Capital Adequacy and Other Information Subject to Disclosure

(Pillar III)

The Group of PKO Bank Polski SA

as at 31 December 2012

Introduction

The Report "Capital Adequacy and Other Information Subject to Disclosure (Pillar III)" (the "Report") of the Group of Powszechna Kasa Oszczędności Bank Polski S.A. (the "Bank Group" or the "Group") as at 31 December 2012 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 rules of publication by banks of qualitative and quantitative information relating to capital adequacy and the scope of required disclosure as amended[2]).

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

This Report was prepared in accordance with the principles of information policy of PKO Bank Polski SA regarding capital adequacy[3], as adopted by the Bank, which contain detailed information on the scope of disclosures concerning capital adequacy, rules of their verification and publication.

The Report covers year 2012 and present data as of 31 December 2012. Unless otherwise stated, the Report includes consolidated data of the PKO Bank Polski SA Group. Since the risk profile of the Group is predominantly affected by PKO Bank Polski SA (91.9%[4] of the Group's consolidated balance sheet total and 94.5%[5] of its consolidated profit/loss on banking activities), some of the information contained in the Report pertains specifically to individual data of PKO Bank Polski SA. Unless otherwise stated, the figures presented in the Report have been expressed in PLN million. Any differences in the totals and proportions result from the rounding to PLN million and to one decimal place respectively.

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

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[1] Journal of Laws 2002, No. 72, item 665 as amended

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

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

[4] The share of companies in the consolidated balance sheet total was calculated in relation to the consolidated balance sheet total before consolidation adjustments and exclusions for the year ended 31 December 2012.

[5] The share of companies in the consolidated profit/loss on banking activities was calculated in relation to the consolidated profit/loss on banking activities of the Bank Group before consolidation adjustments and exclusions for the year ended 31 December 2012.

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1. INFORMATION ON THE BANK AND THE GROUP

The controlling entity of the Group is PKO Bank Polski SA, whose share in the consolidated balance sheet total amounts to 91.9%[4], and in the consolidated profit/loss on banking activities – 94.5%[5].

Besides PKO Bank Polski SA, the Group includes also other companies described below, but the Group of Bankowy Fundusz Leasingowy SA ("BFL SA Group")[6] and Group of KREDOBANK SA were described in more detail due to their participation in the consolidated balance sum totals and consolidated result of the Group's banking activities.

The Group pursues activity mainly in the territory of the Republic of Poland and through its subsidiaries KREDOBANK SA, "Inter-Risk Ukraina" Additional Liability Company, Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. and Finansowa Kompania "Idea Kapitał" Sp. z o.o. and until 14 November 2012 through UKRPOLINWESTYCJE Sp. z o.o. acing in the territory of Ukraine and also through subsidiary PKO Finance AB in the territory of Sweden.

The BFL SA Group – Bankowy Fundusz Leasingowy SA– together with its subsidiary – operates in the leasing area in the territory of the Republic of Poland. The share of BFL SA Group in the consolidated balance sheet total is 1.9%[4], and in the consolidated profit/loss on banking activities – 1.0%[5].

KREDOBANK SA pursues banking operations in the territory of Ukraine and is subject to Ukrainian banking supervision. In March 2012 it become the sole shareholder of Finansowa Kompania "Idea Kapitał" Sp. z o.o. (which subject of business includes rendering of financial services) and established the Capital group. The share of KREDOBANK SA Group in the consolidated balance sheet total is 0.8%[4], and in the consolidated profit/loss on banking activities – 1.0%[5].

Other subsidiaries of the Group covered by the consolidation include:

1) PKO BP BANKOWY PTE SA (management of a pension fund),
2) Centrum Finansowe Puławska Sp. z o.o. until liquidation – the Company was deleted from the National Court Register with effect on 28 May 2012; liquidation assets were taken over by PKO Bank Polski SA,
3) Qualia Development Sp. z o.o., (property development activity) – together with its subsidiaries,
4) PKO Towarzystwo Funduszy Inwestycyjnych SA (investment funds' management),
5) Inteligo Financial Services SA (Internet banking services),
6) Centrum Elektronicznych Usług Płatniczych eService SA (handling and settlement of transactions made with the use of cards),
7) Capital Group of Bankowe Towarzystwo Kapitałowe SA (Bankowe Towarzystwo Kapitałowe SA – service activities, PKO BP Faktoring SA – factoring activities),
8) Fort Mokotów Inwestycje Sp. z o.o. (property development activity),
9) PKO Finance AB (generating funds for PKO Bank Polski SA from the issue of bonds).
10) PKO BP Finat Sp. z o.o. (financial intermediation, including transfer agent services),
11) Capital group of "Inter-Risk Ukraina" Additional Liability Company ("Inter-Risk Ukraina" Sp. z d.o. – debt collection activities, Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. – factoring activities.

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 Bank Group for the year ended 31 December 2012, published 4 March 2013.

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

1) Bank Pocztowy SA and Poznański Fundusz Poręczeń Kredytowych Sp. z o.o. (associated entities valued under the equity method i.e. not subject to consolidation under the full method) which amounted to the total of PLN 106.7 million as at 31 December 2012,
2) "2020 European Fund For Energy, Climate Change and Infrastructure" (investment securities available for sale and valued at fair value) which amounted to PLN 89.5 million as at 31 December 2012.

At the individual level, own funds of the Bank are reduced by the Bank's capital exposure directly in KREDOBANK SA, PKO BP BANKOWY PTE SA, PKO Towarzystwo Funduszy Inwestycyjnych SA (PKO TFI SA), Bankowy Fundusz Leasingowy SA, PKO Finance AB, "2020 European Fund For Energy, Climate Change and Infrastructure", Bank Pocztowy SA, Poznański Fundusz Poręczeń Kredytowych Sp. z o.o., directly and through a non-financial entity in Finansowa Kompania „Prywatne Inwestycje" Sp. z o.o. and PKO BP Faktoring SA amounting to the total of PLN 1,161.0 million as at 31 December 2012. The revaluation write-off of the Bank's credit exposure in KREDOBANK SA amounted to PLN 573.7 million as at 31 December 2012.

Within the Bank Group, there are limitations on the transfer of funds (dividends) to the investor between KREDOBANK SA and the Bank. In accordance with the resolution of the Extraordinary General Shareholders' Meeting of KREDOBANK SA commenced 29 January 2009 and continued 23 February 2009, a moratorium was introduced with respect to dividend payments. The moratorium is valid until revoked under an appropriate resolution. In 2012 the moratorium on dividend payment remained in force.

[6] Since March 2013 – PKO Leasing SA Group (the change of name of this Company was registered in the National Court Register on 27 March 2013).

2. RISK MANAGEMENT

Banking activity is exposed to many types of risk, including such as credit, interest rate, foreign exchange, liquidity, risk of equity securities prices, commodity prices, operational, compliance, business, reputation, models, macroeconomic changes and derivatives (due to the specific nature of those instruments it is subject to special control) risks. Controlling the effect of those types of risk on the functioning of the Bank 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.

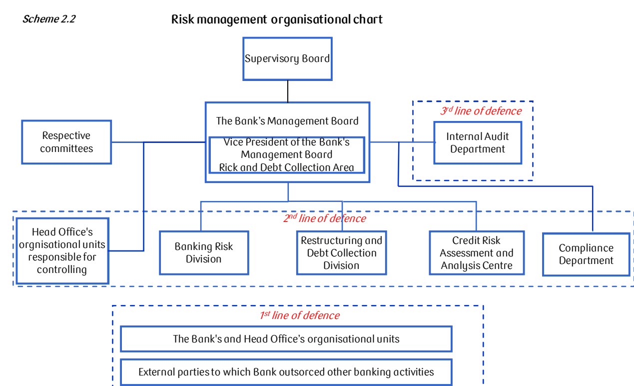
Risk management at the Bank is based in particular on the following principles:
1) the Group manages all defined types of banking risk,
2) the risk management process corresponds to the volume of activities and to significance, volume and complexity of the risk concerned and it is adjusted to new risk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

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

Scheme 2.1

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

Scheme 2.2 **Risk management organisational chart**



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

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

The risk management process is executed in three independent lines of defense:
1) first line of defense – internal functional control to ensure that the risk control mechanisms are used and actions comply with binding legal provisions; the function is performed in particular by the Bank's units, the Head Office units and entities of the Group and includes such aspects of activities those units and entities that may generate risk. The Group's units and entities are responsible for

identification of risks, designing and implementing respective audit mechanism, if audit mechanisms have not been implemented within the scope of activities undertaken in the second line of defense. At the same time the Group's entities are obliged to comply with the principles of coherence and comparability of risk assessment and control in the Bank and Group subsidiaries, taking account of the specific nature of the company's business and market at which it operates,
2) second line of defense – the risk management system, including the risk management methods, tools, process and organisation; this function is performed in particular by the Risk and Debt Collection Area, the Bank's specialist units responsible for credit analyses, the Head Office unit managing compliance risk and the Head Office units responsible for controlling,
3) third line of defense – internal audit; the function performed within the scope of internal audit, including audit on the efficiency of the risk management system related to the Bank's operations.

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

The Bank's Head Office units that are responsible for risk management within the scope of their respective competencies were grouped in 2012 in the Bank Risk Division, Restructuring and Debt Collection Division and the Credit Risk Assessment and Analysis Centre.

Due to the need to ensure appropriate independence of structures responsible for validation of models, in the 1st quarter of 2013 it was decided on separation on the tasks within this area and their inclusion to a new organisational unit, that is Model Validation Office that reports directly to the Vice President responsible for the Risk Management Area.

The purpose of the Banking Risk Division is to prepare and implement systemic solutions for managing risks that have been defined as significant, such as credit, operational, interest rate, foreign exchange, liquidity and business risk as well as capital adequacy. The most important tasks of the Division consist in:
1) identification of risk factors and sources,
2) risk measurement and assessment and cyclical monitoring and reporting of the risk level (significant risks),
3) measurement and assessment of capital adequacy,
4) preparing recommendations for the Management Board or committees as to the acceptable risk level,
5) developing internal regulations relating to risk and capital adequacy management,
6) developing IT systems to support risk and capital adequacy management.

The purpose of the units function within the Restructuring and Debt Collection Division is:
1) effective and efficient collection of bad debts through their restructuring, debt collection and higher efficiency of such activities,
2) efficient interventions within the scope of early monitoring of delays in payment of receivables by retail market clients,
3) effective outsourcing of realised tasks and effective management of the assets taken over as a result of Bank's debt collection,
4) effective sales of bad debts.

The purpose of the Credit Risk Assessment and Analysis Centre is to mitigate credit risk of individual credit exposures of the Bank's retail and corporate market clients and ensuring effective credit analyses in respect to mortgage credits granted to individual clients through the Bank's retail network and credits granted to rated SME clients, as well as taking respective credit decisions.

Risk management is supported by the following committees:
1) Risk Committee ('the RC'),
2) Assets & Liabilities Committee ('the ALCO'),
3) Bank's Credit Committee ('the BCC'),
4) Central Credit Committee ('the CCC'),
5) Operating Risk Committee ('the ORC'),
6) credit committees which operate in the regional retail and corporate branch offices.

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

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

BCC takes credit decisions in respect of individual significant credit exposures of considerable value or issues recommendations in this respect to the Management Board of the Bank.

CCC supports with its recommendations decision-taking by relevant directors of the Division and members of the Management Board, 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

ORC supports the Bank in operational risk management through decision taking, issuing recommendations and opinions, for instance strategic tolerance limits and operational risk limits, key risk indicators (KRI), assumptions of stress tests, results of validation of operation risk measurement models and changes in AMA approach.

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

Internal regulations on management of individual types of risk in the subsidiaries of the Bank Group are defined by internal regulations implemented by such companies upon

consultation with the Bank and taking account of recommendations prepared by the Bank. Subsidiaries' internal regulations on risk management are implemented on the basis of the principle coherence and comparability of assessment of individual types of risk in the Bank and Group subsidiaries, taking account of the specific nature of the company's business and market at which it operates.

The priority of the Bank Group in 2012 was to keep its strong capital position and increase its financing sources that ensure the basis for stable development of business activities, having maintained at the same time the priorities related to efficient activities and efficient cost control.

As a consequence, in 2012, the Bank:
1) continued its conservative credit policy,
2) maintained a high level of deposits,
3) renewed a part of consortium credit payable in July 2012 in the amount of CHF 410 million (payable in June 2015) and issued bonds in the amount of: EUR 50 million in EMTN programme with 10-years' maturity date, CHF 500 million in EMTN programme with ca. 3-years' maturity date, and USD 1 billion at the US market with 20-years' maturity date,
4) executed a call option in the 3rd quarter of 2012 and on 30 October 2012 it redeemed subordinate bonds in the amount of PLN 1.6 billion, that were issued in 2007. Those funds were replaced in the supplementary funds by resources from subordinate bonds issued on 14 September 2012,
5) a part of the Bank's profit for 2011 was allocated to equity and the Bank paid dividend from net profit for 2011 at the level of 40.15%,
6) as of 31 December 2012 it calculated the capital requirement for operational risk fully in compliance with the AMA approach, after the Polish Financial Supervision Authority confirmed that the Bank had met all requirements resulting from the PFSA's decision of June 2011 in respect to application of the AMA approach,
7) it completed the accomplishment of the "Leader" Strategy for years 2010-2012 that contributed to strengthening of the Bank's leading position at the bank market in Poland,
8) included in its banking risk measurement methods the financial crisis conditions (e.g. in respect to risk parameters and the stress test scenarios).

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

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

In 2012 KREDOBANK SA conducted works related to optimization and improvement of the lending process through improvement of the management information system (MIS), optimisation of the credit process for individuals, small and medium-size enterprises (SME) and corporate clients. Moreover, the Bank amended internal regulations concerning basic principles of organization of the credit process and regulations related to the credit process for individual clients and legal entities.

In 2012 the BFL SA Group focused mainly on creation of safe leasing portfolio that guarantees positive consolidated results of the BFL SA Group, capital security and reduction of the share of bad debts in the portfolio. Moreover, internal procedures concerning market risk management were amended.

The General Meeting of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna in its resolutions no 7/2012 and 8/2012 dated 6 June 2012 decided that the dividend for 2011 would amount to PLN 1,587,500 thousand, that is 1.27 per share (details are presented in the consolidated financial statement of the Group of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna for year ended 31 December 2012 on page 47 in section 14 entitled "Paid Dividends (the Total Amount or Per One Share) as Divided into Ordinary and Other Shares").

2.1. IDENTIFYING SIGNIFICANT TYPES OF RISKS

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

The following type of risks was deemed to be significant in the Bank:
1) credit risk,
2) foreign exchange risk,
3) interest rate risk,
4) liquidity risk,
5) operational risk,
6) business risk.

In the 1st quarter of 2013 the Bank extended its significant risk catalogue by adding the following risks:
1) macroeconomic risk,
2) model risk,
3) compliance risk.

The assessment of significance of individual types of risks is determined on the level of the Bank and individual subsidiaries in compliance with the Bank's internal regulations. While determining the criteria of considering particular risk to be important, an impact of such risk on the Bank's, the Bank Group companies' and the whole Bank Group's activities is taken into account, and there are three types of risk:
1) risks that are deemed significant in advance – that are subject to active management,
2) potentially significant risks – in this case a monitoring of significance is performed,
3) other undefined risks or kinds of risks that do not exist in the Bank or in the Group (insignificant or unmonitored).

As of 31 December 2012 significant banking risk level was identified in PKO Bank Polski SA and the BFL SA Group, in KREDOBANK SA Group, the BTK SA Group and the Group of "Inter-Risk Ukraina" Sp. z d.o. Moreover, operational risk and business risk were considered essential in all companies of the Bank Group.

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

2.2. CREDIT RISK

2.2.1. INTRODUCTION

Credit risk is understood as the risk of incurring losses as a result of client's default 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 client'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 companies of the Group apply the following credit risk management principles:
1) a credit transaction requires a comprehensive credit risk assessment, expressed in the internal rating or scoring,
2) credit risk 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,
3) the credit risk assessment of exposures significant for reasons of their risk level or value is additionally verified by credit risk assessment units, irrespective of business units,
4) the terms and conditions of credit transactions offered to clients depend on the assessment of credit risk level generated by the transaction concerned,
5) credit decisions may be taken only by authorised persons,
6) credit risk is diversified by geographical areas, industries, products and clients,
7) the expected level of credit risk is secured by legal collateral accepted by the Bank, credit spreads charged to clients as well as by provisions for impairment of credit exposures.

2.2.1.1. Credit risk of financial institutions

PKO Bank Polski SA cooperates on the wholesale market with financial institutions having their registered offices in the territory of more than 40 countries. Within the limits set, the Bank may enter into transactions with over 280 counterparties, including Polish and foreign banks, insurance companies, pension funds, investment funds companies 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 (foreign banks, credit institutions) and the PBA (domestic banks) standards. The exposure to financial institutions on the wholesale market is of high quality and low credit risk generated, as confirmed by external ratings granted by rating agencies and also by internal ratings granted to the counterparties by the Bank.

2.2.1.2. Derivatives risk

The derivatives risk is the risk of loss in result of the Bank's position in financial instruments that fulfil all the following conditions:
1) the value of an instrument changes together with a change of underlying instrument,
2) they do not require no net initial investments or they require only minor net initial investments, as compared to other types of agreements that respond to changes of market conditions in a similar way,
3) their settlements will take place in the future.

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

Within the scope of its activities the Bank uses various types of financial derivatives for the purposes of management of the risks related to the activities performed. The Bank enters into derivative transactions mainly with other banks.

The majority of derivatives used by the Group for the purpose of risk management and offered to clients are: IRS, FRA, FX Swap, CIRS, FX Forward, options (table 2.1).

Table 2.1
FINANCIAL DERIVATIVES*

	The Bank Capital Group			
	2012			
	Nominal value		Fair value	
	Purchase	Sale	Negative	Positive
Currency transactions (over-the-counter market)	46 231	46 229	700	564
FX Swap	7 835	7 959	208	110
FX Forward	2 714	2 751	61	33
Options	4 373	4 144	62	63
Cross Currency IRS	31 310	31 375	370	358
Interest rate transactions	209 308	209 183	3 262	3 296
Interest Rate Swap (IRS)	168 133	168 133	3 184	3 222
Forward Rate Agreement (FRA)	41 175	41 050	79	75
Credit derivatives	0	0	0	0
Other (including stock market index derivatives)	1 030	214	1	0
Total derivatives	256 570	255 627	3 964	3 861

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

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

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

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

In the Bank there are embedded derivatives. An embedded derivative is an element of hybrid (combined) instrument that contains also the principal agreement that is not a derivative (of both financial and non-financial nature) resulting in the fact

that some cash flows resulting from a combined instrument change in the way similar to cash flows resulting from a separate derivative. An embedded derivative results in the fact that some or all cash flows resulting from the principal agreement are modified on the basis of a specific interest rate, price of a financial instrument, price of goods, foreign exchange rate or another variable, provided that a non-financial variable is not specific for any of the parties of a contract.

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

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

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

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

2.2.2. Credit risk measurement and assessment

2.2.2.1. Credit risk measurement methods

In order to assess the level of credit risk and credit portfolio profitability, the Bank uses various credit risk measurement and assessment methods, including the following:

1) probability of default (PD),
2) expected loss (EL),
3) credit value at risk (CVaR),
4) accuracy ratio,
5) share and structure of loans with recognized impairment (according to IAS),
6) coverage ratio of credits with impairment recognized with write offs,
7) risk cost.

PKO Bank Polski SA systematically extends the scope of its credit risk measures, taking into account the requirements of the IRB approach, as well as the scope of application of risk measures so as to fully cover the Bank's credit portfolio with those methods. In 2012 the Bank worked out new rating methods for assessment of credit risk of institutional clients having complete or simplified reporting. These methods are implemented at the moment.

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

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

2.2.2.2. Rating and scoring methods

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

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

In May 2012, the behavioural scoring system at the Client level was implemented productively in the Bank, which replaced the behavioural scoring system at the product level functioning in the Bank. The implementation of that assessment will allow more precise management of the total individual Customer exposure through the mechanisms of a Client comprehensive assessment with regard to loan and deposit products held.

In case of corporate customers from the small and medium enterprise segment, that meet certain criteria, the Bank assesses credit risk credit risk using the scoring method. This method is available besides the rating method. Its introduction resulted in a reduction of time of credit application examination and an increase of credit risk management efficiency.

Such assessment is dedicated to low-value, uncomplicated loan transactions and it is performed in two dimensions: customers' borrowing capacity and his creditworthiness. The borrowing capacity assessment involves examination of the customer's economic and financial situation, whereas the creditworthiness assessment involves scoring and evaluation of the customer's credit history obtained from internal records of the Bank and external sources.

In result of a positive assessment of scoring portfolio of an corporate customer, the Bank gradually extends the scope of scoring application to SME clients. On 1 January 2013 the Bank introduced centralisation of credit risk monitoring process related to assessment of SME customers.

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

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

2.2.3. Credit risk monitoring

2.2.3.1. Exposure amount

Table 2.2 shows the balance sheet and off-balance sheet items taken into account in the calculation of capital adequacy of the Bank Group as at 31 December 2011 and 31 December 2012.

Table 2.2

	The Bank Capital Group		
	2012	2011	Average
ASSETS	193 480	190 748	192 114
Net credits and loans*	143 876	141 634	142 755
Securities	25 159	28 172	26 665
Receivables from banks	3 392	2 396	2 894
Financial fixed assets	119	123	121
Other assets**	20 933	18 423	19 678
OFF-BALANCE SHEET LIABILITIES	42 891	36 890	39 890
Financial	32 513	30 456	31 485
Guarantees granted	10 377	6 435	8 406
DERIVATIVES***	512 197	658 284	585 241

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

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

Table 2.3

CREDITS AND LOANS* - STRUCTURE BY PORTFOLIO

The Bank Group

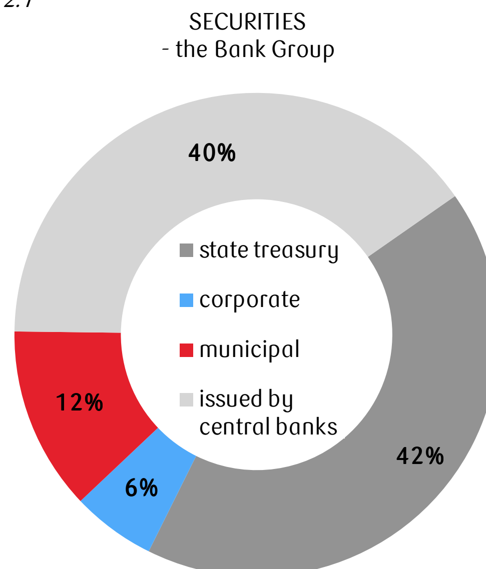
	2012	2011
Net credits and loans	143 876	141 634
consumer loans	20 583	22 873
housing loans	70 564	69 832
commercial loans	50 654	48 929
debt securities	2 074	0

* Including financial lease receivables

A much smaller credit risk level of the Bank Group is related to derivatives, interbank deposits and the Group's holdings of securities (of which 82% are securities issued by the Treasury or the central banks) (chart 2.1.).

Chart 2.1

SECURITIES
- the Bank Group



In 2012, the greatest proportion of the exposure structure of the Group was accounted for by corporate exposures and exposures secured on real property (56.7% in total). The proportions of other exposure classes range between 0.1% and 13.4% (Table 2.4).

Table 2.4

	The Bank Group 2012	
Exposure class*	Total exposure**	Average exposure**
Corporate	61 312	60 576
Secured on real estate property	58 209	55 785
Central governments and central banks	28 274	28 255
Retail	27 072	29 688
Other exposures	13 415	12 074
Institutions (banks)	9 311	8 712
Regional governments and local authorities	7 731	6 230
Past due	4 277	3 855
Administrative bodies and non-commercial undertakings	1 081	791
Other classes***	153	113
Total	210 835	206 079

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

** The value of balance sheet exposures and balance sheet equivalents of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques. The average amount of exposure has been calculated as the arithmetic mean of exposures from individual quarters of 2012

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

A considerable proportion of the Bank Group's exposures with defined maturity date (74%) are exposures with the maturity of over 1 year; for over 51% of exposures with fixed maturity date, such period exceeds 5 years (Table 2.5).

Table 2.5

EXPOSURE STRUCTURE* BY ORIGINAL MATURITY

	The Bank Group 2012								
	PKO Bank Polski SA, KREDOBANK SA Group and BFL SA Group						Other Group companies	Adjustments and exclusions	Total
Exposure class	0 - 1 month	1 - 3 months	3 - 12 months	1 - 5 Years	Over 5 years	Other***			
Corporate	613	306	14 123	24 814	24 637	0	755	-3 935	61 312
Secured on real estate property	4	1	131	1 319	56 763	0	0	-9	58 209
Central governments and central banks	17 872	942	947	6 179	2 226	31	78	0	28 274
Retail	5	89	6 590	9 468	10 920	0	0	0	27 072
Other exposures	3 706	0	0	0	35	8 875	990	-192	13 415
Institutions (banks)	2 741	1 038	1 334	3 403	1 284	656	9 548	-10 693	9 311
Regional governments and local authorities	4	4	151	1 464	6 108	0	0	0	7 731
Past due	68	45	550	1 373	2 078	0	163	0	4 277
Administrative bodies and non-commercial undertakings		0	1 041	11	29	0	0	0	1 081
Other classes**	0	0	0	0	0	512	17	-376	153
Total	25 012	2 426	24 866	48 031	104 080	10 074	11 551	-15 206	210 835

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

** The Group Companies other than the BFL Group and KREDOBANK Group

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

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

2.2.3.2. Impairment of credit exposures

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

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

The method for defining the amount of the write-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:

1) placing receivables on immediate demand,
2) enforcement proceedings in relation to a debtor,
3) announcement of debtor's bankruptcy or filing for announcement of bankruptcy,
4) questioning debtor's receivables,
5) initiation recovery procedure against a debtor,
6) appointment of compulsory administration for debtor's activities or suspension of debtor's activities,
7) deterioration of debtor's rating to a level pointing significant threats to debt repayment,
8) undertaken restructuring activities and granting repayment relief,
9) additional conditions recognized in relation to exposures towards housing cooperatives under "old portfolio" housing credits subject to guarantees granted by the State Treasury.

In determining the period of delay in of credit exposures, the outstanding amounts of interest or principal instalments above defined threshold values are taken into account.

The Bank Group uses three methods for impairment assessment:

1) the individualised method for individually significant loans which meet the condition of individual impairment or referring to debtors in case of which such conditions are met in relation to their other exposures and exposures that are significant individually, that do not meet conditions of individual impairment, in case of which due to the specific nature of a transaction from which they result and events that condition their repayment, determination of a write-off by means of portfolio parameters would be unreasonable,
2) the portfolio method, applied in the case of individually insignificant loans for which the condition of individual impairment has been identified,
3) the collective method (IBNR), used in the case of loans where no conditions of individual impairment have been identified, but there is the possibility of occurrence of incurred but not identified losses.

The write-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:

1) 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,
2) 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 homogeneous portfolios.

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

When defining the provision for off-balance sheet credit exposures of the Bank Group:
1) with respect to individually significant credit exposures or referring debtors whose other exposures meet such conditions and to individually significant credit exposures that do not meet the conditions of individual impairment, if an establishment of the provisions by means of credit parameters is unreasonable – the individualised method is used,
2) 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 2.6. In 2012, the gross value of loans granted by the Group valued under the individualised method increased by ca. PLN 1,539 million, while valued using the portfolio method increased by PLN 843 million.

As of 31 December 2012 the share of credits with recognized impairment amounted to 8.9% (as of 31 December 2011: 8.0%). An increase of the value of credits assessed with the individualised method by 23.5% as of 31 December 2012 resulted mainly from an increase in the value of credits in the area of corporate clients assessed with the individualised method with recognized impairment. The catalogue of impairment conditions applicable in the Bank complies with Recommendation R.

The increase in the value of loans valued under the portfolio method by 13.8% in 2012 resulted mainly from bigger delays in the repayment in the portfolio of small and medium size enterprises.

Table 2.6

CREDITS AND LOANS*

The Bank Group

	2012	2011
Gross credits and loans	150 652	147 293
individualised method	8 088	6 549
portfolio method	6 939	6 096
collective method (IBNR)	135 625	134 648
Write-offs (balance)	-6 776	-5 658
individualised method	-2 708	-2 080
portfolio method	-3 517	-2 910
collective method (IBNR)	-552	-669
Net credits and loans (gross-write-off)	143 876	141 634

* Including financial lease receivables

The result of impairment write-offs is a consequence of the conservative policy of PKO Bank Polski SA in regard of credit risk recognition and assessment and of an increase of the credit base. The growth of the impairment write-offs in 2012 in the amount of PLN 1,118 million in line "Credit and loans" was influenced mainly by a change of write-offs in commercial credits in the amount of PLN 755 million and in housing loans in the amount of PLN 391 million. The result of write-offs increased as a consequence of the deterioration of the credit portfolio quality (table 2.7).

Table 2.7

IMPAIRMENT WRITE-OFFS
The Bank Group

	Balance as at 2012	Balance as at 2011	Change in 2012	Additional write-offs	Release of write-offs	Depreciation charged to write-offs	Other changes, including FX differences	Cost of write-offs input to profit and loss
Credits and loans*	6 776	5 658	1 118	5 871	-3 732	-934	-86	-2 138
consumer loans	1 432	1 464	-32	2 041	-1 472	-612	11	-569
housing loans	1 715	1 324	391	1 204	-744	-28	-41	-460
corporate loans	3 626	2 871	755	2 622	-1 517	-295	-55	-1 106
debt securities	4	0	4	4	0	0	0	-4
Receivables from banks	29	33	-3	1	-1	0	-3	0
Financial instruments	136	110	27	39	-2	-11	0	-38
Other	565	481	83	343	-194	-71	5	-149
Total	7 507	6 282	1 225	6 254	-3 929	-1 015	-84	-2 325

*Including financial lease receivables

The coverage ratio (calculated as the shares of impairment write-offs to awarded credits and loans with recognized impairment) amounted to 50.4% as at 31 December 2012 and to 48.0% as at 31 December 2011 (table 2.8).

Table 2.8

EXPOSURES WITH RECOGNISED IMPAIRMENTS AND TOTAL WRITE-OFFS
The Bank Group

	2012	2011
Exposures with recognised impairment	13 553	11 959
receivables from banks	29	32
credits and loans*	13 446	11 797
debt securities (AFS)	6	18
other financial assets	73	111
Write-offs (balance)**	-6 879	-5 810
receivables from banks	-29	-33
credits and loans*	-6 776	-5 658
debt securities (AFS)	-6	-18
other financial assets	-68	-101

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

Table 2.9

Geographical structure of credits and loans* and revaluation write-offs
The Bank Group
2012

Region	With recognised impairment ** Exposure	Impairment write-offs
Poland (PKO Bank Polski), including:	12 317***	5 590***
mazowiecki****	3 207	1 228
śląsko-opolski	1 259	623
zachodniopomorski	1 123	626
małopolsko-świętokrzyski	1 067	439
łódzki	1 054	454
wielkopolski	951	384
pomorski	679	279
kujawsko-pomorski	638	301
dolnośląski	583	249
podlaski	579	253
lubelsko-podkarpacki	390	147
warmińsko-mazurski	161	84
other*****	117	13
Poland (other companies)	268	110
Ukraine	879	465
Adjustments, exclusions	-19	-1
Total	13 446	6 164

* Including financial lease receivables
** Applies to exposures with identified condition of individual impairment (without IBNR and exposures assessed on individual basis with write-off equal to zero)
*** The totals include IAS income in the amount of PLN 509 million
**** Includes the region of Warsaw and the "Head Office"
***** Unallocated portfolio

Table 2.10

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

The Bank Group
2012

		With recognised impairment**	
	Type of client/branch	Exposure	Impairment write-offs
Institutional clients, of which:		7 729***	2 878***
F	Cosntruction	2 040	710
C	Industrial processing	1 442	652
G	Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household appliances	1 392	602
L	Activities related to real property management	894	236
D	Generation and supply of power, gas, water steam, hot water and air for air-conditioning systems	52	28
O	Public administration and national defence and obligatory social security	3	0
	Other exposures	1 906	649
Banks		0	0
Governments		6	6
Individuals		4 073	2 197
Poland (other Group companies)		268	110
Ukraine		879	465
Adjustment and exclusions		-19	-1
Total		12 937	5 655

* Including financial lease receivables
** Applies to exposures with identified condition of individual impairment (without IBNR)
*** The total includes IAS income in the amount of PLN 509 million

2.2.3.3. Risk concentration

The Group monitors the credit risk concentration in respect of:
1) exposures to individual clients or groups of related clients,
2) exposures to groups of clients or credit portfolios exposed to a single risk factor.

The Group analyses the concentration in relation to:
1) geographical region,
2) currencies,
3) industries,
4) mortgage-backed exposure,
5) largest entities,
6) largest capital groups.

The risk of concentration of exposures to individual clients or groups of related clients is monitored pursuant to Article 71 of the Banking Law. The Law in respect of the exposure concentration limit, where the total amount of individual exposure may not exceed 25% of consolidated own funds.

As at 31 December 2012 and 31 December 2012 concentration limits were not exceeded. As at 31 December 2012 the level of concentration risk of the Bank Group for individual exposures was rather low, the largest exposures to an individual entity amounted to 10.9% and 10.2 % of consolidated own funds. The group of the 10 biggest borrowers of the Group consist of clients of PKO Bank Polski SA only.

Table 2.11

EXPOSURE TOWARDS THE 10 BIGGEST CLIENTS*

The Bank Group

	2012		2011	
No	exposure	% of own funds	exposure	% of own funds
1	2 229	10,9%	1 689	9,2%
2	2 080	10,2%	1 417	7,7%
3	1 933	9,4%	771	4,2%
4	1 404	6,9%	770	4,2%
5	1 206	5,9%	696	3,8%
6	1 121	5,5%	650	3,5%
7	810	4,0%	617	3,4%
8	725	3,5%	600	3,3%
9	600	2,9%	552	3,0%
10	596	2,9%	531	2,9%
Total	12 705	62,0%	8 292	45,2%

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

As at 31 December 2012 the biggest concentration of exposure of the Bank Group in the group of subsidiaries amounted to 19.6% of its consolidated own funds (entities not exempt from the exposure concentration limit).

Table 2.12

EXPOSURE TOWARD THE 5 BIGGEST CAPITAL GROUPS*

The Bank Group

	2012		2011	
No	exposure	% of own funds	exposure	% of own funds
1	4 021	19,6%	1 929	10,5%
2	2 993	14,6%	1 726	9,4%
3	1 957	9,6%	1 286	7,0%
4	1 639	8,0%	950	5,2%
5	1 590	7,8%	803	4,4%
Total	12 200	59,5%	6 695	36,5%

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

As at 31 December 2012, the sum of large exposures of the Group amounted to 59.5% of consolidated own funds.

The credit concentration risk in respect of geographical regions is monitored for:
1) financial institutions – by the country of origin of the counterparty's head office,
2) 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 2012, there was no significant geographical concentration level in the Group's credit portfolio (Table 2.13). The KREDOBANK SA portfolio of loans extended to Ukrainian clients accounted for approx 0.6% of the Group's total portfolio.

Table 2.13
GEOGRAPHICAL STRUCTURE OF EXPOSURES*

The Bank Group 2012

Country/region	No. of exposure class**										Total
	A	B	C	D	E	F	G	H	I	Other***	
Poland, of which:	62 954	57 953	27 947	26 852	12 319	5 079	7 731	4 003	1 081	512	206 432
mazowiecki	15 478	9 365	9	4 528	2	381	378	27	1 044	0	31 210
śląsko-opolski	7 259	7 530	0	3 907	4	0	602	28	0	0	19 330
wielkopolski	4 950	6 972	13	2 683	1	0	379	16	12	0	15 025
małopolsko-świętokrzyski	4 774	5 731	24	2 549	4	0	932	19	12	0	14 046
dolnośląski	3 694	4 719	1	2 312	3	0	960	13	0	0	11 701
lubelsko-podkarpacki	3 670	5 105	6	1 872	12	0	627	12	1	0	11 306
łódzki	4 429	3 204	1	1 877	1	0	840	23	0	0	10 375
pomorski	3 995	3 721	0	1 624	1	0	204	10	0	0	9 556
zachodniopomorski	3 217	4 027	1	1 511	3	0	319	14	0	0	9 094
kujawsko-pomorski	2 525	2 956	2	1 529	2	0	748	32	0	0	7 794
warmińsko-mazurski	1 769	2 304	139	1 069	3	0	122	20	0	0	5 425
podlaski	2 381	1 617	30	769	0	0	85	5	0	0	4 886
other****	4 814	702	27 722	622	12 283	4 698	1 535	3 784	11	512	56 684
Ukraine	667	80	249	182	298	646	0	105	0	0	2 227
United Kingdom	0	124	0	22	0	1 258	0	4	0	0	1 407
France	0	5	0	0	0	1 247	0	0	0	0	1 253
Luxembourg	542	0	0	0	0	0	0	0	0	0	542
Germany	1	16	0	4	0	503	0	0	0	0	525
USA	0	3	0	0	0	380	0	0	0	0	382
Switzerland	0	1	0	0	0	348	0	0	0	0	349
Austria	0	2	0	0	0	279	0	0	0	0	282
Norway	247	6	0	2	0	0	0	0	0	0	255
Netherlands	0	4	0	0	0	250	0	0	0	0	254
Finland	0	0	0	0	0	208	0	0	0	0	208
Denmark	0	0	0	0	0	116	0	0	0	0	116
Italy	0	4	0	1	0	98	0	0	0	0	103
Other	82	20	0	6	0	46	0	1	0	0	155
Total (PKO Bank Polski SA, KREDOBANK SA Group and BFL SA Group)	64 493	58 218	28 196	27 072	12 617	10 457	7 731	4 114	1 081	512	214 490
Other companies of the Group	755	0	78	0	990	9 548	0	163	0	17	11 551
Adjustments and exclusions	-3 935	-9	0	0	-192	-10 693	0	0	0	-376	-15 206
Total	61 312	58 209	28 274	27 072	13 415	9 311	7 731	4 277	1 081	153	210 835

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

** A - Corporate exposures,
B - exposures secured on real estate property,
C - exposures to central governments and central banks,
D - retail exposures,
E - other esposures,
F - exposures to institutions,
G - exposures to regional governments and local authorities,
H - past due exposures,
I - exposures to administration bodies and non-commercial undertakings

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

****Exposures managed at the Head Office level 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 2012, there was no significant credit concentration level with respect to industry sectors (Table 2.14).

Table 2.14

EXPOSURE STRUCTURE BY INDUSTRY*

The Bank Group 2012

Type of client/branch		No. of exposure class **										Total
		A	B	C	D	E	F	G	H	I	Other***	
Institutional clients, of which:		54 352	1 391	0	0	0	24	6 300	2 183	1 081	0	65 331
C	Industrial processing	12 846	174	0	0	0	0	0	399	0	0	13 419
G	Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household appliances	9 362	291	0	0	0	0	0	476	0	0	10 129
O	Public administration and national defence, obligatory social security	60	1	0	0	0	0	6 189	9	1 081	0	7 339
F	Construction	5 338	189	0	0	0	0	0	317	0	0	5 845
L	Activities related to real property management	4 973	255	0	0	0	0	29	172	0	0	5 429
D	Generation and supply of power, gas, water steam, hot water and air for air-conditioning systems	2 705	9	0	0	0	0	0	18	0	0	2 732
	Other exposures	19 068	472	0	0	0	24	82	792	0	0	20 438
Individuals		7 744	56 827	0	26 981	0	0	0	1 923	0	0	93 475
Governments		0	0	28 165	0	0	0	0	0	0	0	28 165
Banks		0	0	0	0	0	10 433	0	0	0	0	10 433
Other***		2 396	0	31	91	12 617	0	1 431	9	0	512	17 086
Total (PKO BP SA, KREDOBANK SA Group and BFL SA Group)		64 493	58 218	28 196	27 072	12 617	10 457	7 731	4 114	1 081	512	214 490
Other companies of the Group		755	0	78	0	990	9 548	0	163	0	17	11 551
Adjustments and exclusions		-3 935	-9	0	0	-192	-10 693	0	0	0	-376	-15 206
Total		61 312	58 209	28 274	27 072	13 415	9 311	7 731	4 277	1 081	153	210 835

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

** A - Corporate exposures
B - exposures secured on real estate property
C - exposures to central governments and central banks
D - retail exposures
E - other esposures
F - exposures to institutions
G - exposures to regional governments and local authorities
H - past due exposures
I - exposures to administration bodies and non-commercial undertakings

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

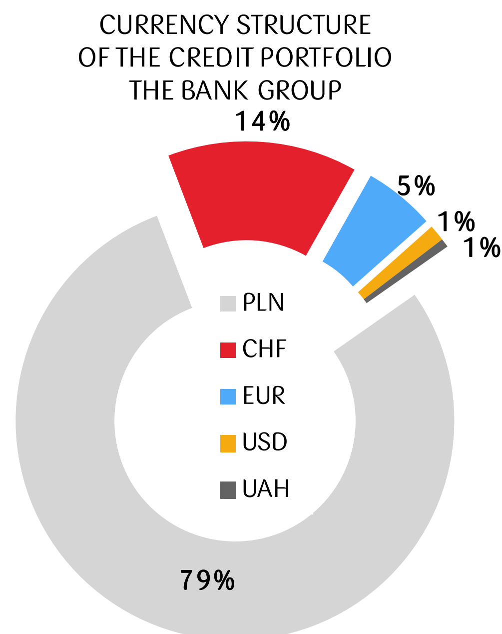
****Exposures managed at the Head Office level include the following, among other items: securities, other assets

As at 31 December 2012, the share of exposures in convertible currencies other than PLN in the Group's total portfolio amounted to 21%. 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 and the BTK SA Group (respectively 95% and 84% of the foreign currency portfolio of the Groups). While portfolios of the Groups of KREDOBANK SA and "Inter-Risk Ukraina" Sp. z. d.o. are dominated by loans extended in USD (respectively 66% and 84% of the foreign currency portfolio of the Groups). Significant concentration risk was identified in case of "Inter-Risk Ukraina" Sp. z. d.o. Group, which is related to the specific nature of the Ukrainian market, at which foreign currency credits prevail due to weak local currency.

The 2011 decrease in the share of loans denominated in foreign currencies resulted mainly from the concentration of new sales of housing credits in PLN.

Chart 2.2



2.2.3.4. Monitoring of derivatives

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

Derivatives subject to separation from major contracts and separate recognition in the ledgers are valued at their fair value. Their valuation is presented in the balance sheet in the line entitled “Financial derivatives”. Changes in valuation of the fair value of derivatives are referred to in the profit and loss account in the line entitled “Result of financial instruments valued at fair value” or “Result of foreign exchange position”. Separated embedded derivatives were not a significant risk factor for the Bank in 2012.

As at 31 December 2012 the Bank had signed general agreements in ISDA and PBA standard with 27 Polish banks and 53 foreign banks and credit institutions. Moreover, the Bank was a party of 58 CSA (Credit Support Annexes) and PBA collateral agreements enabling collateral of exposures related to derivatives and 6 ISMA (International Securities Market Association) agreements enabling setting off liabilities resulting from REPO and BSB (SBB) transactions. The coverage ratio of the nominal value of transactions on derivatives with general agreements and PBA collateral agreements and CSA was 100.00% and 99.26% respectively.

The positive gross fair value of contracts with financial institutions as at 31 December 2012 was PLN 3,681 million. The above amount was calculated as the total of positive market values of all open transactions. The net credit exposure, after taking into account the netting of transactions, for counterparties with framework agreements was ca. PLN 547 million. Netting benefits amounted to approx. PLN 3,134 million (these were not accounted for in the calculation of capital requirements for credit risk, as presented in Chapter 4 “Capital requirements (Pillar I)”). The value of collateral accepted from the counterparties within the CSA and PBA collateral agreements was ca. PLN 549 million.

As at 31 December 2012, the Bank had no derivative credit transactions.

As at 31 December 2012, the Bank recognized adjustments for credit valuation in the valuation of financial derivatives concluded with non-financial business entities based on a performed analysis of recoverability of its exposures. The Bank’s adjustment included the market value of credit risk as assessed by the Bank. Analyse covered all significant exposures on account of the Bank’s positive valuation of financial derivatives contracted with non-financial business entities. In particular, the adjustment included the risk of non-performance of agreements executed with the counterparty, based e.g. on analyses of the business and financial standing of entities, the probability of repayment of specific contracts, and the recoverable value of collateral.

The prevailing numbers of financial institutions – the Bank’s business partners on an interbank market – were awarded high external ratings – between AAA and BBB (Table 2.15).

Table 2.15

THE QUALITY OF EXPOSURES*
TO FINANCIAL INSTITUTIONS**

Rating	PKO Bank Polski SA 2012
AAA	10%
AA	2%
A	68%
BBB	14%
BB	1%
B	3%
No rating	1%
Total	100%

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

** Exposures to institutions from outside the Group

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

2.2.4. Credit risk reporting

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

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

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

2.2.5. Credit risk related management actions

2.2.5.1. Collateral policy

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

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

In granting housing loans, collateral is obligatorily established mainly in the form of a mortgage on the real property subject to a credit. Until the mortgage is effectively established (depending on the loan type and amount), a raised credit spread is applied or a collateral is accepted in the form of a transfer of receivables under the apartment construction agreement, 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:
1) in the case of big loans, the Bank establishes several types of collateral, combining personal and tangible collateral whenever possible,
2) liquid collateral is preferred, that is such collateral subject that may be sold without significant reduction of its price in time, that does not expose the Bank to changes in collateral value due to price fluctuation typical for a given collateral subject,
3) 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,
4) effective establishment of collateral in accordance with clauses of the agreement is a prerequisite to release of the loan funds.

Established collateral is subject to periodic monitoring in order to determine their current value. The following factors are monitored:
1) property/financial standing of the entity that issues personal collateral,
2) the condition and value of the object serving as property collateral,
3) other circumstances affecting the possibility of debt recovery by the Bank.
Collateral in the form of a mortgage is subject to special assessment. The Bank performs periodic monitoring of real properties accepted as collateral (the Loan to value (LtV) ratio 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.

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

2.2.5.2. Credit risk management tools

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

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

2.2.5.3. Credit risk management in the subsidiaries of the Bank Group

The subsidiaries of the Bank Group with significant credit risk level (the KREDOBANK SA Group, the BFL SA Group, the BTK SA Group, the “Inter-Risk Ukraina” Sp. z d.o Group) manage credit risk individually, with the provision that the applied methods for credit risk assessment and measurement are adjusted to the method used by PKO Bank Polski SA, while observing the specific nature of the business activity conducted by those entities.

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

The BFL SA Group, the BTK SA Group and the KREDOBANK SA Group and “Inter-Risk Ukraina” Sp. z d.o Group measure credit risk and report the results of that measurement to the Bank on a cyclical basis.

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

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

The credit decision-making process in the KREDOBANK SA Group and the BFL SA Group is supported by credit

committees activated in the case of credit transactions generating an enhanced credit risk level.

2.2.5.4. Management actions related to derivatives

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

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

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

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

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

Entering into a framework agreement with counterparty is the basis for verification of internal limit per counterparty and of the length of period of the Bank's exposures to forward or repurchase agreement transactions. The client limit is based on the internal assessment (internal rating) as well as on the amount of own funds of the Bank and the client.

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

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

Every month the Bank reviews derivative transactions concluded with economic entities in order to identify transactions threatened with impairment in relation to credit risk and includes recognized impairment in the valuation of such transactions.

The identification of transactions threatened with impairment consists in recognition of events that indicate a threat to payments under such transactions, in particular:
1) delays in making payments under such transactions,
2) no cover of a transaction from foreseeable cash flows from client's economic activities or accepted transaction collateral,
3) significant deterioration of client's internal rating or missing information on current rating.

The following methods are applicable while determining adjustments of derivative transaction valuations:
1) individualised – in relation to:
   a) active transactions that do not have a cover from foreseeable cash flows from client's economic activities or established transaction collateral,
   b) closed unsettled transactions passed to the management by Restructuring and Debt Collection,
2) portfolio – in relation to other derivative transactions if they refer to clients whose internal rating means a failure to fulfil liabilities or that do not have a rating or that are not timely settled (except transactions covered by established collateral).

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

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

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

In 2012, the only companies of the Bank Group beside the Bank to use derivatives within market risk management (to hedge the risk resulting from their major activities) were companies of the BFL SA Group. The other companies of the Group may also enter into such transactions only to hedge their business risk (since February 2012 also KREDOBANK SA may use FX forward transactions to hedge the foreign exchange risk of specific currencies. In 2012 KREDOBANK SA did not conclude any transaction of that type).

2.3. Interest rate risk

2.3.1. Introduction

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

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

2.3.2. INTEREST RATE RISK MEASUREMENT AND ASSESSMENT

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

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

In order to determine VaR for market risk management purposes, the variance-covariance method is applied with the 99% confidence level and 10-day period of position maintenance. 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:
1) hypothetical scenarios – within which fluctuations in interest rates are assumed arbitrarily: parallel movement of the interest rate curves for the individual currencies by ±50 BPS, by 100 BPS and by ±200 BPS and deflection scenarios (nonparallel peak- and twist- type deflections) of profitability curves.
2) historical scenarios – within which fluctuations in interest rates are assumed on the basis of fluctuations in interest rates in the past, including: the biggest historical change, deflection of the profitability curve with due account to portfolio positions, the biggest historical nonparallel defection of interest rate curves for securities and for derivatives guaranteeing those securities.

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

2.3.3. MONITORING THE INTEREST RATE RISK

In 2012, interest rate risk of the Bank Group was determined mainly by the risk of mismatch of dates of reassessment of assets and liabilities.

As at 31 December 2012 the mismatch of reassessment dates of Bank Group in case of PLN interest rate and also for EUR and CHF interest rates comprised mainly the Bank's mismatch. The mismatch of interest rate reassessment dates for these currencies that was generated by the other Group Companies had no significant impact on the interest rate risk for the entire Group and consequently, it did not change its risk profile significantly. The mismatch of the Group's USD reassessment dates comprised mainly the Bank's exposures and the mismatch of the Group's companies. The mismatch of the Bank Group's companies reduced the mismatch of the Group in USD in the range up to 1 month, from 6 to 12 months and more than 5 years. As far as the other ranges are concerned, the mismatch of the Group's companies increased the mismatch of the Group.

The tables 2.16 – 2.19 present the reassessment gaps of the Group as at 31 December 2012 by currencies.

Table 2.16

PLN reassessment gap (in PLN million)

2012	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	29 913	66 428	-69 437	-12 626	3 883	1 225	731	20 117
Cumulative gap	29 913	96 341	26 904	14 278	18 161	19 386	20 117	
Group subsidiaries								
Periodic gap	-396	-476	50	16	17	23	0	-767
Cumulative gap	-396	-872	-822	-806	-789	-767	-767	
TOTAL - Periodic gap	29 518	65 951	-69 388	-12 610	3 900	1 247	731	19 350
TOTAL - Cumulative gap	29 518	95 469	26 082	13 472	17 372	18 619	19 350	

Table 2.17

USD reassessment gap (in USD million)

2012	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	149	673	-381	-384	9	1	-276	-208
Cumulative gap	149	823	442	58	67	67	-208	
Group subsidiaries								
Periodic gap	-94	7	-17	7	18	16	26	-38
Cumulative gap	-94	-87	-104	-97	-79	-63	-38	
TOTAL - Periodic gap	55	680	-398	-377	27	16	-250	-246
TOTAL - Cumulative gap	55	735	337	-39	-12	4	-246	

Table 2.18

EUR reassessment gap (in EUR million)

2012	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	652	312	-771	90	-31	-352	-49	-148
Cumulative gap	652	965	194	284	253	-100	-148	
Group subsidiaries								
Periodic gap	-36	-95	-3	-2	3	14	1	-117
Cumulative gap	-36	-95	-3	-2	3	14	1	
TOTAL - Periodic gap	617	217	-774	88	-28	-338	-48	-265
TOTAL - Cumulative gap	617	834	61	148	120	-218	-265	

Table 2.19

CHF reassessment gap (in CHF million)

2012	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	-596	1 041	-43	-2	1	-492	20	-72
Cumulative gap	-596	444	401	399	400	-92	-72	
Group subsidiaries								
Periodic gap	1	-6	0	0	0	0	0	-5
Cumulative gap	1	-5	-5	-5	-5	-5	-5	
TOTAL - Periodic gap	-595	1 034	-43	-2	1	-492	20	-77
TOTAL - Cumulative gap	-595	439	396	394	395	-97	-77	

The VaR and analysis of stress test scenarios of the Group's exposure to the interest rate risk as at 31 December 2012 and 31 December 2011 respectively are presented below:

Table 2.20

Sensitivity of financial assets
Exposed to interest rate risk

	2012		2011	
	10-day VaR	Stress-test ±200 base points*	10-day VaR	Stress-test ±200 base points*
PKO Bank Polski SA	64,5	-299,0	62,7	-486,1
Group subsidiaries	-	-42,9	-	-99,7
Total	-	-270,8	-	-530,7

*The table presents the value of most adverse stress test among all scenarios: shift of PLN rates by 200 PBS up and by 200 BPS down, separately for the Bank and Group subisidiares and together for them

As at 31 December 2012, the 10-day VaR on the interest rate was PLN 64.5 million for the Bank, which accounted for ca. 0.33% of the Bank's own funds. As of 31 December 2011, the Bank's VaR was 62.7 PLN, which accounted for approx. 0.36% 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 tests results* - parallel shift of interest rate curves by ±200 base points

	Bank		Group Subsidiaries		Total	
Currency	2012	2011	2012	2011	2012	2011
PLN	-260,4	-386,6	-11,0	-15,0	-263,9	-401,5
EUR	-49,1	-90,3	-5,1	-12,1	-44,0	-78,3
USD	16,3	-9,2	-26,7	-72,7	43,0	-50,9
CHF	-4,4	2,7	-0,1	0,0	-4,5	2,6
GBP	-0,6	-1,2	0,0	0,0	-0,6	-1,2

* Main foreign currency values have been shown in PLN equivalents

Given the nature of business activity of the other companies of the Group generating significant interest rate risk and the specific nature of the market on which they operate, the Group does not determine the consolidated VaR sensitivity measure. The companies use their own risk measures to manage interest rate risk. The 10-day VaR measure for interest rate for main currencies is used by KREDOBANK SA, its value as at 31 December 2012 was PLN 14.3 million, while as at 31 December 2011 – ca. PLN 29.7 million.

2.3.4. Interest rate risk reporting

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

2.3.5. Management actions related to interest rate risk

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

1) interest rate risk management procedures,
2) limits and threshold values by individual market risk types,
3) defining the allowed types of transactions exposed to specific market risks,

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

The methods of interest rate management in the Group's subsidiaries are defined by internal regulations that are implemented by companies in which the interest rate risk is significant. Such provisions are worked out consultations with the Bank and taking account of the recommendations sent to companies by the Bank.

2.4. Foreign exchange risk

2.4.1. Introduction

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

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

2.4.2. Foreign exchange risk measurement and assessment

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

Stress tests and crash tests for FX risk are used to assess potential losses on currency positions where extraordinary market situation occurs that is not described in a standard manner using the statistical measures. The following two scenarios are applied at the Bank:

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

2.4.3. Monitoring of the foreign exchang risk

In 2012, the FX risk of the Bank Group was low as it is the Bank's policy to close currency positions in the main currencies, that is EUR, USD, CHF and GBP. 10-day VaR for FX position of the Bank at the end of 2012 amounted to PLN 0.6 million, which accounted for approx. 0.003% of the Bank's own funds. The VaR and stress-test analysis in respect of the Bank's and the Group's financial assets (jointly for all currencies) exposed to FX risk as at 31 December 2012 and 31 December 2011 respectively was as follows:

Table 2.22

Sensitivity of financial assets exposed to FX risk

	2012		2011	
	10-day VaR	Stress-test ±20%	10-day VaR	Stress-test ±20%
PKO Bank Polski SA	0,6	-3,9	1,5	13,6
Group subsidiaries	-	-28,7	-	-30,9
Total	-	-32,6	-	-17,2

*The table presents the value of most adverse stress test among all scenarios: PLN appreciation by 20% and PLN depreciation by 20%

As in the case of interest rate risk, given the nature of business activity of the other companies of the Bank Group generating significant FX risk and the specific nature of the market on which they operate, the Bank does not determine the consolidated VaR sensitivity measure. The companies use their own risk measures to manage FX risk. The 10-day VaR measure is used by KREDOBANK SA, as at 31 December 2012 its value was ca. PLN 0.6 million while as at 31 December 2011 – ca. PLN 0.5 million.

2.4.4. Reporting of the foreign exchange

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

2.4.5. Management actions related to foreign exchange risk

The basic FX risk management tools used in the Group are as follows:
1) FX risk management procedures,
2) limits and threshold values for FX risk,
3) defining the allowed types of FX transactions and FX rates used in such transactions.

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

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

2.5. Liquidity risk

2.5.1. Introduction

Liquidity risk is the risk of inability of timely discharge of liabilities due to absence of liquid 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 secure necessary means to discharge the current and future (also potential) liabilities with due account to the nature of business activity and any needs that may result from a changing market environment, through structuring of balance sheet and off-balance sheet items.

2.5.2. Liquidity risk measurement and assessment

The Bank Group's liquidity policy is based on maintenance of liquid securities portfolio and growth of stable financing sources (in particular stable deposit base). Moreover, money market instruments, including operations of the open market of the National Bank of Poland are used for liquidity risk management.
The Bank Group uses, for instance the following liquidity risk measures:
1) contractual liquidity gap – listing of all balance sheet items by their maturity,
2) real-terms liquidity gap – listing of individual balance sheet categories by their real-terms maturity,
3) liquidity reserve – the difference between the most liquid assets and expected and potential liabilities that mature in a given period,
4) stability measures of deposit and credit portfolio.

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

2.5.3. Monitoring the 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 proper presentation of the liquidity status of the Bank and the companies of the Bank Group.

Put in real terms were in particular the following:
1) the core deposits (interbank market excluded) and their payability - clients' deposits (current accounts, savings accounts and fixed term deposits) have been classified to appropriate time frames with due account to their stability (maintenance of an appropriate balance or revolving after payability),
2) the core deposits on the current accounts of non-financial entities and their maturity - overdrafts have been classified to appropriate time frames with due account to their possibility of revolving,
3) liquid securities and their maturity – liquid securities have been classified into the time frame of up to 7 days according to the possible date of their liquidation (pledging, sale).

The table below presents data concerning periodic gap and cumulative periodic gap of the Bank and of the companies of the Group as at 31 December 2012 and 31 December 2011 respectively.

Table 2.23

REAL-TERMS LIQUIDITY GAP* - ASSETS AND LIABILITIES

2012	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
PKO Bank Polski SA								
Periodic gap	10 223	6 748	402	3 133	2 174	9 249	11 556	-43 486
Cumulative gap	10 223	16 971	17 373	20 506	22 680	31 930	43 486	0
Group subsidiaries								
Periodic gap	163	110	-377	-88	-169	-90	295	156
Cumulative gap	163	273	-104	-192	-362	-451	-156	0
TOTAL - Periodic gap	10 386	6 858	25	3 045	2 005	9 159	11 851	-43 329
TOTAL - Cumulative gap	10 386	17 244	17 269	20 314	22 319	31 478	43 329	0

2011	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
PKO Bank Polski SA								
Periodic gap	7 426	12 229	-1 386	1 477	-1 254	10 195	15 702	-44 389
Cumulative gap	7 426	19 655	18 268	19 746	18 491	28 687	44 389	0
Group subsidiaries								
Periodic gap	-127	-134	-214	-77	85	81	448	-62
Cumulative gap	-127	-261	-475	-552	-467	-386	62	0
TOTAL - Periodic gap	7 299	12 094	-1 600	1 400	-1 170	10 277	16 150	-44 451
TOTAL - Cumulative gap	7 299	19 394	17 794	19 194	18 024	28 301	44 451	0

* Set as a um of real-terms liquidity gap of PKO Bank Polski SA and contractual liquidity gaps of the other companies of the Group

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

Table 2.24 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 Bank Group

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

2011	0-1 miesiąc	1-3 miesiące	3-6 miesięcy	6-12 miesięcy	1-2 lata	2-5 lat	powyżej 5 lat	Razem
TOTAL - Periodic gap	100	181	462	1 038	554	238	9	2 582
TOTAL - Cumulative gap	100	282	744	1 781	2 335	2 573	2 582	0

The table below shows the Bank's liquidity reserve as at 31 December 2012 and 31 December 2011:

Table 2.25

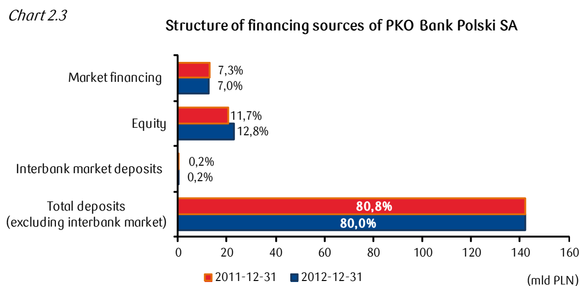
LIQUIDITY RESERVE
PKO Bank Polski SA

Sensitivity measure	2012	2011
Liquidity reserve for up to 1 month	13 568	17 723

As at 31 December 2012, core deposits amounted to approx. 93.3% of all deposits held by the Bank (the interbank market excluded), which was a decrease of approx. 1.5 percentage points compared to 31 December 2011.

The following chart presents the structure of the Bank's financing sources as of 31 December 2012 and 31 December 2011.

Chart 2.3



2.5.4. Liquidity risk reporting

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

2.5.5. Management actions related to liquidity risk

The basic liquidity risk management tools used by the Bank Group are as follows:
1) liquidity risk management procedures including contingency plans,
2) limits and threshold values for liquidity risk,
3) deposit, investment, derivative transactions, including structured FX transactions and security sell and buy transactions,
4) transactions ensuring long-term financing of credit activities.

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

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

These regulations have been developed after consultations with the Bank and after considering the recommendations of the Bank directed to the companies of the Group.

Price risks of equity securities, commodity price risk and other price risks

2.5.6. Introduction

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

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

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

Taking account of other price risks, as of the end of 2012 the Bank was exposed to the price risk of participation units in collective investment institutions.

2.5.7. Measurement and assessment of price risk of equity securities, commodity price risk and other price risks

The impact of the price risk of equity securities and other price risk on the Bank's financial conditions was defined as insignificant. Positions in equity securities and indexed instruments reduced and their significant increase is not expected. In 2012 positions in transactions generating commodity price risk were closed as at end of the day.
The Bank Group's capital exposures in the banking book are divided into two groups depending on the purpose of their acquisition:
1) stocks and shares – exposures to co-subsidiaries and associated entities and to other entities with the minority interest of PKO Bank Polski SA and the Group's companies (except for stocks and shares reducing own funds of the Group). The reason behind acquisition of these assets is to obtain capital gains (dividend) and return on investment following the disposal of stocks and shares (including recovery of capital in result of sales of shares or stock acquired in restructuring of credit receivables) as well as the share of PKO Bank Polski SA in the development of the financial market;
2) participation units in collective investment undertakings – covering investments of PKO TFI SA in participation units of the new investment funds under its management. The reason behind the acquisition of those assets is to obtain, in accordance with the Statutes of PKO TFI SA, the means required to create such fund.

Table 2.26

CAPITAL EXPOSURES - BANKING BOOK

	The Bank Group			
	2012		2011	
	Carrying amount	fair value*	Carrying amount	fair value*
Total	98 428	98 874	55 640	55 900
Shares in other entities	13 760	13 760	17 565	17 565
Equity securities	84 668	85 114	38 075	38 335
Shares in entities listed on regular market **	31 513	31 513	10 357	10 357
Shares in entities not listed on regular market ***	36 006	36 452	19 730	19 990
Participation units in collective investment undertakings	17 149	17 149	7 988	7 988

* Assessed fair value
** Fair value of listed securities equals their market value
*** This line includes also shares that are not listed on the regular market of public companies

Stocks and shares in co-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.

2.5.8. Monitoring of price risk of equity securities and other price risks

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 (that is impairment test is conducted). 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.

Additionally, impairment tests are performed at the end of every year regardless of whether impairment conditions exist for stock and shares in associated entities and co-subsidiaries.

Stocks and shares in other entities are valued as follows:
1) at fair value determined in the following manner:
   a) at market value for those stocks, for which there is an active market,
   b) as a received current offer of purchase or by way of valuation performed by specialised external entity providing this type of service, for stocks and shares, for which there is no active market;
2) at the acquisition cost less impairment write-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 impairment of a given asset, the amounts recognised previously as an increase in the value due to reassessment to fair value decrease revaluation reserve. If the amount of previously recognised increases is not sufficient to cover the impairment, the 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.

As at 31 December 2012, the unrealised loss of the Bank Group relating to evaluation of capital exposures (presented in the profit and loss account and in revaluation capital) and foreign exchange amounted together to PLN 26.7 million. Additionally, on account of its capital exposure in the stocks held, the Bank Group received a gross dividend in 2012 in the total amount of PLN 6.2 million.

2.5.9. Reporting price risk of equity securities, commodity price risk and other price risks

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

2.5.10. Management actions related to price risk of equity securities and other price risks

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

2.6. Operational risk

2.6.1. Introduction

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

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

2.6.2. Operational risk measurement and assessment

2.6.2.1. Method of operational risk measurement and assessment

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

Operational risk measurement includes:

1) calculation of key operational risk indicators (KRI),
2) calculation of capital requirement in compliance with the method,
3) stress tests,
4) calculation of internal capital.

Operational risk assessment comprises operational risk arising in the existing products, processes and IT application of the Bank and it is conducted using the following:

1) collected data on operational risk events,
2) internal audit results,
3) results of internal functional control,
4) the key operational risk indicators (KRI).

The Bank assesses parameters of distributions used for measurement of the operational risk on the basis of internal and external information on operational events. The estimating algorithm of these parameters takes account of existing thresholds of financial losses for which information on operational events are gathered. The value of a threshold for internal events was established with an account of the economic costs related to gathering information on operational events and their value added in operational risk measurement. Used external data on operational events come for instance from the system of information exchange in respect to events within the scope of operational risk that is maintained by the Polish Bank Association (ZORO). Moreover, the operational risk measurements include macroeconomic data and data presenting the volume of the Bank's operational and business activities.

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

AMA = (LDA99,9%+CMR)*(1+IA)+MA
where:
AMA –AMA result,
LDA99,9% – value at risk,
CMR –complementary method result,
IA – adjustment related to changes in quality of internal functional audit,
MA – management adjustment

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

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

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

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

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

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

Moreover, to comply with the best practices of the Basel Committee, the Bank performs back tests of the AMA method. Back test results confirm the sufficient conservatism of the results of AMA measurements.

Furthermore, applied AMA method is validated by an independent internal organisational unit at least once a year. The validation is aimed to ensure that the operational risk measurement and management systems in the Bank with their essential components functioned in compliance with the assumptions. The subject of validation is verification of accuracy, objectivity and conservatism of the operational risk measurement and management system applied by the Bank.

2.6.2.2. The Bank's insurance policy

To minimize negative financial impact of operational events, PKO Bank Polski SA has the insurance policy that requires that a continues and effective insurance cover is granted in return of acceptable cost level.

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

The Bank's insurance programme is regularly monitored in order to identify needs of essential changes and to adjust to the changing nature of the Bank's risk.

2.6.2.3. Impact of insurance

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

The main operational events that occur in the Bank are covered with respective insurance policies. The policies used by the Bank fulfil the criteria defined in § 62-64 of Appendix no 14 to the Resolution of the Polish Financial Supervision Authority no 76/2010 (as amended) and they also comply with internal regulations as regards calculation of capital requirement reduction due to insurance. The Bank's insurance policies refer mainly to all risk property insurance and the Bank's civil liability insurance.

While calculation deductions related to maintained insurance, the Bank takes account of deductibles,

Every reduction of the operational risk result in relation to maintained insurance is subject to verification.

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

2.6.3. Monitoring of operational risk

The Bank regularly monitors:
1) use of strategic limits of operational risk tolerance,
2) use of operational risk limits,
3) efficiency and timeliness of the activities undertaken in relation to operational risk reduction or transfer,
4) KRI values in relation to threshold and critical values,
5) operational events and their consequences,
6) results of AMA, stress tests, identification and assessment of operational risk,
7) results of activities undertaken subject to recommendations after external or internal audits,
8) the quality of functional internal control,
9) data quality.

2.6.4. Operational risk reporting

Reporting on operational risk is made for:
1) the Bank's internal needs, in particular the Supervisory Board, Management Board, RC, ORC and senior management,
2) regulators,
3) shareholders and the financial market.
4) Report for the Bank's internal need of risk-related information concerning the Bank and the companies of the Group are conducted on monthly and quarterly basis.

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

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

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

2.6.5. Management actions related 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:
1) security,
2) IT,
3) settlements,
4) human resources,
5) business processes,
6) administration,
7) support (in particular insurance management, outsourcing of the operations ordered by the Bank to external parties, creation and implementation of internal operational risk models and systems of identification, assessment, monitoring and limiting of operational risk.

Systemic operational risk management is centralised at the level of the Bank's Head Office. Each business and support line has a dedicated person who 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:
1) preventing the operational risk events arising while servicing products, during the course of realisation of internal processes or use of the systems,
2) taking action aimed at limiting the number and scale of threats (operational risk events),
3) liquidating the negative effects of operational risk events,
4) recording data on operational risk events,
5) complying with the operational risk limits.

"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 Bank Group.

Three entities, i.e. PKO Bank Polski SA, the BFL SA Group and the KREDOBANK SA Group have a decisive impact on the operational risk profile of the Bank Group. Other companies of

the Bank Group, due to a considerably lower scale and specific type of their businesses, generate only limited operational risk.

In order to mitigate operational risk exposure at the Bank, various solutions are applied. These include, among other things, the following:
1) control instruments,
2) human resources management instruments (personnel selection and recruitment, employee qualifications enhancement systems and incentive systems),
3) threshold and critical values for key risk indicators (KRI),
4) strategic operational risk tolerance limits and loss limits,
5) contingency plans,
6) insurance,
7) outsourcing.

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

If the operational risk level is higher or high, the Bank uses the following approaches:
1) risk reduction – mitigating impact of risk factors or results of risk materialisation,
2) risk transfer – a transfer of responsibility for coverage of potential losses to an external party,
3) risk avoidance – resignation from a risk generating activity or elimination of a possibility that a risk factor occurs.

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

2.7. COMPLIANCE RISK

2.7.1. . INTRODUCTION

Compliance risk is the risk of incurring legal sanctions or occurrence of financial losses or a loss of reputation or credibility as a result of failure on the part of the Group, the Group's employees or entities operating on its behalf to observe legal regulations, internal regulations and the standards of procedure adopted by the Bank, the ethical standards included. The purpose of compliance risk management is to ensure that the Group complies with the law, adopted standards of conduct and functioning of the Bank as trustworthy, honest and reliable institution through elimination of compliance risk, preventing the possibility of the Group's loss of reputation or credibility and counteracting the risk of financial losses or legal sanctions that might result from the violation of regulations and norms of conduct.

2.7.2. COMPLIANCE RISK IDENTIFICATION AND ASSESSMENT

Identification and assessment of compliance risk includes compliance risk existing in the Bank's internal processes separated on the basis of separate legal regulations on determination of the list of processes in PKO Bank Polski SA.

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

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

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

2.7.3. COMPLIANCE RISK MONITORING

Compliance risk is monitored by means of information provided by organisational units of the Bank and the Group companies and it includes in particular:
1) analysis of cases of non-compliance in the Group and the banking industry, their reasons and consequences,
2) assessment of changes of the key legal regulations that have impact on the Bank's and Group's activities,
3) assessment of activities undertaken by the Group's companies within the scope of compliance risk management,
4) assessment of efficiency of control mechanisms related to limitation of compliance risk.

2.7.4. COMPLIANCE RISK REPORTING

Reporting information on compliance risk refers to the Bank and the companies of the Bank Group. Quarterly reports contain information provided by the Group companies, also on cases of incompliance. The recipients of such reports are the Management and Supervisory Boards of the Bank and the Audit Committee of the Supervisory Board. The reports contain synthetic information concerning:
1) results of compliance risk identification and assessment,
2) observed cases of compliance risk,
3) letters of external auditing and regulatory authorities received by the Bank,
4) external audits conducted in the Bank
5) major activities undertaken within the scope of systemic compliance risk management and fulfilment of recommendations after external audits.

2.7.5. MANAGEMENT ACTIONS RELATED TO COMPLIANCE RISK

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

In 2012 the Bank Group adopted zero tolerance approach to compliance risk which means that the Bank Group focuses its activities on compliance risk elimination.

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

related to compliance risk management it reports directly to the President of the Bank's Management Board.

In all entities of the Bank Group there function consistent compliance risk management principles

2.8. BUSINESS RISK

2.8.1. INTRODUCTION

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

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 Bank's strategic development.

The purpose of business risk management is to maintain an acceptable level of possible negative financial consequences resulting from wrong decisions, decisions made on the basis of improper assessment or from proper decisions taken on the direction of the Bank's strategic development.

2.8.2. STRATEGIC RISK MEASUREMENT AND ASSESSMENT

The Bank's strategic risk level is measured through an assessment of the impact of groups of factors separated in the business and environment. Such groups of factors include in particular:
1) external factors,
2) factors relating to the increase and development of banking activity,
3) factors relating to human resources management,
4) factors relating to investing activities,
5) factors relating to organisation culture.

2.8.3. STRATEGIC RISK MONITORING

The monitoring of strategic risk is performed at least on an annual basis.

2.8.4. STRATEGIC RISK REPORTING

Strategic risk is reported in the Bank on an annual basis. The recipients of the reports on strategic risk level are the Management Board and Directors in Divisions on the Bank's Head Office.

2.8.5. STRATEGIC RISK - RELATED MANAGEMENT ACTIONS

The strategic risk management in the Bank includes:
1) measurements of the strategic risk level,
2) reporting strategic risk level and its changes,
3) activities undertaken in case of a high strategic risk level.

In the 4th quarter of 2012 and in the 1st quarter of 2013 conducted intensive works aimed at preparation of a more advance business risk measurement method bade on EaR (Earnings at Risk) concept.

2.9. REPUTATION RISK

2.9.1. INTRODUCTION

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

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

2.9.2. REPUTATION RISK MEASUREMENT AND ASSESSMENT

Reputation risk ratios are calculated on the basis of an annual assessment of effects of image-related events identified in a given year for individual categories of image-related events. The main tools used to define the Bank's reputation risk level are:
1) catalogue of categories of image-related events that includes a specification of categories of image-related events together with weights assigned to them,
2) records of identified image-related events divided the by categories of image-related events.

2.9.3. REPUTATION RISK MONITORING

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

2.9.4. REPUTATION RISK REPORTING

Reputation risk reporting is performed in the Bank on an annual basis. Information on reputation risk is submitted to the Management Board and the Supervisory Board.

2.9.5. REPUTATION RISK-RELATED MANAGEMENT ACTIONS

Reputation risk management in the Bank comprises in particular preventive activities aimed at limiting cases of or reducing the scale of image-related events and selection of effective tools for protective actions in order to eliminate, mitigate or reduce negative impact of image-related events on the Bank's image.

3. OWN FUNDS

For the purpose of capital adequacy, own funds are calculated according to the regulations of the Banking Law and Resolution no 325/2011[7] of the Polish Financial Supervision Authority dated 20 December 2011 concerning decreases of basic funds, (Official Journal of PFSA no 13 item 49).

Included in the basic funds (so called Tier 1) are the following:
1) core funds comprising:
   a) share capital – in the amount defined in the Bank's Statutes and entry in the Register of Entrepreneurs, at nominal value,
   b) reserve capital – established in accordance with the Bank's Statutes from 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 Meeting,
   c) 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 Meeting,
2) general banking risk fund – created in accordance with the Banking Law from the net profit,
3) retained earnings,
4) net financial result prior to approval and net result for the current reporting period – calculated based on applicable accounting standards, decreased by any expected charges and dividends, in amounts not exceeding amounts audited by a certified public accountant pertaining to article 127 item 2 point 2 letter c of the Banking Law.

In addition, the basic funds are reduced by the following items:
1) intangible assets valued at their carrying amount,
2) equity exposures[8] of the Bank to financial institutions, lending institutions, Polish and foreign banks and insurance companies, in the form of:
   a) shares or stocks held,
   b) amounts classified as subordinated liabilities,
   c) other equity exposure in items classified as own funds or capital of those entities, including additional contributions in favour of a limited liability company, in the amount of 50% of carrying amounts of such exposures,
3) unrealised losses on debt and equity instruments and on other liabilities classified as available for sale,
4) negative amounts from revaluation adjustments of the value of assets held in the trading book,
5) negative differences from conversion of stock abroad.

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

In addition, supplementary funds are reduced by 50% of the value of the Bank's equity exposures 8 in financial or lending institutions, Polish and foreign banks and insurance companies. Where the value of those reductions decreases the amount of supplementary funds to below zero, the surplus amount over the value of supplementary funds is deducted from the basic funds.

In addition, the following is included in the balance of consolidated own funds:
1) goodwill of the subsidiaries (acts to reduce own basic funds),
2) non-controlling interest (have an impact on the value of basic funds).

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

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

Table 3.1

	Group		Bank	
	2012	2011	2012	2011
OWN FUNDS	20 491	18 343	19 875	17 348
Basic funds (Tier 1)	18 788	16 664	18 658	16 225
core funds	20 053	17 752	19 834	17 468
general risk funds	1 070	1 070	1 070	1 070
retained profit/loss	-103	-23	89	0
intangible assets	-1 934	-1 800	-1 681	-1 523
capital exposures	-98	-109	-580	-662
unrealised losses on instruments available for sale	-77	-130	-72	-127
revaluations of assets in the portfolio	-1	0	-1	0
currency translation differences	-121	-94	0	0
minority interest	0	-1	0	0
Supplementary funds (Tier 2)	1 573	1 546	1 087	990
subordinated liabilities	1 601	1 601	1 601	1 601
unrealised profits on instruments available for sale	70	52	67	51
currency translation differences	1	2	0	0
capital exposures	-98	-109	-580	-662
Short-term equity (Tier 3)	130	133	130	133

As of 31 December 2012 the Group's own funds grew ca. PLN 2,148 million, which was mainly due to the fact that the Bank's net profit for 2011 minus disbursed dividend (in the amount of PLN 2,366 million) was recorded as funds. As compared to the end of 2011, the result from previous years decreased by PLN 80 million, while the value of unrealised losses on debt and capital instruments and other receivables in the portfolio of investment securities available for sale - by the amount of ca. PLN 52 million, and capital engagements – by PLN 22 million

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

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

with simultaneous increase of the value of the negative exchange rate differences by the amount of PLN 27 million and intangible assets by PLN 134 million.

According to resolutions no 7/2012 and 8/2012 of the Ordinary General Meeting of PKO Bank Polski SA dated 6 June 2012, the dividend for 2011 was agreed to be PLN 1,587.5 million that is PLN 1.27 gross per share.

On 17 April 2013 the Management Board of PKO Bank Polski SA adopted a resolution and decided to submit a recommendation to the Bank's Ordinary General Meeting on dividend payment for 2012 in the amount of PLN 2.25 billion, that is PLN 1.8 gross per share. The recommended dividend level complies with the stance of the Polish Financial Supervision Authority ("PFSA") on strengthening of banks' capital bases. Dividend payment in the recommended amount will help to maintain the capital adequacy ratio above 12% and Common Equity Tier 1 Ratio above 9% with necessary capital buffer. Dividend payment in the recommended amount will ensure good capital situation and liquidity of the Bank.

The Bank's Supervisory Board expressed its positive opinion on the recommendation of dividend payment.

In the 3rd quarter of 2012 PKO Bank Polski SA executed call option and on 30 October 2012 it repurchased subordinated bonds in the amount of PLN 1.6 billion, that were issued in 2007 Those funds were replaced in the supplementary funds by resources from 5-years' subordinate bonds issued on 14 September 2012.

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

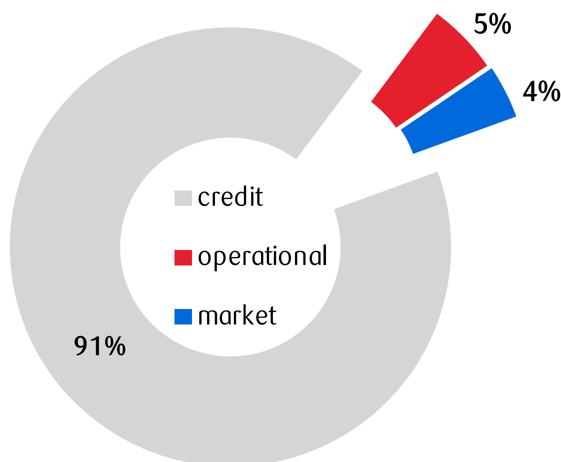
	Group		Bank	
	2012	2 011	2012	2 011
Total capital requirement	12 541	11 865	12 299	11 635
Credit risk	11 387	10 657	11 206	10 487
credit risk (banking book)	11 223	10 535	11 041	10 364
Counterparty risk (trading book)	164	123	165	123
Market risk	495	355	527	391
foreign currency	0	0	0	0
commodities risk	0	0	0	0
equity securities risk	1	2	1	2
specific risk of debt instruments	412	262	441	295
general interest rate risk	82	91	85	94
Operational risk	660	852	567	758
Other types of risk*	0	0	0	0

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

As at 31 December 2012, the biggest part of the Group's total capital requirement was the requirement on account of credit risk (approx. 91%) – chart 4.1.

Chart 4.1

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



As at 31 December 2012:

1) the capital requirement for credit risk and counterparty credit risk was calculated under the standardised approach (pertaining to Appendices no. 4, 11, 16 and 17 to Resolution of PFSA No. 76/2010 as amended[9] (Official Journal of PFSA no 2 item 11 of)),
2) the capital requirement for market risk was calculated under the basic methods (Appendices No. 6 to 10 to Resolution No. 76/2010 of PFSA as amended),
3) the capital requirement for operational risk was calculated for the Bank under the advanced approach (AMA) and under basic indicator approach (BIA) for the companies of the Group (Appendix No. 14 to Resolution No. 76/2010 of PFSA as amended),
4) the capital requirement for:
   a) the settlement and delivery risk – was calculated under the method defined in Appendix No. 11 to Resolution No. 76/2010 of PFSA as amended,
   b) the risk of exceeding the exposure concentration limit – was calculated under the method defined in Appendix No. 12 to Resolution No. 76/2010 of PFSA as amended,
   c) the risk of exceeding the capital concentration threshold – was calculated under the method defined in Appendix No. 13 to Resolution No. 76/2010 of PFSA as amended.

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

1) FX risk,
2) commodities risk,
3) equity securities risk,
4) specific risk of debt instruments,
5) general interest rate risk.

The increase in the credit portfolio (balance sheet and off-balance sheet exposures) contributed to the increased capital requirement for credit risk in 2012 by 3.8% and the fact that the provisions of PFSA'a Resolution no 153/2011 entered into force in result of which since 30 June 2012 the risk weight has increased (from 75% to 100%) for retail exposures and exposures secured on housing real properties, in case of which amounts of principal or interest instalments depend on changes in foreign exchange rates of other currencies than the currency of debtor's income.

The increased capital requirement for market risk by 39% to the amount of PLN 495 million results mainly from increase of the value of liabilities due for guarantees of issues of corporate bonds with a simultaneous decrease of the value of corporate bonds (total increase of the requirement for bonds by ca. 77%).

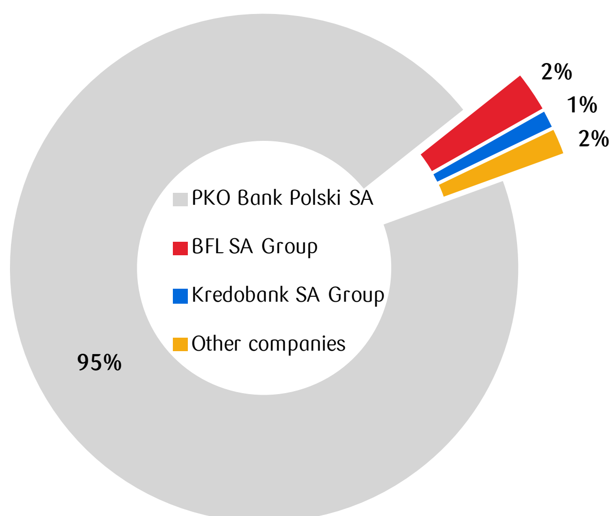
The Bank's capital requirement for operational risk was calculated by means of the advance approach (AMA). Decrease of the requirement for operational risk from PLN 852 million (as of 31 December 2011) to PLN 660 million (as of 31 December 2012) results mainly from elimination of conditions for maintenance of the limitation in respect to decrease of the Bank's capital requirement below the level of 75% of the requirement calculated by means of the standardized approach (TSA) in force from 30 June 2011 to 12 December 2012.

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

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

Chart 4.2

STRUCTURE OF CAPITAL REQUIREMENT BY COMPANIES
The Group



A considerable proportion of the capital requirement of both the Group (Table 4.2) and the Bank (Table 4.3) results from exposure in the banking book especially within the requirement established for balance sheet exposures (over 85%)

Table 4.2

	The Bank Group		
	2012		
	Book		
	banking	trading	total
Capital requirement*	11 223	577	11 800
Balance sheet exposures	10 022	150	10 172
Off-balance sheet liabilities	1 137	262	1 399
Derivatives	65	164	229

* Covers credit risk, counterparty credit risk, specific risk of equity securities and debt instruments. It does not cover general interest rate risk and operational risk

Table 4.3

	PKO Bank Polski SA		
	2012		
	Book		
	banking	trading	total
Capital requirement*	11 041	607	11 648
Balance sheet exposures	9 800	163	9 963
Off-balance sheet liabilities	1 176	279	1 455
Derivatives	65	165	229

* Covers credit risk, counterparty credit risk, specific risk of equity securities and debt instruments. It 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 2012 was calculated under the standardised approach in accordance with Appendices No. 4, 11, 16 and 17 to Resolution No. 76/2010 of PFSA as amended. The value of that capital requirement of the Bank's Group by exposure classes is shown in Table 4.4.

Table 4.4

STRUCTURE OF CAPITAL REQUIREMENT FOR CREDIT RISK

	The Bank Group 2012
TOTAL	11 387
Corporate	4 789
Secured on real estate property	3 689
Retail	1 685
Central governments and central banks	20
Other exposures	380
Institutions (banks)	276
Regional governments and local authorities	129
Past dues	368
Administrative bodies and non-commercial undertakings	45
Other*	7

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

In 2012, the capital requirement of the Group for credit risk (the counterparty credit risk included) increased by PLN 730 million compared to 2011, which was mainly due to the increase of the risk weight (from 75% to 100%) for retail foreign currency exposures secured on housing real properties.

The Group is obliged to maintain the highest capital requirement for the risk related to corporate exposures and exposures secured on real property, which results from the Bank's high exposure to such types of 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 1,894 million as at 31 December 2012 (Tables 4.5 and 4.6).

Table 4.5

EXPOSURES COLLATERALISED WITH GUARANTEES
The Bank Group
2012

TOTAL	1 232
Corporate	1 150
Secured on real estate property	0
Central governments and central banks	5
Retail	0
Other exposures	31
Institutions (banks)	0
Regional governments and local authorities	35
Past dues	11
Administrative bodies and non-commercial undertakings	0
Other*	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 (83% 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 59 billion as at 31 December 2012.

In 2012 and in the previous years, the Group did not conclude any securitisation transaction within the meaning of the Banking Law and Appendix no 18 to the Resolution of PSFA no 76/2010 (as amended).

In 2012 the Bank conducted package sales:

1) in the 1st quarter more than 22 thousand retail receivables classified as lost due from individual persons who do not run economic activity. The sales covered a portfolio of debts of the total value of PLN 90.9 million,
2) in the 2nd quarter over 49 thousand retail receivables classified as lost due from individual persons who do not run economic activity. The sales covered a portfolio of debts of the total value of PLN 720.3 million and more than 2 thousand receivables due from institutional clients classified as lost of the total value of PLN 288.2 million,
3) in 4th quarter: over 28 thousand retail receivables classified as lost due from individual persons who do not run economic activity. The sales covered a package of debts of the total value of PLN 321.8 million.

The total balance sheet value of provisions for potential claims related to sold receivables as at 31 December 2012 amounted to PLN 5.5 million (as at 31 December 2011 is was PLN 3.9 million).

Table 4.6

EXPOSURES COLLATERALISED WITH RECOGNIZED FINANCIAL COLLATERAL*
The Bank Group
2012

TOTAL	662
Corporate	478
Secured on real estate property	0
Central governments and central banks	4
Retail	61
Other exposures	0
Institutions (banks)	111
Regional governments and local authorities	
Past dues	9
Administrative bodies and non-commercial undertakings	0
Other **	0

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

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 2012. Approximately 85% 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 MITIGATION TECHNIQUES

The Bank Group
2012

	PKO Bank Polski SA, KREDOBANK SA Group and BFL SA Group							Other Group companies	Adjustments and exclusions	Total
	Counterparty's credit quality step									
	1	2	3	4	5	6	none			
Corporate	0	0	40	149	0	0	64 303	755	-3 935	61 312
Secured on real estate property	0	0	0	0	0	0	58 218	0	-9	58 209
Central governments and central banks	0	27 683	0	0	248	0	265	78	0	28 274
Retail	0	0	0	0	0	0	27 072	0	0	27 072
Other exposures	0	0	51	0	0	0	12 566	990	-192	13 415
Institutions (banks)	243	2 115	710	114	354	21	6 900	9 548	-10 693	9 311
Regional governments and local authorities	0	8	0	0	0	0	7 723	0	0	7 731
Past dues	0	0	0	0	0	0	4 114	163	0	4 277
Administrative bodies and non-commercial undertakings	0	0	0	0	0	0	1 081	0	0	1 081
Other**	0	0	0	0	0	0	512	17	-376	153
Total	243	29 806	802	262	602	21	182 754	11 551	-15 206	210 835

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

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

Table 4.8

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

The Bank Group
2012

	PKO Bank Polski SA, KREDOBANK SA Group and BFL SA Group							Other Group companies	Adjustments and exclusions	Total
	Counterparty's credit quality step									
	1	2	3	4	5	6	none			
Corporate	0	0	40	149	0	0	62 851	755	-3 935	59 860
Secured on real estate property	0	0	0	0	0	0	58 218	0	-9	58 208
Retail	0	0	0	0	0	0	27 034	0	0	27 034
Central governments and central banks	0	27 683	0	0	248	0	1 282	78	0	29 291
Other exposures	0	0	51	0	0	0	12 534	990	-192	13 383
Institutions (banks)	243	2 115	710	114	354	21	6 789	9 548	-10 693	9 200
Regional governments and local authorities	0	8	0	0	0	0	7 821	0	0	7 829
Past dues	0	0	0	0	0	0	4 095	163	0	4 258
Administrative bodies and non-commercial undertakings	0	0	0	0	0	0	1 081	0	0	1 081
Other**	0	0	0	0	0	0	512	17	-376	153
Total	243	29 806	802	262	602	21	182 216	11 551	-15 206	210 297

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

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

In 2012, the transactions that had the greatest influence on the amount of the Group's capital requirement for derivatives were the IRS and CIRS transactions (Table 4.9).

Table 4.9

CAPITAL REQUIREMENT
FOR DERIVATIVES *
2012

The Bank Group

	Book		
	banking	trading	Total
Derivatives	65	164	229
IRS	22	135	157
CIRS	39	18	57
Forward	0	5	5
SWAP	4	0	4
Options	0	4	4
FRA	0	2	2
Revers Repo	0	0	0
BSB	0	0	0

* Credit risk and counterparty credit risk

In 2012, 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 assessments assigned by the following external credit assessment institutions (rating agencies):
1) Moody's Investors Service,
2) Standard and Poor's Ratings Services,
3) Fitch Ratings.

The Bank implemented the process of carrying the issuer's and issue's rating to off-trading book items for the purposes of calculation of the capital requirements in accordance with the regulations of Annexes No. 4 and No. 15 to Resolution No. 76/2010 of PFSA of 10 March 2010 as amended and Resolution No. 387/2008 of PFSA of 17 December 2008[10] .

4.2. MARKET RISK

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

The total capital requirement for market risk increased in 2012 by ca. 39%. The largest share in the value of requirement for market risk in this period fell to the specific risk of debt instruments (approx. 83%), which results from growth of liabilities for underwriting of the corporate bonds. Another type of capital requirement that is significant in terms of value is the capital requirement for the general interest rate risk (approx. 17%).

The change in the amount of the capital requirement for interest rate risk in the consolidated statements for 2012 resulted from exclusions of the mutual transactions in the capital requirement calculations.

The capital requirement for all other types of market risk was PLN 0.6 million. The capital requirement for FX risk was zero due to the fact that the total currency position did not exceed 2% of the Bank's own funds. As at the end of 2012 the Bank did not have an open position for commodity price risk, so the respective capital requirement was zero.

4.3. OPERATIONAL RISK

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

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

The value of the Group's capital requirement for operational risk was ca. PLN 660 million (including PLN 567 million of the capital requirement for the Bank's operational risk). As compared to 2011 this amount was lower by ca. PLN 193 million which resulted from a reduction of the capital requirements by 23% in consequence of the approval received to fully apply advance methods by the Bank.

Table 4.10

CAPITAL REQUIREMENT
FOR OPERATIONAL RISK
2012

The Bank Group

	Portfolio		
	Bank	Companies	Group
Total	567	93	660
Basic Index Approach - BIA	n.a.	93	93
Advanced approach - AMA	567	n.a.	567

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

5. INTERNAL CAPITAL (PILLAR II)

The Group determines the internal capital in compliance with the PFSA's Resolution no 258/2011 of 4 October 2011 on detailed principles of operation of the risk management system and internal audit system and detailed conditions of internal capital estimation by banks, and reviews of the process of internal capital estimation and maintenance (PFSA's Official Journal no 11, item 42 of 23 November 2011).

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

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

The internal capital of the Bank Group in 2012 was estimated to cover each significant risk type:
1) credit risk, including default risk, concentration risk and dilution risk,
2) FX risk,
3) interest rate risk,
4) liquidity risk,
5) operational risk,
6) business risk (including strategic risk).

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

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

The amount of internal capital for credit risk is determined for exposures subject to credit risk at the level of unexpected loss for the portfolio of exposures, covered by the portfolio risk measures and is calculated pertaining to the VaR model. The unexpected credit loss (UL) is the difference between the credit value at risk (CVaR) and the amount of the expected loss (EL). For credit portfolios not covered by the portfolio risk measures, it is assumed that internal capital for credit risk equals capital requirement for credit risk, calculated under the approaches defined in resolution no 76/2010 of PFSA as amended.

The total internal capital to cover the credit insolvency risk is the total internal capital established for separated exposure portfolios.

The internal capital to cover the credit risk of concentration is determined as the product of:
1) the multipliers of the internal capital surcharge for each material risk concentration type and
2) the internal capital to cover the credit insolvency risk.

In 2012, PD, LGD and CCF parameters (the latter two for retail portfolios only) based on the models worked out during the project works related to the implementation of the advance method of capital requirement calculation for credit risk were used in the process of internal capital assessment for credit risk.

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

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

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

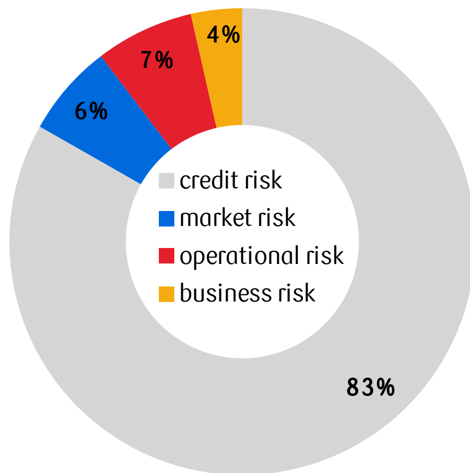
The internal capital for the Bank's operational risk is equal to the level of the Bank's operational risk calculated by means of AMA. The internal capital for the operational risk of the Group's subsidiaries is adopted as follows:
1) for the Bank Group's financial subsidiaries – as the additional capital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

The internal capital for business risk was determined in 2012 as the product of ratio of internal capital calculation for business risk and result on banking activities. At the same time, in 2012 the Bank started activities aimed at preparation of new estimation method of internal capital for business risk for the Bank on the basis of EaR (Earnigs at Risk) approach.

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

The chart below presents the structure of internal capital by risk type, as assessed as at 31 December 2012 for the Group.

Chart 5.1



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

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

6. Capital adequacy

Capital adequacy is the condition under which the amount of own funds of the Bank and the Group is higher than total capital requirements (the so-called Pillar I) and total internal capital (the so-called Pillar II). The objective of capital adequacy management is to maintain, on an ongoing basis, the level of capital that is adequate to the scale and risk profile of business activity of the Group.

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

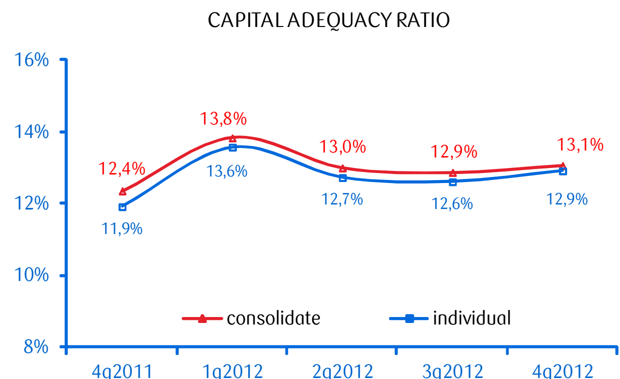
The main measures of capital adequacy are as follows:
1) the capital adequacy ratio (CAR) of at least 8% as required by the Banking Law,
2) the own funds to internal capital ratio of at least 1.0 pursuant to the Banking Law,
3) Common Equity Tier 1 Ratio –CET1 Ratio with the minimum level equal to 9%.

Due to the expectations of the Polish Financial Supervisions Authority (letter of 28 November 2012) for the banks to pay dividend in the amount that is not higher than 75% of net profit for 2012 provided that they obtain:
1) capital adequacy ratio at a higher level than 12%, Common Equity Tier 1 Ratio at a higher level than 9%,
2) capital adequacy ratio for regulatory scenarios of stress tests higher than 12% at the end of 2013,
3) Common Equity Tier 1 Ratio for regulatory scenarios of stress tests higher than 9% at the end of 2013, and
4) receiving BION (regulatory examination and assessment), that is general, in respect to capital adequacy and in respect to capital at a lower level than 2.5.

PKO Bank Polski SA continued activities aimed at ensuring proper capital buffer, and maintaining and enhancing its liquidity position. As at the end of 2012 the Bank met all PFSA's requirements entitling to dividend payment for 2012.

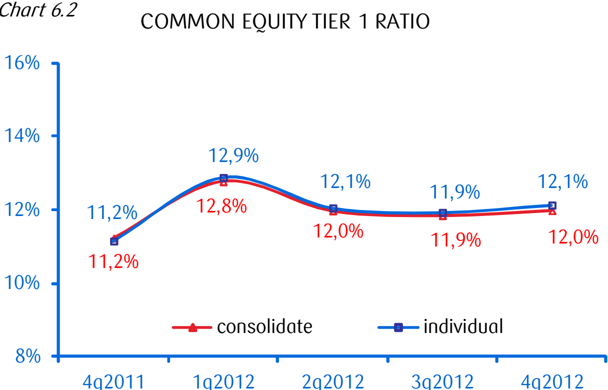
The chart below presents changes in the capital adequacy ratio calculated for the Bank and the Bank Group

Chart 6.1



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

Chart 6.2



In 2012 the measures of capital adequacy remained at above internal and external limits, and above the minimum values recommended by the PFSA.

As at 31 December 2012, as compared to the state as of 31 December 2011, the Group's capital adequacy ratio grew by 0.7 percentage points, to the level of 13.07%, which resulted mainly from increase of own funds of the Bank Group for the needs of capital adequacy (resulting mainly from the fact that 59.85% of the profit for 2011 were allocated to the basic funds) and a decrease of the capital requirement for operational risk (because of full use of AMA approach for calculations).

The Bank monitors drafted changes in regulations (in particular requirements of so called Basel III and directives CRD, IV/CRR) that in the future may have a significant impact on the operations of European banks. The Bank participates in preparation of opinions on such solutions.

Every half a year PKO Bank Polski SA participates in the quantitative studies (QIS) of Basel III's impact on the banking sector.

In 2012 the Bank participated in stress tests organised by the PFSA (TWS). The tests were aimed at presenting the general resistance of the banking sector and ability of banks to absorb potential shocks that have an impact on the growth of credit and market risks. The results of the tests confirm the strong capital position of PKO Bank Polski SA and the Bank's

considerable resistance to macroeconomic shocks, fulfilment of negative market scenarios. They also confirmed the Bank's high resistance to macroeconomic shocks. The Bank records net profit in every scenario and the value of capital adequacy remains above internal and external limits. Obtained results did not point out to a need to undertake non-standard activities in response to the macroeconomic situation.

In 2012 PKO Bank Polski SA successfully passed another capital adequacy examination conducted by the European Banking Authority (EBA) in close cooperation with the Polish Financial Supervision Authority. In December 2011 EBA adopted a recommendation on establishment of temporary capital buffers by banks in order to regain the confidence of financial markets to the banking industry. Banks were obliged to enhance their capital base in such a way, that the capital adequacy for Core Tier I was at least 9%, having taken account of market evaluation of exposures in respect to governments.

PKO Bank Polski SA's capital adequacy for Core Tier I, including a buffer for market evaluation of exposures in respect to governments, as at 30 June 2012 amounted to 12% and was much higher than the level of 9% determined by EBA. Results of the examination confirmed that the Bank has a safe level of own funds and fall of creditworthiness of certain EU Member States does not have a direct impact on the financial situation of PKO Bank Polski SA

7. Principles of determination of variable components of remuneration of the management

Pertaining to the regulations of PFSA's Resolution no 258/2011[11] the Group implemented principles of determination of variable components of remuneration in the following resolutions:

1) Resolution of the Bank's Supervisory Board – policy on variable components of remuneration entitled "Principles of variable components of remuneration for the Bank's management" (on the basis of which further regulations have been issued) and the Regulation on variable components of remuneration for the Management Board Members,
2) Resolution of the Bank's Management Board – the Regulation on variable components of remuneration for the Management,
3) Resolution of the Supervisory Boards of selected subsidiaries of the Bank Group – PKO Leasing SA, PKO Towarzystwo Funduszy Inwestycyjnych SA and PKO BP Bankowy PTE SA ("the Group Companies") – the Regulation on variable components of remuneration for the Management Board Members.

7.1. The process of determination of variable components of remuneration

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

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

7.2. Remuneration committee

The Remuneration Committee was appointed in the Bank to support the Supervisory Board in fulfilment of its statutory obligations and execution of tasks defined in the legal regulations. The Remuneration Committee prepares opinion on the policy on variable components of remuneration of the Bank's management, principles of remuneration payment and salary payment of the Management Board Members.
The Remuneration Committee is responsible in particular for accomplishment of the following tasks:

1) preparing opinions on general principles of the policy on variable components of remuneration of the Bank's management that are subject to approval by the Supervisory Board,
2) performing periodical reviews of general principles of the policy on variable components of remuneration of the Bank's management and presenting results of such reviews to the Supervisory Board,
3) proposing remuneration principles, policy on variable components of remuneration of the Bank's management and salary payment to the Supervisory Board.

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

1) Chairman – Krzysztof Kilian,
2) Deputy Chairman – Tomasz Zganiacz,
3) Members – Cezary Banasiński, Jan Bossak, Marek Mroczkowski.

7.3. Most significant information on the shape of remuneration depending on results and criteria of result assessments

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

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

According to the Regulations, such objective should ensure:

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

Assessment criteria of such objectives should include in particular:

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

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

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

1) Net financial result of the Bank/ the Bank Group,
2) ROE ratio,

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

3) Profit/loss on business activity of supervised area, taking into account the real profit/loss on write-offs and costs of current activities of a given area

and the following risks:

4) strategic,
5) operational,
6) credit,
7) liquidity, etc.

Analogically, with different structure of objective depending on specific nature of accomplished tasks, e.g.:

1) Bank's risk cost,
2) Share of liabilities with recognized impairment in the credit portfolio of the Bank/ the Bank Group,
3) Maintenance of operational risk measure within strategic limits of tolerance,
4) Maintenance of liquidity provision by the Bank up to 1M

in a given range.

Moreover, the assessment criteria include responsibility for accomplished strategic objectives.

7.4. Major information on the main parameters of determination of remuneration depending on results

Pertaining to the requirements of PFSA's Resolution no 258/2011 KNF and proportions defined therein, variable components of remuneration for a given period of time (a calendar year) are granted on the basis of Regulations, after bonus objectives have been settled, in the following forms:

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

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

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

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

Bonus amount:

1) Of the Bank's Management Board Member may change up or down by an adjustment ratio according to the level of fulfilment of specified MbO objectives as compared to the level of fulfilment of objectives defined in annual Bank's Memorandum (list of the Bank's key management indicators) for a given calendar year,
2) Of the Bank's management member may change up by an adjustment ratio according to the level of fulfilment of specified MbO objectives as compared to the level of fulfilment of objectives defined in annual Bank's Memorandum for a given calendar year,
3) Of a Management Board Member of the Group company may change up by an adjustment ratio according to the level of fulfilment of specified MbO objectives as compared to the level of fulfilment planned for the periods of net profit assessment in the Group.

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

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

1) Violation of professional obligations,
2) Non-compliance with legal regulations or customer service standards,
3) Incorrect fulfilment of assigned professional duties,
4) Violation of principles of community life in relation to other employees.

In case of the Members of the Management Boards of the Bank/ Group company, variable components are granted and released on the condition of approval of the financial statement for the given period of assessment.

In case of:

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

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

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

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

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

Table 7.1

REMUNERATION BY BUSINESS LINES

PKO Bank Polski SA

Areas	Retail market area	Corporate market area	Investment banking area	Other areas	Total
Amount of remuneration (regular remuneration and variable remuneration subejct to CRD III principles)	5,68	8,76	7,06	21,50	43,01

Regular and variable remuneration in 2012 for management members in PKO Bank Polski SA who are Management Board Members, persons reporting directly to the Management Board Members and other persons on key positions is presented in table 7.2

Table 7.2

REMUNERATION DIVIDED INTO REGULAR AND VARIABLE

PKO Bank Polski SA

Specification	Management Board Members	persons reporting directly to Management Board members (including chief accountant) and directors of corporate regions	other persons	Total
Number of persons	**6**	**34**	**16**	**56**
Paid regular remuneration	7,59	14,55	5,01	27,15
Variable remuneration subject to CRD III principles for 2012	5,21	7,99	2,66	15,86
granted non-deferred component of the amount subejct to CRD III principles, including	**3,11**	**4,80**	**1,60**	**9,50**
cash (50% of non-deferred component)	*1,55*	**2,40*	**0,80*	*4,75*
financial instrument - number of shares - 50% of non-deferred component converted into a number of phantom shares at the rate in force in Q4 2012	*43 290*	*66 821*	*22 231*	*132 342*
calculated but not yet granted deferred component (for the period of three upocoming years) of the amount subject to CRD III principles, including :	**2,10**	**3,20**	**1,06**	**6,36**
cash (50% of deferred component)	*1,05*	*1,60*	*0,53*	*3,18*
financial instrument - number of shares - 50% of deferred component converted into a number of phantom shares at the rate in force in Q4 2012	*29 309*	*44 548*	*14 820*	*88 677*
value of deferred remuneration granted in the given financial year, paid and reduced due to an adjustment related to results	n.a.	n.a.	n.a.	n.a.
payments related to commencement and termination of an employment relationship	n.a.	n.a.	n.a.	n.a.
number of persons who receive such payments	n.a.	n.a.	n.a.	n.a.
the highest payment	n.a.	n.a.	n.a.	n.a.

* non-deferred remuneration paid in 2013

8. Glossary of terms and abbreviations

AR (Accuracy Ratio) – 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

AMA (Advanced Measurement Approach) – operational risk advanced measurement approach for the purpose of defining the capital requirements for operational risk

Basel II – a set of external regulations 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 PFSA of March 2007, which became binding upon Polish banks as of 1 January 2008 (with the assumption of exercise of the option contained in § 14 clause 1 of Resolution No. 1/2007 of PFSA) amended with resolutions no 380-385/2008 of PFSA and resolution no 76/2010 of PFSA as amended.

Basel III/CRD IV – set of amendments to Basel II regulations published in December 2010 with planned date of entering into force in January 2014 and they implemented gradually until January 2019.

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.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

FX Swap – a foreign currency exchange swap

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

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

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)

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

PFSA – the Polish Financial Supervision Authority

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

LMA – the Loan Market Association

IAS – the International Accounting Standards

(LDA) Loss Distribution Approach – an approach in which historical data on internal and external events are used, as well as the information on the development of operational

environment factors for statistical measurement of operational risk.

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

NBP – the National Bank of Poland

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)

Outsourcing – use of external resources

PCBA – the Polish Classification of Business activity

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

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

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

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

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)

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

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

REPO – an operation within which funds are borrowed on securities

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

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

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

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

Price risk of commodities – risk of loss related to negative changes in prices of commodities.

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.)

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

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

Operational risk – the risk of losses resulting from inadequacy or unreliability of the internal processes, the human factor and systems, or from external events

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

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

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

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

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

Foreign Exchange (FX risk) – the risk of loss due to unfavourable changes of foreign exchange rates or their volatility

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 bank's strategic development

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Hedge ratio – hedge ratio that is the measure of collateral value (in %), defined while taking a credit decision and in a crediting period

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

PBA – the Polish Bank Association