2 585 |
| Regulatory high risk categories | 0 | 0 | 0 | 0 | 0 | 210 | 0 | -138 | 73 |
| Central governments and central banks | 939 | 199 | 2 445 | 3 904 | 3 660 | 3 636 | 222 | 0 | 15 006 |
| Other exposures | 2 337 | 4 | 375 | 344 | 160 | 8 801 | 1 088 | -457 | 12 653 |
| Other classes** | 0 | 0 | 0 | 1 | 0 | 0 | 20 | 0 | 21 |
| Total | 6 988 | 349 | 23 564 | 31 798 | 74 725 | 10 188 | 1 605 | -2 795 | 146 422 |

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

** Includes: administrative bodies and non-commercial undertakings, claims in the form of collective investment undertakings.

*** Includes items with unspecified maturity (e.g. fixed assets, stocks, impairment write-offs on credit exposures).

## IMPAIRMENT OF CREDIT EXPOSURES

The Group periodically reviews its credit exposures to identify exposures threatened with impairment; measures the impairment of its credit exposures; and establishes write-offs and provisions.

The process of establishing write-offs and provisions comprises the following stages:

- identification of the conditions of impairment and of events material for such identification,

- recording in the Bank's IT systems of events material for identification of the conditions of impairment of credit exposures,
- definition of the method for impairment measurement,
- measuring the impairment and deciding on a write-off or provision,
- verification and aggregation of the impairment measurement findings,
- recording of the impairment measurement findings.

The method for defining the amount of the write-offs 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:

- delay in loan repayment of at least 3 months,
- significant deterioration of a client's internal rating.

In determining the period of loan repayment delay, the outstanding amounts, of interest or principal installments are taken into account. Overdue debt of up to PLN 10 is treated as insignificant when identifying the condition of impairment.

The Group uses three methods for impairment assessment:

- the individualised method for individually significant clients who meet the condition of individual impairment or who are under restructuring,
- the portfolio method, applied in the case of individually insignificant loans for which the condition of individual impairment has been detected,
- the collective method (IBNR), used in the case of loans where no conditions of individual impairment have been detected, but there are conditions indicating the possibility of occurrence of incurred but not identified losses.

The write-off 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

- when defining the write-off under the individualised method, the future cash flows are assessed for each credit exposure individually, the possible scenarios of performance of the agreement take into account and weighed with the probability of their fulfillment,
- the write-off 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 homogenous portfolios.

When defining the provision for off-balance sheet credit exposures:

- with respect to individually significant credit exposures meeting the conditions of an individual impairment or pertaining to debtors whose other exposures meet such conditions – the Group uses the individualised method,
- with respect to the remaining individually significant exposures it was assumed that the result on write-offs is similar to that on special provisions – as at 31 December 2008, the Bank had provisions for off-balance sheet liabilities defined pursuant to the provisions of the Ordinance of the Minister of Finance pertaining to the principles of establishing provisions for risk related to banking activity adjusted by the differences between the amounts of such provisions and the amounts of provisions established under the IAS 37 methodology, with respect to individually assessed exposures.

The provision for off-balance sheet credit exposure, defined under the individualised method, 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 assessment date 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 liability, in excess of the current value of the balance sheet exposure concerned.

The structure of the loan portfolio and of established write-offs for credit exposure impairment of the Group is shown in Table 2.5. In 2008, the gross balance of loans granted by the Group valued under the individualised method increased by PLN 898 million, while valued using the portfolio method – by PLN 595 million.

The 2008 growth in the balance of loans valued under the individualised method resulted mainly from the fact that qualified for such valuation were business loans of institutional clients whose business and financial standing deteriorated as a result of a negative valuation of option transactions.

The 2008 growth in the balance of loans valued under the portfolio method resulted mainly from the fact that qualified for such valuation were consumer credits and housing loans awarded to individual clients as a result of changes of their overdue structure.

In 2008, the increase in the balance of loans for which impairment indicators have been identified (using the individualised and portfolio method) was higher than the dynamics of the entire loan portfolio, as a result of which the share of those loans in the entire portfolio increased from 3.9% as at the end of 2007 to 4.4% as at the end of 2008.

*Table 2.5*

CREDITS AND LOANS GRANTED TO CLIENTS*

| | The PKO BP SA Group | |
|---|---|---|
| | 2008 | 2007 |
| Gross credits and loans | 104 026 | 78 833 |
| individualised method | 2 310 | 1 412 |
| portfolio method | 2 253 | 1 658 |
| collective method (IBNR) | 99 463 | 75 763 |
| Impairment provisions | -2 918 | -2 416 |
| individualised method | -766 | -542 |
| portfolio method | -1 426 | -1 391 |
| collective method (IBNR) | -726 | -483 |
| Net credits and loans (gross-impairment provisions) | 101 108 | 76 417 |

* Including financial lease receivables.

The amount of the Group's revaluation write-offs in 2008 was affected by amortization to write-offs of credit and loans in the total amount of PLN 474 million, the write-off taken to the financial result in the amount of PLN 1.02 billion (Table 2.6).

*Table 2.6*

IMPAIRMENT PROVISIONS

| | The PKO BP SA Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | Balance as at | | Change in 2008 | Provisions write-offs | Additional provisions | F/X differences | Other |
| | 2008 | 2007 | | | | | |
| Credits and loans | 2 901 | 2 376 | 525 | -474 | 1 018 | -52 | 33 |
| consumer loans | 716 | 654 | 61 | -358 | 423 | -4 | 0 |
| housing loans | 536 | 494 | 42 | -49 | 100 | -9 | 0 |
| corporate loans | 1 622 | 1 228 | 394 | -67 | 495 | -40 | 5 |
| receivables from banks | 28 | 0 | 28 | 0 | 0 | 0 | 28 |
| Financial lease receivables | 45 | 40 | 5 | 0 | 5 | 0 | 0 |
| Financial instruments | 30 | 92 | -62 | -3 | -58 | -1 | 0 |
| Other | 313 | 157 | 156 | -1 | 166 | -3 | -6 |
| Total | 3 289 | 2 665 | 625 | -477 | 1 130 | -56 | 27 |

The 2008 growth in the revaluation write-offs for impairment of PLN 156 million under the item "Other" was affected mainly by write-offs for intangible assets in the amount of PLN 76 million.

*Tabela 2.7*

EXPOSURES WITH RECOGNISED IMPAIRMENT AND WRITE-OFFS

| | The PKO BP SA Group | |
|---|---|---|
| | 2008 | 2007 |
| Exposures with recognised impairment | 3 927 | 2 584 |
| receivables from banks | 28 | 0 |
| credits and loans awarded to clients* | 3 820 | 2 512 |
| debt securities (AFS) | 22 | 35 |
| other financial assets | 56 | 37 |
| Impairment write-offs** | -3 021 | -2 471 |
| receivables from banks | -28 | 0 |
| credits and loans awarded to clients* | -2 918 | -2 416 |
| debt securities (AFS) | -20 | -19 |
| other financial assets | -55 | -37 |

* Including financial lease receivables.
** Apply to exposures with recognised impairment. For the credits and loans with respect to which the IBNR method has been applied, the losses pertain also to exposures without recognised impairment.

## RISK MANAGEMENT TOOLS

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

- regulations concerning assessment of credit availability, including cut-off points – the minimum number of points awarded during the course of client 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,
- the minimum transaction terms and conditions defined for a given type of transaction (i.e. the minimum value of the LtV rate, the maximum credit amount, the required collateral),
- the minimum credit spread – credit risk spreads related to the Bank's specific credit transaction concluded with an institutional client, with the provision that the client may not be offered an interest rate lower than that resulting from reference rate increased by the credit risk spread,
- concentration limits – limits defined in § 71 clause 1 of the Banking Act, industry limits, as well as those relating to financing real properties,
- competence limits – define 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 levels (within the Bank's organisational structure).

## RISK CONCENTRATION

The Bank monitors the credit risk concentration in respect of:

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

In particular, the Bank monitors credit portfolios by:

- geographical regions,
- loan currency,
- industry sector,
- loans collateralised by real properties.

The risk of concentration of exposures to individual clients or groups of related clients is monitored pursuant to § 71 of the Banking Act in respect of:

- the exposure concentration limit (the total amount of individual exposure may not exceed 25% of the Bank's own funds in the case of entities not related to the Bank, or 20% of the Bank's own funds in the case of entities related to the Bank),
- the large exposure limit (the sum of individual exposures in excess of 10% of the Bank's own funds may not exceed 800% of the Bank's own funds).

As at 31 December 2008, the Bank's level of concentration of risk for individual exposures was rather low, the largest exposure to an individual entity amounting to 8.4% of the Bank's own consolidated funds.

*Table 2.8*

EXPOSURE TOWARD
THE 10 BIGGEST CLIENTS*

| | The PKO BP SA Group | | | |
|---|---|---|---|---|
| | 2008 | | 2007 | |
| No. | exposure | % | exposure | % |
| 1 | 1 077 | 8,4% | 918 | 9,2% |
| 2 | 938 | 7,3% | 867 | 8,7% |
| 3 | 915 | 7,1% | 830 | 8,3% |
| 4 | 697 | 5,4% | 699 | 7,0% |
| 5 | 607 | 4,7% | 577 | 5,8% |
| 6 | 603 | 4,7% | 543 | 5,4% |
| 7 | 565 | 4,4% | 522 | 5,2% |
| 8 | 500 | 3,9% | 452 | 4,5% |
| 9 | 471 | 3,7% | 447 | 4,5% |
| 10 | 344 | 2,7% | 427 | 4,3% |
| Total | 6 717 | 52,1% | 6 282 | 62,9% |

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

The biggest concentration of the exposure of the PKO BP SA Group in its subsidiaries amounted, as at the end of 2008, to 12.3% of its consolidated own funds, and resulted from consolidation of power engineering companies.

*Table 2.9*

EXPOSURE TOWARD THE 5 BIGGEST CAPITAL GROUPS*

| | The PKO BP SA Group | | | |
|---|---|---|---|---|
| | 2008 | | 2007 | |
| No. | exposure | % | exposure | % |
| 1 | 1 591 | 12,3% | 1 743 | 17,5% |
| 2 | 1 403 | 10,9% | 1 426 | 14,3% |
| 3 | 1 319 | 10,2% | 1 117 | 11,2% |
| 4 | 1 287 | 10,0% | 1 058 | 10,6% |
| 5 | 823 | 6,4% | 787 | 7,9% |
| Total | 6 422 | 49,8% | 6 132 | 61,4% |

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

As at the end of 2008, the sum of large exposures amounted to 43.5% of the Bank's own consolidated funds, as compared to the limit of 800% of the Bank's own funds.

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

- financial institutions – by the country of origin of the client's head office,
- for 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 2008, there was no significant geographical exposure concentration in the Group's credit portfolio (Table 2.10). The KREDOBANK SA portfolio of loans granted to Ukrainian clients accounted for approx. 2% of the Capital Group's total portfolio.

*Table 2.10*
GEOGRAPHICAL STRUCTURE OF EXPOSURES*

The PKO BP SA Group
2008

| Country/region | No. of exposure class** | | | | | | | | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | A | B | C | D | E | F | G | H | I | Other*** | |
| Poland, of which: | 60 142 | 33 352 | 12 181 | 5 737 | 914 | 2 585 | 210 | 14 608 | 11 677 | 0 | 141 405 |
| zachodniopomorski | 4 136 | 2 244 | 1 025 | 0 | 306 | 152 | 0 | 7 | 13 | 0 | 7 883 |
| wielkopolski | 6 194 | 3 005 | 1 536 | 0 | 136 | 241 | 0 | 0 | 4 | 0 | 11 117 |
| warmińsko-mazurski | 2 131 | 815 | 682 | 0 | 91 | 99 | 0 | 68 | 3 | 0 | 3 890 |
| śląsko-opolski | 8 760 | 2 912 | 1 427 | 0 | 306 | 259 | 0 | 8 | 21 | 0 | 13 692 |
| pomorski | 3 582 | 3 230 | 797 | 0 | 125 | 110 | 0 | 1 | 8 | 0 | 7 853 |
| podlaski | 1 972 | 1 114 | 126 | 0 | 22 | 103 | 0 | 18 | 2 | 0 | 3 357 |
| mazowiecki | 9 132 | 9 269 | 944 | 0 | 263 | 338 | 0 | 267 | 22 | 0 | 20 235 |
| małopolsko-świętokrzyski | 5 176 | 2 960 | 1 431 | 0 | 172 | 442 | 0 | 151 | 8 | 0 | 10 340 |
| łódzki | 3 596 | 1 909 | 933 | 0 | 141 | 365 | 0 | 8 | 3 | 0 | 6 954 |
| lubelsko-podkarpacki | 3 982 | 1 370 | 1 427 | 0 | 123 | 216 | 0 | 14 | 36 | 0 | 7 168 |
| kujawsko-pomorski | 2 892 | 1 355 | 702 | 0 | 113 | 121 | 0 | 180 | 21 | 0 | 5 385 |
| dolnośląski | 4 896 | 1 973 | 1 154 | 0 | 107 | 155 | 0 | 3 | 7 | 0 | 8 295 |
| other**** | 3 693 | 1 196 | -3 | 5 736 | -993 | -15 | 210 | 13 882 | 11 529 | 0 | 35 236 |
| United Kingdom | 46 | 0 | 6 | 719 | 0 | 0 | 0 | 88 | 0 | 0 | 859 |
| Ukraine | 556 | 526 | 683 | 835 | 22 | 0 | 0 | 64 | 238 | 1 | 2 925 |
| France | 1 | 0 | 0 | 585 | 0 | 0 | 0 | 0 | 0 | 0 | 586 |
| Germany | 6 | 0 | 1 | 405 | 0 | 0 | 0 | 0 | 0 | 0 | 411 |
| Austria | 0 | 0 | 1 | 262 | 0 | 0 | 0 | 0 | 0 | 0 | 263 |
| USA | 2 | 0 | 0 | 234 | 0 | 0 | 0 | 0 | 0 | 0 | 236 |
| The Netherlands | 1 | 0 | 0 | 217 | 0 | 0 | 0 | 0 | 0 | 0 | 219 |
| Denmark | 0 | 0 | 0 | 198 | 0 | 0 | 0 | 0 | 0 | 0 | 198 |
| Latvia | 0 | 0 | 0 | 95 | 0 | 0 | 0 | 0 | 0 | 0 | 95 |
| Belgium | 0 | 0 | 0 | 77 | 0 | 0 | 0 | 0 | 0 | 0 | 77 |
| Other | 8 | 66 | 0 | 133 | 1 | 0 | 0 | 24 | 106 | 0 | 338 |
| Total (PKO BP, KREDOBANK, BFL) | 60 763 | 33 944 | 12 873 | 9 496 | 937 | 2 585 | 210 | 14 783 | 12 021 | 1 | 147 612 |
| Other Group companies | 9 | 35 | 0 | 230 | 0 | 0 | 0 | 222 | 1 088 | 20 | 1 605 |
| Adjustments and exclusions | 0 | -1 360 | -8 | -833 | 0 | 0 | -138 | 0 | -457 | 0 | -2 795 |
| Total | 60 772 | 32 618 | 12 865 | 8 892 | 937 | 2 585 | 73 | 15 006 | 12 653 | 21 | 146 422 |

* The value of balance sheet exposures and the balance sheet equivalent of off-balance sheet liabilities and transactions before the application of the credit risk mitigation techniques.
** A - retail claims,
B - claims on corporates,
C - claims secured on real estate property,
D - claims on institutions,
E - past due items,
F - claims on regional governments and local authorities,
G - items belonging to regulatory high-risk categories,
H - claims on central governments and central banks,
I - other items.

*** Includes: administrative bodies and non-commercial undertakings, claims in the form of collective investment undertakings.

**** Including impairment write-offs.

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

As at 31 December 2008, there was no significant credit exposure concentration by industry sectors (Table 2.11).

*Table 2.11*

EXPOSURE STRUCTURE BY INDUSTRY*

The PKO BP SA Group

2008

| | Type of client/branch | No. of exposure class** | | | | | | | | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | A | B | C | D | E | F | G | H | I | Other*** | |
| Institutional clients, of which: | | 9 116 | 27 718 | 1 082 | 0 | 1 319 | 2 601 | 0 | 0 | 640 | 1 | 42 476 |
| D | Industrial processing | 1 566 | 9 452 | 216 | 0 | 480 | 2 | 0 | 0 | 1 | 0 | 11 718 |
| G | Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household appliances | 2 601 | 4 383 | 301 | 0 | 335 | 0 | 0 | 0 | 1 | 0 | 7 620 |
| L | Public administration and national defense, obligatory social security and public health insurance | 1 | 0 | 0 | 0 | 2 | 2 568 | 0 | 0 | 0 | 0 | 2 572 |
| K | Real property maintenance, rental and services related to pursuit of business activity | 840 | 4 706 | 138 | 0 | 52 | 0 | 0 | 0 | 0 | 0 | 5 736 |
| F | Construction | 885 | 1 985 | 108 | 0 | 87 | 0 | 0 | 0 | 0 | 0 | 3 065 |
| E | Generation and supply of power, gas and water | 44 | 1 480 | 6 | 0 | 12 | 1 | 0 | 0 | 0 | 0 | 1 542 |
| | Other exposures | 3 180 | 5 712 | 314 | 0 | 350 | 30 | 0 | 0 | 637 | 0 | 10 224 |
| Bakns | | 0 | 0 | 0 | 9 496 | 0 | 0 | 0 | 0 | 0 | 0 | 9 496 |
| Governments | | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 14 711 | 0 | 0 | 14 711 |
| Individuals | | 50 333 | 4 614 | 11 867 | 0 | 1 506 | 0 | 0 | 0 | 40 | 0 | 68 359 |
| Other**** | | 1 314 | 1 611 | -76 | 0 | -1 888 | -16 | 210 | 73 | 11 342 | 0 | 12 570 |
| Total (PKO BP, KREDOBANK, BFL) | | 60 763 | 33 944 | 12 873 | 9 496 | 937 | 2 585 | 210 | 14 783 | 12 021 | 1 | 147 612 |
| Other Group companies | | 9 | 35 | 0 | 230 | 0 | 0 | 0 | 222 | 1 088 | 20 | 1 605 |
| Adjustments and exclusions | | 0 | -1 360 | -8 | -833 | 0 | 0 | -138 | 0 | -457 | 0 | -2 795 |
| Total | | 60 772 | 32 618 | 12 865 | 8 892 | 937 | 2 585 | 73 | 15 006 | 12 653 | 21 | 146 422 |

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

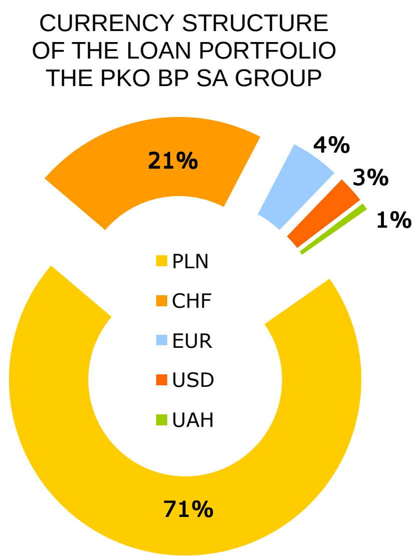
** A - retail claims,
B - claims on corporates,
C - claims secured on real estate property,
D - claims on institutions,
E - past due items,
F - claims on regional governments and local authorities,
G - items belonging to regulatory high-risk categories,
H - claims on central governments and central banks,
I - other items.

*** Includes: administrative bodies and non-commercial undertakings, claims in the form of collective investment undertakings.

**** Including impairment write-offs.

The level of foreign currency credit risk concentration is moderate. In 2008, there was an increase in the share of loans denominated in foreign currencies in the overall credit portfolio to 29% (which was mainly due to the impact of an increased exchange rate on the value in PLN of loans denominated in foreign currencies).

*Chart 2.2*




Due to the special profile of credit exposure related to loans taken out by individual clients for real estate property financing, the Bank sets specific limits for this portfolio, taking the following among other factors into account: the industry sector, group of entities, type of credit transaction, length of crediting period, credit transaction currency, and accepted collateral.

## RISK REPORTING

The Bank prepares monthly and quarterly credit risk reports for ALCO, BCC and the Bank's Management and Supervisory Boards. The reports state the historical and projected credit risk levels. Beside information about the Bank, the reports also include the credit risk data for the Group's two subsidiaries: KREDOBANK SA and BFL SA, which both report a significant credit risk level.

## FINANCIAL INSTITUTIONS AND DERIVATIVES

### Derivatives used by the Bank

During the course of its business activities, the Bank uses various types of derivatives to manage the risk resulting from the conducted business activity. The main types of risk relating to derivatives include the market and credit risk. The Bank enters into transactions with the use of derivatives mainly with other banks.

Derivates used by the Bank within risk management and offered to its clients are mostly IRS, FRS, FX, Swap, CIRS, FX Forward and FX options (Table 2.12).

*Table 2.12*

DERIVATIVES*

| | The PKO BP SA Group | | | |
|---|---|---|---|---|
| | 2008 | | | |
| | Nominal value | | Fair value | |
| | Purchase | Sale | Negative | Positive |
| Currency transactions (over-the-counter market) | 35 340 | 37 799 | 3 471 | 857 |
| FX swap | 7 001 | 7 323 | 359 | 22 |
| FX forward | 3 012 | 2 949 | 136 | 204 |
| Options | 8 914 | 8 817 | 585 | 574 |
| Cross Currency IRS | 16 414 | 18 709 | 2 391 | 56 |
| Interest rate transactions | 175 079 | 175 189 | 2 679 | 2 728 |
| Interest Rate Swap (IRS) | 141 439 | 141 439 | 2 554 | 2 599 |
| Forward Rate Agreement (FRA) | 33 640 | 33 750 | 124 | 129 |
| Credit Default Swaps | 207 | 0 | 0 | 12 |
| Other (stock market index derivatives) | 12 | 1 | 0,1 | 1 |
| Total derivatives | 210 639 | 212 989 | 6 150 | 3 598 |

*Nominal value of base instruments and fair value of derivative financial instruments.

A derivative becomes an asset if its fair value is positive, or a liability – if its fair value is negative.

The fair value of financial instruments traded on the market is their market price. In other cases, derivative's fair value is the fair value determined based on the valuation model for which input data was taken from an active market. Valuation techniques applied are based, among other, on models of discounted cash flows, option models and yield curves.

In order to assess capital requirements for derivatives (in respect of credit risk and counterparty credit risk), the Bank uses the mark-to-market valuation method.

The Bank reports embedded derivatives, which are elements of contracts of both financial and non-financial nature, and the resultant cash flows, in whole or in part, relating to such contracts change in the manner similar to that resultant from a separate derivative.

Contracts including embedded derivatives are monitored by the Bank and are subject to periodic evaluation.

Embedded derivatives are separated from host contracts and recognised separately in the books of account and are valued at fair value. Derivatives' valuation is recognised in the balance sheet under „Derivatives". The effects of evaluation of derivatives at fair value are taken to the profit and loss account and recognised under "Result from financial instruments at fair value".

In 2008, the scale of the Group's activities as regards embedded derivatives was not significant.

### Policy of determining credit limits and collateralising derivatives

In order to limit credit risk relating to derivatives, the Bank enters into framework agreements which are aimed at collateralising the Bank's claims towards counterparties, resulting from derivative transactions, by netting due and payable liabilities (mitigation of settlement risk) and liabilities which are not due and payable (mitigation of pre-settlement risk).

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 (Polish Banks Association). Framework agreements with Polish financial institutions for debts 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 framework agreement, the parties enter into a collateral CSA (Credit Support Annex) agreement.

Based on the Credit Support Annex, each of the parties, after meeting certain criteria specified in the agreement, undertakes to establish an appropriate collateral along with the right to set it off.

The Bank has developed a standard of signing ISDA 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 frameworks agreements and credit support annexes with foreign banks and credit institutions.

The ISMA and CSA agreements signed by the Bank contain provisions defining the allowed difference between credit exposure and collateral value.

The CSA agreements, which are annexes to the ISDA agreements, allow two types of collateral: cash and securities.

As at the end of 2008, the Bank held 23 open framework agreements with Polish banks (and, additionally, with the Treasury) and 31 agreements with foreign banks and credit institutions. In addition, the Bank is a party to 17 CSA agreements facilitating collateralisation of exposures relating to derivatives and 2 ISMA agreements which enable to set off liabilities resulting from REPO and BSB/SBB transactions. The level of coverage of the face value of transactions involving derivatives with Framework Agreements and Collateral Agreements/CSA was 99.6% and 38.9% respectively.

The Bank requires that its counterparty establishes an 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. Subject to collateral are also transactions under the CSA agreement where the value of exposure exceeds the threshold amount specified in the agreement.

Entering into framework agreement with counterparty is the basis for verification of internal limit per counterparty and of the length of period of the Bank's engagement in forward and 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.

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

Collateralisation of transactions made on an interbank market is executed as part of the CSA agreements. The agreements signed by the Bank determine, separately for each counterparty, a fixed amount of allowed non-collateralised exposure. The agreements signed by the Bank to date, did not include any provisions that would require an additional collateral if the rating of one of the parties deteriorated.

The positive gross fair value of contracts with financial institutions as at the end of December 2008 was PLN 2.9 billion. The above amount was calculated as the total of positive market values of all open transactions. The net credit exposure, after taking into account setting off of transactions, for clients with framework agreements was approx. PLN 322 million. Balancing benefit amounted to approx. PLN 2.5 billion (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 Hedging Agreements was PLN 57.8 million.

As at 31 December 2008, the Bank had no derivative credit transactions commissioned by its clients or contracted for speculative purposes (under its internal regulations, the Bank may conclude derivative credit transactions only to hedge its own deposit and bond portfolio).

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-offs.

As at 31 December 2008, the Bank recognized an adjustment for credit valuation in the valuation of derivatives concludes with non-financial business entities based on an analysis of recoverability of its exposures. The Bank's adjustment included the market value of the credit risk as assessed by the Bank. Analysed were all significant exposures on account of the Bank's positive valuation of 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 the business and financial standing of entities, the probability of repayment of specific contracts, and the recoverable value of collateral.

### Credit quality of counterparties

The majority of financial institutions - the Bank's business partners on an interbank market – were awarded high external ratings – A or AA (Table 2.13).

*Table 2.13*

THE QUALITY OF EXPOSURE TO FINANCIAL INSTITUTIONS*

| Rating | PKO BP SA 2008 |
|---|---|
| AAA | 0% |
| AA | 11% |
| A | 65% |
| BBB | 4% |
| B | 0% |
| Lack of rating | 20% |
| Total | 100% |

* Exposure to institutions from outside the Capital 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.

### Credit derivatives

In order to hedge credit risk, the Bank enters into credit derivatives or other agreements, based on which a transfer is made, of all or part, of the credit risk relating to the Bank's receivables.

As at the end of 2008, the Bank had credit derivatives – the Credit Default Swaps (CDS) with two contractors, hedging its exposure on account of bonds issued by 5 financial entities, in the total amount of approx. PLN 207 million. The counterparties to the CDS transactions have high credit ratings of the AA level.

### Credit risk of financial institutions

PKO BP SA actively cooperates on the wholesale market with financial institutions whose registered offices are located in the territory of nearly 50 countries. Within the limits set, the Bank may enter into transactions with over 200 counterparties, including Polish and foreign banks, insurance companies, pension and investment funds. The transactions made include loan and deposit transactions, securities transactions, foreign exchange operations and derivative transactions.

The Bank regularly monitors the financial standing of its counterparties on a regular 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 and the PBA's standards. The exposure to financial institutions on the wholesale market is of high quality and low credit risk generated, as confirmed by external ratings granted by rating agencies and also by internal ratings granted to the counterparties by the Bank.

## RISK MANAGEMENT AT SUBSIDIARIES OF THE GROUP

The Group's subsidiaries with significant credit risk (KREDOBANK SA, BFL SA) manage credit risk individually, with the provision that the applied methodologies for credit risk assessment and measurement are adjusted to those used by PKO BP SA, while observing the specific nature of the business conducted by those entities.

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

BFL SA and KREDOBANK SA cyclically measure credit risk and the results of that measurement are reported to the Bank.

### Derivatives at subsidiaries of the Group

Subsidiaries of the Group introduced internal regulations concerning derivatives risk management – after obtaining the opinion of the Bank and after considering recommendations directed by the Bank to individual companies. The regulations define the method and manner of taking positions in derivatives instruments by individual subsidiaries.

The positions taken by individual subsidiaries in given derivatives are determined in a manner similar to that of the Bank in these derivatives, and after taking into account the specific nature of business of those companies.

KREDOBANK SA does not hold any derivatives. However, other subsidiaries of the Group may conclude transactions with the use of derivatives only to hedge the risk resulting from core business activities (banking book).

## CAPITAL EXPOSURES IN THE BANKING BOOK

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

- stocks and shares – exposures to co-subsidiaries and associated entities (except for stocks and shares reducing own funds of the Group) and to other entities with the minority interest of PKO BP SA and subsidiaries of the Group. The reason behind acquisition of these assets is to obtain capital gains (dividend) and return from investment following the disposal or redemption of stocks and shares as well as the share of PKO BP SA in the development of the financial market;
- 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 to create such fund.

*Table 2.14*

CAPITAL EXPOSURES - BANKING BOOK

| | The PKO BP SA Group | | | |
|---|---|---|---|---|
| | 2008 | | 2007 | |
| | Carrying amount | Fair value* | Carrying amount | Fair value* |
| Total | 162 | 162 | 170 | 170 |
| Shares in other entities | 59 | 59 | 58 | 58 |
| Equity securities | 103 | 103 | 112 | 112 |
| shares in entities listed on regulated market** | 66 | 66 | 79 | 79 |
| shares in entities not-listed on regulated market | 17 | 17 | 11 | 11 |
| collective investment undertakings | 20 | 20 | 22 | 22 |

* Estimated fair value.

** Fair value of listed securites equals their market value.

### Valuation methods and accounting policies applied

Stocks and shares in co-subsidiaries and associated entities are valued using the equity method (acquisition costs adjusted by a change in the net assets of the company for the period from the acquisition to valuation date) less impairment write-offs. As at each balance sheet date, an assessment is made of whether impairment indicators exist for investments in associated entities and co-subsidiaries. If impairment indicators are identified, an assessment is made of the higher of the investment's value in use and fair value less selling expenses. The forecast of the usable value is estimated 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 of individual entities.

Stocks and shares in other entities are valued as follows:

- at fair value determined in the following manner:

— market value for those stocks, for which there is an active market,

— at a received current offer of the purchase price 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,

- at the acquisition cost less impairment write-offs for those stocks and shares, for which reasonable 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-offs which are taken to the profit and loss account. Revaluation reserve item is amortised to the profit and loss account at the time the asset is sold or impaired. In the case of loss impairment of a given asset, the amounts recognised previously as an increase in the value due to revaluation to fair value decrease revaluation reserve. If the amount of previously recognised revaluation is not sufficient to cover the permanent loss impairment, the resultant difference is taken to the profit and loss account.

Revaluation write-offs 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 profit and loss account.

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.

In 2008, the PKO BP SA Group earned profit on disposal and liquidation of capital exposures in the total amount of PLN 6.6 million.

At the end of 2008, the unrealised loss of the PKO BP SA Group relating to revaluation of the capital exposure amounted to the total of PLN 0.7 million.

Additionally, on account of its capital exposure in the stocks held, the PKO BP SA Capital Group received a gross dividend in 2008 in the total amount of PLN 22 million.

## 2.2. Operational risk

The operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

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

- sets the objectives for the operational risk management,
- defines policies for the operational risk,
- accepts reports relating to the operational risk.

The operational risk management is carried out in the area of strategic and "day-to-day" operational risk management.

Strategic operational risk management consists in developing internal regulations and other solutions relating to the operational risk and concerning, among other, the following:

- human resources,
- organisation of the Bank,
- accounting,
- IT,
- security,
- internal processes,
- client service processes,
- outsourcing of the banking operations and actual business operations to external parties.

Strategic operational risk management is centralised at the level of the Bank's Head Office. Each business and support line has a dedicated unit which is responsible for identification and monitoring of operational risk in the products or internal processes supervised and for taking appropriate steps to ensure acceptable operational risk level.

"Day-to-day" operational risk management consists in the following:

- preventing the operational risk from events arising during the course of product realisation and within internal processes or systems,
- undertaking activities aimed at limiting the number and scale of threats (operational risk events),
- liquidating the negative effects of operational risk events,
- collecting data on operational risk events.

"Day-to-day" operational risk management is carried out by each operational unit of the Bank.

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

### Mitigation of operational risk

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

- control instruments,
- human resources management instruments (personnel selection and recruitment, employee qualifications enhancement systems and incentive systems),
- defining threshold values for key risk indicators (KRI),
- contingency plans,
- insurance,
- outsourcing.

Selection of instruments used to mitigate operational risk is performed, among other, depending on the following:

- availability and adequacy of instruments mitigating the risk,
- nature of the business or process, in which the operational risk has been identified,
- risk materiality,
- cost of use of an instrument.

In addition, internal regulations of the Bank provide for the obligation not to undertake any business activity subject to an excessive risk, and if such business activity is conducted – withdrawal from such business activity or its limitation. The level of the operational risk is considered to be excessive, if potential benefits from conducting such business activity are lower than potential operational losses from engagement in such operations.

### Operational risk assessment

Operational risk assessment is conducted using the following:

- collected data on operational risk events,
- internal audit results,
- results of internal functional control,
- results of operational risk self-assessment,
- the key risk indicators (KRI).

The Bank regularly monitors the level of KRI and operational risk events that exceed the threshold value defined for the operational risk.

### Risk reporting

Reporting operational risk-related information concerning the Bank or subsidiaries of the Group is conducted on a semi-annual (from 2009 – quarterly) basis. The recipients of such reports are the Management and Supervisory Boards of the Bank. The reports contain information relating to the following:

- the Bank's operational risk profile resulting from the process of identification and assessment of threats,
- results of operational risk assessment and monitoring,
- operational events and their financial effects,
- the most significant projects and undertakings as regards the operational risk management.

### Risk management at subsidiaries of the Group

Other subsidiaries of the Group manage operational risk in accordance with the operational risk policies binding in the PKO BP SA Group, including the specific nature and scale of their business.

In 2008, the Group's subsidiaries were improving their operational risk management processes, developing new solutions for operational risk monitoring with KRI.

## 2.3. Compliance risk

Compliance risk is understood as 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 Bank, the Bank's employees or entities on the Bank's behalf to observe legal provisions, internal regulations and the standards of procedure adopted by the Bank, the ethical standards included.

The purpose of compliance risk management it to consolidate, through elimination of compliance risk, the image of the PKO BP SA Group as a group of entities operating in compliance with the law and the generally recognised standards of procedure, trustworthy, honest and reliable; to prevent the Bank's loss of reputation or credibility; and to prevent financial losses or legal sanctions that might result from the violation of the law and norms of conduct.

Compliance risk management covers specifically the following issues:

- prevention of the Bank's involvement in illegal activities,
- ensuring data protection,
- propagation of the ethical standards and monitoring of their functioning,
- management of conflicts of interests,
- prevention of situations where the conduct of the Bank's employees in official matters might seem self-interested,
- a professional, reliable and clear formulation of the product offer and the advertising and marketing messages,
- immediate, honest and professional consideration of the clients' complaints and suggestions.

The compliance risk management tasks are coordinated within the PKO BP SA Group by the Banking Risk Division.

In the latter half of 2008, compliance risk management policies consistent with those operative at the Bank were implemented in all subsidiaries of PKO BP S.A.

## 2.4. Market risk

Market risk is defined as the risk of loss due to unfavourable market parameters such as interest rate, foreign exchange rate or the risk of liquidity loss. Market risk covers the interest rate risk, foreign exchange risk and liquidity risk.

The Bank and subsidiaries of the Group apply the following market risk management policies:

- activities are undertaken with a view to keeping the level of risk within the accepted risk profile,
- an acceptable level of liquidity is maintained, which depends on keeping the appropriate level of liquid assets,
- the main sources of financing of the Bank's assets are stable sources such as a stable deposit base,
- the FX position is closed within the accepted limits for FX risk,
- the result of the Bank is optimised while observing the accepted level of interest rate risk.

### Market risk measurement

In order to determine the level of market risk, the Bank uses various methods of its measurement, including:

- for interest rate risk: the value at risk model (VaR), stress tests and interest income sensitivity measures,
- for FX risk: the value at risk model (VaR) and stress tests,
- for liquidity risk: contractual and real-terms liquidity gap method, surplus liquidity method, verification of stability of deposit base and loan portfolio and shock analyses.

The value at risk (VaR) is defined as potential loss resulting from changes in the present value of cash flows from financial instruments or as potential loss of value on the maintained currency positions due to changes in the currency exchange rates, on the assumption that a defined confidence level and holding period of the position are kept. In order to determine VaR for market risk management purposes, the variance-covariance method is applied with the 99% confidence level. For interest rate and FX 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 activities of the Bank.

Stress tests are used to assess potential losses on interest rate positions as well as potential losses on currency positions where market situation occurs that can not be described using the statistical measures. The following scenarios are applied at the Bank:

- for interest rate risk:
  - hypothetical scenarios - within which fluctuations in interest rates are assumed arbitrarily (parallel movements of the interest rate curves in the following currencies: PLN, EUR, USD, CHF and GBP by ±50 BPS and by ±200 BPS, and non-parallel movements of the yield curves);
  - historical scenarios – within which fluctuations in interest rates are assumed on the basis of fluctuations of interest rates in the past;
  - base risk scenarios, which assume a change of the spread between profitability curves used in the valuation of the hedged and hedging instruments;
- for FX risk:
  - hypothetical scenarios – within which hypothetical appreciation or depreciation of exchange rates is assumed (by 15% and 50%),
  - historical scenarios – scenarios of fluctuations of exchange rates observed in the past;
- for liquidity risk:
  - scenarios of mass withdrawal of deposits by non-financial clients.
  - scenarios of sensitivity of in- and outflows to changing market conditions.

In the process of interest rate risk measurement, the Bank assumed that the balance of future earlier repayments of loans and withdrawal of deposits with unspecified maturity date will be replaced, respectively, by future sales of loans and future unspecified maturity dates of the placements made. The assumption results from implemented types of interest rates for loan and deposit products in the Bank.

For the purpose of liquidity risk management, the Bank defines the following:

- contractual liquidity gap – listing of all balance sheet items by their maturity,
- real-terms liquidity gap – listing of individual balance sheet categories by their real maturity,
- liquidity reserve – the difference between the most liquid assets and expected and potential liabilities that mature in a given period.

## RISK MANAGEMENT TOOLS

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

- limits and threshold values by individual market risk types,
- defining the allowed types of transactions exposed to specific market risks,
- transactions ensuring long-term financing of credit activities.

As regards mitigating the interest rate risk, the Bank defined limits and threshold values relating to, among other things, the degree of price sensitivity and interest income sensitivity, the amount of losses and allowed derivatives sensitive to interest rate fluctuations. The limits have been set for individual portfolios of the Bank.

As regards FX risk mitigation, the Bank defined limits relating, among other things, to the value of currency position, value at risk calculated in the 10-day time frame (10-day VaR) and daily loss from speculative transactions on the FX market.

As for limiting liquidity risk, the Bank defined limits and threshold values for measures of the current as well as mid- and long-term liquidity.

## INTEREST RATE RISK

In 2008, the interest rate risk of the PKO BP SA Group was moderate. It was determined mainly by the risk of mismatch of dates of revaluation of assets and liabilities, and by the base risk.

At the end of 2008, the PKO BP SA Group reported a cumulative negative gap in PLN in the time frame of 1 month and a cumulative positive gap in other time ranges. The exposure of the PKO BP SA Group to the risk of PLN interest rate at the end of 2008 consisted mainly of the exposure of the Bank. The PLN interest rate risk generated by other subsidiaries of the Group did not significantly influence the interest rate risk of the entire Group and hence did not materially change its risk profile.

The Group's exposure to the USD interest rate risk consisted of both the Bank's exposure and the exposures of individual subsidiaries of the Group. The interest rate risk of subsidiaries reduced the interest rate of the Group in the time frame of up 1 month and 1 to 6 months. In the remaining time intervals, the subsidiaries' interest rate risk increased the Group's exposure to the interest rate risk.

The Group's exposure to the USD interest rate risk consisted of both the Bank's exposure and the exposures of individual subsidiaries of the Group. The EUR interest rate risk generated by the subsidiaries decreased the Group's risk in the 3 to 6 months, 6 to 12 months, and 1 to 2 years intervals, and increased it in other time intervals.

The Group exposure to the CHF interest rate risk is composed mainly of the Bank's exposure. The CHF interest rate risk generated by subsidiaries of the Group did not significantly influence the interest rate risk of the Group and hence did not change its risk profile.

The Group's exposure to interest rate risk remained within accepted limits.

The tables below present the reassessment gaps as at 31 December 2008 by currencies.

*Table 2.15*

PLN Interest rate gap (in PLN mln)

| 2008 | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-2 years | 2-5 years | over 5 years | Total |
|---|---|---|---|---|---|---|---|---|
| PKO BP SA | | | | | | | | |
| Periodic gap | -4 943 | 6 771 | 11 376 | 1 416 | -7 164 | -708 | 24 | 6 773 |
| Cumulative gap | -4 943 | 1 828 | 13 204 | 14 620 | 7 457 | 6 749 | 6 773 | - |
| Group subsidiaries | | | | | | | | |
| Periodic gap | -195 | -96 | -170 | -38 | 9 | -62 | 15 | -538 |
| Cumulative gap | -195 | -291 | -461 | -499 | -490 | -553 | -538 | |
| TOTAL - Periodic gap | -5 137 | 6 675 | 11 206 | 1 378 | -7 155 | -770 | 39 | 6 235 |
| TOTAL - Cumulative gap | -5 137 | 1 537 | 12 743 | 14 121 | 6 966 | 6 197 | 6 235 | - |

*Table 2.16*

USD Interest rate gap (in USD mln)

| 2008 | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-2 years | 2-5 years | over 5 years | Total |
|---|---|---|---|---|---|---|---|---|
| PKO BP SA | | | | | | | | |
| Periodic gap | 45 | -157 | -28 | 6 | -15 | 22 | 15 | -112 |
| Cumulative gap | 45 | -112 | -140 | -134 | -149 | -127 | -112 | - |
| Group subsidiaries | | | | | | | | |
| Periodic gap | -46 | -81 | -60 | -10 | 33 | 58 | 111 | 5 |
| Cumulative gap | -46 | -127 | -187 | -197 | -163 | -106 | 5 | |
| TOTAL - Periodic gap | -1 | -238 | -88 | -3 | 18 | 79 | 126 | -106 |
| TOTAL - Cumulative gap | -1 | -239 | -327 | -330 | -312 | -232 | -106 | - |

*Table 2.17*

EUR Interest rate gap (in EUR mln)

| 2008 | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-2 years | 2-5 years | over 5 years | Total |
|---|---|---|---|---|---|---|---|---|
| PKO BP SA | | | | | | | | |
| Periodic gap | -314 | -18 | 52 | 38 | -14 | 32 | -8 | -233 |
| Cumulative gap | -314 | -332 | -281 | -243 | -257 | -225 | -233 | - |
| Group subsidiaries | | | | | | | | |
| Periodic gap | -26 | -1 | -18 | -1 | 8 | 32 | -5 | -10 |
| Cumulative gap | -26 | -26 | -45 | -45 | -37 | -5 | -10 | |
| TOTAL - Periodic gap | -340,03 | -18,827 | 33,4097 | 36,9537 | -5,625 | 63,539 | -13,035 | -243,61 |
| TOTAL - Cumulative gap | -340,03 | -358,85 | -325,44 | -288,49 | -294,12 | -230,58 | -243,61 | - |

*Table 2.18*

CHF Interest rate gap (in CHF mln)

| 2008 | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-2 years | 2-5 years | over 5 years | Total |
|---|---|---|---|---|---|---|---|---|
| PKO BP SA | | | | | | | | |
| Periodic gap | 4 983 | -4 901 | -3 | -2 | 0 - | | 3 | 81 |
| Cumulative gap | 4 983 | 83 | 80 | 78 | 78 | 78 | 81 | - |
| Group subsidiaries | | | | | | | | |
| Periodic gap | -13 | 5 | 4 | 0 | 0 | 0 | 0 | -4 |
| Cumulative gap | -13 | -8 | -4 | -4 | -4 | -4 | -4 | |
| TOTAL - Periodic gap | 4 970 | -4 896 | 1 | -2 | 0 | - | 3 | 77 |
| TOTAL - Cumulative gap | 4 970 | 74 | 76 | 74 | 74 | 74 | 77 | - |

The VaR and analysis of stress test scenarios in respect of financial assets of the Bank and of the Group (jointly for the banking and trading portfolios) exposed to the interest rate risk at the end of 2008 and 2007 respectively are presented in the table below.

*Table 2.19*

Sensitivity of financial assets exposed to interest rate risk

| | 2008 | | 2007 | |
|---|---|---|---|---|
| | 10-day VaR* | Stress-test +200 base points | 10-day VaR* | Stress-test +200 base points |
| PKO BP SA | 72,3 | 141,9 | 36,3 | 101,9 |
| Other Group companies | - | 90,9 | - | 54,0 |
| Total | 72,3 | 232,8 | 36,3 | 155,9 |

* The VaR as at 31 December 2007 has been determined with consideration to changes in the VaR methodology made in 2008 due to the financial crisis. Determined under the methodology as at 31 December 2007, VaR amounted to PLN 10.5 million.

As at 31 December 2008, the 10-day VaR on interest rate was PLN 72.3 million and accounted for approx. 0.60% 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 2.20*

Stress-test results* - parallel shift of interest rate curves by +200 base points

| | Bank | | Other Group companies | | Total | |
|---|---|---|---|---|---|---|
| Currency | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| PLN | 124,0 | 51,4 | 2,7 | 0,8 | 126,7 | 52,2 |
| EUR | 0,6 | 26,4 | 4,5 | 4,9 | 5,1 | 31,3 |
| USD | 2,4 | 9,9 | 89,0 | 48,3 | 91,4 | 58,2 |
| CHF | 29,7 | 14,4 | 0,1 | 0,0 | 29,8 | 14,4 |
| GBP | 0,5 | 0,1 | 0,0 | 0,0 | 0,5 | 0,1 |

* Foreign currency values shown as PLN equivalents.

Given the nature of business operations of subsidiaries of the Group generating the largest interest rate risk (BFL SA and KREDOBANK SA) and the specific nature of the market on which those companies operate, the Bank does not determine the consolidated VaR sensitivity measure in respect of the interest rate. The Group companies use their own risk measures to manage interest rate risk. The 10-day VaR measure for main currencies is used by KREDOBANK SA. Its value as at the end of 2008 was PLN 17.8 million.

## FX RISK

In 2008, the FX risk of the Group was low as it is the Bank's policy to close currency positions.

The VaR and stress-test analysis in respect of the Bank's and the Group's financial assets (jointly for all currencies) exposed to the FX risk as at the end of 2008 and 2007 respectively was as follows:

*Table 2.21*

Sensitivity of financial assets exposed to FX risk (in PLN mln)

| | 2008 | | 2007 | |
|---|---|---|---|---|
| | 10-day VaR | Stress-test** | 10-day VaR | Stress-test** |
| PKO BP SA | 11,3* | 16,1 | 1,6 | 2,4 |
| Other Group companies | - | 4,1 | - | 0,8 |
| Total | 11,3 | 20,2 | 1,6 | 1,8*** |

* VaR as at 31 December 2008 resulted mailny from USD position due to the acquisition of KREDOBANK SA shares, registered on 31 December 2008.

** The most disadvantageous scenario has been presented, which assumes changes of the CUR/PLN exchange rates by the values noted in 2008: USD/PLN:-11.43%, EUR/PLN: -6.90%, CHF/PLN: -8.78%, Other/PLN: -5.92% (if PLN grows stronger), USD/PLN: +18.78%, EUR/PLN: +10.55%, CHF/PLN: +16.11%, Other/PLN: +10.53 (if PLN grows weaker). The data for 2007 have been brought to comparability.

*** The stress-tests for the Bank and for the Companies do not add up due to the fact that the loss on the currency positions of the Companies would be incurred at exchange rate changes opposite to those in the case of the Bank's currency positions.

As in the case of interest rate risk exposure, given the nature of business activities of the subsidiaries of the Group exposed to the largest FX risk (BFL SA and KREDOBANK SA) and the specific nature of the market on which those companies operate, the Bank does not determine the consolidated VaR sensitivity measure for FX risk. The companies use their own risk measures to manage FX risk. The 10-day VaR measure is used by KREDOBANK SA. As at the end of 2008, its value was PLN 0.81 million.

## LIQUIDITY RISK

The table below presents data concerning periodic gap and cumulative periodic gap of the Bank and of the Group's subsidiaries as at the end of 2008 and 2007 respectively

*Table 2.22*

REAL-TERMS LIQUIDITY GAP - ASSETS AND LIABILITIES

| 2008 | a'vista | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-3 years | 3-5 years | over 5 years |
|---|---|---|---|---|---|---|---|---|
| PKO BP SA | | | | | | | | |
| Periodic gap | 4 569 | 5 852 | -2 915 | -1 798 | 1 990 | 4 251 | 1 924 | -13 873 |
| Cumulative gap | 4 569 | 10 421 | 7 506 | 5 708 | 7 698 | 11 949 | 13 873 | - |
| Group subsidiaries | | | | | | | | |
| Periodic gap | 42 | -184 | -465 | -185 | 157 | -386 | 706 | 316 |
| Cumulative gap | 42 | -143 | -607 | -793 | -636 | -1 021 | -316 | - |
| TOTAL - Periodic gap | 4 610 | 5 668 | -3 379 | -1 983 | 2 147 | 3 865 | 2 630 | -13 557 |
| TOTAL - Cumulative gap | 4 610 | 10 279 | 6 899 | 4 916 | 7 062 | 10 927 | 13 557 | - |

| 2007* | a'vista | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-3 years | 3-5 years | over 5 years |
|---|---|---|---|---|---|---|---|---|
| PKO BP SA | | | | | | | | |
| Periodic gap | 3 206 | 14 321 | 3 331 | 3 043 | 5 591 | 8 832 | 2 053 | -40 377 |
| Cumulative gap | 3 206 | 17 527 | 20 858 | 23 901 | 29 492 | 38 324 | 40 377 | - |
| Group subsidiaries | | | | | | | | |
| Periodic gap | 50 | -132 | -221 | -86 | 81 | -92 | 466 | -67 |
| Cumulative gap | 50 | -82 | -303 | -389 | -307 | -399 | 67 | - |
| TOTAL - Periodic gap | 3 256 | 14 189 | 3 110 | 2 957 | 5 672 | 8 740 | 2 519 | -40 444 |
| TOTAL - Cumulative gap | 3 256 | 17 445 | 20 555 | 23 512 | 29 185 | 37 925 | 40 444 | - |

* Values brought to comparability under the liquidity gap real-terms methodology in force as at 31 December 2008.

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

The table below shows data concerning contractual off-balance sheet liquidity gap of derivatives of the Group.

*Table 2.23*

CONTRACTUAL OFF-BALANCE SHHET LIQUIDITY GAP FOR DERIVATIVES

The PKO BP SA Group

| 2008 | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-3 years | 3-5 years | over 5 years | Total |
|---|---|---|---|---|---|---|---|---|
| TOTAL - Periodic gap | -203 | 66 | 112 | 222 | 46 | -785 | -521 | -1 062 |
| TOTAL - Cumulative gap | -203 | -137 | -24 | 198 | 244 | -541 | -1 062 | - |

| 2007 | 0-1 month | 1-3 months | 3-6 months | 6-12 months | 1-3 years | 3-5 years | over 5 years | Total |
|---|---|---|---|---|---|---|---|---|
| TOTAL - Periodic gap | -87 | 107 | 138 | 102 | 585 | 352 | 278 | 1 476 |
| TOTAL - Cumulative gap | -87 | 21 | 159 | 261 | 846 | 1 198 | 1 476 | - |

The table below shows the Bank's liquidity reserve as at the end of 2008 and as at the end of 2007.

*Table 2.24*

LIQUIDITY RESERVE
The PKO BP SA

| Sensitivity measure | 31.12.2008 | 31.12.2007 |
|---|---|---|
| Liquidity reserve for up to 1 month | 6 666 | 9 248 |

On 15 December 2008, the Bank launched new deposit products. As at 10 January 2009, the reserve of liquidity of up to 1 month was about PLN 8,930 million.

### RISK PEPORTING

Reporting on the level of market risk is carried out in the following cycles:

- on a daily and weekly basis – for operating purposes,
- on a monthly, quarterly and half-year basis – for management purposes.

The recipients of monthly, quarterly and half-year reports are mainly ALCO and the Management and Supervisory Boards of the Bank. The reports contain information on the market risk to which the Bank and the PKO BP SA Group are exposed.

### RISK MANAGEMENT AT SUBSIDIARIES OF THE GROUP

Other subsidiaries of the PKO BP SA Group, which due to the nature of their business report a significant level of market risk, have their own internal regulations in place for management of this type of risk. These regulations have been developed after consultations with the Bank and after considering the recommendations of the Bank to subsidiaries of the Group.

Transactions in the trading book are made exclusively by PKO BP SA. Other subsidiaries of the Group make transactions solely on the banking book to hedge against the risk.

## 2.5. BUSINESS RISK

Apart from the credit, operational and market risk, other types of risk that the Group is exposed to are managed as part of the so-called business risk management. These comprise in particular:

- reputation risk – relating to the possibility of occurrence of negative deviations from budgeted figures due to deterioration of the Bank's image,
- strategic risk – relating to occurrence of negative financial consequences caused by incorrect decisions, decisions taken on the basis of incorrect assessment, or caused by a failure to take correct decisions relating to the direction of the Bank's strategic development.

### REPUTATION RISK

Reputation risk management is to limit reputation losses by minimising the effects of image-related events on the reputation risk level or taking preventive measures.

Reputation risk management covers in particular:

- monitoring the external and internal channels of the Bank's communication with its environment in order to define the effects of image-related events,
- recording image-related events and describing their effects,
- selecting the effective tools and protective measures and carrying out preventive actions,
- conducting research and analyses of the effectiveness of protective and preventive actions,
- assessment of the level of reputation risk.

Reputation-affecting events are monitored and recorded on the on-going basis. The reputation risk is measured annually. Information about reputation risk is submitted to the Banking Risk Division units.

### STRATEGIK RISK

Strategic risk management at the Bank comprises:

- strategic risk measurement,
- reporting the level of strategic risk and its changes,
- actions undertaken in the event of occurrence of high level of strategic risk.

Strategic risk measurement is carried out by way of assessment and then quantification of the effect of a group of factors that are the main sources of strategic risk identified in the Bank's activities and environment. These include in particular:

- external factors,
- factors relating to the increase and development of banking business,
- factors relating to human resources management,
- factors relating to investing activities,
- factors relating to organisation culture.

The monitoring and measurement of strategic risk is performed on the annual basis. In the case of occurrence of high level of strategic risk (as per internal rating scale adopted by the Bank), the Bank's Management Board takes actions aimed at reducing the level of the strategic risk of the Bank.

# 3. OWN FUNDS

Own funds comprise basic funds, supplementary funds and short-term capital.

Included in the basic funds are the following:

- core funds comprising:
  - share capital – in the amount defined in the Bank's Statutes and entry in the Register of Entrepreneurs, at face value,
  - reserve capital – established in accordance with the Bank's Statutes from appropriations of net profits and premiums on the issue of shares, assigned to absorb balance sheet losses that may arise within the Bank's regular activities; decisions concerning utilisation of the reserve capital are taken by the General Meeting of Shareholders,
  - other reserve capital – to be utilised for purposes defined in the Statutes, created from appropriation of net profits in the amount defined by the General Meeting of Shareholders,
- general banking risk fund – created in accordance with the Banking Act from the net profit,
- retained earnings,
- net profit prior to approval and net profit for the current reporting period – calculated based on appropriate accounting standards, decreased by any expected charges and dividends, in amounts not exceeding amounts audited by a certified public accountant.

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

- intangible assets at their carrying amount,
- equity exposures[6] of the Bank to financial institutions, lending institutions, Polish and foreign banks and insurance companies, in the form of:
  - shares or stocks held,
  - amounts classified as subordinated liabilities,
  - other equity exposures in items classified as own funds or capital of those entities, including additional contributions to the share capital of limited liability companies, in the amount of 50% of their carrying amounts,
- unrealised losses on debt and equity instruments classified as available for sale.

Supplementary funds comprise the following:

- unrealised gains on debt and equity instruments classified as available for sale – in the amount of 60% of their pre-tax value,
- subordinated liabilities understood as liabilities arising from acceptance by the Bank – in the amount and based on the principles defined by the Commission for Banking Supervision – of the funds, which together with the agreement meet the following criteria:
  - the funds have been accepted for the period of at least 5 years (term of contract),
  - the funds may not be withdrawn from the bank prior to expiration of contract,
  - the funds are to be returned as the last item in the case of the bank's bankruptcy or liquidation,
  - the refund is not guaranteed by the bank, either directly or indirectly.

In addition, supplementary funds are reduced by 50% of the value of the Bank's equity exposures[6] 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 amount is deducted from the base funds.

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

- goodwill of subsidiaries (acts to reduce own funds),
- negative goodwill of subsidiaries (acts to increase own funds),
- minority interests in equity (acts to increase own funds),
- currency translation differences from foreign operations (negative differences decrease own funds, whereas positive differences increase own funds).

The value of short-term capital reflects the total of daily market profits:

- in 2007 – for the second half-year of 2007 – due to the inclusion in own funds of a part of the verified profit for the first half of 2007,
- in 2008 – for the second half of 2008 – due to inclusion in own funds of the profit reported in the Bank's financial statements prepared for the first half of 2008, reviewed by a certified auditor.

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

*Table 3.1*

| | Group | | Bank | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| OWN FUNDS | 12 885 | 9 983 | 12 389 | 9 543 |
| Basic funds (Tier 1) | 11 266 | 8 449 | 11 004 | 8 324 |
| core funds | 9 799 | 8 110 | 9 612 | 7 983 |
| general banking risk fund | 1 070 | 1 070 | 1 070 | 1 070 |
| retained earnings | 53 | -72 | 0 | 0 |
| net profit for the current period | 1 825 | 654 | 1 825 | 654 |
| intangible assets | -1 353 | -1 183 | -1 155 | -928 |
| equity exposures | -73 | -84 | -306 | -399 |
| unrealised losses on instruments available for sale | -43 | -55 | -42 | -55 |
| currency translation differences | -57 | -48 | 0 | 0 |
| minority interest | 46 | 58 | 0 | 0 |
| Supplementory funds (Tier 2) | 1 529 | 1 518 | 1 294 | 1 203 |
| subordinated liabilities | 1 601 | 1 601 | 1 601 | 1 601 |
| unrealised profits on instruments available for sale | 1 | 1 | 0 | 1 |
| equity exposures | -73 | -84 | -306 | -399 |
| Short-term equity (Tier 3) | 91 | 16 | 91 | 16 |

---

6 Exposures in financial institutions meeting the requirements set forth in § 5.1 of Resolution No. 2/2007 of the Commission for Banking Supervision dated 13 March 2007 concerning other decreases to basic funds, their amount, scope and terms and conditions of decreasing basic funds by those amounts, other bank balance sheet items included in supplementary funds, their amount, scope and terms and conditions to include in the supplmenetary funds, decreases to supplementary funds, their amount, scope and terms and conditions of decreasing basic funds by those amounts, as well as the scope and manner of accounting for bank activities in holdings in calculation of own funds (Official Journal of the National Bank of Poland 2007, No. 3, item 4).

In 2008, the amount of the Group's own funds increased by about PLN 2.9 billion; this increase was mainly due to:

- a contribution of about 60% of the Bank's net profit for the second half of 2007 (PLN +0.9 billion),
- inclusion in the Bank's base funds of the profit for the first half of 2008, as verified by a certified auditor (PLN +1.8 billion), with the assumed zero dividend yield (the entire profit to be retained by the Bank).

On 30 June 2009, the General Meeting of Shareholders of the Bank resolved on payment of 34.71% of the net profit for 2008 (i.e. PLN 1 billion) as a dividend. The remaining part of the Bank's net profit for 2008 (i.e. PLN 1.9 billion) was assigned to increase of the reserve capital.

At the same time, the General Meeting of Shareholders decided to increase the Bank's share capital by up to PLN 300 million by way of issue of the Bank's new shares.

# 4. CAPITAL REQUIREMENTS (PILLAR I)

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

*Table 4.1*

| | Group | | Bank | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Total capital requirement | 9 127 | 6 645 | 8 822 | 6 431 |
| Credit risk | 7 676 | 6 425 | 7 463 | 6 183 |
| credit risk (banking book) | 7 515 | 6 401 | 7 301 | 6 159 |
| counterparty risk (trading book) | 162 | 24 | 162 | 24 |
| Market risk | 203 | 220 | 203 | 248 |
| foreign exchange risk | 0 | 0 | 0 | 0 |
| commodities risk | 0 | 0 | 0 | 0 |
| equity securities risk | 1 | 1 | 1 | 1 |
| specific risk of debt instruments | 168 | 167 | 168 | 193 |
| general interest rate risk | 34 | 52 | 34 | 54 |
| Operational risk | 1 248 | 0 | 1 156 | 0 |
| Other kinds of risk* | 0 | 0 | 0 | 0 |

* Includes capital requirements in regards to the settlement and delivery risks, the risk of exceeding the exposure concentration limit and the large exposure limit, and the risk of exceeding the capital concentration threshold.

Starting from January 2008, the Bank calculated the capital requirements in accordance with Resolution No. 1/2007 of the Commission for Banking Supervision (Basel II). As at 31 December 2008:

- the capital requirement for credit risk was calculated under the standardised approach (Appendix No. 4 to Resolution No. 1/2007 of the Commission for Banking Supervision),
- the capital requirement for market risk was calculated under the standardised method (Appendices No. 6 to 10 to Resolution No. 1/2007 of the Commission for Banking Supervision),
- the capital requirement for operational risk was calculated under the basic indicator approach (Appendix No. 14 to Resolution No. 1/2007 of the Commission for Banking Supervision),
- the capital requirement for:
  - the settlement risk and delivery risk – was calculated under the method defined in Appendix No. 11 to Resolution No. 1/2007 of the Commission for Banking Supervision,
  - the risk of exceeding the exposure concentration limit and the large exposure risk – was calculated under the method defined in Appendix No. 12 to Resolution No. 1/2007 of the Commission for Banking Supervision,
  - the risk of exceeding the capital concentration threshold – was calculated under the method defined in Appendix No. 13 to Resolution No. 1/2007.

The amounts of the capital requirement as at 31 December 2007 were calculated in accordance with Basel I requirements.

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

- foreign exchange risk,
- commodities risk,
- equity securities risk,
- specific risk of debt instruments,
- general interest rate risk.

The implementation of Basel II as of 1 January 2008 resulted in an increase of the Bank's total capital requirement by about PLN 0.5 billion, which was a consequence of the newly introduced capital requirement for operational risk (PLN +1.0 billion – until 31 December 2007, the Bank used the option contained in § 14 clause 1 of Resolution No. 1/2007 of the Commission for Banking Supervision that permitted a reduction of the capital requirement for operational risk by 100%), accompanied by a decrease of the capital requirement for credit risk (PLN –0.5 billion).

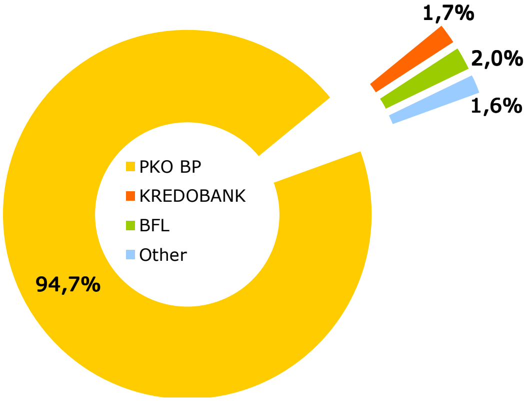
The 2008 significant increase of the loan portfolio (by 32%) contributed to the increased capital requirement for credit risk. Apart from the growth in crediting action, another fact that also contributed to the increase of the loan portfolio value was also a significant growth of the exchange rates and the related revaluation of the currency loan portfolio from September to December 2008.

The capital requirements of the Bank and the Group for settlement and delivery risks, the risk of exceeding the exposure concentration limit and the capital concentration threshold were zero at the end of 2007 and 2008 due to the fact that such events did not occur.

A significant part (approx. 95%) of the total capital requirements of the Group represented capital requirements of the Bank.

*Chart 4.1*

STRUCTURE OF CAPITAL REQUIREMENTS OF THE GROUP




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 receivables (over 80%).

*Table 4.2*

| | The PKO BP SA Group | | |
|---|---|---|---|
| | 2008 | | |
| | Book | | |
| | banking | trading | total |
| Capital requirement* | 7 515 | 332 | 7 847 |
| Balance sheet exposures | 6 791 | 118 | 6 909 |
| cash | 0 | 0 | 0 |
| receivables | 6 412 | 0 | 6 412 |
| debt securities | 21 | 117 | 138 |
| equity securities | 14 | 0,4 | 15 |
| non-current assets | 237 | 0 | 237 |
| other assets | 107 | 0 | 107 |
| Off-balance sheet liabilities | 688 | 53 | 741 |
| loan liabilities | 539 | 0 | 539 |
| guarantees granted | 127 | 53 | 180 |
| letters of credit granted | 22 | 0 | 22 |
| other | 0 | 0 | 0 |
| Derivatives | 35 | 162 | 197 |

* Covers credit risk, counterparty credit risk and specific risk of debt instruments. Does not cover general interest rate risk and operational risk.

*Table 4.3*

| | PKO BP SA | | |
|---|---|---|---|
| | 2008 | | |
| | Book | | |
| | banking | trading | total |
| Capital requirement* | 7 301 | 333 | 7 633 |
| Balance sheet exposures | 6 556 | 118 | 6 674 |
| cash | 0 | 0 | 0 |
| receivables | 6 254 | 0 | 6 254 |
| debt securities | 17 | 117 | 135 |
| equity securities | 40 | 0,4 | 40 |
| non-current assets | 197 | 0 | 197 |
| other assets | 47 | 0 | 47 |
| Off-balance sheet liabilities | 710 | 53 | 763 |
| loan liabilities | 542 | 0 | 542 |
| guarantees granted | 145 | 53 | 198 |
| letters of credit granted | 22 | 0 | 22 |
| other | 0 | 0 | 0 |
| Derivatives | 35 | 162 | 197 |

* Covers credit risk, counterparty credit risk and specific risk of debt instruments. Does not cover general interest rate risk and operational risk.

## 4.1. CREDIT RISK

The capital requirement for credit risk and the counterparty credit risk as at 31 December 2008 was calculated under the standardised approach in accordance with Appendices No. 4 and 16 to Resolution No. 1/2007 of the Commission for Banking Supervision. The value of that capital requirement of the Group by exposure classes is shown in Table 4.4.

*Table 4.4*

THE STRUCTURE OF CAPITAL REQUIREMENT FOR CREDIT RISK

The PKO BP SA Group

2008

| | |
|---|---|
| TOTAL | 7 676 |
| Retail | 3 616 |
| Corporate | 2 555 |
| Secured on real estate property | 750 |
| Institutions (banks) | 193 |
| Past due | 98 |
| Regional governments and local authorities | 42 |
| Regulatory high risk categories | 9 |
| Central governments and central banks | 5 |
| Other exposures | 408 |
| Other classes* | 2 |

* Includes: administrative bodies and non-commercial undertakings, claims in the form of collective investment undertakings.

In 2008, the capital requirement for credit risk (the counterparty credit risk included) increased by almost PLN 1.25 billion compared to 2007, which was mainly due to the Bank's increased crediting action.

The Bank is obliged to maintain the highest capital requirement for the risk related to retail and corporate exposures, which results from the Bank's high exposure to such types of clients. 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 hedged with collateral types recognised under Basel II, which permit a reduction of the capital requirement, amounted to PLN 1.9 billion as at the end of 2008 (Tables 4.5 and 4.6).

*Table 4.5*

EXPOSURES COLLATERALISED WITH GUARANTEES

The PKO BP SA Group

2008

| | |
|---|---|
| TOTAL | 1 045 |
| Retail | 352 |
| Corporate | 575 |
| Secured on real estate property | 0 |
| Institutions (banks) | 0 |
| Past due | 59 |
| Regional governments and local authorities | 7 |
| Regulatory high risk categories | 0 |
| Central governments and central banks | 2 |
| Other exposures | 51 |

As part of the credit risk mitigation techniques, the Bank, in accordance with Basel II, uses guarantees (98% of the guarantees accepted 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 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 include its exposures to the class of exposures secured on real estate property. The value of the portfolio of those exposures was PLN 13 billion as at the end of 2008.

In 2008 and in previous years, the Bank did not conclude any securitisation transaction within the meaning of the Banking Act and supervisory regulations. In 2008, the controlling entity effected three transactions of sale of balance sheet and off-balance sheet liabilities, classified as lost; one transaction was to a securitization fund and two were with debt collection firms. These transactions covered about 140 thousand exposures with the total value of PLN 1.22 billion.

*Table 4.6*

EXPOSURES COLLATERALISED WITH ELIGIBLE FINANCIAL COLLATERAL*

The PKO BP SA Group

2008

| | |
|---|---|
| TOTAL | 822 |
| Retail | 188 |
| Corporate | 114 |
| Secured on real estate property | 4 |
| Institutions (banks) | 497 |
| Past due | 4 |
| Regional governments and local authorities | 0 |
| Regulatory high risk categories | 0 |
| Central governments and central banks | 16 |
| Other exposures | 0 |

* After volatility haircuts.

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's credit quality step as at 31 December 2008. About 84% of the exposures lack the credit quality step. This results from the small number of entities operating on the Polish market that have 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 THE APPLICATION OF CREDIT RISK MITIGATION TECHNIQUES

The PKO BP SA Group

2008

| | PKO BP, KREDOBANK i BFL | | | | | | | Other Group companies | Adjustments and exclusions | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | Counterparty's credit quality step | | | | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | none | | | |
| Retail | 0 | 0 | 0 | 0 | 0 | 0 | 60 763 | 9 | 0 | 60 772 |
| Corporate | 0 | 0 | 813 | 0 | 0 | 0 | 33 131 | 35 | -1 360 | 32 618 |
| Secured on real estate property | 0 | 0 | 0 | 0 | 0 | 0 | 12 873 | 0 | -8 | 12 865 |
| Institutions (banks) | 3 361 | 2 897 | 795 | 0 | 720 | 0 | 1 724 | 230 | -833 | 8 892 |
| Past due | 0 | 0 | 0 | 0 | 0 | 0 | 937 | 0 | 0 | 937 |
| Regional governments and local authorities | 0 | 55 | 81 | 0 | 0 | 0 | 2 448 | 0 | 0 | 2 585 |
| Regulatory high risk categories | 0 | 0 | 0 | 0 | 0 | 0 | 210 | 0 | -138 | 73 |
| Central governments and central banks | 88 | 14 166 | 0 | 0 | 0 | 0 | 530 | 222 | 0 | 15 006 |
| Other exposures | 0 | 0 | 0 | 0 | 0 | 0 | 12 021 | 1 088 | -457 | 12 653 |
| Other classes** | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 20 | 0 | 21 |
| Total | 3 449 | 17 118 | 1 689 | 0 | 720 | 0 | 124 637 | 1 605 | -2 795 | 146 422 |

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

** Includes: administrative bodies and non-commercial undertakings, claims in the form of collective investment undertakings.

*Table 4.8*

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

The PKO BP SA Group

2008

| | PKO BP, KREDOBANK i BFL | | | | | | | Other Group companies | Adjustments and exclusions | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | Counterparty's credit quality step | | | | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | none | | | |
| Retail | 0 | 0 | 0 | 0 | 0 | 0 | 60 261 | 0 | 0 | 60 261 |
| Corporate | 0 | 0 | 813 | 0 | 0 | 0 | 32 447 | 35 | -1 360 | 31 934 |
| Secured on real estate property | 0 | 0 | 0 | 0 | 0 | 0 | 12 869 | 0 | -8 | 12 861 |
| Institutions (banks) | 3 361 | 2 897 | 795 | 0 | 720 | 0 | 730 | 239 | -833 | 7 908 |
| Past due | 0 | 0 | 0 | 0 | 0 | 0 | 873 | 0 | 0 | 873 |
| Regional governments and local authorities | 0 | 55 | 81 | 0 | 0 | 0 | 2 452 | 0 | 0 | 2 589 |
| Regulatory high risk categories | 0 | 0 | 0 | 0 | 0 | 0 | 210 | 0 | -138 | 73 |
| Central governments and central banks | 88 | 14 166 | 0 | 0 | 0 | 0 | 1 538 | 222 | 0 | 16 013 |
| Other exposures | 0 | 0 | 0 | 0 | 0 | 0 | 11 970 | 1 088 | -457 | 12 602 |
| Other classes** | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 20 | 0 | 21 |
| Total | 3 449 | 17 118 | 1 689 | 0 | 720 | 0 | 123 351 | 1 605 | -2 795 | 145 136 |

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

** Includes: administrative bodies and non-commercial undertakings, claims in the form of collective investment undertakings.

In 2008, the transactions that had the greatest influence on the amount of the Group's capital requirement for derivatives were the IRS, CIRS and FRA transactions (Table 4.9).

*Table 4.9*

CAPITAL REQUIREMENT FOR DERIVATIVES*

2008

The PKO BP SA Group

| | Book | | |
|---|---|---|---|
| | banking | trading | total |
| Derivatives | 35 | 162 | 197 |
| FRA | 0 | 4 | 4 |
| IRS | 12 | 87 | 99 |
| Forward | 0 | 18 | 18 |
| SWAP | 1 | 0 | 1 |
| FX Futures | 0 | 0 | 0 |
| CIRS | 19 | 4 | 22 |
| Options | 1 | 49 | 50 |
| SBB | 2 | 0 | 2 |
| CDS | 1 | 0 | 1 |
| other | 0 | 0 | 0 |

* Credit risk and counterparty credit risk.

In 2008, within the calculation of capital requirement for derivatives, no netting of the on-balance sheet and off-balance sheet items was used. Also, when calculating the capital requirement, no CDS contracts were used as unfunded credit protection.

Within the calculation of its capital requirements, the Bank utilizes the creditworthiness ratings granted by the following rating agencies:

- Moody's Investors Service,
- Standard and Poor's Ratings Services,
- 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 provisions of Annexes No. 4 and No. 15 to Resolution No. 1/2007 of the Commission for Banking Supervision of 13 March 2007 and Resolution No. 10/2007 of the Commission for Banking Supervision of 20 June 2007[7].

Table 4.10 includes information on assessments made by the Bank of the Basel II implementation effect on the amount of its capital requirement for credit risk as at the end of 2007.

*Table 4.10*

ESTIMATED EFFECT OF BASEL II IMPLEMENTATION ON CAPITAL REQUIREMENT FOR CREDIT RISK AND COUNTERPARTY CREDIT RISK

PKO BP SA

| | Basel I | Basel II | B II - B I |
|---|---|---|---|
| Credit risk | 6 183 | 5 712 | -471 |
| credit risk (banking book) | 6 159 | 5 668 | -491 |
| balance sheet exposures | 5 717 | 4 947 | -770 |
| off-balance sheet exposures | 424 | 694 | 270 |
| derivatives | 18 | 26 | 8 |
| counterparty credit risk (trading book) | 24 | 44 | 20 |

As follows from these assessments, implementation of Basel II (standardised method) resulted in a decrease in capital requirement for credit risk of approx. PLN 500 million. This results mainly from the fact that a significant portion of credit portfolio of the Bank, according to Basel II, was classified as retail exposures (chart 4.2), to which Basel II assigns a smaller risk weight compared to Basel I (75% compared to 100%).

## 4.2. OPERATIONAL RISK

PKO BP SA has the decisive effect on the operational risk profile of the Group. Other Group companies, due to considerably lower scale of their businesses, only generate limited operational risk.

At the end of 2008, the Bank calculated the capital requirement for operational risk using the basic indicator approach (BIA), in accordance with Appendix No. 14 to Resolution No. 1/2007 of CFBS. Starting from January 2009, the capital requirement for operational risk is calculated at the Bank under the standardised approach.

The value of the Group's capital requirement for operational risk was PLN 1.25 billion (including PLN 1.16 billion of the capital requirement for the Bank's operational risk).

In the latter half of 2008, the Bank started to implement projects aimed at developing the operational risk measurement methods and implementation of a specialized IT tool supporting the operational risk management process.

## 4.3. MARKET RISK

The market risk of the PKO BP SA Group is determined primarily by the Bank. The Group's capital requirement for its market risk is calculated in accordance with the provisions of Resolution No. 1/2007 of the Commission for Banking Supervision. To calculate the capital requirement for FX risk, equity securities risk and specific risk of debt instruments, the Bank uses standardised methods. To calculate the capital requirement for general interest rate risk, the Bank uses the duration method.

The total capital requirement for market risk decreased in 2008 by approx. 8%. The largest share in the value of capital requirement for market risk falls to the specific risk of debt instruments (approx. 83%), which results from the corporate and municipal

[7] Resolution No. 10/2007 of the Commission for Banking Supervision of 20 June 2007 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 National Bank of Poland of 2007 No. 6, item 16 as amended).

debt securities held in the Bank's trading book and from underwriting of the issue of those securities. Another type of capital requirement that is significant in terms of value is the capital requirement for the general interest rate risk (approx. 17%).

The capital requirement for all other types of market risk is approx. PLN 1 million. The capital requirement for FX risk is zero due to the fact that the total currency position does not exceed 2% of the Bank's own funds, and that for the commodities risk is also zero due to the absence of this type of instruments in the Bank's portfolio.

# 5. INTERNAL CAPITAL (PILLAR II)

Internal capital is the amount of capital, as assessed by the Bank, that is required to cover all identified significant types of risk present in the Bank's activities and the effect of changes in the business environment, the anticipated risk level taken into account.

Starting from 2008, the internal capital of the PKO BP SA Group is calculated to cover each significant risk type:
- credit risk, including default risk,
- market risk, including FX risk, interest rate risk and liquidity risk,
- operational risk,
- business risk, including strategic risk and reputation risk.

The Bank periodically monitors the significance of individual types of risk related to the activities of the Bank and other subsidiaries of the Group.

The total of the internal capital of the Group is the sum of internal capital required to cover all significant risk types that occur in Group companies (the coefficient of correlation between individual risk types and individual companies of the Bank's Group, as assumed within calculation of the internal capital, amounts to 1).

The amount of internal capital for credit risk is determined at the level of unexpected loss for the portfolio of exposures, covered by the portfolio risk measurement and is calculated based on the VaR model. The unexpected credit loss 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 measurement, it is assumed that internal capital for credit risk equals capital requirement for credit risk, calculated with the standardised approach.

The value of exposure to a client 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.

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

The internal capital for operational risk equals the capital requirement for operational risk determined using the basic indicator approach.

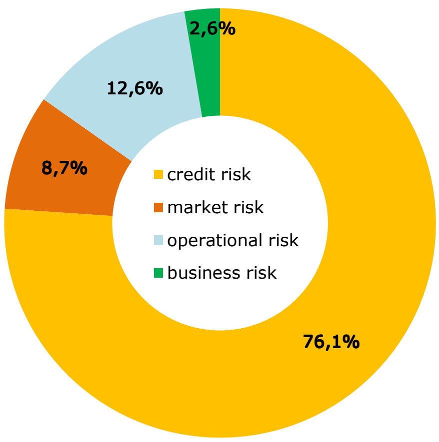
The internal capital for business risk is determined in proportion to the result on banking activity.

The internal capital calculation methodologies are defined in internal regulations adopted by the Bank's Management Board. To assess the 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 2008 for the Group.

*Chart 5.1*

INTERNAL CAPITAL OF THE GROUP




Allocation of total internal capital is made by business lines and by Group companies.

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

# 6. CAPITAL ADEQUACY

Capital adequacy is the condition under which the amount of capital base of the PKO BP SA Group is sufficient to meet regulatory requirements concerning capital requirements (the so-called Pillar I) and internal capital (the so-called Pillar II). The objective of capital adequacy management is to maintain, on the on-going basis, the level of capital that is adequate to the scale and risk profile of business activities of the Group.

The process of capital adequacy management at the Bank comprises:

- identifying and monitoring of the list of significant types of risk,
- calculating the amount of internal capital for individual significant types of risk,
- calculating the amount of total internal capital required to cover all significant types of risk,
- carrying out stress tests of capital adequacy,
- monitoring, reporting, forecasting and limiting of capital adequacy,
- allocating internal capital to business lines for the purpose of profitability analyses,
- using tools influencing the capital adequacy level (including: tools changing the level of own funds, the scale of deduction of own funds and the amount of credit portfolio).

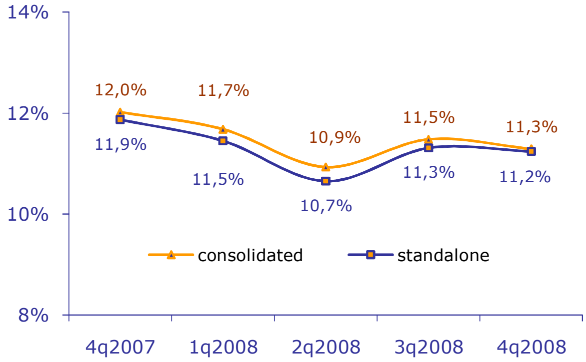
The main measures of capital adequacy are as follows:

- the capital adequacy ratio of at least 8% as required by the Banking Law,
- the own funds to internal capital ratio of at least 1.0 pursuant to the Banking Law.

The chart below presents changes in the capital adequacy ratio calculated for the Bank and the PKO BP SA Group.

*Chart 6.1*

CAPITAL ADEQUACY RATIO




In 2008, the Bank's and Group's capital adequacy ratio and own funds to internal capital ratio remained at safe levels above both the statutory and the Bank's internal limits.

As at the end of 2008, compared to the end of 2007, the Group's capital adequacy ratio decreased by 0.7 percentage points, which was due mainly to the high dynamics of its credit portfolio and increased capital requirements caused by implementation of Basel II.

The table below shows the Bank's assessment of the effects of Basel II on the level of capital adequacy ratio and the level of the Bank's capital requirements as at 31 December 2007.

*Table 6.1*

EFFECT OF IMPLEMENTATION OF BASEL II

| | PKO BP SA | | |
|---|---|---|---|
| | Basel I | Basel II | B II - B I |
| Capital adequacy ratio | 11,9% | 11,0% | -0,9 pp. |
| Own funds | 9 543 | 9 543 | 0 |
| Capital requirements, of which: | 6 431 | 6 975 | 544 |
| credit risk* | 6 183 | 5 712 | -471 |
| operational risk | 0 | 1 015 | 1 015 |
| market risk | 248 | 248 | 0 |

* Covers also counterparty credit risk.

The change in the level of capital adequacy ratio, which is the effect of implementation of the Basel II requirements, results to a large extent from the implementation of a new capital requirement for operational risk (for detailed information see Chapter 4 "Capital requirements (Pillar I)").

# 7. GLOSSARY OF TERMS AND ABBREVIATIONS

**Accuracy Ratio (AR)** – a measure of effectiveness of the scoring tables, expressed as the ratio of effectiveness of the actual scoring table to effectiveness of the optimum table; the measure can assume values from 0 to 1, where the value 0 means the table's inability to discriminate (i.e. the scoring table assesses the borrower's readiness to discharge its liabilities in a manner that is next to random); the value 1 means that the table is 100% capable of identifying a client about to become insolvent

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

**Application scoring system –** a system for assessing the Bank's credit risk involved in the financing of clients from scores awarded on the basis of information provided by the client

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

**Basel II** – a set of external provisions defining a new approach to the calculation of capital requirements and management of the banking risk; in Poland, Basel II was implemented by way of amendment of the Banking Law and adoption of Resolutions 1-6/2007 of the Commission for Banking Supervision 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 the Commission for Banking Supervision

**Behavioral scoring system** – a system for assessing the Bank's credit risk involved in the financing of clients mainly on the basis of transactions on that client's current account, used for defining the renewable credit limits

**BSB** (Buy-Sell-Back) – a transaction of purchase of securities with the promise that they will be sold back upon expiration of a specified period before their maturity at a price agreed in advance

**Business risk** – a risk category covering all types of risk other than the credit, market, operational and compliance risk, including specifically:
a) reputation risk – relating to the possibility of occurrence of negative deviations from the Bank's budgeted financial result due to deterioration of the Bank's image,
b) strategic risk – negative financial consequences of wrong decisions, decisions based on wrong assessments, or failures to take the right decisions in areas pertaining to the Bank's direction of strategic development

**Capital requirement** – the minimum amount of capital that the bank is obliged, pursuant to Art. 128 of the Banking Law and Resolution No. 1/2007 of the Commission for Banking Supervision, to maintain as coverage of the credit, market and operational risk (an element of the so-called Pillar I NUK)

**CDS** (Credit Default Swap) – a credit swap (credit derivative) relating to insolvency of one reference entity

**CFBS** – the Commission for Banking Supervision

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

**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 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** - a 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

**Credit exposure** – an asset, awarded off-balance sheet liability or concluded off-balance sheet (derivative) transaction

**Credit risk** – the risk of losses in the case of the debtor's default or deterioration of its credit quality rating

**Credit Value-at-Risk, CVaR** – – a potential loss, not to be exceeded, on the credit risk of a maintained loan portfolio, at an assumed (high) confidence level and period of maintaining the position

**CRM** (Credit Risk Mitigation) – a credit risk mitigation technique (recognised by Basel II)

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

**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

**Cumulated real-terms 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

**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

**EU –** the European Union

**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

**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 the 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 –** the 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

**ICAAP** (Internal Capital Adequacy Assessment Process) – a process of assessment of the internal capital adequacy

**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 assets, off-balance sheet liabilities awarded, and liabilities indexed to that currency on the other hand

**Internal capital –** an amount, assessed by the Bank, that is required to cover all identified significant types of risk present in the Bank's activities 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 Risk Indicators, KRI** – an amount related to the operational risk profile, describing a specific risk, action or process in terms of frequency, susceptibility or loss; KRI are used for prompt risk measurement and monitoring, and also for projections of future threats

**Liquidity surplus** – the difference between the most liquid assets and the expected and potential liabilities becoming mature in a given period for the currency concerned

**LMA** – the Loan Market Association

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

**Market risk** – the risk of loss due to unfavourable market parameters such as interest rate, foreign exchange rate or their volatility, as well as the risk of liquidity loss

**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; legal risk is treated as a subcategory of operational risk

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

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

**PAS –** the Polish Accounting Standards

**PBA –** the Polish Bank Association

**PCBA –** the Polish Classification of Business Activities

**PFSA** – the Polish Financial Supervision Authority

**Pillar I** – – a part of the Basel II requirements containing provisions on the minimum capital requirements for credit, market and operational risk

**Pillar II –** a part of the Basel II requirements containing provisions on a bank's internal risk management processes and risk mitigation

**Pillar III –** a part of the Basel II requirements containing provisions 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 system –** a system 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

**REPO –** an operation within which funds are borrowed on securities

**SBB (Sell-Buy-Back) –** a transaction of sale of securities with the promise that they will be bought back upon expiration of a specified period before their maturity at a price agreed in advance

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

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

**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, currency 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

**Unfunded credit risk protection –** a credit risk mitigation technique where the bank's credit risk related to exposure is reduced by a third party's obligation to pay a specified amount in the case of the debtor's default or of occurrence of other credit events listed in the agreement (guarantees or credit derivatives)

**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 currency exchange rates, on the assumption that a defined confidence level and holding period of the position are kept

**WIG** – the Warsaw Stock Exchange Index