Capital Adequacy and Risk Management

(Pillar III)

The Group of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna

As at 31 December 2009

INTRODUCTION

The Report "Capital Adequacy and Risk Management (Pillar III)" (the "Report") of the Group of Powszechna Kasa Oszczędności Bank Polski SA (the "PKO BP SA Group" or the "Group") as at 31 December 2009 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 the Polish Financial Supervision Authority").

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

This Report was prepared in accordance with the Principles of information policy of PKO BP SA regarding capital adequacy[2] as adopted by the Bank, which contain detailed information on the scope of disclosures concerning capital adequacy, manner of their verification and publication.

The Report covers the year ended 31 December 2009. Unless stated otherwise, the Report includes consolidated data of the PKO BP SA Group. Since the risk profile of the PKO BP SA Group is predominantly affected by PKO BP SA (96%[3] of the Group's consolidated balance sheet total and 92%[4] of its consolidated profit/loss on banking activities), 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.

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

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

[2] The principles of information policy of PKO BP SA regarding capital adequacy are available on the Bank's website (www.pkobp.pl).

[3] The share of companies in the consolidated balance sheet total was calculated in relation to the consolidated balance sheet total before consolidation adjustments and exclusions for the year ended 31 December 2009.

[4] The share of companies in the consolidated profit/loss on banking activities was calculated in relation to the consolidated profit/loss on banking activities of the PKO BP SA Group before consolidation adjustments and exclusions for the year ended 31 December 2009.

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1. INFORMATION ON 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%[3], and in the consolidated profit/loss on banking activities – 92%[4]. PKO BP SA pursues activity in the territory of the Republic of Poland and is subject to Polish banking supervision.

Beside PKO BP SA, the PKO BP SA Group comprises also other companies; in the companies of the Bankowy Fundusz Leasingowy SA Group (the "BFL SA Group") 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 its subsidiaries) in the consolidated balance sheet total is 1.6%[3], and in the consolidated profit/loss on banking activities – 1.3%[4].

KREDOBANK SA pursues banking operations in the territory of Ukraine and is subject to Ukrainian banking supervision. The share of KREDOBANK SA in the consolidated balance sheet total is 1.2%[3], and in the consolidated profit/loss on banking activities – 2%[4].

Other companies of the Group covered by the consolidation include:

- PKO BP BANKOWY Powszechne Towarzystwo Emerytalne SA (management of a pension fund),
- Centrum Finansowe Puławska Sp. z o.o. (management and operation of Centrum Finansowe Puławska),
- PKO BP Inwestycje Sp. z o.o. (property development activity) – 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 (transfer agent services),
- Centrum Elektronicznych Usług Płatniczych eService SA (handling and settlement of transactions made with the use of cards),
- Bankowe Towarzystwo Kapitałowe SA (staffing and payroll as well as bookkeeping services for the Group's companies) – together with its subsidiary (factoring services),
- Fort Mokotów Inwestycje Sp. z o.o. (property development activity),
- PKO Finance AB (generating funds for PKO BP SA from the issue of Eurobonds).

Detailed information on the subsidiaries of the Group, 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 Group of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna for the year ended 31 December 2009, published 15 March 2010.

At the consolidation level, own funds of the 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 179.2 million as at 31 December 2009,
- Bank Ochrony Środowiska SA and "2020 European Fund For Energy, Climate Change and Infrastructure" (investment securities available for sale and valued at fair value) which amounted to the total of PLN 105.6 million as at 31 December 2009.

At the individual level, own funds of the Bank are reduced by the Bank's capital exposure in KREDOBANK SA, PKO BP BANKOWY PTE SA, PKO TFI SA, BFL SA, Bankowe Towarzystwo Kapitałowe SA, PKO Finance AB, Bank Pocztowy SA, Poznański Fundusz Poręczeń Kredytowych Sp. z o.o., Bank Ochrony Środowiska SA and "2020 European Fund For Energy, Climate Change and Infrastructure" amounting to the total of PLN 1,135 million as at 31 December 2009.

Within the PKO BP SA 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 Shareholders' Meeting of KREDOBANK SA commenced 29 January 2009 and continued 23 February 2009, a moratorium was introduced with respect to dividend payments. The moratorium is valid until revoked under an appropriate resolution.

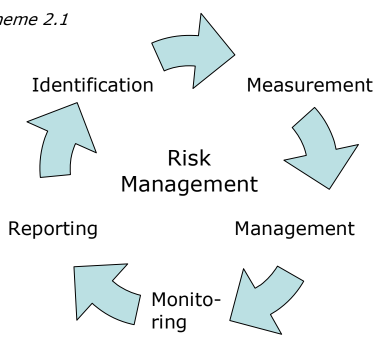
2. RISK MANAGEMENT

Banking activity is exposed to many types of risk, including such as credit, interest rate, foreign exchange, liquidity, derivatives, operational, compliance, strategic and reputation risk. Controlling the effect of those types of risk on the functioning of the PKO BP SA 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:
- 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 risk and debt collection function supports, on the ongoing basis, the achievement of business objectives while maintaining the acceptable risk level,
- the risk level is regularly monitored,
- the risk management model is regularly updated to accommodate new risk factors and sources.

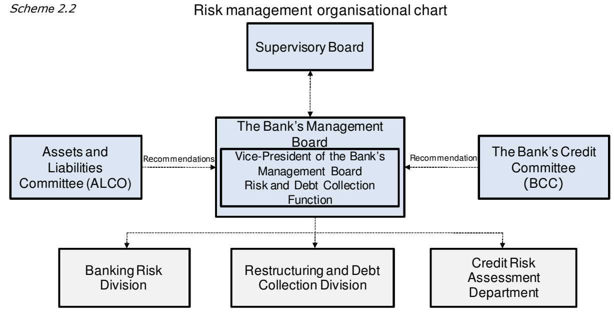
The banking risk management process in the Group includes the following activities:
- risk identification which consists in defining both current and potential risk sources, which result from the Bank's current and planned activity,
- risk measurement,
- risk management which consists in taking decisions 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 informed on a cyclical basis 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 organisational chart



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

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

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

The market and credit risk management at the Bank is supported by the following committees:
- the Assets and Liabilities Committee ("ALCO"),
- the Bank's Credit Committee ("BCC"),
- the Head Office's Credit Committee ("HOCC") and credit committees operating in regional retail and corporate branches.

ALCO and BCC are committees chaired by Vice-President of the Management Board of the Bank who supervises the Risk and Debt Collection Function.

ALCO takes decisions within the scope of its respective competencies and issues recommendations to the Management Board of the Bank as regards market and portfolio credit risk management and the Bank's assets and liabilities 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.

HOCC supports with its recommendations decision-taking by relevant managing directors and members of the Management Board of the Bank, while the credit committees operating in the regions support directors of branches and directors of Regional Corporate Branches in relation to issues involving greater risk level.

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

The priority of the PKO BP SA Group in 2009 was to keep its strong capital position and increase its stable deposit base, which together condition a growth of the Bank's credit portfolio.

As a consequence, in 2009, the Bank:
- effected the issue of shares,
- continued its activities to obtain new deposits from its clients,
- included in its banking risk measurement methods the financial crisis conditions (such as e.g. the stress test scenarios).

To facilitate immediate response to the changing situation on the financial markets, the Bank has a special working group (appointed in 2008), which submits reports to the Management Board of the Bank on a cyclical basis.

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

Besides, in order to prevent the deterioration of the macroeconomic situation of Ukraine, the Bank extended the scope of its activities which directly influence the safety of activity of KREDOBANK SA, including those related to financing, monitoring the economic and financial situation and restructuring of the credit portfolio of this bank, and it increased the revaluation write-off of its credit exposure in KREDOBANK SA which was charged to costs in 2009.

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

The Bank and the subsidiaries of the Group apply the following credit risk management principles:
- a credit transaction requires a comprehensive credit risk assessment, expressed in the internal rating or scoring,
- credit risk measurement of credit transactions is made at the stage of consideration of the loan application and on a cyclical basis as part of monitoring, and takes into account both the changing external conditions and changes in the financial standing of the borrowers,
- 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 legal collateral accepted by the Bank, credit spreads

charged to clients as well as by provisions for impairment of credit exposures.

The application of the above principles 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) approach, i.e. an advanced method of measuring credit risk, which may be used to calculate the capital requirement for credit risk following the obtaining by the Bank of the Polish Financial Supervision Authority's approval.

RATING AND SCORING METHODS

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

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

In 2009, the Bank continued to develop the aforementioned principles of credit risk assessment for individual clients, in particular with respect to validation of scoring models dedicated to consumer loans.

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 credit risk management, within the system of competencies in the area of credit decisions, when determining the criteria for activation of the credit risk assessment units, and within the system for credit risk measurement and reporting.

In 2009, the Bank developed solutions with respect to the functioning of the Early Warning System (EWS) and prepared support for this system in the form of a dedicated IT application.

As regards institutional clients making transactions involving derivatives, in December 2009 the Bank adopted new principles of derivatives-related risk assessment and of monitoring the limits applicable to such transactions.

COLLATERAL POLICY

The purpose of the collateral policy followed by the Bank and the subsidiaries of the Group 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 internal regulations of the subsidiaries of the Group.

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

In granting housing loans, collateral is obligatorily established on the financed real property in the form of a mortgage. Until the mortgage is effectively established (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 receivables 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 collateral on the client's bank account, car or securities.

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

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

- 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 unfavourable value fluctuations is treated as ancillary,
- in the case of acceptance of property collateral, as an additional security the Bank accepts transfer of cash receivables under insurance policy for the subject of collateral, or insurance policy issued in favour 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 a 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, the BFL SA Group as the owner of the leased assets treats them as collateral 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, 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, 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 (according to IAS),
- coverage ratio,
- risk cost.

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's credit portfolio with those methods.

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

PKO BP SA carries out analyses and stress tests of the impact of potential changes in its macroeconomic environment on the Bank's credit portfolio quality and reports the results thereof to the Bank's Management. The aforementioned information makes it possible to identify the negative effects of unfavourable market conditions on the Bank's result and to take action 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 Group as at 31 December 2008 and 31 December 2009.

Table 2.1

	The PKO BP SA Group		
	2009	2008	Average
ASSETS	156 479	134 636	145 557
Net credits and loans*	116 573	101 108	108 840
Securities	22 528	14 667	18 597
Receivables from banks	2 023	3 364	2 693
Financial fixed assets	229	247	238
Other assets**	15 126	15 251	15 188
OFF-BALANCE SHEET LIABILITIES	32 882	30 444	31 663
Financial	27 385	26 141	26 763
Guarantees granted	5 497	4 303	4 900
DERIVATIVES	335 425	423 628	379 527

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

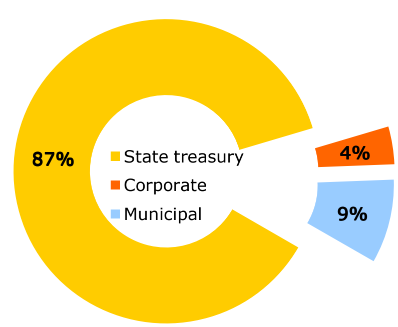
	The PKO BP SA Group	
	2009	2008
Net credits and loans	116 573	101 108
consumer loans	22 296	20 203
housing loans	51 938	45 402
corporate loans	42 339	35 503

* Including financial lease receivables.

A much smaller credit risk level of the Group is related to derivatives, interbank deposits and the Group's holdings of securities (of which 87% are securities issued by the Treasury or the National Bank of Poland).

Chart 2.1

SECURITIES - THE PKO BP SA GROUP



In 2009, the greatest proportion of the exposure structure of the Bank's Group was accounted for by retail and corporate exposures (approx. 62% in total). The proportions of other exposure classes range between 0.01% to 14.2% (Table 2.3).

Table 2.3

Exposure class*	The PKO BP SA Group 2009	
	Total exposure**	Average exposure**
Retail	67 052	64 771
Corporate	34 990	34 061
Central governments and central banks	23 544	18 804
Secured on real estate property	16 682	15 548
Other exposures	10 324	11 210
Institutions (banks)	5 522	7 137
Regional governments and local authorities	3 171	2 745
Past due	2 506	1 898
Administrative bodies and non-commercial undertakings	1 773	444
Other classes***	88	89
Total	165 651	156 707

* Pursuant to § 20 of Appendix No. 4 to Resolution No. 380/2008 of PFSA.

** The value of balance sheet exposures and balance sheet equivalent of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques. The average amount of exposure has been calculated as the arithmetic mean of exposures from individual quarters of 2009.

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

A considerable proportion of the Group's exposures (approx. 74%) are exposures with the original maturity of over 1 year; for over 54% of exposures with fixed maturity date the original maturity exceeds 5 years (Table 2.4).

Table 2.4

EXPOSURE* STRUCTURE BY ORIGINAL MATURITY

Exposure class	The PKO BP SA Group 2009: PKO BP SA, KREDOBANK SA and the BFL SA Group						Other Group companies	Adjustments and exclusions	Total
	0 - 1 month	1 - 3 months	3 - 12 months	1 - 5 years	over 5 years	Other***			
Retail	5	12	10 239	12 962	43 833	0	0	0	67 052
Corporate	29	91	10 477	10 256	15 436	85	129	-1 514	34 990
Central governments and central banks	7 062	517	5 402	4 371	332	5 660	200	-1	23 544
Secured on real estate property	1	0	148	487	16 056	0	0	-9	16 682
Other exposures	2 369	0	1	55	85	7 569	1 201	-956	10 324
Institutions (banks)	1 769	51	1 185	551	2 348	0	256	-639	5 522
Regional governments and local authorities	18	4	75	548	2 527	0	0	0	3 171
Past due	18	9	560	868	1 051	0	0	0	2 506
Administrative bodies and non-commercial undertakings	0	0	1 773	0	0	0		0	1 773
Other classes**	0	0	0	0	0	255	22	-189	88
Total	11 270	686	29 860	30 098	81 669	13 824	1 809	-3 309	165 651

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

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

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

IMPAIRMENT OF CREDIT EXPOSURES

The PKO BP SA Group reviews each month its credit exposures to identify credit 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,
- conclusion of a restructuring agreement or granting payment concessions.

In determining the period of delay in loan repayment, the outstanding amounts of interest or principal instalments are taken into account.

The PKO BP SA Group uses three methods for impairment assessment:

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

The write-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 expected future cash flows are assessed for each credit exposure individually, the possible scenarios of performance of the agreement taken into account and weighed with the probability of their fulfilment,
- 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.

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

When defining the provision for off-balance sheet credit exposures of the PKO BP SA Group:

- with respect to individually significant credit exposures meeting the conditions of individual impairment or pertaining to debtors whose other exposures meet such conditions – the individualised method is used,
- with respect to the remaining off-balance sheet credit exposures – the portfolio method (if the exposure meets the conditions of individual impairment) or the collective method (if the exposure meets only the conditions of collective impairment).

The provision is set as the difference between the expected value of the balance sheet exposure to arise from the off-balance sheet liability awarded (from the date as at which assessment is made to the date of occurrence of the overdue debt that is identified as the condition of individual impairment) and the current value of the expected future cash flows generated from the balance sheet exposure arising from the awarded liability.

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

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

The structure of the credit portfolio and of established write-offs for credit exposure impairment of the Group is shown in Table 2.5. In 2009, the gross value of loans granted by the Group valued under the individualised method increased by PLN 3.7 billion, while valued using the portfolio method – by PLN 1.5 billion.

The 2009 increase in the value of loans valued under the individualised method resulted mainly from a change in the methodology of determining write-offs for credit exposure impairment and from extension of the impairment conditions to include the following: deterioration of the economic/financial standing down to rating G, conclusion of the restructuring agreement and, in the case of individuals, repayment delayed by 3 to 6 months.

The 2009 increase in the volume of loans valued under the portfolio method resulted mainly from bigger delays in the repayment in the portfolio of consumer and housing loans extended to individual clients.

In 2009, the increase in credit portfolios for which impairment conditions have been identified (using the individualised and portfolio method) was higher than the growth dynamics of the entire credit portfolio, as a result of which the share of those loans in the entire portfolio increased from 4.4% as at the end of 2008 to 8.1% as at the end of 2009.

Table 2.5

CREDITS AND LOANS*

	The PKO BP SA Group	
	2009	2008
Gross credits and loans	120 510	104 026
individualised method	6 050	2 310
portfolio method	3 752	2 254
collective method (IBNR)	110 708	99 462
Write-offs (balance)	-3 937	-2 918
individualised method	-1 344	-766
portfolio method	-1 990	-1 426
collective method (IBNR)	-603	-726
Net credits and loans (gross - write-off)	116 573	101 108

* Including financial lease receivables.

The amount of the Group's revaluation write-offs in 2009 was affected most by the bigger delays in the repayment of consumer and housing loans extended to individual clients, and also by deterioration of the economic and financial standing of corporate clients. (Table 2.6).

Table 2.6

IMPAIRMENT WRITE-OFFS
The PKO BP SA Group

	Balance as at 2009	Balance as at 2008	Change in 2009	Release of write-offs**	Additional write-offs	FX differences	Other
Credits and loans*	3 937	2 918	1 019	-2 847	3 896	-28	-2
consumer loans	1 363	716	647	-751	1 400	-2	0
housing loans	735	536	199	-385	590	-6	0
corporate loans	1 839	1 666	173	-1 711	1 906	-20	-2
Receivables from banks	27	28	-1	0	0	0	-1
Financial instruments	27	30	-3	-18	18	0	-3
Other	458	313	145	-157	234	0	68
Total	4 449	3 289	1 160	-3 022	4 148	-28	62

* Including financial lease receivables.
** Including redemption charged to write-offs (in the total amount of PLN 556 million).

The 2009 increase in write-offs under "Other" amounted to PLN 145 million and resulted mainly from additional write-offs made during 2009 for off-balance sheet liabilities.

Table 2.7

EXPOSURES WITH RECOGNISED IMPAIRMENT AND WRITE-OFFS

	The PKO BP SA Group 2009	The PKO BP SA Group 2008
Exposures with recognised impairment	9 316	3 893
receivables from banks	27	28
credits and loans*	9 108	3 784
debt securities (AFS)	21	22
other financial assets	160	59
Write-offs (balance)**	-4 122	-3 024
receivables from banks	-27	-28
credits and loans*	-3 937	-2 918
debt securities (AFS)	-19	-20
other financial assets	-139	-58

* 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 write-offs pertain also to exposures without recognised impairment.

Table 2.8

EXPOSURES WITH RECOGNISED IMPAIRMENT AND WRITE-OFFS
(geographical structure)
The PKO BP SA Group
2009

Region	Exposures with regonised impairment*	Impairment write-offs*
Poland (PKO BP, BFL), of which:	7 734	2 938
mazowiecki	1 756	685
śląsko-opolski	1 067	371
małopolsko-świętokrzyski	920	359
zachodniopomorski	796	439
łódzki	600	215
podlaski	485	63
pomorski	494	175
wielkopolski	486	157
dolnośląski	338	167
kujawsko-pomorski	304	124
lubelsko-podkarpacki	306	111
warmińsko-mazurski	181	73
other	1	1
Poland (other companies)	1	0
Ukraine (Kredobank)	1 372	416
Adjustments	32	-20
Total	9 139	3 334

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

CREDIT 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 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 (e.g. the minimum value of the LtV rate, the maximum loan amount, the required collateral),
- the minimum credit spreads – 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 interest rate lower than that resulting from reference rate increased by the credit risk spread,
- concentration limits – limits defined in Article 71 clause 1 of the Banking Law, industry limits and limits on mortgage-backed exposures,
- 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 level (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 region,
- loan currency,
- industry sector,
- mortgage-backed exposure.

The risk of concentration of exposures to individual clients or groups of related clients is monitored pursuant to Article 71 of the Banking Law 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 and 20% of 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 2009, the level of concentration risk of the PKO BP SA Group for individual exposures was rather low, the largest exposure to an individual entity not exempt from the exposure concentration limit amounting to 4.7% of consolidated own funds.

Table 2.9

EXPOSURE TOWARD THE 10 BIGGEST CLIENTS*

	The PKO BP SA Group			
	2009		2008	
No.	exposure	% own funds	exposure	% own funds
1**	2 698	15,1%	1 077	8,4%
2	844	4,7%	938	7,3%
3	802	4,5%	915	7,1%
4	697	3,9%	697	5,4%
5	645	3,6%	607	4,7%
6	636	3,6%	603	4,7%
7	610	3,4%	565	4,4%
8	585	3,3%	500	3,9%
9	500	2,8%	471	3,7%
10	475	2,7%	344	2,7%
Total	8 492	47,5%	6 717	52,1%

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

** Exposure to entities exempt from the exposure concentration limit under Article 71 clause 3 of the Banking Law.

The biggest concentration of exposure of the PKO BP SA Group in the group of subsidiaries amounted, as at the end of 2009, to 8.1% of its consolidated own funds (entities not exempt from the exposure concentration limit).

Table 2.10

EXPOSURE TOWARD THE 5 BIGGEST CAPITAL GROUPS*

	The PKO BP SA Group			
	2009		2008	
No.	exposure	% own funds	exposure	% own funds
1**	1 555	8,7%	1 591	12,3%
2	1 440	8,1%	1 403	10,9%
3	1 356	7,6%	1 319	10,2%
4	1 078	6,0%	1 287	10,0%
5	737	4,1%	823	6,4%
Total	6 166	34,6%	6 422	49,8%

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

** Exposure to entities exempt from the exposure concentration limit under Article 71 clause 3 of the Banking Law.

As at the end of 2009, the sum of large exposures of the Group amounted to 0% of consolidated own funds, as compared to the limit of 800% of own funds.

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

- financial institutions – by the country of origin of the counterparty'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 2009, there was no significant geographical concentration level in the Group's credit portfolio (Table 2.11). The KREDOBANK SA portfolio of loans extended to Ukrainian clients accounted for approx. 1.5% of the Group's total portfolio.

Table 2.11
GEOGRAPHICAL STRUCTURE OF EXPOSURES*

The PKO BP SA Group

2009

Country/region	No. of exposure class**										Total
	A	B	C	D	E	F	G	H	I	Other***	
Poland, of which:	66 736	36 069	23 187	16 263	9 830	2 878	3 171	2 024	1 772	255	162 186
mazowiecki	10 648	9 590	28	1 480	9	1	323	37	1 772		23 888
śląsko-opolski	9 588	3 527	6	1 960	9	0	381	69	0	0	15 540
wielkopolski	6 447	3 160	0	2 422	3	0	295	15	0	0	12 342
małopolsko-świętokrzyski	5 897	3 287	113	1 702	7	0	504	13	0	0	11 524
dolnośląski	5 496	2 321	2	1 217	6	0	328	12	0	0	9 381
lubelsko-podkarpacki	4 514	1 495	4	1 728	34	0	228	21	0	0	8 022
zachodniopomorski	4 268	2 019	6	1 393	8	0	171	14	0	0	7 879
łódzki	3 896	1 493	0	1 119	3	0	431	34	0	0	6 976
pomorski	3 874	2 897	1	1 051	6	0	204	127	0	0	8 159
kujawsko-pomorski	3 220	1 486	191	890	5	0	122	14	0	0	5 926
warmińsko-mazurski	2 386	987	77	873	0	0	93	9	0	0	4 424
podlaski	2 168	1 152	13	232	2	0	91	6	0	0	3 663
other****	4 334	2 658	22 746	196	9 740	2 877	1	1 655	0	255	44 462
Ukraine	240	248	158	397	248	589	0	480	1	0	2 361
United Kingdom	51	0	0	24	0	739	0	1	0	0	816
France	2	0	0	1	0	534	0	0	0	0	536
Germany	6	0	0	2	0	337	0	0	0	0	345
Netherlands	2	0	0	0	0	55	0	0	0	0	57
USA	2	0	0	0	0	167	0	0	0	0	170
Austria	1	0	0	0	0	261	0	0	0	0	262
Denmark	0	0	0	0	0	155	0	0	0	0	156
Cyprus	0	57	0	0	0	0	0	0	0	0	58
Slovenia	0	0	0	0	0	65	0	0	0	0	65
Other	11	0	0	4	0	125	0	0	0	0	140
Total (PKO BP SA, KREDOBANK SA and the BFL SA Group)	67 052	36 374	23 345	16 691	10 079	5 905	3 171	2 506	1 773	255	167 151
Other companies	0	129	200	0	1 201	256	0	0	0	22	1 809
Adjustments and exclusions	0	-1 514	-1	-9	-956	-639	0	0	0	-189	-3 309
Total	67 052	34 990	23 544	16 682	10 324	5 522	3 171	2 506	1 773	88	165 651

* The value of balance sheet exposures and the balance sheet equivalent of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques.
** A - retail exposures,
B - corporate exposures,
C - exposures to central governments and central banks,
D - exposures secured on real estate property,
E - other exposures,
F - exposures to institutions (banks),
G - exposures to regional governments and local authorities,
H - past due exposures,
I - exposures to administrative bodies and non-commercial undertakings.
*** Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.
**** Exposures managed at the Head Office level include the following, among other items: cash, tangible fixed assets, intangible assets, assets from securities valuation, securities.

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

As at 31 December 2009, there was no significant credit concentration level with respect to industry sectors (Table 2.12).

Table 2.12
EXPOSURE STRUCTURE BY INDUSTRY*

The PKO BP SA Group
2009

Type of client/branch		No. of exposure class**										Total
		A	B	C	D	E	F	G	H	I	Other***	
Institutional clients, of which:		10 716	29 591	0	1 026	1	0	3 171	1 314	1 773	0	47 593
D	Industrial processing	1 727	9 602	0	169	0	0	1	514	1	0	12 014
G	Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household appliances	2 707	4 232	0	295	0	0	0	301	0	0	7 535
K	Real property maintenance, rental and services related to pursuit of business activity	1 040	4 943	0	100	0	0	0	71	0	0	6 154
F	Construction	1 113	2 203	0	95	0	0	0	72	0	0	3 484
L	Public administration and national defense, obligatory social security and public health insurance	2	0	0	0	0	0	2 763	0	0	0	2 765
E	Generation and supply of power, gas and water	91	1 636	0	6	0	0	0	7	0	0	1 740
	Other exposures	4 036	6 975	0	362	0	0	407	349	1 773	0	13 902
Banks		0	0	68	1	0	5 905	0	0	0	0	5 974
Governments		0	0	23 166	0	0	0	0	0	0	0	23 166
Individuals		54 799	4 521	0	15 663	31	0	0	1 152	0	0	76 166
Other****		1 537	2 262	111	0	10 047	0	0	40	0	255	14 252
Total (PKO BP SA, KREDOBANK SA and the BFL SA Group)		67 052	36 374	23 345	16 691	10 079	5 905	3 171	2 506	1 773	255	167 151
Other companies		0	129	200	0	1 201	256	0	0	0	22	1 809
Adjustments and exclusions		0	-1 514	-1	-9	-956	-639	0	0	0	-189	-3 309
Total		67 052	34 990	23 544	16 682	10 324	5 522	3 171	2 506	1 773	88	165 651

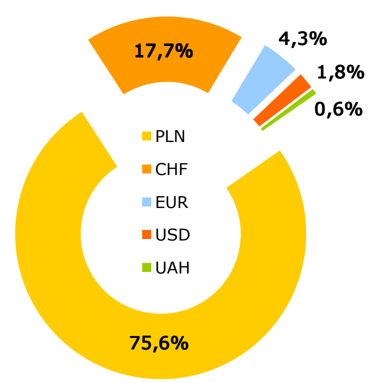
* The value of balance sheet exposures and the balance sheet equivalent of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques.
** A - retail exposures,
B - corporate exposures,
C - exposures to central governments and central banks,
D - exposures secured on real estate property,
E - other exposures,
F - exposures to institutions (banks),
G - exposures to regional governments and local authorities,
H - past due exposures,
I - exposures to administrative bodies and non-commercial undertakings.
*** Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.
**** Exposures managed at the Head Office level include the following, among other items: securities, other assets.

As at 31 December 2009, the share of exposures in currencies other than PLN in the Group's total portfolio amounted to 24.4%. The biggest portion of the Group's currency exposure is the exposure in CHF pertaining to the Bank's credit portfolio. The situation is different in the case of the companies of the Group, i.e. exposures in EUR prevail in the currency portfolio of the BFL SA Group (68.5% of the currency portfolio), while in KREDOBANK SA – loans extended in USD account for approximately 78.0% of the currency portfolio and 46.2% of the total portfolio of the company.

The 2009 drop in the share of loans denominated in foreign currencies resulted from concentration of the new sales of housing loans in the Polish currency.

Chart 2.2

CURRENCY STRUCTURE
OF THE CREDIT PORTFOLIO
THE PKO BP SA GROUP



Due to the special profile of credit risk related to loans taken out by individual clients for real 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, duration of the agreement, credit transaction currency, and accepted collateral.

CREDIT RISK REPORTING

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

FINANCIAL INSTITUTIONS AND DERIVATIVES

Derivatives used by the Bank

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

Derivates used by the Bank within risk management and offered to its clients are mostly IRS, FRA, FX Swap, CIRS, FX Forward and FX options (Table 2.13).

Table 2.13

FINANCIAL DERIVATIVES*

	The PKO BP SA Group			
	2009			
	Nominal value		Fair value	
	Purchase	Sale	Negative	Positive
Currency transactions (over-the-counter market)	33 611	33 393	238	715
FX Swap	7 725	7 654	27	90
FX Forward	2 969	3 019	49	24
Options	4 987	4 868	128	198
Cross Currency IRS	17 930	17 852	34	402
Interest rate transactions	137 033	128 483	1 304	1 315
Interest Rate Swap (IRS)	114 199	114 199	1 296	1 307
Forward Rate Agreement (FRA)	22 834	14 284	8	8
Credit Default Swaps	0	0	0	0
Other (including stock market index derivatives)	1 449	1 457	2	0
Total derivatives	172 093	163 333	1 544	2 029

*Nominal values of underlying 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, such instruments' 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 things, 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; in addition, separated embedded derivatives are subject to periodic valuation.

Derivatives intended for separation from host contracts and separate recognition in the books of account are valued at fair value. Derivatives' valuation is presented in the balance sheet under „Financial derivatives". The changes in the valuation of derivatives at fair value are taken to the profit and loss account and recognised under "Result from financial instruments valued at fair value".

The separated embedded derivatives were not a material risk factor for the Bank in 2009.

Policy of determining credit limits and collateralising derivatives

In order to limit credit risk relating to derivative transactions, the Bank enters into framework agreements which are aimed at collateralising the Bank's claims towards counterparties, resulting from derivative transactions, by setting off 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 transactions involving debt securities are made based on the Bank's internal standard. To mitigate credit risk, in the case of a planned increase in the scale of operations with a financial institution under a framework agreement, the parties enter into a collateral CSA (Credit Support Annex) agreement. Based on the collateral agreement, each of the parties, after meeting certain criteria specified in the agreement, undertakes to establish appropriate collateral along with the right to set it off.

The Bank has developed a standard for 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 framework agreements and credit support annexes with foreign banks and credit institutions.

The ISMA and CSA agreements concluded 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 2009, the Bank held 25 open framework agreements with Polish banks and 36 agreements with foreign banks and credit institutions. In addition, the Bank was a party to 28 CSA agreements/PBA Collateral Agreements facilitating collateralisation of exposures relating to derivatives and 3 ISMA/GMRA agreements which enable to set off liabilities resulting from REPO and BSB/SBB transactions. The level of coverage of the nominal value of transactions involving derivatives with Framework Agreements and Collateral Agreements/CSA was 99.42% and 71.54% respectively.

The Bank requires that its counterparty establishes additional collateral, for example in the form of blocked securities account, where the planned scope of cooperation with that given counterparty exceeds the level of the limit granted. 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 a framework agreement with a counterparty is the basis for verification of internal limit per counterparty and of the length of period of the Bank's exposures to forward or repurchase agreement transactions. The client limit is based on the internal assessment (internal rating) as well as on the amount of own funds of the Bank and the client.

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

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 concluded by the Bank to date do not include any provisions that would require 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 2009 was PLN 1.8 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 the netting of transactions, for counterparties with framework agreements was approx. PLN 539 million. Netting benefits amounted to approx. PLN 1.3 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 Collateral Agreements was PLN 161.5 million.

As at 31 December 2009, the Bank had no derivative credit transactions.

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 2009, the Bank recognized adjustments for credit valuation in the valuation of financial derivatives concluded with non-financial business entities based on an analysis of recoverability of its exposures. The Bank's adjustment included the market value of credit risk as assessed by the Bank. Analysed were all significant exposures on account of the Bank's positive valuation of financial derivatives contracted with non-financial business entities. In particular, the adjustment included the risk of non-performance of agreements executed with the counterparty, based e.g. on the analysis of 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 2.14).

Table 2.14

THE QUALITY OF EXPOSURE TO*
FINANCIAL INSTITUTIONS**

	PKO BP SA
Rating	2009
AA	39%
A	45%
BBB	11%
B	2%
Lack of rating	3%
Total	100%

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

** Exposures to institutions from outside the Group.

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

Credit derivatives

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

Credit risk of financial institutions

PKO BP SA cooperates on the wholesale market with financial institutions having their registered offices 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 monitors the financial standing of its counterparties on an ongoing basis and sets exposure limits adequate to the risk incurred for pre-settlement and settlement exposures of individual counterparties. The integral tools for the management of credit risk of financial institutions are framework agreements signed with counterparties on the basis of ISDA and the PBA 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.

CREDIT RISK MANAGEMENT AT SUBSIDIARIES OF THE GROUP

The subsidiaries of the Group with significant credit risk level (KREDOBANK SA, the BFL SA Group) 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 activity conducted by those entities.

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

The BFL SA Group and KREDOBANK SA measure credit risk and report the results of that measurement to the Bank on a cyclical basis.

The organization structures of KREDOBANK SA and the BFL SA Group include risk units that are specifically in charge of the following:
- development of the methods of credit risk assessment and establishing provisions and write-offs,
- credit risk control and monitoring in the credit process,
- the quality and efficiency of restructuring and the debt collection process.

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

The credit decision-making process in KREDOBANK SA and the BFL SA Group is supported by credit committees activated in the case of credit transactions generating an enhanced credit risk level.

The competent units of the Banking Risk Division contribute to credit risk management in the companies of the Group in that they give opinions on drafts and periodically review those companies' internal regulations on credit risk assessment and prepare recommendations as to changes in draft regulations. The Bank supports implementation in the companies of the Group of the recommended changes in the principles of credit risk assessment.

In 2009, KREDOBANK SA centralized the credit risk assessment and the administration of corporate clients' credit operations, and also centralized the credit risk assessment in the area of mortgage loans extended to individuals. To raise the efficiency of bad debt collection, KREDOBANK SA:
- reorganized its Restructuring and Debt Collection Division (by organizing the Division's regional branches, among other things),
- implemented a program for individual bad debt outsourcing and sales,
- developed new methods of restructuring individual debts,
- amended the decision-making procedure with respect to bad debts to optimize the credit process.

In 2009, the BFL SA Group continued activities aimed at mitigating credit risk, which consisted in extension of the scope of verification of applications in the registers of unreliable clients. Besides, it also introduced limits on financing entities from enhanced risk industries, tightened its crediting policy and rules, and also verified the competence thresholds and cut-off points.

Derivatives at subsidiaries of the Group

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

The positions taken by the subsidiaries of the Group 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 activity of those companies.

The following is utilized in the process of derivatives risk management of the remaining companies of the Group:
- the derivatives risk measures determined for individual companies and for the Bank,
- the companies' positions with respect to specific derivatives, as determined by the Bank.

In 2009, the only companies of the Group beside the Bank to use derivatives within market risk management were companies of the Group of Bankowy Fundusz Leasingowy SA.

KREDOBANK SA does not make any transactions with the use of derivatives due to the fact that this is prohibited by Ukrainian banking supervision authority. However, other subsidiaries of the Group may enter into transactions with the use of derivatives only to hedge the risk resulting from core business activity of a given subsidiary (banking book).

CAPITAL EXPOSURES IN THE BANKING BOOK

The PKO BP SA 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 and to other entities with the minority interest of PKO BP SA and the Group' subsidiaries (except for stocks and shares reducing own funds of the Group). The reason behind acquisition of these assets is to obtain capital gains (dividend) and return on investment following the disposal of stocks and shares 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 required to create such fund.

Table 2.15

CAPITAL EXPOSURES - BANKING BOOK

	The PKO BP SA Group			
	2009		2008	
	carrying amount	fair value*	carrying amount	fair value*
Total	107	108	162	162
Shares in other entities	51	51	59	59
Equity securities	56	57	103	103
shares in entities listed on regular market**	15	15	66	66
shares in entities not listed on regular market	19	20	17	17
participation units in collective investment undertakings	22	22	20	20

* Assessed fair value.
** Fair value of listed securities 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 cost adjusted by a change in the net assets of the company for the period from the acquisition to valuation date) less impairment write-offs.

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

At the end of each reporting period, an assessment is made of whether impairment conditions exist for investments in associated entities and co-subsidiaries. If impairment conditions 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 value in use is assessed using the discounted cash flow method under the assumption that the stocks or shares will continue to be held. Forecasts concerning cash flows are developed on the basis of financial plans of entities and cover the period from 3 to 5 years using varied discount rates adjusted to the specific nature of business activity of individual entities.

Stocks and shares in other entities are valued as follows:

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

The effects of changes in the fair value of stocks and shares are taken to revaluation reserve, except for impairment write-offs, which are taken to the profit and loss account. The revaluation reserve item is taken to the profit and loss account at the time the asset is disposed of or impaired. In the case of permanent impairment of a given asset, the amounts recognised previously as an increase in the value due to reassessment to fair value decrease revaluation reserve. If the amount of previously recognised increases is not sufficient to cover the permanent impairment, the resultant difference is taken to the profit and loss account.

Impairment 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 revaluation reserve.

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

At the end of 2009, the unrealised loss of the PKO BP SA Group relating to reassessment of capital exposures amounted to PLN 2.4 million, and the realised loss on the disposal of capital exposures amounted to PLN 0.5 million.

Additionally, on account of its capital exposure in the stocks held, the PKO BP SA Group received a gross dividend in 2009 in the total amount of PLN 5.4 million.

2.2. MARKET AND LIQUIDITY RISK

Market risk is defined as the risk of loss due to unfavourable changes in the market parameters such as interest rate and foreign exchange rate or volatility of such parameters.

Interest rate risk is the risk of loss on the Bank's active and passive positions sensitive to the interest rate changes, resulting from unfavourable interest rate changes on the market.

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

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

The purpose of FX risk management is to mitigate the risk of loss resulting from a mismatch of the currency structure of balance sheet and off-balance sheet items to an acceptable level.

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

The purpose of liquidity risk management is to shape the balance sheet structure and the off-balance sheet liabilities so as to secure means sufficient to discharge the current and future (also potential) liabilities with due account to the nature of business activity and any needs that may result from a changing market environment.

The Bank and the subsidiaries of the Group apply the following market risk and liquidity risk management principles:
- 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 of financing such as in particular 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 AND LIQUIDITY RISK MEASUREMENT

In order to determine the level of market and liquidity risk, the Bank uses various methods of its measurement and assessment, including:
- for interest rate risk: the value at risk model (VaR), interest income sensitivity measure, stress tests and reassessment gaps;
- 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 portfolio and credit 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 due to changes in interest rates or as potential value of loss on the maintained currency positions due to changes in foreign 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 activity of the Bank.

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

The reassessment gap is the difference between the current value of the active and passive positions exposed to interest rate risk, reassessed in a given time interval, with the items shown as at the transaction date.

Stress tests for interest rate risk are used to assess potential losses resulting from the maintained structure of the balance sheet and off-balance sheet items where market situation occurs that is not described in a standard manner using the statistical measures. The following scenarios are applied at the Bank:
- hypothetical scenarios – within which the scale of fluctuations in interest rates is assumed arbitrarily, e.g. parallel movement of the interest rate curves in the following currencies: PLN, EUR, USD, CHF and GBP by ±50 BPS and by ±200 BPS,
- historical scenarios – within which fluctuations in interest rates are assumed on the basis of fluctuations in interest rates in the past, including: the biggest historical change, deflection of the profitability curve with due account to portfolio positions, peak- and twist-type deflections of the profitability curve, the biggest historical non-parallel shift of interest rates for securities and for derivates guaranteeing those securities.

In the process of interest rate risk measurement, the Bank assumed that the value 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 at the Bank.

Stress tests and crash tests for FX risk are used to assess potential losses on currency positions where extraordinary market situation occurs that is not described in a standard manner using the statistical measures. The following two scenarios are applied at the Bank:
- hypothetical scenarios – within which the historical appreciation or depreciation of foreign exchange rates is assumed (by 15% and 50%),
- historical scenarios – scenarios of fluctuations in exchange rates observed in the past.

For the purposes 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-terms maturity,

- liquidity reserve – the difference between the most liquid assets and expected and potential liabilities that mature in a given period.

Stress tests for liquidity risk are used to assess the minimum number of business days over which the Bank could fully pay funds to non-financial entities and to verify if the Bank's funds would be enough to cover the liabilities should the shock scenario be fulfilled. The following two scenarios are applied at the Bank:

- scenarios of mass withdrawal of deposits by non-financial clients,
- scenarios of sensitivity of in- and outflows to changing market conditions.

RISK MANAGEMENT TOOLS

The basic market and liquidity 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 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 horizon and daily loss 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 2009, interest rate risk of the PKO BP SA Group was moderate. It was determined mainly by the risk of mismatch of dates of reassessment of assets and liabilities.

At the end of 2009, the PKO BP SA Group reported a cumulative positive gap in PLN in all time frames. The exposure of the PKO BP SA Group to PLN interest rate risk at the end of 2009 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 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 risk of the Group in the time frame of up to 1 month. In the remaining time frames, the subsidiaries' interest rate risk increased the Group's exposure to interest rate risk.

The Group's exposure to EUR 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 time frames of 1 to 3 months, 6 to 12 months and over 5 years, and increased it in other time frames.

The Group's exposure to 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 tables 2.16 – 2.19 present the reassessment gaps as at 31 December 2009 by currencies.

Table 2.16

PLN reassessment gap (in PLN million)

2009	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	over 5 years	Total
Bank PKO BP SA								
Periodic gap	26 246	28 202	-28 721	-11 760	-1 765	1 492	266	13 960
Cumulative gap	26 246	54 448	25 727	13 967	12 201	13 694	13 960	-
Group subsidiaries								
Periodic gap	-168	-194	-57	41	10	107	2	-259
Cumulative gap	-168	-361	-419	-378	-368	-261	-259	
TOTAL - Periodic gap	26 079	28 008	-28 778	-11 720	-1 755	1 599	268	13 701
TOTAL - Cumulative gap	26 079	54 087	25 309	13 589	11 834	13 433	13 701	-

Table 2.17

USD reassessment gap (in USD million)

2009	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	over 5 years	Total
Bank PKO BP SA								
Periodic gap	181	-132	-129	-140	-1	0	0	-221
Cumulative gap	181	49	-80	-220	-221	-221	-221	-
Group subsidiaries								
Periodic gap	-64	-76	-37	-5	33	66	127	44
Cumulative gap	-64	-140	-177	-183	-150	-84	44	
TOTAL - Periodic gap	118	-209	-166	-145	32	66	127	-177
TOTAL - Cumulative gap	118	-91	-257	-402	-370	-305	-177	-

Table 2.18

EUR reassessment gap (in EUR million)

2009	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	over 5 years	Total
Bank PKO BP SA								
Periodic gap	-311	116	-42	-83	3	-3	-4	-324
Cumulative gap	-311	-195	-237	-320	-317	-320	-324	-
Group subsidiaries								
Periodic gap	-28	-34	-4	1	5	24	7	-30
Cumulative gap	-28	-62	-65	-65	-60	-37	-30	
TOTAL - Periodic gap	-339	82	-46	-82	7	21	3	-354
TOTAL - Cumulative gap	-339	-256	-303	-385	-378	-357	-354	-

Table 2.19

CHF reassessment gap (in CHF million)

2009	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	over 5 years	Total
Bank PKO BP SA								
Periodic gap	-57	-246	2	-7	1	1	6	-299
Cumulative gap	-57	-303	-301	-307	-306	-305	-299	-
Group subsidiaries								
Periodic gap	-15	15	0	0	0	0	0	0
Cumulative gap	-15	0	0	0	0	0	0	
TOTAL - Periodic gap	-72	-231	2	-7	1	1	6	-299
TOTAL - Cumulative gap	-72	-303	-301	-308	-306	-305	-299	-

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 books) exposed to interest rate risk at the end of 2009 and 2008 respectively are presented below:

Table 2.20

Sensitivity of financial assets exposed to interest rate risk

	2009		2008	
	10-day VaR	Stress test ± 200 base points	10-day VaR	Stress test ± 200 base points
Bank PKO BP SA	17,1	164,4	72,3	133,9*
Group subsidiaries	-	117,3	-	132,3*
Total	-	233,3	-	266,2*

* Data brought to comparability.

As at 31 December 2009, the 10-day VaR on the Bank's interest rate was PLN 17,086 thousand and accounted for approx. 0.10% of the Bank's own funds.

The results of stress tests showing changes in the market value resulting from shifts of the yield curves by individual currencies are presented in the table below.

Table 2.21

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

	Bank		Group subsidiaries		Total	
Currency	2009	2008	2009	2008	2009	2008
PLN	148,8	124,0	7,2	2,7	156,0	126,7
EUR	8,6	0,6	12,8	4,5	21,4	5,1
USD	2,1	2,4	97,3	89,0	99,4	91,4
CHF	4,2	29,7	0,1	0,1	4,3	29,8
GBP	0,6	0,5	0,0	0,0	0,6	0,5

*Foreign currency values have been shown as PLN equivalents.

Given the nature of business activity of the subsidiaries of the Group generating the largest interest rate risk (the BFL SA Group 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 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 2009 was PLN 40.0 million.

FX RISK

In 2009, the FX risk of the Group was low as it is the Bank's policy to close currency positions. 10-day VaR for FX position of the Bank at the end of 2009 amounted to PLN 1.1 million, which accounted for approx. 0.01% of the Bank's own funds. The VaR and stress-test analysis in respect of the Bank's and the Group's financial assets (jointly for all currencies) exposed to FX risk as at the end of 2009 and 2008 respectively was as follows:

Table 2.22

Sensitivity of financial assets exposed to FX risk

	2009		2008	
	10-day VaR	Stress test ± 15%	10-day VaR	Stress test ± 15%
Bank PKO BP SA	1,1	4,4	11,3*	10,6
Group subsidiaries	-	3,7	-	2,6
Total	-	0,7	-	13,2

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

As in the case of interest rate risk, given the nature of business activity of the subsidiaries of the Group generating the largest FX risk (the BFL SA Group 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 2009, its value was PLN 0.06 million.

LIQUIDITY RISK

The real-terms liquidity gaps presented below include a list of matured assets, payable liabilities, and additionally selected balance sheet items for a realistic presentation of the liquidity status of the Bank and the subsidiaries of the Group. Put in real terms were in particular the following:

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

The table below presents data concerning periodic gap and cumulative periodic gap of the Bank and of the subsidiaries of the Group as at the end of 2009 and 2008 respectively.

Table 2.23

REAL-TERMS LIQUIDITY GAP - ASSETS AND LIABILITIES

2009	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	over 5 years
Bank PKO BP SA								
Periodic gap	7 012	15 935	-3 179	431	3 539	1 468	4 447	-29 652
Cumulative gap	7 012	22 946	19 767	20 198	23 737	25 205	29 652	
Group subsidiaries								
Periodic gap	156	-559	-431	-114	49	188	323	388
Cumulative gap	156	-403	-833	-948	-899	-711	-388	
TOTAL - Periodic gap	7 168	15 376	-3 610	317	3 587	1 656	4 770	-29 263
TOTAL - Cumulative gap	7 168	22 544	18 934	19 251	22 838	24 494	29 263	

2008*	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	over 5 years
Bank 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	-

* Values brought to comparability under the liquidity gap real-terms methodology in force as at 31 December 2009.

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 2.24

CONTRACTUAL OFF-BALANCE SHEET LIQUIDITY GAP FOR DERIVATIVES

The PKO BP SA Group

2009	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	161	524	131	352	1 105	481	109	2 863
TOTAL - Cumulative gap	161	685	816	1 168	2 273	2 754	2 863	-

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	-202	66	113	223	45	-786	-521	-1 061
TOTAL - Cumulative gap	-202	-136	-23	200	245	-540	-1 061	-

The table below shows the Bank's liquidity reserve as at the end of 2009 and as at the end of 2008.

Table 2.25

LIQUIDITY RESERVE
The PKO BP SA

Sensitivity measure	31.12.2009	31.12.2008
Liquidity reserve for up to 1 month	16 030	6 666

As at 31 December 2009, core deposits amounted to approx. 95.5% of all deposits held by the Bank (the interbank market excluded), which was an increase of approx. 1.5 percentage points compared to the end of 2008.

MARKET AND LIQUIDITY RISK REPORTING

Reporting on the level of market risk is carried out in the following cycles:
- on a daily and weekly basis – for operational purposes,
- on a monthly, quarterly and half-year basis – for management purposes.

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

MARKET AND LIQUIDITY RISK MANAGEMENT AT SUBSIDIARIES OF THE GROUP

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

Transactions in the trading book are made exclusively by PKO BP SA. Other subsidiaries of the Group enter into transactions solely on the banking book.

2.3. OPERATIONAL RISK

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

The purpose of operational risk management is to optimize the operational efficiency by means of reducing operational losses, rationalizing costs, and also increasing the promptness and adequateness of response of the PKO BP SA Group to events beyond its control.

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

Operational risk management is carried out in the area of systemic and "day-to-day" operational risk management solutions.

Systemic operational risk management consists in developing internal regulations and other solutions relating to operational risk and concerning, among other things, 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.

Systemic 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 action to ensure acceptable operational risk level.

"Day-to-day" operational risk management consists in the following:
- preventing the operational risk events arising during the course of product realisation and within internal processes or systems,
- taking action aimed at limiting the number and scale of threats (operational risk events),
- liquidating the negative effects of operational risk events,
- recording 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 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.

Three entities, i.e. PKO BP, the BFL SA Group and KREDOBANK SA, have a decisive impact on the operational risk profile of the Group (the total of 99% of all financial effects). Other companies of the Group, due to a considerably lower scale and specific type of their businesses, generate only limited operational risk.

In 2009, the Bank implemented the SAS OpRisk Management application for systemic support of operational risk management.

Mitigation of operational risk

In order to mitigate operational risk exposure at the Bank, various solutions are applied. These include, among other things, the following:
- control instruments,
- human resources management instruments (personnel selection and recruitment, employee qualifications enhancement systems and incentive systems),
- threshold values for key risk indicators (KRI),
- contingency plans,
- insurance,
- outsourcing.

Selection of instruments used to mitigate operational risk is performed depending on the following, among other factors:
- 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 excessive risk, and if such business activity is conducted – to withdraw from such business activity or limit its scope. The level of operational risk is considered to be excessive, if potential benefits from conducting such business activity are lower than potential operational losses.

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 for processes, products and IT applications,
- 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 and the subsidiaries of the Group is conducted on a 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 its 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 operational risk management.

Risk management at subsidiaries of the Group

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

In 2009, the subsidiaries of the Group continued works aimed at development of a system of the key operational risk indicators.

2.4. Compliance risk

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

The purpose of compliance risk management is 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 Group'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 Group'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 Group's employees in official matters might seem self-interested,
- professional, reliable and clear formulation of the product offer and the advertising and marketing messages,
- immediate, honest and professional consideration of the clients' complaints, applications and suggestions.

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

In all entities of the PKO BP SA Group there function consistent compliance risk management principles.

2.5. Business risk

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

Strategic risk is related to the possibility of occurrence of negative financial consequences of mistaken decisions, decisions made based on improper assessment, or an absence of proper decisions pertaining to the direction of the Group's strategic development.

The purpose of strategic risk management is to take action aimed at maintaining that risk at an acceptable level.

Strategic risk management at the Group comprises:
- strategic risk measurement,
- reporting the level of strategic risk and its changes,
- action undertaken in the event of occurrence of high level of strategic risk.

When measuring the strategic risk level, the Group takes the following into account:
- external factors,
- factors relating to the increase and development of banking activity,
- 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 an annual basis. The recipients of the strategic risk reports are members of the Management Board of the Bank and managing directors of the Bank's Head Office.

2.6. REPUTATION RISK

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

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

Reputation risk management at the Group covers in particular:
- monitoring the external and internal channels of the Bank's communication with its environment in order to identify adverse effects of image-related events,
- gathering and analyzing information on the occurrence or potential occurrence of an image-related event,
- recording data on identified negative effects of image-related events in the Group,
- selecting efficient tools for protective actions aimed at elimination, mitigation or minimizing of the unfavourable impact of the negative effects of image-related events on the Group's image, as well as carrying out of such actions,
- analyzing the nature, weight, scale and dynamics of the negative effects of image-related events,
- assessment of the level of reputation risk.

The Group monitors and records image-related events on an ongoing basis, and measures the reputation risk yearly. Information on reputation risk is submitted to the Banking Risk Division units.

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 nominal value,
  - reserve capital – established in accordance with the Bank's Statutes from write-offs of net profits and premiums on the issue of shares, assigned to absorb balance sheet losses that may arise within the Bank's activities; decisions concerning utilisation of the reserve capital are taken by the General Shareholders' Meeting,
  - other reserve capital – to be utilised for the purposes defined in the Statutes, created from write-offs of net profits in the amount defined by the General Shareholders' Meeting,
- general banking risk fund – created in accordance with the Banking Law from the net profit,
- retained earnings,
- net financial result prior to approval and net result for the current reporting period – calculated based on applicable accounting standards, decreased by any expected charges and dividends, in amounts not exceeding amounts audited by a certified public accountant.

In addition, the basic funds are reduced by the following items:
- intangible assets valued at their carrying amount,
- equity exposures[5] 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 exposure in items classified as own funds or capital of those entities, including

[5] Exposures in financial institutions meeting the requirements set forth in § 5.1 of Resolution No. 381/2008 of the Polish Financial Supervision Authority dated 17 December 2008 concerning other decreases to basic funds, their amount, scope and terms and conditions of decreasing the bank's basic funds by those amounts, other bank's balance sheet items included in supplementary funds, their amount, scope and terms and conditions of including them in the bank's supplementary funds, decreases to supplementary funds, their amount, scope and terms and conditions of decreasing the bank's basic funds by those amounts as well as the scope and manner of accounting for banks' activities in holdings in calculation of own funds (Official Journal of PFSA of 2008, No. 8, item 35).

additional contributions in favour of a limited liability company,

in the amount of 50% of carrying amounts of such exposures,

- 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 meet in accordance with the contract the following criteria:
  - the funds have been accepted for a 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[5] 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 basic funds.

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

- goodwill of the 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 2008 – for the second half-year of 2008 – due to the inclusion in own funds of profit disclosed in the Bank’s financial statements for the first half-year of 2008, subject to audit by a certified public accountant,
- in 2009 – for 2009.

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

Table 3.1

	Group		Bank	
	2009	2008	2009	2008
OWN FUNDS	17 865	12 885	16 938	12 389
Basic funds (Tier 1)	16 254	11 266	15 756	11 004
core funds	16 805	9 799	16 574	9 612
general risk fund	1 070	1 070	1 070	1 070
retained profit/loss	249	53	0	0
profit/loss for the current period	0	1 825	0	1 825
intangible assets	-1 573	-1 353	-1 269	-1 155
capital exposures	-142	-73	-568	-306
unrealised losses on instruments available for sale	-53	-43	-53	-42
currency translation differences	-109	-57	0	0
minority interest	7	46	0	0
Supplementary funds (Tier 2)	1 481	1 529	1 053	1 294
subordinated liabilities	1 601	1 601	1 601	1 601
unrealised profits on instruments available for sale	23	1	19	0
capital exposures	-142	-73	-568	-306
Short-term equity (Tier 3)	130	91	130	91

In 2009, the amount of the Group’s own funds increased by approx. PLN 4.9 billion, which was mainly due to their replenishment with PLN 5.1 billion on account of an issue of the Bank's shares, with a parallel growth of the capital exposures reducing the Group's own funds by approx. PLN 138 million. Own funds do not include the net profit for 2009.

On 30 June 2009, the General Shareholders’ Meeting of the Bank resolved on payment of 34.71% of the net profit for 2008 (i.e. PLN 1 billion) as 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 Shareholders’ Meeting 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.

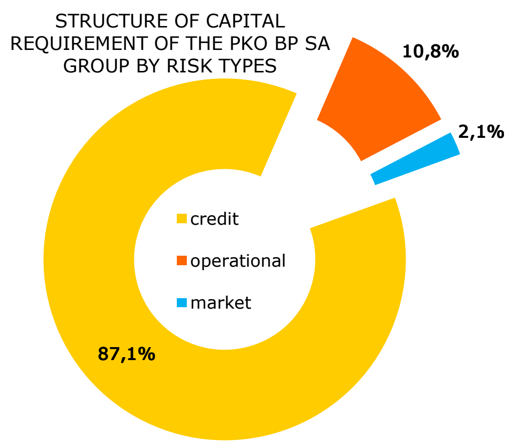
Table 4.1

	Group		Bank	
	2009	2008	2009	2008
Total capital requirement	9 749	9 127	9 491	8 822
Credit risk	8 488	7 676	8 303	7 463
credit risk (banking book)	8 414	7 515	8 229	7 301
counterparty risk (trading book)	74	162	74	162
Market risk	204	203	230	203
foreign currency	0	0	0	0
commodities risk	0	0	0	0
equity securities risk	2	1	2	1
specific risk of debt instruments	168	168	192	168
general interest rate risk	34	34	35	34
Operational risk	1 057	1 248	957	1 156
Other types of risk*	0	0	0	0

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

As at 31 December 2009, the biggest part of the Group's total capital requirement was the requirement on account of credit risk (approx. 87%) – chart 4.1.

Chart 4.1



As at 31 December 2009:
- the capital requirement for credit risk and counterparty credit risk was calculated under the standardised approach (Appendices No. 4 and No. 16 to Resolution No. 380/2008 of PFSA),
- the capital requirement for market risk was calculated under the basic methods (Appendices No. 6 to 10 to Resolution No. 380/2008 of PFSA),
- the capital requirement for operational risk was calculated under the standardised approach (Appendix No. 14 to Resolution No. 380/2008 of PFSA),
- the capital requirement for:
  - the settlement risk and delivery risk – was calculated under the method defined in Appendix No. 11 to Resolution No. 380/2008 of PFSA,
  - 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. 380/2008 of PFSA,
  - the risk of exceeding the capital concentration threshold – was calculated under the method defined in Appendix No. 13 to Resolution No. 380/2008 of PFSA.

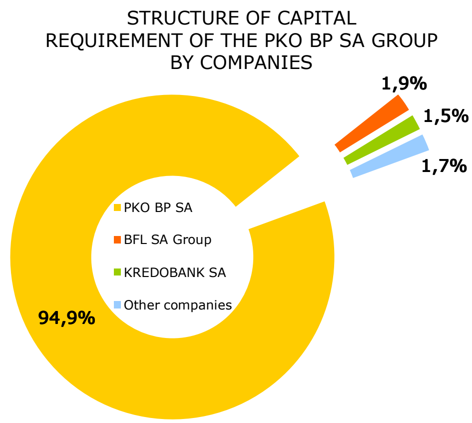
The scale of trading activities of the Bank and the Group is considerable and hence the total capital requirement for market risk is the total of capital requirements for the following risks:
- FX risk,
- commodities risk,
- equity securities risk,
- specific risk of debt instruments,
- general interest rate risk.

The 2009 significant increase in the credit portfolio of the Group (by 15%) contributed to the increased capital requirement for credit risk.

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 2008 and 2009 due to the fact that such events did not occur.

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

Chart 4.2



A considerable proportion of the capital requirement of both the Group (Table 4.2) and the Bank (Table 4.3) results from exposure in the banking book especially within the requirement established for balance sheet exposures (over 80%).

Table 4.2

	The PKO BP SA Group		
	2009		
	Book		
	banking	trading	Total
Capital requirement*	8 414	245	8 658
Balance sheet exposures	7 647	94	7 741
Off-balance sheet liabilities	724	76	800
Derivatives	43	74	117

* 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		
	2009		
	Book		
	banking	trading	Total
Capital requirement*	8 229	269	8 498
Balance sheet exposures	7 452	114	7 566
Off-balance sheet liabilities	734	81	815
Derivatives	43	74	117

* 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 2009 was calculated under the standardised approach in accordance with Appendices No. 4 and 16 to Resolution No. 380/2008 of PFSA. The value of that capital requirement of the Group by exposure classes is shown in Table 4.4.

Table 4.4

STRUCTURE OF CAPITAL REQUIREMENT FOR CREDIT RISK

The PKO BP SA Group

2009

TOTAL	8 488
Retail	4 002
Corporate	2 756
Central governments and central banks	13
Secured on real estate property	969
Other exposures	317
Institutions (banks)	142
Regional governments and local authorities	51
Past due	228
Administrative bodies and non-commercial undertakings	0
Other classes*	10

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

In 2009, the capital requirement of the Group for credit risk (the counterparty credit risk included) increased by PLN 812 million compared to 2008, which was mainly due to the Bank's increased crediting action.

The Group 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 1.03 billion as at the end of 2009 (Tables 4.5 and 4.6).

Table 4.5

EXPOSURES COLLATERALISED WITH GUARANTEES

The PKO BP SA Group

2009

TOTAL	634
Retail	208
Corporate	381
Central governments and central banks	8
Secured on real estate property	0
Other exposures	20
Institutions (banks)	0
Regional governments and local	6
Past due	11
Administrative bodies and non-commercial undertakings	0
Other classes*	0

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

As part of the credit risk mitigation techniques, the Bank, in accordance with Basel II, uses guarantees (93% of the guarantees accepted by the Bank are guarantees issued by the State Treasury of Poland) and financial collateral as funded credit protection (mainly registered pledges on securities, irrevocably blocked funds on a bank account or a deposit account at the Bank or payment of cash to the account of the Bank). The Bank applies the Financial Collateral Comprehensive Method, which makes use of collateral haircuts. Apart from financial collateral and guarantees, the Bank uses mortgages to classify its exposures as belonging to the class of exposures secured on real properties. The value of the portfolio of those exposures was PLN 16.7 billion as at the end of 2009.

In 2009 and in the previous years, the Bank did not conclude any securitisation transaction within the meaning of the Banking Law and supervisory regulations.

In 2009, the Bank (the controlling entity) effected three transactions of sale of balance sheet and off-balance sheet receivables, classified as lost (all transactions were taken to the securitization fund). The sale covered 59 thousand items of retail receivables with the total value of PLN 627.8 million and 2.9 thousand items of business receivables with the total value of PLN 885.3 million.

Table 4.6

EXPOSURES COLLATERALISED WITH RECOGNISED FINANCIAL COLLATERAL*
The PKO BP SA Group
2009

TOTAL	396
Retail	163
Corporate	200
Central governments and central banks	8
Secured on real estate property	3
Other exposures	0
Institutions (banks)	0
Regional governments and local	0
Past due	22
Administrative bodies and non-commercial undertakings	0
Other classes**	0

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

The tables below show the value of exposures (before and after the application of the credit risk mitigation techniques) by exposure classes and the counterparty credit quality steps as at 31 December 2009. Approximately 82% 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 step are mainly: securities of and receivables to the State Treasury of Poland and the National Bank of Poland as well as transactions with other banks.

Table 4.7

VALUE OF EXPOSURES* BEFORE APPLICATION OF THE CREDIT RISK MITTIGATION TECHNIQUES
The PKO BP SA Group
2009

	PKO BP SA, KREDOBANK SA and BFL SA Group							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	67 052	0	0	67 052
Corporate	0	0	0	0	0	0	36 374	129	-1 514	34 990
Central governments and central banks	0	22 719	0	158	0	0	468	200	-1	23 544
Secured on real estate property	0	0	0	0	0	0	16 691	0	-9	16 682
Other exposures	0	0	0	0	0	0	10 079	1 201	-956	10 324
Institutions (banks)	2 390	1 917	700	41	4	376	479	256	-639	5 522
Regional governments and local authorities	0	185	122	0	0	0	2 864	0	0	3 171
Past due	0	0	71	529	0	0	1 906	0	0	2 506
Administrative bodies and non-commercial undertakings	0	0	0	0	0	0	1 773	0	0	1 773
Other classes**	0	0	0	0	0	0	255	22	-189	88
Total	2 390	24 821	892	728	4	376	137 941	1 809	-3 309	165 651

* The value of balance sheet exposures and balance sheet equivalent of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques.
** Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.

Table 4.8

VALUE OF EXPOSURES* AFTER APPLICATION OF THE CREDIT RISK MITTIGATION TECHNIQUES
The PKO BP SA Group
2009

	PKO BP SA, KREDOBANK SA and BFL SA Group							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	66 705	0	0	66 705
Corporate	0	0	0	0	0	0	35 833	129	-1 514	34 448
Central governments and central banks	0	22 719	0	158	0	0	1 040	200	-1	24 116
Secured on real estate property	0	0	0	0	0	0	16 690	0	-9	16 680
Other exposures	0	0	0	0	0	0	10 059	1 201	-956	10 305
Institutions (banks)	2 390	1 917	700	41	4	376	479	256	-639	5 522
Regional governments and local authorities	0	185	122	0	0	0	2 886	0	0	3 193
Past due	0	0	71	529	0	0	1 874	0	0	2 474
Administrative bodies and non-commercial undertakings	0	0	0	0	0	0	1 773			1 773
Other classes**	0	0	0	0	0	0	255	22	-189	88
Total	2 390	24 821	892	728	4	376	137 593	1 809	-3 309	165 303

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

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

In 2009, the transactions that had the greatest influence on the amount of the Group's capital requirement for derivatives were the IRS and CIRS transactions as well as options (Table 4.9).

Table 4.9

CAPITAL REQUIREMENT FOR DERIVATIVES*
2009
The PKO BP SA Group

	Book		
	banking	trading	Total
Derivatives	43	74	117
IRS	6	50	57
CIRS	34	2	36
Options	0	16	16
Forward	0	4	4
SWAP	3	0	3
Reverse Repo	0	2	2

* Credit risk and counterparty credit risk.

In 2009, within the calculation of capital requirement for derivatives, no netting of the balance sheet and off-balance sheet items was used.

Within the calculation of its capital requirements, the Bank utilizes the credit assesments assigned by the following external credit assessment institutions (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. 380/2008 of PFSA of 17 December 2008 and Resolution No. 387/2008 of PFSA of 17 December 2008[6].

4.2. 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. 380/2008 of PFSA. To calculate the capital requirement for FX risk, equity securities risk and specific risk of debt instruments, the Bank uses basic methods. To calculate the capital requirement for general interest rate risk, the Bank uses the duration method.

There was no significant change in the total capital requirement for market risk in 2009. The largest share in the value of capital requirement for market risk falls to the specific risk of debt instruments (approx. 82%), which results from the corporate and municipal debt securities held in the Bank's trading book and from underwriting by the Bank 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 change in the amount of the capital requirement for market risk in the consolidated statements for 2009 resulted from the scale of exclusions of the mutual transactions in the capital requirement calculations.

The capital requirement for all other types of market risk is approx. PLN 2 million. The capital requirement for FX risk is zero due to the fact that the total

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

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.

4.3. OPERATIONAL RISK

PKO BP SA has a decisive influence on the operational risk profile of the Group. Other subsidiaries of the Group, due to considerably lower scale of their business activity, 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 in accordance with the Appendix No. 14 of Resolution No. 380/2008 of PFSA.

The value of the Group's capital requirement for operational risk was PLN 1.06 billion (including PLN 957 million of the capital requirement for the Bank's operational risk).

In 2009, the Bank continued works within implementation of the advanced operational risk measurement methods.

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 business activity and the effect of changes in the business environment, the anticipated risk level taken into account.

The internal capital of the PKO BP SA Group is calculated to cover each significant risk type:

- credit risk, including default and concentration risk,
- FX risk,
- interest rate risk,
- liquidity risk,
- operational risk,
- business risk (including strategic risk).

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

The total internal capital of the Group is the sum of internal capital required to cover all significant risk types that occur in the companies of the Group (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 measures 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 measures, it is assumed that internal capital for credit risk equals capital requirement for credit risk, calculated under the standardised approach.

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

- the multipliers of the internal capital surcharge for each material risk concentration type and
- the internal capital to cover the credit risk of insolvency.

The value of exposure to a counterparty being a financial institution is determined on the basis of the market value of balance sheet transactions (deposits and bonds) and of the balance sheet equivalent understood as the sum of the cost of replacement and the future potential credit exposure, for off-balance sheet transactions, less the recovery rate. The value of the recovery rate and probability of default for exposures to financial institutions is calculated from data of the Moody's rating agency.

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

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

The internal capital to cover the Bank's operational risk is assumed to be equal to the capital requirement for operational risk, determined under the basic indicator approach for 2008 and under the standard approach for 2009. The internal capital to cover the operational risk of the Group's subsidiaries is assumed as follows:

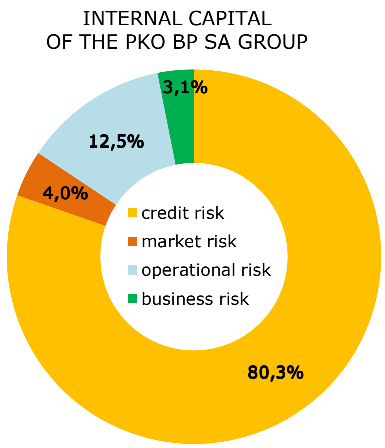
- for the Group's financial companies - as the additional capital requirement for operational risk, calculated under the basic indicator approach,
- for non-financial companies – as equal to the maximum amount of the annual operational losses for the last 3 years.

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 Management Board of the Bank. To assess internal capital based on statistical models, the time horizon of one year and 99.9% confidence level is applied.

The chart below presents the structure of internal capital by risk type, as assessed as at 31 December 2009 for the Group.

Chart 5.1



Allocation of the total internal capital is made by business lines and by the companies of the Bank's Group.

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

6. CAPITAL ADEQUACY

Capital adequacy is the condition under which the amount of 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 an ongoing basis, the level of capital that is adequate to the scale and risk profile of business activity of the Group.

The process of capital adequacy management at the Bank comprises:

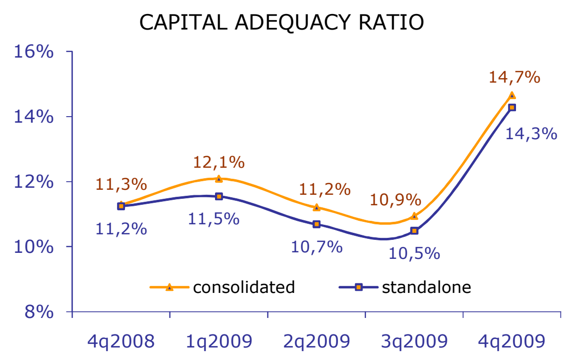
- identifying and monitoring significant types of risk,
- assessing the amount of internal capital for individual significant types of risk and of total internal capital,
- monitoring, reporting, forecasting and limiting of capital adequacy,
- allocating internal capital to business areas, client segments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

The main measures of capital adequacy are as follows:

- 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



In 2009, the Bank's and the Group's capital adequacy ratio remained at a safe level above both the statutory and internal limits.

As at the end of 2009, compared to the end of 2008, the Group's capital adequacy ratio increased by 3.4 percentage points, which was mainly due to the increase in the Bank's equity on account of the issue of stocks by PLN 5.1 billion, together with a parallel growth of the capital requirement for credit risk, resulting mainly from the high dynamics of the credit portfolio of the Bank's Group.

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 extended and deposits accepted within the bank's business 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 No. 1-6/2007 of CFBS 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 CFBS)

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

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

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

Capital requirement – the minimum amount of capital that the bank is obliged, pursuant to Article 128 of the Banking Law and Resolution No. 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 of Basel II Accord)

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 operating on the Bank's behalf to observe legal provisions, internal regulations and the standards of procedure adopted by the Bank, the ethical standards included

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

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

Coverage ratio – the ratio of the revaluation write-offs on account of impairment on credits and loans to the value of credits and loans assessed under the individualised and portfolio methods

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

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

Credit Value-at-Risk, CVaR – a potential loss, not to be exceeded, on the credit risk of a maintained credit 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 collateral 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

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 forward financial transactions

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

FX Swap – a foreign currency exchange swap

GMRA (Global Master Repurchase Agreement) – a framework agreement used within the REPO and BSB/SBB transactions

IAS – the International Accounting Standards

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

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

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

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

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

ISDA – the International Swap and Derivatives Association

ISMA – the International Securities Market Association

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

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

LMA – the Loan Market Association

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

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

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

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

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

PBA – the Polish Bank Association

PCBA – the Polish Classification of Business activity

PFSA – the Polish Financial Supervision Authority

Pillar I – a part of the Basel II requirements containing 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 and risk mitigation processes

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

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

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

Strategic risk – the negative financial consequences of mistaken decisions, decisions made based on improper assessment, or an absence of proper decisions pertaining to the direction of the Group's strategic development

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

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

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

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