Bank Polski

Consolidated financial statements of the PKO Bank Polski SA Group for the year ended 31 December 2016

Report publication date:
6 March 2017

Bank Polski

SELECTED FINANCIAL DATA DERIVED FROM THE FINANCIAL STATEMENTS

SELECTED CONSOLIDATED FINANCIAL DATA	PLN million		EUR million	
	period from 01.01.2016 to 31.12.2016	period from 01.01.2015 to 31.12.2015	period from 01.01.2016 to 31.12.2016	period from 01.01.2015 to 31.12.2015
Net interest income	7 754.8	7 028.6	1 772.2	1 679.6
Net fee and commission income	2 693.4	2 850.6	615.5	681.2
Operating profit	3 748.7	3 152.6	856.7	753.3
Profit before income tax	**3 783.2**	**3 190.7**	**864.6**	**762.4**
Net profit (including non-controlling shareholders)	**2 876.1**	**2 601.2**	**657.3**	**621.6**
Net profit attributable to equity holders of the parent company	**2 874.0**	**2 609.5**	**656.8**	**623.6**
Earnings per share for the period – basic (in PLN/EUR)	**2.30**	**2.09**	**0.53**	**0.50**
Earnings per share for the period – diluted (in PLN/EUR)	**2.30**	**2.09**	**0.53**	**0.50**
Net comprehensive income	2 303.7	2 649.3	526.5	633.1
Net cash flows used in operating activities	7 095.7	15 394.7	1 621.6	3 678.7
Net cash flows used in investing activities	(8 956.5)	(4 597.5)	(2 046.9)	(1 098.6)
Net cash flows from / used in financing activities	2 562.4	(7 787.4)	585.6	(1 860.9)
Total net cash flows	701.6	3 009.8	160.3	719.2

SELECTED CONSOLIDATED FINANCIAL DATA	PLN million		EUR million	
	as at 31.12.2016	as at 31.12.2015	as at 31.12.2016	as at 31.12.2015
Total assets	285 572.7	266 939.9	64 550.8	62 639.9
Total equity	32 568.6	30 264.9	7 361.8	7 101.9
Capital and reserves attributable to equity holders of the parent company	32 584.8	30 283.2	7 365.5	7 106.2
Share capital	1 250.0	1 250.0	282.5	293.3
Number of shares (in million)	1 250.0	1 250.0	1 250.0	1 250.0
Book value per share (in PLN/EUR)	26.05	24.21	5.89	5.68
Diluted number of shares (in million)	1 250.0	1 250.0	1 250.0	1 250.0
Diluted book value per share (in PLN/EUR)	26.05	24.21	5.89	5.68
Capital adequacy ratio	15.81%	14.61%	15.81%	14.61%
Tier 1	28 349.9	24 608.3	6 408.2	5 774.6
Tier 2	2 523.0	2 483.1	570.3	582.7

Selected consolidated financial statements items translated into EUR using the following rates	31.12.2016	31.12.2015
average NBP rates as at the last day of each month of the year	4.3757	4.1848
mid NBP rate as at 31 December of a given year	4.4240	4.2615

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CONSOLIDATED INCOME STATEMENT

	Note	2016	2015
Interest and similar income	7	9 964.4	9 657.8
Interest expense and similar charges	7	(2 209.6)	(2 629.2)
Net interest income		**7 754.8**	**7 028.6**
Fee and commission income	8	3 579.6	3 598.3
Fee and commission expense	8	(886.2)	(747.7)
Net fee and commission income		**2 693.4**	**2 850.6**
Dividend income	9	10.3	10.7
Net income from financial instruments measured at fair value	10	4.4	40.6
Gains less losses from investment securities	11	506.1	87.7
Net foreign exchange gains (losses)	12	503.2	369.0
Other operating income	13	648.5	513.1
Other operating expense	13	(330.0)	(235.6)
Net other operating income and expense		**318.5**	**277.5**
Net impairment allowance and write-downs	14	(1 622.7)	(1 475.9)
Administrative expenses	15	(5 590.4)	(6 036.2)
Tax on certain financial institutions	16	(828.9)	-
Operating profit		**3 748.7**	**3 152.6**
Share in profit (loss) of associates and joint ventures		34.5	38.1
Profit before income tax		**3 783.2**	**3 190.7**
Income tax expense	17	(907.1)	(589.5)
Net profit (including non-controlling shareholders)		2 876.1	2 601.2
Profit (loss) attributable to non-controlling shareholders		2.1	(8.3)
Net profit attributable to equity holders of the parent company		**2 874.0**	**2 609.5**
Earnings per share			
– basic earnings per share for the period (in PLN)		2.30	2.09
– diluted earnings per share for the period (in PLN)		2.30	2.09
Weighted average number of ordinary shares during the period (in million)		1 250.0	1 250.0
Weighted average diluted number of ordinary shares during the period (in milion)		1 250.0	1 250.0

Notes on pages 11 to 176 are an integral part of these
consolidated financial statements

(IN PLN MILLION)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Note	2016	2015
Net profit (including non-controlling shareholders)		**2 876.1**	**2 601.2**
Other comprehensive income		**(572.4)**	**48.1**
Items that may be reclassified to the income statement		**(574.4)**	**51.7**
Cash flow hedges (gross)	23	(62.7)	(77.6)
Deferred tax on cash flow hedges	17, 23	11.9	14.7
Cash flow hedges (net)	23	(50.8)	(62.9)
Unrealised net gains on financial assets available for sale (gross)	39	(636.1)	171.3
Deferred tax on unrealised net gains on financial assets available for sale	17	118.1	(31.7)
Unrealised net gains on financial assets available for sale (net)		(518.0)	139.6
Currency translation differences from foreign operations		(5.0)	(23.8)
Share in other comprehensive income of an associate	41	(0.6)	(1.2)
Items that may not be reclassified to the income statement		**2.0**	**(3.6)**
Actuarial gains and losses, gross		2.4	(4.5)
Deffered tax	17	(0.4)	0.9
Actuarial gains and losses		2.0	(3.6)
Total net comprehensive income		**2 303.7**	**2 649.3**
Total net comprehensive income, of which attributable to:		2 303.7	2 649.3
equity holders of PKO Bank Polski SA		2 301.6	2 657.6
non-controlling shareholders		2.1	(8.3)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Note	31.12.2016	31.12.2015
ASSETS			
Cash and balances with the Central Bank	19	13 325.1	13 743.9
Amounts due from banks	20	5 345.4	4 553.0
Trading assets excluding derivative financial instruments	21	326.4	783.2
Derivative financial instruments	22	2 900.6	4 347.3
Financial assets designated upon initial recognition at fair value through profit and loss	24	13 937.2	15 154.1
Loans and advances to customers	25	200 606.5	190 413.7
Investment securities available for sale	26	36 675.6	28 309.5
Investment securities held to maturity	27	465.6	210.3
Investments in associates and joint ventures	41	385.6	391.8
Non-current assets held for sale	28	14.4	220.0
Inventories	29	259.9	400.9
Intangible assets	30	3 422.2	3 271.0
Tangible fixed assets	30	3 085.7	2 782.2
Current income tax receivables		10.0	46.5
Deferred income tax assets		1 779.0	901.6
Other assets	31	3 033.5	1 410.9
TOTAL ASSETS		**285 572.7**	**266 939.9**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to the Central Bank		4.1	4.2
Amounts due to banks	32	19 208.4	18 288.8
Derivative financial instruments	22	4 197.9	4 624.8
Amounts due to customers	33	205 066.4	195 758.5
Liabilities due to insurance operations	34	2 943.6	2 400.5
Debt securities in issue	35	14 493.2	9 432.9
Subordinated liabilities	36	2 539.0	2 499.2
Other liabilities	37	3 987.1	3 356.2
Current income tax liabilities		304.9	26.1
Deferred income tax liabilities		30.9	31.8
Provisions	38	228.6	252.0
TOTAL LIABILITIES		**253 004.1**	**236 675.0**
Equity			
Share capital	39	1 250.0	1 250.0
Other capital	39	28 700.9	25 417.8
Currency translation differences from foreign operations	39	(221.5)	(216.5)
Undistributed profits	39	(18.6)	1 222.4
Net profit for the year	39	2 874.0	2 609.5
Capital and reserves attributable to equity holders of the parent company	39	32 584.8	30 283.2
Non-controlling interest	39	(16.2)	(18.3)
TOTAL EQUITY		**32 568.6**	**30 264.9**
TOTAL LIABILITIES AND EQUITY		**285 572.7**	**266 939.9**
Total capital ratio	71	15.81%	14.61%
Book value (in PLN million)		32 568.6	30 264.9
Number of shares (in million)	39	1 250.0	1 250.0
Book value per share (in PLN)		26.05	24.21
Diluted number of shares (in million)		1 250.0	1 250.0
Diluted book value per share (in PLN)		26.05	24.21

(IN PLN MILLION)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

2016	Share capital	Other capital								Currency translation differences from foreign operations	Undistributed profits	Net profit for the period	Total capital and reserves attributable to equity holders of the parent company	Non-controlling interest	Total equity
		Reserves			Other comprehensive income										
		Reserve capital	General banking risk fund	Other reserves	Share in other comprehensive income of an associate and joint venture	Financial assets available for sale	Cash flow hedges	Actuarial gains and losses	Total other capital						
Note 40															
As at 1 January 2016	1 250.0	20 711.2	1 070.0	3 536.4	(0.2)	170.6	(57.7)	(12.5)	25 417.8	(216.5)	1 222.4	2 609.5	30 283.2	(18.3)	30 264.9
Transfer of net profit from previous years	-	-	-	-	-	-	-	-	-	-	2 609.5	(2 609.5)	-	-	-
Total comprehensive income, of which:	-	-	-	-	(0.6)	(518.0)	(50.8)	2.0	(567.4)	(5.0)	-	2 874.0	2 301.6	2.1	2 303.7
Net profit	-	-	-	-	-	-	-	-	-	-	-	2 874.0	2 874.0	2.1	2 876.1
Other comprehensive income	-	-	-	-	(0.6)	(518.0)	(50.8)	2.0	(567.4)	(5.0)	-	-	(572.4)	-	(572.4)
Transfer from undistributed profits	-	3 779.4	-	71.1	-	-	-	-	3 850.5	-	(3 850.5)	-	-	-	-
As at 31 December 2016	1 250.0	24 490.6	1 070.0	3 607.5	(0.8)	(347.4)	(108.5)	(10.5)	28 700.9	(221.5)	(18.6)	2 874.0	32 584.8	(16.2)	32 568.6

2015	Share capital	Other capital								Currency translation differences from foreign operations	Undistributed profits	Net profit for the period	Total capital and reserves attributable to equity holders of the parent company	Non-controlling interest	Total equity
		Reserves			Other comprehensive income										
		Reserve capital	General banking risk fund	Other reserves	Share in other comprehensive income of an associate and joint venture	Financial assets available for sale	Cash flow hedges	Actuarial gains and losses	Total other capital						
Note 40															
As at 1 January 2015	1 250.0	18 802.4	1 070.0	3 474.1	1.0	31.0	5.2	(8.9)	23 374.8	(192.7)	(60.6)	3 254.1	27 625.6	(10.0)	27 615.6
Transfer of net profit from previous years	-	-	-	-	-	-	-	-	-	-	3 254.1	(3 254.1)	-	-	-
Total comprehensive income, of which:	-	-	-	-	(1.2)	139.6	(62.9)	(3.6)	71.9	(23.8)	-	2 609.5	2 657.6	(8.3)	2 649.3
Net profit	-	-	-	-	-	-	-	-	-	-	-	2 609.5	2 609.5	(8.3)	2 601.2
Other comprehensive income	-	-	-	-	(1.2)	139.6	(62.9)	(3.6)	71.9	(23.8)	-	-	48.1	-	48.1
Transfer from undistributed profits	-	1 908.8	-	62.3	-	-	-	-	1 971.1	-	(1 971.1)	-	-	-	-
As at 31 December 2015	1 250.0	20 711.2	1 070.0	3 536.4	(0.2)	170.6	(57.7)	(12.5)	25 417.8	(216.5)	1 222.4	2 609.5	30 283.2	(18.3)	30 264.9

(IN PLN MILLION)

Bank Polski

CONSOLIDATED STATEMENT OF CASH FLOWS

	Note	2016	2015
Net cash flows from operating activities			
Profit before income tax		**3 783.2**	**3 190.7**
Adjustments:		**3 312.5**	**12 204.0**
Amortisation and depreciation		800.7	818.6
(Gains) losses from investing activities	47	(186.2)	(13.5)
Interest and dividends	47	(236.0)	(110.5)
Change in:			
amounts due from banks	47	325.5	(1 029.2)
trading assets and financial assets designated upon initial recognition at fair value through profit and loss		1 673.7	1 710.3
derivative financial instruments		1 019.8	227.1
loans and advances to customers	47	(3 821.9)	(10 609.6)
other assets, inventories and non-current assets held for sale	47	(1 311.3)	(79.0)
amounts due to banks	47	(3 042.3)	1 590.3
amounts due to customers	47	8 592.1	20 695.2
liabilities classified as held for sale		-	(35.0)
debt securities in issue	47	443.2	652.0
provisions and impairment allowances	47	(291.0)	(63.3)
other liabilities, liabilities due to insurance operations and subordinated liabilities	47	1 100.9	201.7
Income tax paid		(917.4)	(544.1)
Other adjustments	47	(837.3)	(1 207.0)
Net cash generated from/used in operating activities		**7 095.7**	**15 394.7**
Net cash flows from investing activities			
Inflows from investing activities		**50 579.6**	**45 852.9**
Proceeds from disposal on subsidiaries		133.5	-
Proceeds from sale and interest of investment securities		50 293.7	45 423.7
Proceeds from sale of intangible assets, tangible fixed assets and assets held for sale		131.1	113.7
Subsidies from acquisition		-	279.3
Other investing inflows (dividends)		21.3	36.2
Outflows from investing activities		**(59 536.1)**	**(50 450.4)**
Purchase of a subsidiary, net of cash acquired		(571.1)	-
Increase in equity of a subsidiary		(1.1)	-
Purchase of investment securities		(58 208.2)	(49 619.0)
Purchase of intangible assets and tangible fixed assets		(755.7)	(831.4)
Net cash used in investing activities		**(8 956.5)**	**(4 597.5)**
Net cash flows from financing activities			
Proceeds from debt securities in issue		7 807.1	3 646.2
Redemption of debt securities		(4 747.2)	(8 165.7)
Repayment of interest from debt securities in issue and subordinated loans		(352.6)	(544.6)
Long-term borrowings		460.0	240.6
Repayment of long-term borrowings		(604.9)	(2 963.9)
Net cash generated from/used in financing activities		**2 562.4**	**(7 787.4)**
Net cash flow		**701.6**	**3 009.8**
of which currency translation differences on cash and cash equivalents		135.0	45.1
Cash and cash equivalents at the beginning of the period		17 264.7	14 254.9
Cash and cash equivalents at the end of the period	47	17 966.3	17 264.7
of which restricted	47	13.3	15.9

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL INFORMATION ON THE GROUP AND THE BANK

BUSINESS ACTIVITIES OF THE GROUP AND THE BANK

Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna ('PKO Bank Polski' SA or 'The Bank') was established in 1919 as Pocztowa Kasa Oszczędnościowa. In 1950 it started operations as the Powszechna Kasa Oszczędności State-owned bank. Pursuant to the Decree of the Council of Ministers dated 18 January 2000 (Journal of Laws No. 5, item 55 with subsequent amendments) Powszechna Kasa Oszczędności (a State-owned bank) was transformed into a State-owned joint-stock company, Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna with its Head Office in Warsaw, Puławska 15 Street, 02-515 Warsaw, Poland.

On 12 April 2000 Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna was registered and entered into the Register of Companies by the District Court for the capital city of Warsaw, Commercial Court XVI Registration Department. At present, the appropriate court is the District Court for the capital city of Warsaw, XIII Economic Department of the National Court Register. The Bank was registered under entry No. KRS 0000026438 and was granted a statistical REGON No. 016298263.

According to the Warsaw Stock Exchange Bulletin (Ceduła Giełdowa), the Bank is classified under the macro-sector 'Finance', sector 'Banks'.

The Powszechna Kasa Oszczędnościowa Bank Polski Spółka Akcyjna Group ('PKO Bank Polski SA Group', 'the Bank's Group', 'the Group') conducts its operations within the territory of the Republic of Poland and through subsidiaries: in the territory of Ukraine, Sweden and Ireland, and – as of 7 December 2015 as a Branch in the Federal Republic of Germany ('the Branch in Germany').

PKO Bank Polski SA as the parent company is a universal deposit and credit bank which services individuals, legal entities and other entities, both Polish and foreign. The Bank may hold foreign exchange and foreign currencies and trade in those currencies, as well as conduct foreign exchange and foreign currency transactions, and open and close bank accounts in banks abroad, as well as deposit foreign exchange funds in those accounts.

The Group offers mortgage loans, provides financial services related to leases, factoring, investment funds, pension funds, insurance and debt collection services, transfer agent services, IT outsourcing and business outsourcing services, conducts development and real estate management operations.

Composition of the Group and the scope of operations of its entities are presented in the note 'Structure of the PKO Bank Polski SA Group and the scope of activities of the Group entities'.

INFORMATION ON MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARD OF THE BANK

As at 31 December 2016, the Bank's Supervisory Board consisted of:

- Piotr Sadownik — Chairman of the Supervisory Board
- Grażyna Ciurzyńska — Deputy-Chairman of the Supervisory Board
- Zbigniew Hajłasz — Secretary of the Supervisory Board
- Mirosław Barszcz — Member of the Supervisory Board
- Adam Budnikowski — Member of the Supervisory Board
- Wojciech Jasiński — Member of the Supervisory Board
- Andrzej Kisielewicz — Member of the Supervisory Board
- Elżbieta Mączyńska – Ziemacka — Member of the Supervisory Board
- Janusz Ostaszewski — Member of the Supervisory Board

On 25 February 2016 the Extraordinary General Shareholders' Meeting of the Bank dismissed from the Supervisory Board of the Bank: Jerzy Góra, Mirosław Czekaj, Piotr Marczak, Marek Mroczkowski, Krzysztof Kilian and Zofia Dzik, and appointed: Mirosław Barszcz, Adam Budnikowski, Wojciech Jasiński, Andrzej Kisielewicz, Janusz Ostaszewski, Piotr Sadownik and Agnieszka Winnik – Kalemba as members of the Supervisory Board of the Bank.

On 30 June 2016 the Ordinary General Shareholders' Meeting of the Bank dismissed from the Supervisory Board of the Bank Agnieszka Winnik–Kalemba and Małgorzata Dec–Kruczkowska and appointed Grażyna Ciurzyńska and Zbigniew Hajłasz as members of the Supervisory Board of the Bank.

As at 31 December 2016, the Bank's Management Board consisted of:

• Zbigniew Jagiełło	President of the Management Board
• Janusz Derda	Vice-President of the Management Board, from the 1 December 2016
• Bartosz Drabikowski	Vice-President of the Management Board
• Maks Kraczkowski	Vice-President of the Management Board, from the 4 July 2016
• Mieczysław Król	Vice-President of the Management Board, from the 2 June 2016
• Piotr Mazur	Vice-President of the Management Board
• Jakub Papierski	Vice-President of the Management Board
• Jan Emeryk Rościszewski	Vice-President of the Management Board, from the 18 July 2016

In 2016, the following persons resigned from the Management Board: Jacek Obłękowski, Jarosław Myjak and Piotr Alicki.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

Consolidated financial statements of the Group have been prepared for the year ended 31 December 2016 and include comparative data for the year ended 31 December 2015. Financial data have been presented in Polish zloty (PLN) in millions, with one decimal place, unless indicated otherwise.

2.1. COMPLIANCE WITH ACCOUNTING STANDARDS

These consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) as at 31 December 2016, and in the areas not regulated by these standards, in accordance with the requirements of the Accounting Act of 29 September 1994 and the respective secondary legislation issued on its basis, as well as the requirements relating to issuers of securities registered or applying for registration on an official quotations market.

2.2. GOING CONCERN

Consolidated financial statements of the Group have been prepared on the basis that the Group will continue as a going concern for at least the period of 12 months from the publication date, i.e. from 6 March 2017. As at the date of signing these financial statements, the Bank’s Management Board is not aware of any facts or circumstances that would indicate a threat to continuing activity of the Bank for 12 months following the publication date as a result of any intended or compulsory withdrawal or significant limitation in the activities of the Group.

In 2016 and 2015, the Group had no discontinued operations.

2.3. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

These consolidated financial statements have been prepared on a fair value basis in respect of financial assets and liabilities measured at fair value through profit and loss, including derivatives and financial assets available for sale, except of those for which the fair value cannot be reliably estimated. Other financial assets (including loans and advances) are measured at amortized cost less impairment or at purchase price less impairment. The other financial liabilities are recognised at amortized cost. Non-current assets are measured at acquisition cost less accumulated depreciation and impairment allowances. Non-current assets (or groups of the above-mentioned assets) classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

The Group recognises all significant expenses and income in accordance with the following policies: accrual basis, matching principle, policies for recognition and valuation of assets and liabilities, policies for recognition of impairment losses. The accounting policies relating to the individual items are presented in the individual notes to the income statement.

(IN PLN MILLION)

While preparing financial statements, the Group makes certain estimates and assumptions, which have a direct influence on both the financial statements and enclosed supplementary information. The estimates and assumptions that are used by the Group in determining the value of assets and liabilities as well as revenues and costs, are made based on historical data and other factors which are available and are considered to be proper in the given circumstances. Assumptions regarding the future and the available data are used for assessing carrying amounts of assets and liabilities which cannot be determined unequivocally using other sources. In making estimates the Group takes into consideration the reasons and sources of the uncertainties that are anticipated at the end of the reporting period. Actual results may differ from estimates.

Estimates and assumptions made by the Group are subject to periodic reviews. Changes to estimates are recognised in the period to which they relate.

2.4. Approval of the financial statements

These financial statements, subject to review of the Audit Committee and adoption by the Supervisory Board of the Bank on 2 March 2017, were approved for publication by the Management Board on 21 February 2017.

3. Summary of significant accounting policies

Major accounting policies and estimates and judgements applied in the preparation of these consolidated financial statements are presented in the notes and below. These policies were applied consistently in all the years presented. Presented below is a summary of accounting policies and major estimates and judgements for the individual items of the consolidated income statement and the consolidated statement of financial position.

INCOME STATEMENT	Note	The accounting policies*
Interest income and expense	7	Y
Fee and commission income and expense	8	Y
Dividend income	9	Y
Net income from financial instruments measured at fair value	10	Y
Gains less losses from investment securities	11	Y
Net foreign exchange gains (losses)	12	Y
Other operating income and expenses	13	Y
Net impairment allowance and write-downs	14	Y
Administrative expenses	15	Y
Income tax expense	17	Y

* The letter Y indicates the presence of a particular accounting policy

(IN PLN MILLION)

STATEMENT OF FINANCIAL POSITION	Note	The accounting policies*	Critical estimates and judgements*
Cash and balances with the Central Bank	19	Y	
Amounts due from banks	20	Y	
Trading assets excluding derivative financial instruments	21	Y	
Derivative financial instruments	22	Y	Y
Derivative hedging instruments	23	Y	
Financial assets designated upon initial recognition at fair value through profit and loss	24	Y	
Loans and advances to customers	25	Y	Y
Investment securities available for sale	26	Y	Y
Investment securities held to maturity	27	Y	
Non-current assets held for sale	28	Y	
Intangible assets	30	Y	Y
Tangible fixed assets	30	Y	Y
Other assets	31	Y	
Amounts due to banks	32	Y	
Amounts due to customers	33	Y	
Debt securities in issue	35	Y	Y
Subordinated liabilities	36	Y	
Other liabilities	37	Y	
Provisions	38	Y	Y
Equity and shareholding structure of the Bank	39	Y	

* The letter Y indicates the presence of a particular accounting policy or major estimates and judgements

3.1. Foreign currencies

Functional and presentation currency

Items presented in the financial statements of the individual Group entities operating outside of Poland are measured in functional currency i.e. in the currency of the basic economic environment in which the given entity operates. The functional currency of the parent company and other entities included in these financial statements, except for the Branch in Germany and entities conducting their activities outside of the Republic of Poland is the Polish zloty. The functional currency of the entities operating in Ukraine is the Ukrainian hryvnia, and the functional currency of the branch in Germany and the entities operating in Sweden and in Ireland is euro.

Transactions and balances denominated in foreign currencies

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions. At each balance sheet date items are translated by the Group using the following principles:

1) monetary assets denominated in foreign currency using a closing rate i.e. the average rate announced by the National Bank of Poland prevailing as at the balance sheet date,
2) non-monetary assets measured at historical acquisition cost in foreign currency using exchange rate as of the date of the transaction,
3) non-monetary assets measured at fair value in foreign currency using exchange rates prevailing as at the date of the determination of fair value.

Gains and losses on settlements of these transactions and the carrying amount valuations of monetary and non-monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

UAH	2016	2015
Exchange rate as at the end of the given period	0.1542	0.1622
Average of exchange rates as at the end of each month in the given period	0.1542	0.1722
The highest exchange rate in the given period	0.1632	0.2381
The lowest exchange rate in the given period	0.1436	0.1096

(IN PLN MILLION)

EUR	2016	2015
Exchange rate as at the end of the given period	4.4240	4.2615
Average of exchange rates as at the end of each month in the given period	4.3757	4.1848
The highest exchange rate in the given period	4.4405	4.2652
The lowest exchange rate in the given period	4.2684	4.0337

3.2. BASIS OF CONSOLIDATION

SUBSIDIARIES

Subsidiaries are entities controlled by the parent company, which means that the parent company has a direct or indirect impact on the financial and operating policy of the given entity in order to gain economic benefits from its operations.

THE 'FULL' METHOD OF CONSOLIDATION

All entities of the PKO Bank Polski SA Group are consolidated using the 'full' consolidation method.

The 'full' method of consolidation requires the adding up of full amounts of all individual items of the statement of financial position, income statement and other comprehensive income of the parent company and the subsidiaries, and making appropriate consolidation adjustments and eliminations. The carrying amount of the Bank's investments in subsidiaries and the equity of these entities at the date of their acquisition are eliminated at consolidation. The following items are eliminated in full at consolidation:

1) inter-company receivables and payables, and any other settlements of a similar nature, between the consolidated entities,
2) revenue and costs arising from business transactions conducted between the consolidated entities,
3) gains or losses from business transactions conducted between consolidated entities, included in the carrying amount of the assets of the consolidated entities, except for losses indicating impairment,
4) dividends accrued or paid by the subsidiaries to the parent company and to other consolidated entities,
5) inter-company cash flows in the statement of cash flows.

The consolidated statement of cash flows has been prepared on the basis of the consolidated statement of financial position, consolidated income statement and the additional notes and explanations.

The parent company and consolidated subsidiaries reporting periods for the financial statements are consistent. Consolidation adjustments are made in order to eliminate any differences in the accounting policies applied by the Bank and its subsidiaries.

ACQUISITION METHOD

The acquisition of subsidiaries by the Group is accounted for under the acquisition method.

In respect of mergers of the Group companies, i.e. so-called transactions under common control, the accounting policy is to apply the predecessor accounting, i.e. to recognise the acquired subsidiary at the carrying amount of its assets and liabilities recognised in the Group consolidated financial statements in respect of the given subsidiary, including also the goodwill which arose from the acquisition of that subsidiary.

ASSOCIATES AND JOINT VENTURES

Associates are entities on which the Group exerts significant influence but whose financial and operating policies it does not control, which usually accompanies having from 20% to 50% of the total number of votes in the decision-making bodies of the entities.

Joint ventures are trade companies or other entities, which are jointly controlled by the Bank on the basis of the Memorandum of Association, company's agreement or an agreement concluded for a period longer than one year.

Investments in these entities are accounted in accordance with the equity method and are initially stated at cost. The investment includes goodwill determined as at the acquisition date, net of any potential accumulated impairment allowances.

The Group's share in the results of the associates and joint ventures from the acquisition date are recorded in the income statement and its share in changes of other comprehensive income from the acquisition date is recorded in other comprehensive income. The carrying amount of investments is adjusted by the total movements in particular equity items from the acquisition date. When the Group's share in the losses of an associate or joint ventures becomes equal or higher than the Group's share in the associate or joint ventures, which covers potential unsecured receivables, the Group discontinues recognizing further losses unless it has assumed the obligation or has made payments on behalf of the given associate or joint ventures.

Unrealized gains on transactions between the Group and these entities are eliminated in proportion to the Group's share in the above-mentioned entities. Unrealized losses are also eliminated unless the transaction proves that the given asset transferred has been impaired.

At each balance sheet date, the Group makes an assessment of whether there is any objective evidence of impairment in investments in associates and joint ventures. If any such evidence exists, the Group estimates the recoverable amount, i.e. the value in use of the investment or the fair value of the investment less costs to sale, depending on which of these values is higher. If carrying amount of the asset exceeds its recoverable amount, the Group recognises an impairment allowance in the income statement.

3.3. Accounting for transactions

Financial assets and financial liabilities, including forward transactions and standardized transactions giving rise to an obligation or a right to acquire or sell in the future a given number of specified financial instruments at a given price, are recognised in the books of account in trade date, irrespective of the settlement date provided in the contract.

3.4. Derecognition of financial instruments from the statement of financial position

Financial assets are derecognised from the statement of financial position when contractual rights to the cash flows from the financial asset expire, or when the financial asset is transferred by the Group to another entity. The financial asset is transferred when the Group:

- transfers the contractual rights to receive the cash flows from the financial asset, or
- retains the contractual rights to receive cash flows from the financial asset, but assumes a contractual obligation to pay cash flows to an entity outside the Group.

When the Group transfers a financial asset, it evaluates the extent to which it retains the risks and rewards of ownership of the financial asset. In such a case:

- if all the risks and rewards on a financial asset are substantially transferred, then the Group derecognises the financial asset from the statement of financial position,
- if all the risks and rewards on a financial asset are substantially retained by the Group, then the financial asset continues to be recognised in the statement of financial position,
- if substantially all the risks and rewards of the financial asset are neither transferred nor retained by the Group, then a determination is made as to whether control of the financial asset has been retained.

If the Group has retained control, it continues to recognise the financial asset in the statement of financial position to the extent of its continuing involvement in the financial asset, if control has not been retained, then the financial asset is derecognised from the statement of financial position.

The Group derecognizes a financial liability (or a part of a financial liability) from its statement of financial position when the obligation specified in the contract is met or cancelled or expires.

Usually the Group derecognises loans when they have been extinguished, when they are expired, or when they are not recoverable. Loans, advances and other receivables are written off against impairment allowances that were recognised for these accounts. In the case where no allowances were recognised against the account or the amount of the allowance is less than the amount of the loan, advance or other receivable, the loan, advance or receivable is written off after the amount of the impairment allowance is increased by the difference between the value of the receivable and the amount of the allowances that have been recognised to date.

4. CHANGES IN ACCOUNTING POLICIES

4.1. AMENDMENTS TO PUBLISHED STANDARDS AND INTERPRETATIONS AS ADOPTED BY THE EU THAT ARE EFFECTIVE FROM 1 JANUARY 2016

CHANGES IN IAS 1 PRESENTATION OF THE FINANCIAL STATEMENTS

The amendments to IAS 1 clarify that materiality applies to both the primary financial statements and the explanatory notes and show that only material information needs to be presented. A similar position was presented in ESMA documents with regard to disclosures for financial statements. The Group reviewed the financial statements paying attention to materiality and the reasonableness of the disclosure of information, and immaterial disclosures were not presented even if they constituted part of the requirement of a given standard. Selected items of the income statement or the statement of financial position were also aggregated to make the financial statements more useful. Furthermore, the presentation of financial data in millions of Polish zlotys (PLN) with one place after the decimal point was introduced in place of the presentation in thousands of Polish zlotys used so far. In addition, to ensure a better understanding of the financial statements for the user, the accounting policies as well as major estimates and assessments were presented in the notes to the individual items of the income statement and the statement of financial position.

OTHER AMENDMENTS TO STANDARDS AND ANNUAL IMPROVEMENTS

The remaining amendments to published standards and interpretations, i.e. to IAS 16, 19, 28, 38 and IFRS 10, 11 and 12 and IFRS Improvements 2010-2012 and 2012-2014, which came into force on 1 January 2016 did not affect the financial statements.

4.2. NEW STANDARDS, INTERPRETATIONS AND AMENDMENTS TO PUBLISHED STANDARDS, THAT WERE PUBLISHED AND ADOPTED BY THE EU, BUT DID NOT COME INTO FORCE YET AND WERE NOT INTRODUCED BY THE GROUP

The Management Board does not expect the adoption of the new standards, their changes and interpretations to have a significant impact on the accounting policies applied by the Group with the exception of IFRS 9. The Group intends to apply them in the periods indicated in the relevant standards and interpretations (without early adoption), provided adoption by the EU.

IFRS 9 FINANCIAL INSTRUMENTS

IFRS 9 Financial Instruments was published in July 2014 and endorsed for application in the EU Member States on 22 November 2016 by Commission Regulation (EU) 2016/2067. It is mandatory for financial statements prepared for the financial years starting on or after 1 January 2018 (with the exception of insurance companies, which may apply the standard from 1 January 2021). The standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The amendments cover the classification and measurement of financial instruments, recognition and calculation of impairment and hedge accounting.

Classification and measurement:

IFRS 9 defines 3 measurement categories of financial instruments:

- amortized cost calculated using the effective interest rate method (hereinafter ‘amortized cost’);
- fair value through other comprehensive income (hereinafter ‘FVOCI’); and
- fair value through profit or loss (hereinafter ‘FVP&L’).

The above corresponds to the measurement methods known from IAS 39, but the principles of classifying items to the individual categories are completely different.

In the case of debt instruments, classification of financial assets is based on the entity's business model and the characteristics of cash flows generated by those assets.

The business model test determines whether a given instrument is maintained to obtain contractual cash flows or to realize fair value changes before the maturity date. There are three groups distinguished within the business model: 'hold to collect', 'hold to collect and sell' and 'sell'.

The test of the cash flow characteristics establishes whether contractual cash flows are solely payments of principal and interest defined as consideration for the time value of money and risks related to the value of the exposure in a given period (hereinafter 'SPPI').

If both these tests are satisfied, debt assets are classified as measured at amortized cost, with the exception of the possibility of classifying to FVP&L the instruments in case of which such measurement eliminates the accounting mismatch in the measurement method.

The standard introduced a new measurement category of fair value through other comprehensive income (FVOCI) which will include debt instruments used under a business model assuming both obtaining contractual cash flows and selling financial assets. The condition is that the SPPI test must be satisfied. In the case of FVOCI measurement, all fair value changes are recognized in other comprehensive income. Whereas, changes related to impairment, interest income and foreign exchange differences are recognised in profit or loss.

If debt financial assets do not satisfy any of the above-mentioned criteria, they are classified and measured as FVP&L.

Classification of financial instruments is performed as at the moment of first-time adoption of IFRS 9, i.e. as at 1 January 2018 and at the moment of initial recognition of an instrument. Changes in the classification are only possible in case of a significant change of the business model and should occur very rarely.

In the case of equity instruments, instruments as held for trading are classified as FVP&L, and in the case of the remaining instruments, the Bank is able to elect to either classify and measure them as FVP&L or as FVOCI. In the case of FVOCI, the entity recognises fair value changes in other comprehensive income, with the exception of dividends, impairment losses, accrued interest or foreign exchange differences – which are recognised in profit or loss. Fair value changes thus recognised in other comprehensive income would never be transferred to profit or loss which makes a difference compared to similar measurement of available-for-sale financial assets (AFS) under current IAS 39. Although the valuation changes may be transferred between the categories of equity.

Financial liabilities are measured according to the former provisions of IAS 39, with the exception of the obligation to recognise in other comprehensive income a part of the fair value measurement arising from changes in own credit risk – in the case of financial liabilities to which the fair value option was applied.

In 2016, the Group in cooperation with an external advisor executed the first stage of the preparation for implementing the standard. Work performed in the area of classification and measurement comprised identifying changes in accounting policies introduced by IFRS 9, initial assessment of business models for the individual asset categories and initial assessment of the products in terms of cash flow characteristics.

The analysis performed with regard to classification and measurement comprised aspects such as verifying the lending products in terms of the cash flow characteristic test (SPPI test), verifying the adopted business models and performing a simulation of the effect of implementing IFRS 9 in the form of a transposition matrix presenting the change in classification of financial instruments taking into account the effect on the Group's financial statements.

The analyses performed led to the following conclusions:

- The most significant potential change in the classification may concern the portfolio of cash loans with an embedded financial leverage mechanism, i.e. loans with clauses of automatic interest rate change by the multiple of a change in the reference rate which, failing the SPPI test, may be classified for measurement at fair value. The question of measurement of such instruments in the context of the provisions of IFRS 9 is being discussed on the market, and as of today no unified position has been reached on the market;
- The potential change in the classification may also concern the measurement at FVOCI of the portfolio of housing loans which will be subject to sale to PKO Bank Hipoteczny as part of the so-called pooling. Such classification will be maintained for the purpose of preparing the Bank's standalone financial statements. From the perspective of the consolidated financial statements, the adjustment will not apply because the loans subject to pooling will meet the business model criterion of 'hold to collect' within the Group;

- Other adjustments (the fair value measurement of reverse-repo/buy-sell-back transactions, split of the liquidity portfolio) will not have a material impact on the Group's financial statements;
- IFRS 9 distinguishes a new asset category – POCI (purchased or originated credit impaired), i.e. impaired assets acquired or originated, which will be measured using the effective interest rate taking into account credit risk throughout the lifetime of the instrument. The triggers for classification as POCI include: acquisition of an impaired portfolio, granting a loan to a non-performing entity, and a significant change in the lending terms for impaired loans.

Impairment

A fundamental change in the area of impairment is that IAS 39 is based on the concept of incurred losses, whereas IFRS 9 is based on the concept of expected losses.

In line with the general principle, impairment will be measured as 12-month expected credit losses or lifetime expected credit losses. The measurement basis will depend on whether credit risk increased significantly from the moment of initial recognition. Loans will be allocated to 3 categories (stages):

Not impaired portfolio (IBNR according to IAS 39)	Stage 1 (assets with low credit risk)	12-month expected credit losses
	Stage 2 (increase in credit risk)	lifetime expected credit losses
Impaired portfolio	Impaired loans (the portfolio includes purchased or originated credit-impaired assets – POCI)	lifetime expected credit losses

The Group identifies the evidence of a significant increase in risk based on the comparison of the probability curves over the life of an exposure as at the date of initial recognition and as at the reporting date. For each reporting date, only the parts of the original and current insolvency probability curves which correspond to the period starting from the reporting date to the maturity of the exposure are compared. The comparison is based on the value of the average probability of default in the analysed period, adjusted for the current and forecasted macroeconomic ratios.

In order to identify other evidence of a significant increase in credit risk, the Group makes use of the full quantitative and qualitative information available, including:

- restructuring measures involving granting concessions to the debtor due to its financial difficulties – forbearance;
- a delay in repayments of more than 30 days;
- early warning signals identified as part of the monitoring process, indicating an increase in credit risk;
- a dispute in progress with a customer;
- an assessment by an analyst as part of the individualized analysis process;
- no credit risk assessment available for an exposure as at the date of initial recognition, preventing the Group from assessing whether credit risk has increased.

The loss expected both during the life of an exposure and in a 12-month period is the total of the losses expected in the individual periods, discounted using the effective interest rate. The Group assumes one month to be the base period. In order to properly recognise an asset as at the default date in a given period, the Group adjusts the parameter which determines the amount of the exposure as at the default date for future repayments.

As regards the portfolio analysis, the impact of macroeconomic scenarios is included in the levels of the individual parameters. In determining the methodology of calculation of the individual risk parameters, the Group examines the dependence of the levels of these parameters on macroeconomic conditions based on historical data. For calculating an expected loss, similarly to the case of identification of the evidence of a significant increase in risk, macroeconomic scenarios are used. The ultimate expected loss is the average of losses expected in the individual scenarios, weighted with the probability of the scenarios occurring. The Group ensures the consistency of the macroeconomic scenarios used for calculating risk parameters with the macroeconomic scenarios used in credit risk budgeting processes.

At the time of initial recognition, all loans are recognised in stage 1, excluding the POCI portfolio.

In 2016, in cooperation with an external advisor, the Group completed the first stage of the preparations for the implementation of the standard, i.e. the gap analysis. The work performed with regard to impairment comprised: the identification of the evidence of a significant increase in credit risk, methodology of building models estimating an expected loss over a 12-month period as well as over the lifetime of an exposure, methodology of building models which make an expected loss dependent on the current and forecasted macroeconomic conditions, and the concepts of recognition of interest income in the gross carrying value of an exposure.

Hedge accounting

IFRS 9 increases the range of items that can be designated as hedged items, as well as allows designating as a hedging instrument financial assets or liabilities measured at fair value through profit or loss. The obligation of retrospective measurement of hedge effectiveness together with previously applicable threshold of 80%-125% were eliminated (the condition to the application of hedge accounting is the economic relationship between the hedging instrument and the hedged item). In addition, the scope of required disclosures regarding risk management strategies, cash flows arising from hedging transactions and the impact of hedge accounting on the financial statements was extended.

Due to the fact that the standard is still being worked on to introduce amendments relating to accounting for macro hedges, entities have a choice of applying hedge accounting provisions: entities can either continue to apply IAS 39 or apply the new IFRS 9 standard with the exception of fair value macro hedges relating to interest rate risk.

In 2016, the Group in cooperation with an external advisor conducted a gap analysis of the requirements.

Currently, the Group has not yet decided whether it will apply the new standard, or continue to apply the provisions of IAS 39.

Disclosures and comparative data

In the Group's opinion, the application of IFRS 9 requires making considerable changes to the manner of presentation and the scope of disclosures concerning the area of financial instruments, including in the first year of its application, when extensive information about the opening balance and restatements made is required. The Group intends to use the IFRS 9 provisions which exempt entities from the obligation to restate the comparative data for the prior periods with regard to changes resulting from classification and measurement as well as impairment. Differences in the carrying amounts of financial assets and liabilities resulting from the application of IFRS 9 will be recognised in undistributed profits/accumulated losses, in equity as at 1 January 2018.

Implementation schedule

As described above, in 2016 the 'IFRS 9 Gap analysis' project was conducted, which comprised a business analysis of gaps in the preparation of the Group for the implementation of IFRS 9. The project was split into two areas: 1) classification and measurement, including hedge accounting and reporting and tax issues, and 2) impairment. The first area was managed by the Accounting Division, and the second by the Risk Division. Additionally, the Bank established a Steering Committee whose task was to take key decisions and control the conduct of the project. The Steering Committee comprised the Directors of the Accounting Division, Risk Division and the following Departments: Credit Risk, Accounting and Reporting, Management Information and Development of Transactional Applications. The

Steering Committee was supported by the Project Sponsors: the Vice-President of the Management Board responsible for Risk Management and the Vice-President of the Management Board responsible for Finance and Accounting. Apart from the accounting and reporting area, tax and risk area employees, the business, settlements and IT department employees were also involved in the project. Additionally, representatives of PKO Bank Hipoteczny (accounting and risk area) participated in the project.

In 2017, the second stage of the project will be carried out, aimed at implementing the changes resulting from IFRS 9. Similarly as in the first stage, which covers gap analysis, it will be divided into two cooperating areas: 1) classification and measurement, including hedge accounting and reporting and tax issues, and 2) impairment. The second stage of the project will cover, i.a.:

- developing the optimum solutions in IT systems, and their implementation;
- determining business models and developing new business processes, including in the areas of: SPPI tests, benchmark tests and modifications of cash flows;
- amendments to the Bank's internal regulations;
- calculating opening balance adjustments (as at 1 January 2018) resulting from implementing IFRS 9, including those which will be recognised in the Bank's equity as at 1 January 2018.

The completion of implementing changes in respect of IFRS 9 is planned for Q4 2017.

Quantification of the impact of IFRS 9 on the financial position and equity

Due to the methodological work in progress, mainly in respect of the area of impairment, the lack of a developed position in the banking market on cash loans with embedded financial leverage, and the lack of information on the directions of change in tax regulations (including mainly the recognition of deferred tax due to impairment allowances on loan exposures) in the Group's opinion, presentation of preliminary quantitative data would not increase the informational value of the financial statements for the readers. Taking the above into consideration, the Group presented qualitative information which enables assessing the impact of IFRS 9 on the Group's financial position and equity management.

The Group assumes that the introduction of a new impairment model based on the concept of expected loss and, as a result, the early recognition of a loss will have an impact, in particular, on the amount of impairment allowances on the exposures classified into stage 2. As regards the impact of IFRS 9 on capital requirements, according to the draft CRRII / CRD V published on 23 November 2016, the Group will have the right to temporarily include an additional component of own funds in Tier 1, relating to the implementation of IFRS 9. The aim of the additional component of own funds is to take into account gradually (i.e. over 5 years, on a straight line basis at 20% p.a.) the impact of a significant increase in allowances on the equity level. The additional component of own funds would be calculated as the difference in the amount of allowances in respect of an expected credit loss over the life of an exposure and an expected 12-month credit loss for loans with a significant increase in credit risk. According to the draft CRRII, the Group will have the right to recognise 100% of this difference as a component of own funds in 2018, in 2019 it will be possible to recognise 80% of this value; in the following years, it will be 60%, 40% and 20% respectively. The entire drop in own funds resulting from the horizon for calculating allowances being changed from the loss identification period (the LIP parameter) to 12 months will already be included in the calculation of capital adequacy as at the moment of implementation of IFRS 9. A quantitative assessment of the impact of changes in impairment on financial statements is not yet available mainly due to the work currently in progress, related to the implementation of the assumptions made on the project on gap analysis in credit risk models.

In addition, in the case of classification of the portfolio of cash loans with an embedded financial leverage mechanism into the portfolio measured at fair value through profit or loss, as at 1 January 2018 the Group will recognise an adjustment in respect of fair value measurement, which will be recognised in the income statement in future periods. Similarly, in the case of the portfolio of mortgage loans subject to pooling the Group will measure this portfolio at fair value, considering the result of this adjustment will be recognised in other comprehensive income.

IFRS 15 Revenue from contracts with customers

IFRS 15 replaces IAS 11 Construction contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the construction of real estate, IFRIC 18 Transfers of Assets from Customers, SIC 31 Revenue – barter transactions involving advertising services.

(IN PLN MILLION)

Main principle is to recognize revenue in such way as to reflect the transaction transfer of goods or services in the amount that reflects the value of remuneration, which the company expects in exchange for those goods or services. For the purpose of recognizing revenue at the appropriate moment and amount, the standard presents five-level analysis model, consisting of: the identification of an agreement with a customer and binding commitment, the determination of transaction price, its appropriate allocation and the recognition of revenue when the obligation is met.

Taking into consideration the structure of the Group and the share of non-financial entities in the Group, it is assessed that the impact on the Group financial statements should not be material.

4.3. New standards and interpretations and amendments, which have been published but not yet approved by the European Union

IFRS 16 Leases

Application date of IFRS 16 is 1 January 2019. The new standard will replace the current IAS 17, Leases. Under the new standard lessee are obliged to recognise the right to use the asset and liabilities (the obligation to pay for that right, that is, financing) in the balance sheet for all lease contracts (and not as so far). The exceptions are short-term lease agreements with a term of up to 12 months and lease contracts for assets of minor value. In the Group's opinion, the new standard will not have a significant impact on the consolidated financial statements of the Group.

IAS 7 Statement of cash flows

Application date of amendments to IAS 7 is 1 January 2017. The amendments have been introduced to improve the quality of disclosures in the financial statements and are related to the requirement of making disclosures enabling the users of the financial statements to assess changes in liabilities arising from financial activity, including changes arising from both cash and non-cash flows. The amendments will be of presentation nature.

Other changes:

- Amendments to IAS 12 clarify the recognition of deferred tax assets in connection with debt instruments measured at fair value. Amendments to IFRS 10 and IAS 28 concern the sale or contribution of assets between an investor and its joint venture or associate. The Group does not expect the impact of the amendments to IAS 12, IAS 28 and IFRS 10 to be material. The impact of the amendments to IFRS 4 (connected with IFRS 9) on the insurance activities within the Group has not yet been estimated.
- Amendments to IAS 40 and improvements to IFRS 2014-2016 (IFRS 1, IAS 28) will have no impact on the financial statements of the Group.

5. Explanation of the differences between previously published financial statements and these consolidated financial statements

The change relates to the manner of presenting the gain or loss on the sale of leased assets. In 2015, the gains and losses on the sale of leased assets were presented on a gross basis, i.e. the income on sales of leased assets was recognised in other operating income, and the costs related to the sale of the leased assets were recognised in other operating expenses. The above changes relate only to the presentation of the data and have no impact on the profit or loss.

The table below presents the impact of changes in respect of the presentation of comparative data.

	01.01.2015 31.12.2015 data before restatement	change in presentation of result on sale of leased assets	01.01.2015 31.12.2015 restated
Other operating income	574.6	(61.5)	513.1
Other operating expense	(297.1)	61.5	(235.6)
Other operating income and expense, net	277.5	-	277.5

6. INFORMATION ON THE SEGMENTS OF ACTIVITIES AND ON GEOGRAPHICAL AREAS

INFORMATION ON THE SEGMENTS OF ACTIVITIES

The PKO Bank Polski SA Group conducts business activities within segments offering specific products and services addressed to specific groups of customers. The manner in which the business segments are divided ensures consistency with the sales management model and offers the customers a comprehensive product mix comprising both traditional banking products and more complex investment products, as well as services provided by the PKO Bank Polski SA Group entities. The segment note below is included in internal reporting system, i.e. information presented to the Management Board of PKO Bank Polski SA, used to assess achieved results and to allocate resources. The segment report below presents an internal organizational structure of the PKO Bank Polski SA Group.

The PKO Bank Polski SA Group comprises three basic segments: retail, corporate and investment, and transfer centre:

1. The retail segment offers a full range of services for individuals as part of retail and private banking as well as mortgage banking. Moreover, it comprises transactions conducted with legal persons, i.e. small and medium enterprises. The products and services offered to customers in this segment include, amongst others: current accounts, savings accounts, term deposits, private banking services, investment and insurance products, credit and debit cards, electronic banking services. With regard to financing, it covers consumer loans, mortgage loans, including those offered by PKO Bank Hipoteczny SA, as well as business loans to small and medium-sized enterprises, developers, cooperatives and property managers, and leases and factoring offered by the PKO Leasing SA Group. In addition, the results of the retail segment comprise the results of the following companies: PKO TFI SA, PKO BP BANKOWY PTE SA, PKO Życie Towarzystwo Ubezpieczeniowe SA, PKO Towarzystwo Ubezpieczeń SA and PKO BP Finat Sp. z o.o.
2. The corporate and investment segment includes transactions concluded with large corporate clients and financial institutions. This segment comprises, i.a., the following products and services: current accounts, term deposits, depositary services, currency and derivative products, corporate loans, leases and factoring offered by the PKO Leasing SA Group. Within this segment, PKO Bank Polski SA also enters, individually or in a syndicate with other banks, into loan agreements financing large investment projects and issuance of non-Treasury securities. This segment also comprises the Bank's portfolio activity on its own account i.e. investing and brokerage activities, interbank transactions, derivative instruments and debt securities. The results of the corporate and investment segments also comprise the results of the companies operating in Ukraine, mainly KREDOBANK SA and the companies which conduct real estate development and real estate management activities.
3. The transfer centre comprises the result on internal settlements related to funds transfer pricing, the result on long-term sources of financing and the result on positions classified for hedge accounting. Internal funds transfer is based on transfer pricing dependent on market rates. The transactions between business segments are conducted at arms' length. Long-term external financing includes the issuance of securities, subordinated liabilities and loans received from financial institutions. As part of this segment, the results of PKO Finance AB are presented. Moreover, the total results achieved by PKO Bank Polski SA on the acquisition of Visa Europe Ltd. by Visa Inc. were presented in the transfer centre.

The PKO Bank Polski SA Group typically settles inter-segment transactions as if they were concluded between unrelated parties, using internal settlement rates. The transactions between business segments are conducted at arms' length.

Accounting policies applied in the segment report are consistent with accounting policies described in these financial statements.

Disclosed values of assets and liabilities are operating assets and liabilities used by segment in operating activities. Values of assets, liabilities, income and expenses of particular segments are based on internal management information. Assets and liabilities as well as income and costs related to these assets and liabilities are assigned to particular segments.

The income tax expense in respect of the presentation of the financial result, and deferred income tax assets, current income tax receivables, current income tax liabilities and deferred income tax liability in respect of statement of financial position presentation were recognised at the Group level.

(IN PLN MILLION)

The following tables present data on revenues and results of individual operating segments of the PKO Bank Polski SA Group for the 12 month period ended 31 December 2016 and 31 December 2015, as well as assets and liabilities as at 31 December 2016, and as at 31 December 2015.

For the year ended 31 December 2016	Continuing operations			
	Retail segment	Corporate and investment segment	Transfer centre	Total activity of the PKO Bank Polski SA Group
Net interest income	6 584.7	1 202.6	(32.5)	7 754.8
Net fee and commission income	2 141.3	554.8	(2.7)	2 693.4
Other net income	356.8	524.6	461.1	1 342.5
Net result from financial operations	10.1	102.3	398.1	510.5
Net foreign exchange gains (losses)	266.2	175.4	61.6	503.2
Dividend income	-	10.3	-	10.3
Net other operating income and expense	54.1	263.0	1.4	318.5
Income/expenses relating to internal customers	26.4	(26.4)	-	-
Net impairment allowance and write-downs	(1 088.2)	(534.5)	-	(1 622.7)
Administrative expenses, of which:	(4 684.7)	(905.4)	(0.3)	(5 590.4)
amortisation and depreciation	(705.4)	(95.3)	-	(800.7)
Tax on certain financial institutions	(605.7)	(227.9)	4.7	(828.9)
Share of profit (loss) of associates and joint ventures	-	-	-	34.5
Segment gross profit	2 704.2	614.2	430.3	3 783.2
Income tax expense (tax burden)	-	-	-	(907.1)
Profit (loss) attributable to non-controlling shareholders	-	-	-	2.1
Net profit attributable to equity holders of the parent company	2 704.2	614.2	430.3	2 874.0

As at 31 December 2016	Continuing operations			
	Retail segment	Corporate and investment segment	Transfer centre	Total activity of the PKO Bank Polski SA Group
Assets	157 417.3	122 295.8	4 070.6	283 783.7
Unallocated assets	-	-	-	1 789.0
Total assets	157 417.3	122 295.8	4 070.6	285 572.7
Liabilities	168 476.3	48 899.1	35 292.9	252 668.3
Unallocated liabilities	-	-	-	335.8
Total liabilities	168 476.3	48 899.1	35 292.9	253 004.1

(IN PLN MILLION)

For the year ended 31 December 2015	Continuing operations*			
	Retail segment	Corporate and investment segment	Transfer centre	Total activity of the PKO Bank Polski SA Group
Net interest income	6 233.4	1 013.6	(218.4)	7 028.6
Net fee and commission income	2 337.6	510.8	2.2	2 850.6
Other net income	352.1	427.5	5.9	785.5
Net result from financial operations	6.3	131.2	(9.2)	128.3
Net foreign exchange gains (losses)	184.5	173.9	10.6	369.0
Dividend income	-	10.7	-	10.7
Net other operating income and expense	135.2	137.8	4.5	277.5
Income/expenses relating to internal customers	26.1	(26.1)	-	-
Net impairment allowance and write-downs	(1 110.7)	(365.2)	-	(1 475.9)
Administrative expenses, of which:	(5 146.6)	(889.3)	(0.3)	(6 036.2)
amortisation and depreciation	(728.4)	(90.2)	-	(818.6)
Share of profit (loss) of associates and joint ventures	-	-	-	38.1
Segment gross profit	2 665.8	697.4	(210.6)	3 190.7
Income tax expense (tax burden)	-	-	-	(589.5)
Profit (loss) attributable to non-controlling shareholders	-	-	-	(8.3)
Net profit attributable to equity holders of the parent company	2 665.8	697.4	(210.6)	2 609.5

* The data for 2015 was restated to ensure comparability due to a presentation change resulting from the allocation of subsidiaries to individual segments.

As at 31 December 2015	Continuing operations*			
	Retail segment	Corporate and investment segment	Transfer centre	Total activity of the PKO Bank Polski SA Group
Assets	147 631.6	114 820.7	3 539.5	265 991.8
Unallocated assets	-	-	-	948.1
Total assets	147 631.6	114 820.7	3 539.5	266 939.9
Liabilities	153 031.3	52 881.5	30 704.3	236 617.1
Unallocated liabilities	-	-	-	57.9
Total liabilities	153 031.3	52 881.5	30 704.3	236 675.0

* The data for 2015 was restated to ensure comparability due to a change in the accounting treatment of funds deposited with the Central Bank (these funds were moved from the transfer centre to the corporate and investment segment), a change relating to funds raised as a result of the issuance of medium- and long-term securities (these funds were moved from the corporate and investment segment to the transfer centre) and a presentation change resulting from the allocation of subsidiaries to individual segments.

INFORMATION ON GEOGRAPHICAL AREAS

Complementary, the Group applies geographical areas distribution. The Group conducts activities in the Republic of Poland and in Ukraine through the KREDOBANK SA Group, ‘Inter-Risk Ukraina’ Sp. z o.o. and Finansowa Kompania ‘Prywatne Inwestycje’ Sp. z o.o., in Sweden through subsidiaries: PKO Finance AB and PKO Leasing Sverige AB, in Ireland: ROOF Poland Leasing 2014 DAC, as well as in the Federal Republic of Germany through corporate branch of PKO Bank Polski SA. For presentation purposes, the results of companies operating in Sweden and results of the Branch operating in the Germany, which from the point of view of the scale of operations of the PKO Bank Polski SA Group are not significant, are included in the segment of Poland.

(IN PLN MILLION)

For the year ended 31 December 2016	Poland	Ukraine	Total
Net interest income	7 617.3	137.5	7 754.8
Net fee and commission income	2 649.7	43.7	2 693.4
Other net income	1 340.5	2.0	1 342.5
Administrative expenses	(5 481.6)	(108.8)	(5 590.4)
Net impairment allowance and write-downs	(1 588.8)	(33.9)	(1 622.7)
Tax on certain financial institutions	(828.9)	-	(828.9)
Share of profit (loss) of associates and joint ventures	-	-	34.5
Profit (loss) before income tax	3 708.2	40.5	3 783.2
Income tax expense (tax burden)	-	-	(907.1)
Profit (loss) attributable to non-controlling shareholders	-	-	2.1
Net profit (loss) attributable to equity holders of the parent company	3 708.2	40.5	2 874.0

As at 31 December 2016	Poland	Ukraine	Total
Assets of which:	283 860.9	1 711.8	285 572.7
non-financial fixed assets	6 685.3	82.5	6 767.8
deferred tax assets and current income tax receivable	1 779.9	9.1	1 789.0
Liabilities	251 444.2	1 559.9	253 004.1

For the year ended 31 December 2015	Poland	Ukraine	Total
Net interest income	6 926.0	102.6	7 028.6
Net fee and commission income	2 807.9	42.7	2 850.6
Other net income	832.5	(47.0)	785.5
Administrative expenses	(5 935.7)	(100.5)	(6 036.2)
Net impairment allowance and write-downs	(1 439.9)	(36.0)	(1 475.9)
Share of profit (loss) of associates and joint ventures	-	-	38.1
Profit (loss) before income tax	3 190.8	(38.2)	3 190.7
Income tax expense (tax burden)	-	-	(589.5)
Profit (loss) attributable to non-controlling shareholders	-	-	(8.3)
Net profit (loss) attributable to equity holders of the parent company	**3 190.8**	**(38.2)**	**2 609.5**

As at 31 December 2015	Poland	Ukraine	Total
Assets of which:	265 572.2	1 367.7	266 939.9
non-financial fixed assets	6 388.2	65.9	6 454.1
deferred tax assets and current income tax receivable	936.0	12.1	948.1
Liabilities	235 382.2	1 292.8	236 675.0

NOTES TO THE CONSOLIDATED INCOME STATEMENT

7. INTEREST INCOME AND EXPENSE

ACCOUNTING POLICIES

Interest income and expense comprise interest, including premiums and discounts in respect of financial instruments measured at amortized cost and instruments at fair value. Interest income include interest income from hedging derivatives. Interest income also includes deferred fee and commission received and paid accounted for using effective interest rate, which are part of the financial instrument.

Interest income and interest expense are recognised on an accrual basis using the effective interest rate method, that discounts estimated future cash inflows and payments made through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the asset or financial liability. Calculation of the effective interest rate includes all commissions paid and received by parties to an agreement, transaction costs and all other premiums and discounts constituting an integral part of the effective interest rate.

Interest income in the case of financial assets or a group of similar financial assets for which an impairment allowance was recognised is calculated on the basis of the current values of receivables (i.e. net of the impairment allowance) by using the current interest rate used for discounting future cash flows for the purposes of estimating losses due to impairment.

The effect of the fair value measurement of financial assets taken over as part of the acquisition of the subsidiary is also recognised in interest income.

INCOME AND EXPENSES FROM SALE OF INSURANCE PRODUCTS RELATED TO LOANS AND ADVANCES

Due to the fact that the Group offers insurance products along with loans and advances and there is no possibility of purchasing from the Group the identical insurance product as to the legal form, conditions and economic content without purchasing a loan or an advance, fees received by the Group from sale of insurance products are treated as an integral part of the remuneration from the offered financial instruments.

Remuneration received and due to the Group from offering insurance products for the products directly associated with the financial instruments is settled using the effective interest rate method and recognised in interest income.

Remuneration received and due to the Group for performing intermediary services is recognised in commission income upon the sale of an insurance product or its renewal.

Distribution of remuneration for a commission and an interest part is made in the proportion of the fair value of a financial instrument and the fair value of intermediary service in relation to the sum of these two values.

Costs directly related to the sale of insurance products are settled in a similar manner to the settlement of revenues, according to the principle of matching revenues and expenses, i.e. as part of the amortized cost of a financial instrument or on a one-off basis.

The Group makes a periodical estimation of the compensation amount that will be recoverable in the future due to the early termination of the insurance agreement and accordingly reduces the recognised interest or commission income.

(IN PLN MILLION)

FINANCIAL INFORMATION

INTEREST AND SIMILAR INCOME ON:	2016	2015
loans and other advances to banks	121.5	110.8
loans and advances to customers, of which:	8 363.2	8 111.7
on impaired loans	278.2	349.3
investment securities available for sale	840.1	703.1
derivative hedging instruments	340.1	450.9
financial assets designated upon initial recognition at fair value through profit and loss	225.8	222.8
trading financial assets	68.6	55.2
other	5.1	3.3
Total	**9 964.4**	**9 657.8**
including amount of interest income reduction due to negative LIBOR	0.2	0.4

INTEREST EXPENSE AND SIMILAR CHARGES ON:	2016	2015
amounts due to banks	(107.9)	(74.0)
amounts due to customers	(1 592.8)	(1 955.2)
debt securities in issue and subordinated liabilities	(373.4)	(509.0)
debt securities available for sale	(78.7)	(57.2)
trading financial assets	(32.7)	(18.6)
financial assets designated upon initial recognition at fair value through profit and loss	(24.1)	(15.2)
Total	**(2 209.6)**	**(2 629.2)**

8. FEE AND COMMISSION INCOME AND EXPENSE

ACCOUNTING POLICIES

Fee and commission income is generally recognised on an accrual basis at the time when the related service is performed. Fee and commission income includes one-off amounts charged by the Group for services not related directly to creation of loans, advances and other receivables, as well as amounts charged by the Group for services performed over a period exceeding 3 months, which are recognised on a straight-line basis. Fee and commission income also includes fee and commission recognised on a straight-line basis, received on loans and advances granted with unspecified schedule of future cash flows for which the effective interest rate cannot be determined.

The accounting policies for recognizing commission income on sales of insurance products linked to loans and advances is described in the note 'Interest income and expense'.

(IN PLN MILLION)

FINANCIAL INFORMATION

FEE AND COMMISSION INCOME ON:	2016	2015
debit and credit cards	1 024.1	945.9
maintenance of bank accounts	879.5	890.7
loans and advances granted	592.2	636.9
maintenance of investment and open pension funds (including management fees)	450.3	468.5
cash transactions	102.7	101.2
servicing foreign mass transactions	88.7	74.4
brokerage activities	149.9	161.6
offering insurance products	31.1	40.5
sale and distribution of court fee stamps	12.4	12.3
investment and insurance products	105.1	105.8
other	143.6	160.5
Total	**3 579.6**	**3 598.3**

FEE AND COMMISSION EXPENSE ON:	2016	2015
card activities	(550.7)	(471.7)
commission paid to external entities for sales of products	(64.6)	(67.7)
cost of construction investment supervision and property valuation	(39.8)	(33.8)
settlement services	(33.4)	(29.9)
fee and commissions for operating services provided by banks	(18.4)	(18.9)
sending text messages (SMS)	(15.8)	(17.9)
asset management	(12.1)	(10.7)
fees incurred by the Brokerage House	(17.2)	(17.6)
other	(134.2)	(79.5)
Total	**(886.2)**	**(747.7)**

9. DIVIDEND INCOME

ACCOUNTING POLICIES

Dividend income is recognised at the date on which shareholders' rights to receive the dividend have been established.

FINANCIAL INFORMATION

DIVIDEND INCOME FROM:	2016	2015
Investment securities available for sale	9.2	8.3
Trading assets	1.1	2.4
Total	**10.3**	**10.7**

(IN PLN MILLION)

10. NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

ACCOUNTING POLICIES AND CLASSIFICATION

The result on financial instruments measured at fair value through profit or loss includes gains and losses arising from the disposal of financial instruments designated as financial assets / liabilities measured at fair value through profit or loss (both held for trading and designated at fair value through profit or loss at initial recognition) and the effect of their measurement to fair value. This item also includes the ineffective portion of cash flow hedges.

FINANCIAL INFORMATION

NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	2016	2015
Debt securities	(15.2)	9.0
Equity instruments	2.7	(5.9)
Derivative instruments	20.9	38.6
An ineffective portion related to cash flow hedges	(9.5)	(2.7)
Other	5.5	1.6
Total	**4.4**	**40.6**

11. GAINS LESS LOSSES FROM INVESTMENT SECURITIES

ACCOUNTING POLICIES

Gains less losses from investment securities include gains and losses arising from the disposal of financial instruments classified as available for sale.

FINANCIAL INFORMATION

RESULT ON INVESTMENT SECURITIES	2016	2015
Equity instruments*	417.7	1.6
Debt securities	88.4	86.1
Total	**506.1**	**87.7**

* In 2016, the Group recognised a gain on settlement of Visa transaction in the amount of PLN 417.6 million (details of the transaction are presented in the note 'Investment securities available for sale').

12. FOREIGN EXCHANGE GAINS (LOSSES)

ACCOUNTING POLICIES AND CLASSIFICATION

Foreign exchange gains (losses) comprise foreign exchange gains and losses, both realized and unrealized, resulting from daily revaluation of assets and liabilities denominated in foreign currency using the National Bank of Poland average exchange rates at the balance sheet date, and from the fair value valuation of outstanding derivatives (FX forward, FX swap, CIRS and currency options)

The Group recognises in net foreign exchange gains (losses) both realized and unrealized foreign exchange gains and losses on fair value measurement of unrealized currency options. From an economic point of view, the method of presentation of net gains (losses) on currency options applied allows the symmetrical recognition of net gains (losses) on currency options and on spot and forward transactions concluded to hedge such options (transactions hedging the currency position generated as a result of changes in the market parameters affecting the currency option position)

(IN PLN MILLION)

The effects of changes in fair value and the result realized on the Gold Index option are also included in the net foreign exchange gains (losses) due to the fact that the Group treats gold as one of the currencies, in line with the provisions of the Regulation (EU) No. 575/2013 of the European Parliament and Council dated 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR Regulation).

The Group presented monetary assets and liabilities, constituting on and off-balance sheet items denominated in foreign currency, translated into Polish zloty using the average National Bank of Poland rate prevailing as at the balance sheet date.

Impairment allowances on loan exposures and other receivables denominated in foreign currencies, which are recognised in Polish zloty, are adjusted in line with a change in the valuation of the foreign currency assets for which these impairment allowances are recognised. The effect of this adjustment is recognised in net foreign exchange gains (losses).

13. OTHER OPERATING INCOME AND EXPENSE

ACCOUNTING POLICIES

Other operating income and expense includes income and expense not related directly to banking activity. Other operating income mainly includes gains on sale of housing investments, sale or liquidation of non-current assets and foreclosed collateral, sale of shares of a subsidiary, recovered non-performing loans, legal damages, fines and penalties, income from lease/rental of properties. Other operating expense mainly includes losses on sale or liquidation of non-current assets, including foreclosed collateral, costs of debt collection and donations.

Other operating income and expense in relation to the Group entities include also income from sale of finished goods, goods for resale and raw materials, and the corresponding costs of their production.

Income from construction services (real estate development activities) is recognised on a completed contract basis, which involves recognition of all costs related to the housing investments that are incurred during the period of construction as work-in-progress. Payments received on account of a purchase of apartments are shown within deferred income.

FINANCIAL INFORMATION

OTHER OPERATING INCOME	2016	2015
gain on sale of products and services	265.6	200.4
gain on sale of subsidiaries*	77.0	-
gain on sale and disposal of tangible fixed assets, intangible assets and assets held for sale**	85.6	42.2
damages, penalties and fines received	80.2	53.7
sundry income	26.5	23.3
recovery of expired and written-off receivables	7.0	43.0
other	106.6	150.5
Total	**648.5**	**513.1**

* Sale of the company 'Fort Mokotów Inwestycje'

** The item 'Gains on sale and disposal of fixed assets, intangible assets and assets held for sale' includes the gain on the sale of land of the Qualia Development Sp. z o.o. Group of PLN 37.0 million.

(IN PLN MILLION)

OTHER OPERATING EXPENSE	2016	2015
cost of sale of products and services	(149.6)	(91.2)
loss on sale and disposal of tangible fixed assets, intangible assets and assets held for sale	(32.9)	(28.7)
donations	(31.1)	(11.4)
sundry expenses	(18.6)	(7.5)
other	(97.8)	(96.8)
Total	**(330.0)**	**(235.6)**

14. NET IMPAIRMENT ALLOWANCE AND WRITE-DOWNS

ACCOUNTING POLICIES

The accounting policies relating to the recognition of net impairment allowance and write-downs are discussed for the individual items in the notes indicated in the table below. Net impairment allowance and write-downs comprise impairment allowances and write-downs recorded and released.

FINANCIAL INFORMATION

NET IMPAIRMENT ALLOWANCE AND WRITE DOWNS	Note	2016	2015
Investment securities available for sale	26	(52.0)	(57.8)
Loans and advances to customers	25	(1 503.6)	(1 395.2)
Non-current assets held for sale	28	-	(12.2)
Tangible fixed assets	30	9.9	(17.9)
Intangible assets	30	(4.1)	(0.2)
Investments in associates and joint ventures	41	(30.3)	18.9
Inventories	29	(3.0)	-
Other receivables (other assets)	31	(47.9)	(41.0)
Provision for legal claims, loan commitments and guarantees granted	38	9.1	29.9
Provision for future liabilities (Other provisions)	38	(0.8)	(0.4)
Total		**(1 622.7)**	**(1 475.9)**

15. ADMINISTRATIVE EXPENSES

ACCOUNTING POLICIES AND CLASSIFICATION

EMPLOYEE BENEFITS	Employee benefits comprise salaries and wages and social insurance (including contributions for retirement benefits, which are discussed in detail in the note 'Provisions'), as well as costs of the employee pension scheme constituting a defined contribution scheme and the programme of variable remuneration components for persons occupying managerial positions, a part of which is recorded as a liability in respect of share-based payments settled in cash, in accordance with IFRS 2 'Share-based payments' (the programme of variable remuneration components has been discussed in detail in the note entitled 'Remuneration of the PKO Bank Polski SA key management'. The Employee Pension Programme (EPP) has operated at the Bank since 2013. As part of the EPP (for employees who joined the Programme), the Bank accrues the basic contribution of 3% of the salary components on which social insurance contributions are accrued. Employees are entitled to declare additional contributions which are paid to the EPP by the Employer and deducted from the Employee's salary. PKO Towarzystwo Funduszy Inwestycyjnych SA manages the EPP. Moreover, as part of wages and salaries the Group creates a provision for future liabilities in respect of compensation and severance bonuses paid out to employees with whom the employment relationship is terminated for reasons not related to the employees; and accruals related to costs attributable to the current period which will be incurred in the next period, including bonuses and holiday pay, taking account of all unused holiday.
OVERHEADS	The balance includes the following items: maintenance and lease of fixed assets, IT and telecommunications services, costs of administration, promotion and advertising, property protection and training. Lease payments under an operating lease and subsequent instalments are recognised as an expense in the income statement and are recognised on a straight-line basis over the lease term.
DEPRECIATION / AMORTIZATION	Depreciation/amortization principles have been described in detail in the note 'Intangible assets and tangible fixed assets'
CONTRIBUTION AND PAYMENTS TO THE BANK GUARANTEE FUND	According to IFRIC 21 'Levies', fees paid by the Group to the Bank Guarantee Fund, i.e. the annual fee and the prudential fee, are recognised in profit or loss on occurrence of the obligating event. The Group is obliged to make contributions on a quarterly basis, therefore in 2016 the respective costs were recognised in profit or loss on a quarterly basis.
TAXES AND FEES	The following items are recorded here: property tax, payments made to the State Fund for Rehabilitation of Disabled Persons, municipal and administration fees, fees for perpetual usufruct of land.

(IN PLN MILLION)

FINANCIAL INFORMATION

ADMINISTRATIVE EXPENSES	2016	2015
Employee benefits	(2 835.8)	(2 766.5)
Overheads	(1 421.9)	(1 462.7)
Amortisation and depreciation	(800.7)	(818.6)
Contribution and payments to the Bank Guarantee Fund	(437.9)	(445.3)
Taxes and other charges	(69.7)	(63.2)
Additional contribution to the Bank Guarantee Fund	(24.4)	(337.9)
Contribution to Borrowers' Support Fund	-	(142.0)
Total	**(5 590.4)**	**(6 036.2)**

EMPLOYEE BENEFITS	2016	2015
Wages and salaries, of which:	(2 373.3)	(2 310.7)
expenses on employee pension program	(45.9)	(44.7)
Social insurance, of which:	(379.0)	(375.4)
contributions to retirement benefits and pensions	(309.6)	(308.8)
Other employee benefits	(83.5)	(80.4)
Total	**(2 835.8)**	**(2 766.5)**

OPERATING LEASE – LESSEE

Total value of future lease payments under irrevocable operating lease for the period:	31.12.2016	31.12.2015
up to 1 year	243.0	233.6
from 1 year to 5 years	448.8	466.4
over 5 years	140.6	150.3
Total	**832.4**	**850.3**

Lease and sub-lease payments recognised as an expense of a given period in 2016 amounted to PLN 262.8 million (in 2015 PLN 243.4 million).

COMMENTS TO SELECTED ITEMS OF ADMINISTRATIVE EXPENSES

'Contribution to Borrower Support Fund':

According to Article 25 of the Act from 9 October 2015 on support for borrowers in a difficult financial situation who took out mortgage loans, Guarantee Fund Council, based on information from the Polish Financial Supervision Authority (PFSA), set out for the Group the amount of payment to PLN 142 million and the day of payment until 18 February 2016. As at 31 December 2015 the Group recognised accrual in other liabilities charged as costs of 2015.

'Additional payment to the Bank Guarantee Fund':

On 23 November 2015 the Group received information from the Bank Guarantee Fund (BGF), pursuant to which the Group was obliged to make the mandatory contribution earmarked for disbursement of guaranteed funds on deposits accumulated in the Co-operative Crafts and Agriculture Bank in Wołomin (Spółdzielczy Bank Rzemiosła i Rolnictwa w Wołominie). On 26 November 2015 the BGF published its resolution No. 87/DGD/2015 of the Management Board of the BGF on paying out guaranteed funds to depositors of Co-operative Crafts and Agriculture Bank in Wołomin, and informed Group that it is obliged to make a payment in the amount of PLN 337.9 million until 30 November 2015. The Group made the payment on 30 November 2015.

(IN PLN MILLION)

On 28 October 2016 the Group received information from BGF, pursuant to which the Group was obliged to make the mandatory contribution earmarked for disbursement of guaranteed funds on deposits accumulated in Cooperative Bank in Nadarzyn (Bank Spółdzielczy w Nadarzynie). On 28 October 2016 the BGF published Resolution No. 308/DGD/2016 of the Management Board of the BGF on paying out guaranteed funds to depositors of Cooperative Bank in Nadarzyn and notified the Group of the need to pay PLN 24.4 million to the BGF by 2 November 2016. The Group made the payment on 2 November 2016.

16. TAX ON CERTAIN FINANCIAL INSTITUTIONS

As of 1 February 2016, the Act of 15 January 2016 on tax on certain financial institutions came into force, which covered, among other things, banks and insurance companies. The tax basis is the surplus of an entity's total assets above PLN 4 billion in the case of banks arising from the trial balance as at the end of each month. Banks are entitled to reduce the tax basis, i.a. by the value of own funds and the value of Treasury securities. Additionally, banks reduce the tax basis by the value of assets acquired from the NBP, constituting collateral of a refinancing loan granted by the NBP. The tax rate for all taxpayers is 0.0366% per month, and the tax is paid monthly by the 25th of the month following the month to which it relates. The tax was paid for the first time for February 2016. The tax paid is not tax-deductible for the purpose of corporate income tax.

	2016	2015
Tax on certain financial institutions, of which:		
PKO Bank Polski SA	(820.2)	-
PKO Życie Towarzystwo Ubezpieczeń SA	(3.9)	-
PKO Bank Hipoteczny SA	(4.3)	-
PKO Towarzystwo Ubezpieczeń SA	(0.5)	-
Total	**(828.9)**	-

17. INCOME TAX

ACCOUNTING POLICIES

The income tax expense is classified into current and deferred income tax. The current income tax is recognised in the income statement. Deferred income tax, depending on the source of the temporary differences, is recorded in the income statement or in other comprehensive income.

CURRENT INCOME TAX

Current income tax is calculated on the basis of gross accounting profit adjusted by non-taxable income, taxable income that does not constitute accounting income, non-tax deductible expenses and tax costs which are not accounting costs, in accordance with tax regulations. These items mainly include income and expenses relating to accrued interest receivable and payable, impairment allowances on receivables and provisions for off-balance sheet liabilities.

DEFERRED INCOME TAX

Deferred tax is recognised in the amount of the difference between the tax value of the assets and liabilities and their carrying amounts for the purpose of financial reporting. The Group records a deferred tax liabilities and assets which are recognised in the statement of financial position on the assets and liabilities side respectively. Changes in the balance of the deferred tax liabilities and assets are recognised in mandatory charges to profit, with the exception of the effects of the measurement of financial assets available for sale, cash flow hedges and actuarial gains and losses which are recognised in other comprehensive income, where changes in the balance of the deferred tax liabilities and assets are recognised in other comprehensive income. In determining deferred income tax, the deferred tax assets and liabilities as at the beginning and as at the end of the reporting period are taken into account.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or a part of the deferred income tax assets to be utilized.

Deferred income tax assets and liabilities are measured using tax rates that are expected to apply in the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date or that will be enacted in future according to the balance sheet date.

For deferred income tax calculation the Group uses the 19% tax rate for entities operating on the territory of Poland, 18% tax rate for entities operating in Ukraine and 22% tax rate for entities operating in Sweden.

Deferred tax assets are offset by the Group with deferred tax liabilities only when the enforceable legal entitlement to offset current income tax receivables with current income tax liabilities exists and deferred income tax is related to the same taxpayer and the same tax authority.

(IN PLN MILLION)

FINANCIAL INFORMATION

INCOME TAX EXPENSE

	2016	2015
Current income tax expense	(1 243.1)	(647.9)
Deferred income tax related to creating and reversal of temporary differences	336.0	58.4
Income tax expense recognised in the income statement	**(907.1)**	**(589.5)**
Income tax expense recognised in other comprehensive income related to creating and reversal of temporary differences	129.6	(16.1)
Total	**(777.5)**	**(605.6)**

The Group entities are subject to corporate income tax. The amount of current tax liability of the entities is transferred to the appropriate tax authorities.

The final settlement of the corporate income tax liabilities of the Group entities for the year 2016 is made within the statutory deadline.

RECONCILIATION OF THE EFFECTIVE TAX RATE

	2016	2015
Profit before income tax	3 783.2	3 190.7
Tax calculated using the enacted tax rate (19%) in force in Poland	(718.8)	(606.2)
Effect of other tax rates of foreign entities	0.4	0.1
Permanent differences between profit before income tax and taxable income, of which:	(238.7)	(12.8)
recognising a non-tax-deductible impairment allowance on investments in associates and joint ventures	(5.5)	-
impairment allowances on loan exposures not constituting tax-deductible expense	(17.8)	(3.4)
prudential payment to the BGF	(26.5)	(17.7)
tax on certain financial institutions	(157.5)	-
other permanent differences	(31.4)	8.3
Other differences between profit before income tax and taxable income, including new technologies tax relief and donations	49.6	28.1
Settlement of tax loss	0.4	1.3
Income tax recognised in the income statement	(907.1)	(589.5)
Effective tax rate	**23.98%**	**18.48%**
Temporary difference due to the deferred tax presented in the income statement	336.0	58.4
Total current income tax expense recognised in the income statement, of which:	**(1 243.1)**	**(647.9)**
Tax calculated using the enacted tax rate (19%) in force in Poland	(1 243.5)	(648.0)
Efffect of other tax rates of foreign entities	0.4	0.1

According to regulations on considering tax liabilities as past due, tax authorities can verify the correctness of income tax settlements within 5 years from the end of the accounting year in which the tax declaration was submitted.

(IN PLN MILLION)

DEFERRED TAX ASSETS, NET

DEFERRED TAX LIABILITY	31.12.2015	Income statement	Other comprehensive income	Effect of business combination and other	31.12.2016
Interest accrued on receivables (loans)	260.7	(24.2)	-	-	236.5
Capitalised interest on performing housing loans	129.0	(10.6)	-	-	118.4
Interest on securities	27.6	15.3	-	-	42.9
Difference between carrying amount and tax value of tangible fixed assets and intangible fixed assets	342.8	(13.5)	-	-	329.3
Taxable temporary differences concerning Group entities	31.8	2.7	(3.6)	-	30.9
Gross deferred tax liability	**791.9**	**(30.3)**	**(3.6)**	**-**	**758.0**
DEFERRED TAX ASSET					
Interest accrued on liabilities	161.4	(56.0)			105.4
Valuation of derivative financial instruments	0.2	178.8	7.3		186.3
Valuation of securities	(26.7)	46.0	114.3		133.6
Provision for employee benefits	84.8		(0.4)		84.4
Impairment allowances on loan exposures	579.1	16.7			595.8
Adjustment of straight-line valuation method and EIR	474.4	97.8			572.2
Other temporary negative differences	131.5	(47.7)			83.8
Deductible temporary differences relating to Group entities	257.0	70.1	4.8	412.7	744.6
Gross deferred income tax asset	**1 661.7**	**305.7**	**126.0**	**412.7**	**2 506.1**
Total deferred tax impact	869.8	336.0	129.6	412.7	1 748.1
Deferred tax liability (presented in the statement of financial position)	31.8				30.9
Deferred income tax asset (presented in the statement of financial position)	901.6				1 779.0

INFORMATION ABOUT IMPORTANT TAX CLUES

As at 31 December 2015, PKO Bankowy Leasing Sp. z o.o. (Company) showed a receivable in the amount of PLN 20.4 million due to overpayment of VAT and penalty interest on tax liabilities in connection with the adjustments of VAT declarations submitted in December 2014 for the periods from January 2011 to June 2013. On 7 January 2015, the Company made a payment of arrears of VAT including penalty interest. At the same time, on 26 January 2015 the company applied for a refund of overpaid tax. On 6 February 2015, the Tax Office in Łódź (TO) issued an unfavourable decision on the settlement of overpayments and VAT returns for the periods from January 2011 to June 2013. The settlement of overpaid VAT refunds and arrears of VAT does not occur until the date of the submission of corrected declaration and the application for overpaid tax refund. The settlement does not occur on the date of payment of the tax in the amount greater than the tax due, as argued by the Company.

On 19 February 2015 the Company filed a complaint to Head of the Tax Chamber in Łódź and then, on 14 August 2015 filled a complaint to the Regional Administrative Court in Łódź against the decision of the TO of 6 February 2015 on the method of settlement of excessive tax payments and tax refunds on account of tax arrears, indicating on the contravention of the Tax Ordinance resulting in misinterpretation and incorrect application of its articles and non-application of the principle of proportionality for charging interest on tax debts. On 30 December 2015 the Regional Administrative Court issued a favourable verdict for the Company, repealing the appealed resolution of the TO of 6 February 2015 and sustaining Company's objections to misinterpretation of the Ordinance's articles and non-application of the principle of proportionality by the tax authorities. On 19 February 2016 Head of the Tax Chamber filled the cassation complaint to the Supreme Administrative Court (SAC). On 30 August 2016 the Supreme Administrative Court reversed the judgment of the Regional Administrative Court and remanded the issue back. The Supreme Administrative Court recognised that the provisions of the Tax Ordinance were precise sufficiently and the authorities applied them correctly. On 10 January, 13 January and 8 February 2017, the Regional Administrative Court dismissed all of the Company's complaints concerning the recognition of excessive tax payments and tax refunds in the matter in question.

Due to the ruling of the Supreme Administrative Court and the above-mentioned rulings of the Regional Administrative Court, in 2016 the PKO Leasing SA Group recognised a full impairment allowance against the above-mentioned receivable and the other receivables and liabilities, totalling PLN 21.1 million.

18. Earnings per share

Earnings per share	**2016**	**2015**
Earnings per ordinary shareholders	2 874.0	2 609.5
Weighted average number of ordinary shares during the period (in million)	1 250	1 250
Earnings per share (in PLN per share)	2.30	2.09

In 2016 as well as in 2015 there were no dilutive instruments. Therefore the amount of diluted earnings per share is equal to basic earnings per share.

(IN PLN MILLION)

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

19. Cash and balances with the Central Bank

ACCOUNTING POLICIES

The item 'Cash and balances with the central bank' presents cash recognised at nominal value, and funds in the current account and deposits with the Central Bank measured at amounts due, which includes the potential interest on those funds.

Financial information

CASH AND BALANCES WITH THE CENTRAL BANK	31.12.2016	31.12.2015
Current account in the Central Bank	7 459.7	9 854.1
Cash on hand	4 185.4	3 889.7
Deposits with the Central Bank	1 680.0	0.1
Total	**13 325.1**	**13 743.9**

During the course of the working day, the Group may use funds from the obligatory reserve accounts for ongoing payments, on the basis of an instruction submitted to the National Bank of Poland (NBP). However, the Group must ensure that the average monthly balance on this account complies with the requirements set in the obligatory reserve declaration.

Funds on the obligatory reserve account bear interest of 0.9 of the reference rate. As at 31 December 2016 and 2015, this interest rate was 1.35%.

20. Amounts due from banks

Accounting policies

Amounts due from banks comprise financial assets measured at amortized cost using the effective interest rate method, less potential impairment allowances, with the exception of cash in transit which is measured at nominal value. If no future cash flow schedule can be determined for a financial receivable measured at amortized cost, and thus the effective interest rate cannot be determined, the receivable is measured at the amount due.

Buy-sell-back securities are recognised as amounts due from banks, if the counterparty is a bank entity. Receivables due from repurchase agreements are measured at amortized cost. The difference between the buy and repurchase (sell) price is treated as interest income and settled over the period of the contract using the effective interest rate.

(IN PLN MILLION)

FINANCIAL INFORMATION

AMOUNTS DUE FROM BANKS	31.12.2016	31.12.2015
Deposits with banks	3 846.5	2 484.5
Current accounts	783.9	951.5
Loans and advances granted	50.4	134.2
Receivables due from repurchase agreements	661.2	980.6
Cash in transit	3.6	2.6
Gross total	**5 345.6**	**4 553.4**
Impairment allowances on receivables	(0.2)	(0.4)
Net total	**5 345.4**	**4 553.0**

Amounts due from banks - the Group's exposure to credit risk	Exposure	
	31.12.2016	31.12.2015
Amounts due from banks impaired, of which:	0.2	0.5
assessed on an individual basis	0.2	0.1
Amounts due from banks not impaired, not past due	5 345.4	4 552.9
Gross total	**5 345.6**	**4 553.4**
Impairment allowances	(0.2)	(0.4)
Net total by carrying amount	**5 345.4**	**4 553.0**

21. TRADING ASSETS EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS

ACCOUNTING POLICIES

The Group classifies to this category financial instruments acquired or drawn mainly for the purpose of sale or redemption in the short term, the Group's so-called trading portfolio and instruments in the portfolio of the Brokerage House. They are measured at fair value, both on initial recognition and on subsequent valuation, and the effects of the valuation are recognised in profit or loss. The Group also recognises derivative financial instruments as trading assets (presented in a separate note), excluding derivatives classified as cash flow hedges.

FINANCIAL INFORMATION

TRADING ASSETS	31.12.2016	31.12.2015
Debt securities	311.6	766.7
Treasury bonds PLN	186.2	640.0
foreign currency Treasury bonds	5.9	8.7
municipal bonds PLN	41.5	48.6
corporate bonds PLN	75.7	69.3
foreign currency corporate bonds	2.3	0.1
Shares in other entities – listed on stock exchange	11.3	9.9
Investment certificates, rights to shares, pre-emptive rights	3.5	6.6
Total	**326.4**	**783.2**

(IN PLN MILLION)

DEBT SECURITIES BY MATURITY (THE CARRYING AMOUNT)	31.12.2016	31.12.2015
up to 1 month	20.1	188.8
3 months - 1 year	65.2	277.0
1 - 5 years	114.3	151.4
over 5 years	112.0	149.5
Total	**311.6**	**766.7**

22. Derivative financial instruments

Accounting policies

The Group uses various types of derivatives in order to manage risk involved in its business activities. The most frequently used types of derivatives are: IRS, CIRS, FX Swap, FRA, Options and FX Forward.

Derivative financial instruments are recognised at fair value from the trade date. A derivative instrument is presented under ‘Derivative financial instruments’ as an asset if its fair value is positive, and as a liability if its fair value is negative.

The Group recognises changes in the fair values of derivative instruments not classified as cash flow hedges and the result on the settlement of those instruments in the result on financial instruments measured at fair value through profit or loss, or in net foreign exchange gains, depending on the type of derivative.

The notional amounts of the underlying derivative instruments are presented as off-balance sheet items from the trade date until maturity.

Embedded derivative instruments

With respect to embedded derivatives, the Group assesses whether a given contract contains an embedded derivative instrument as at the moment of concluding the contract. A reassessment can only be made when there is a change in the terms of the contract that significantly modifies the cash flows required under the contract. Derivative instruments separated from host contracts and recognised separately in the books of account are measured at fair value. Valuation is presented in the statement of financial position under ‘Derivative financial instruments’. Changes in the valuation of fair value of derivative instruments are recorded in the income statement under the item ‘Net income from financial instruments measured at fair value or ‘Net foreign exchange gains (losses)’.

Estimates and judgements

The fair value of non-option derivatives is determined using valuation models based on discounted cash flows expected to be received from the given financial instrument. Options are valued using option pricing models. The variables and assumptions used in a valuation include, where available, data derived from observable markets.

(IN PLN MILLION)

The fair value of derivatives includes the Group's own credit risk as well as counterparty credit risk. In case of derivative instruments adjustment of the valuation of derivatives reflecting counterparty credit risk CVA (credit value adjustment) and adjustment of the valuation of derivatives reflecting the Group's own credit risk DVA (debt value adjustment) is calculated. The process of calculation of CVA and DVA adjustments includes the selection of method determining the spread of the counterparty's or the Group's credit risk (e.g. a market price method based on the continuous price quotations of debt instruments issued by the counterparty, a method of spread implied from Credit Default Swap contracts), an estimation of the probability of default of the counterparty or the Group and the recovery rate, and calculation of the amount of CVA and DVA adjustments.

The valuation techniques used by the Group for non-option derivative instruments are based on yield curves based on available market data (deposit margins on interbank market, IRS quotations).

FINANCIAL INFORMATION

DERIVATIVE FINANCIAL INSTRUMENTS	31.12.2016		31.12.2015	
	Assets	Liabilities	Assets	Liabilities
Hedging instruments	382.1	1 135.2	508.7	998.5
Other derivative instruments	2 518.5	3 062.7	3 838.6	3 626.3
Total	**2 900.6**	**4 197.9**	**4 347.3**	**4 624.8**

TYPE OF CONTRACT	31.12.2016		31.12.2015	
	Assets	Liabilities	Assets	Liabilities
IRS	1 386.5	2 097.5	3 206.3	3 053.1
CIRS	569.7	1 391.1	472.4	1 210.2
FX Swap	205.3	164.0	310.0	86.0
Options	546.5	436.8	237.9	177.5
FRA	2.5	2.2	16.2	22.2
Forward	176.7	106.3	104.5	72.6
Other	13.4	-	-	3.2
Total	**2 900.6**	**4 197.9**	**4 347.3**	**4 624.8**

(IN PLN MILLION)

Nominal amounts of underlying instruments (both sale and purchase) as at 31.12.2016

	up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	over 5 years	Total
Currency transactions						
FX Swap	23 608.5	5 908.4	8 403.7	1 562.6	-	39 483.2
Purchase of currency	11 818.2	2 962.2	4 213.4	795.2	-	19 789.0
Sale of currency	11 790.3	2 946.2	4 190.3	767.4	-	19 694.2
FX forward	5 920.5	3 678.5	9 113.8	4 650.9	6.0	23 369.7
Purchase of currency	2 971.8	1 832.4	4 553.6	2 296.5	6.0	11 660.3
Sale of currency	2 948.7	1 846.1	4 560.2	2 354.4	-	11 709.4
Options	1 987.4	2 784.1	22 339.8	6 622.4	148.6	33 882.3
Purchase	1 112.2	1 372.3	11 402.7	3 528.6	74.3	17 490.1
Sale	875.2	1 411.8	10 937.1	3 093.8	74.3	16 392.2
Cross Currency (CIRS)	3 605.6	2 550.4	1 721.6	22 347.8	10 576.9	40 802.3
Purchase	1 734.5	1 275.2	860.8	10 687.1	6 507.6	21 065.2
Sale	1 871.1	1 275.2	860.8	11 660.7	4 069.3	19 737.1
Interest rate transactions	-	-	-	-	-	-
Interest Rate Swap (IRS)	5 974.2	18 136.7	121 272.2	164 764.6	37 809.6	347 957.3
Purchase	2 987.1	9 068.4	60 636.1	82 382.3	18 904.8	173 978.7
Sale	2 987.1	9 068.3	60 636.1	82 382.3	18 904.8	173 978.6
Forward Rate Agreement (FRA)	-	-	18 477.0	1 250.0	-	19 727.0
Purchase	-	-	7 087.0	500.0	-	7 587.0
Sale	-	-	11 390.0	750.0	-	12 140.0
Other transactions:						
Other (including options on stock indices)	2 093.8	1.2	400.0	6.9	-	2 501.9
Purchase	7.9	0.3	400.0	6.9	-	415.1
Sale	2 085.9	0.9	-	-	-	2 086.8
Total derivative instruments	43 190.0	33 059.3	181 728.1	201 205.2	48 541.1	507 723.7

Nominal amounts of underlying instruments (both sale and purchase) as at 31.12.2015

	up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	over 5 years	Total
Currency transactions						
FX Swap	31 379.5	10 782.6	7 271.3	2 218.1	-	51 651.5
Purchase of currency	15 726.0	5 432.2	3 668.2	1 137.4	-	25 963.8
Sale of currency	15 653.5	5 350.4	3 603.1	1 080.7	-	25 687.7
FX forward	4 674.7	2 128.6	5 855.3	3 353.3	-	16 011.9
Purchase of currency	2 337.6	1 075.5	2 926.8	1 657.7	-	7 997.6
Sale of currency	2 337.1	1 053.1	2 928.5	1 695.6	-	8 014.3
Options	2 026.6	3 215.5	10 167.3	8 121.4	154.0	23 684.8
Purchase	1 088.0	1 787.2	5 413.2	4 123.4	77.0	12 488.8
Sale	938.6	1 428.3	4 754.1	3 998.0	77.0	11 196.0
Cross Currency (CIRS)	1 719.7	169.0	1 899.4	25 454.3	12 779.3	42 021.7
Purchase	797.3	84.5	914.6	12 436.1	6 436.3	20 668.8
Sale	922.4	84.5	984.8	13 018.2	6 343.0	21 352.9
Interest rate transactions						
Interest Rate Swap (IRS)	17 405.8	44 348.8	82 712.8	225 911.4	41 427.2	411 806.0
Purchase	8 702.9	22 174.5	41 356.8	112 955.7	20 713.6	205 903.5
Sale	8 702.9	22 174.3	41 356.0	112 955.7	20 713.6	205 902.5
Forward Rate Agreement (FRA)	16 313.0	17 500.0	18 215.0	750.0	-	52 778.0
Purchase	8 824.0	8 625.0	7 155.0	750.0	-	25 354.0
Sale	7 489.0	8 875.0	11 060.0	-	-	27 424.0
Other transactions:						
Other (including options on stock indices)	2 309.5	8.3	17.4	1.0	-	2 336.2
Purchase	834.3	-	16.1	-	-	850.4
Sale	1 475.2	8.3	1.3	1.0	-	1 485.8
Total derivative instruments	75 828.8	78 152.8	126 138.5	265 809.5	54 360.5	600 290.1

(IN PLN MILLION)

CALCULATION OF ESTIMATES

The Group conducted a simulation to assess the potential influence of changes of the yield curves on the transaction valuation.

Estimated change in valuation with parallel shift of yield curves:	31.12.2016		31.12.2015	
	+50 b.p. scenario	-50 b.p. scenario	+50 b.p. scenario	-50 b.p. scenario
IRS	(119)	121	(34)	34
CIRS	(88)	91	(95)	99
other derivatives	(4)	4	(1)	1
Total	**(211)**	**216**	**(130)**	**134**

As at 31 December 2016 the amount of CVA and DVA adjustments amounted to PLN 7.4 million (as at 31 December 2015: PLN 2 million).

23. DERIVATIVE HEDGING INSTRUMENTS

ACCOUNTING POLICIES

THE USE OF HEDGE ACCOUNTING

The Group applies hedge accounting when all the terms and conditions below have been met:

1) upon setting up the hedge, a hedge relationship, the purpose of risk management by the entity and the hedging strategy were officially established,
2) a hedge is expected to be highly effective,
3) the planned hedged transaction must be highly probable and must be exposed to variability of cash flows which may, as a result, have an impact on the income statement,
4) the effectiveness of a hedge may be reliably assessed,
5) the hedge is assessed on a current basis and its high effectiveness in all reporting periods for which the hedge had been established is confirmed

As at 31 December 2016 and as at 31 December 2015, the Group did not use fair value hedges.

DISCONTINUING HEDGE ACCOUNTING:

- A HEDGE INSTRUMENT EXPIRES, IS SOLD, RELEASED OR EXERCISED - accumulated gains or losses related to the hedging instrument which were recognised directly in other comprehensive income over the period in which the hedge was effective are recognised in a separate item in other comprehensive income until the planned transaction occurs,

- THE HEDGE CEASES TO MEET THE HEDGE ACCOUNTING CRITERIA - accumulated gains or losses related to the hedging instrument which were recognised directly in other comprehensive income over the period in which the hedge was effective are recognised in a separate item in other comprehensive income until the planned transaction occurs,

- **THE PLANNED TRANSACTION IS NO LONGER CONSIDERED PROBABLE** - all the accumulated gains or losses related to the hedging instrument which were recognised directly in other comprehensive income over the period in which the hedge was effective, are recognised in the income statement,
- **CANCELLATION OF HEDGING RELATIONSHIP** - the accumulated gains or losses related to the hedging instrument which were recognised directly in other comprehensive income over the period in which the hedge was effective, are recognised in a separate item in other comprehensive income until the planned transaction occurs.

CASH FLOW HEDGES

Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognised directly in other comprehensive income in respect of the portion constituting the effective portion of the hedge. The ineffective portion of a hedge is recognised in the income statement in the item 'Net income from financial instruments designated at fair value'.

Amounts transferred directly to other comprehensive income are transferred to the income statement in the same period or periods in which the hedged planned transaction affects the income statement. Interest and foreign exchange differences are shown in the income statement, in 'Net interest income' and 'Net foreign exchange gains (losses)', respectively.

All types of hedging relationships applied by the Group are cash flow hedge accounting (macro cash flow hedge).

The effectiveness tests comprise the valuation of hedging transactions, net of interest accrued and currency translation differences on the nominal value of the hedging transactions (in case of CIRS transactions).

Hedge effectiveness is verified through the use of prospective and retrospective effectiveness tests. Tests are performed on a monthly basis.

TYPES OF HEDGING STRATEGIES APPLIED BY THE GROUP

STRATEGY 1	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN CHF AND NEGOTIATED TERM DEPOSITS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING CIRS TRANSACTIONS
DESCRIPTION OF HEDGE RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate loans denominated in CHF and negotiated term deposits in PLN, resulting from fluctuations in reference interest rates in CHF and PLN, and changes in foreign exchange rates CHF/PLN using CIRS transactions during the hedged period.
HEDGED RISK	currency risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Group pays coupons based on 3M CHF LIBOR, and receives coupons based on 3M WIBOR on the nominal value defined in CHF and PLN respectively.
HEDGED POSITION	the portfolio of floating interest rate mortgage loans denominated in CHF and the portfolio of short-term negotiated term deposits, including renewals in the future (high probability of occurrence). The Group designated the hedged position according to the regulations of IAS 39 AG 99C as adopted by the European Union
	Periods in which cash flows are expected and in which they should have an impact on the financial result: January 2017 – October 2026

STRATEGY 2	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF HEDGE RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate PLN loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS transactions where the Group pays coupons based on floating 3M WIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded
HEDGED POSITION	the portfolio of loans in PLN indexed to the floating 3M WIBOR rate
	Period in which cash flows are expected and in which they should have an impact on the financial result: January 2017 – December 2021

STRATEGY 3	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN EUR, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF HEDGE RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate EUR loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS transactions, where the Group pays coupons based on floating 3M EURIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded
HEDGED POSITION	the portfolio of loans in EUR indexed to the floating 3M EURIBOR rate
	Periods in which cash flows are expected and in which they should have an impact on the financial result: January 2017 - June 2022

STRATEGY 4	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN CHF, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF HEDGE RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate CHF loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge
HEDGED RISK	interest rate risk
HEDGING INSTRUMENT	IRS transactions where the Group pays coupons based on floating 3M CHF LIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded
HEDGED POSITION	the portfolio of loans in CHF indexed to the floating 3M CHF LIBOR rate
	As at 31 December 2016, the Group had no active hedging relationships based on this strategy. As at 31 December 2015 the nominal value of hedging instruments amounted to CHF 250 million.

STRATEGY 5	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN FOREIGN CURRENCIES, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND FROM FOREIGN EXCHANGE RATE RISK AND HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FIXED INTEREST RATE FINANCIAL LIABILITY IN FOREIGN CURRENCY, RESULTING FROM FOREIGN EXCHANGE RATE RISK, USING CIRS TRANSACTIONS
DESCRIPTION OF HEDGE RELATIONSHIP	elimination of the risk of cash flow fluctuations of floating interest rate loans in foreign currencies, resulting from the risk of fluctuations in interest rates and from foreign exchange rate risk and elimination of the risk of cash flow fluctuations of fixed interest rate financial liability in foreign currency, resulting from foreign exchange rate risk, using CIRS transactions in the period covered by the hedge
HEDGED RISK	currency risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions, where the Group pays coupons based on floating 3M CHF LIBOR rate, and receives coupons based on a fixed USD rate on the nominal value, for which they were concluded
HEDGED POSITION	the portfolio of floating interest rate mortgage loans denominated in CHF and fixed interest rate financial liability denominated in USD
	Period in which cash flows are expected and in which they should have an impact on the financial result: January: 2017 - September 2022

STRATEGY 6	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM MORTGAGE LOANS IN FOREIGN CURRENCIES OTHER THAN CHF AND NEGOTIATED TERM DEPOSITS IN PLN, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES AND IN FOREIGN EXCHANGE RATES, USING CIRS TRANSACTIONS
DESCRIPTION OF HEDGE RELATIONSHIP	elimination of the risk of cash flow fluctuations generated by floating interest rate loans denominated in convertible currencies other than CHF and negotiated term deposits in PLN, resulting from fluctuations in reference interest rates, and changes in foreign exchange rates using CIRS transactions in the period covered by the hedge
HEDGED RISK	currency risk and interest rate risk
HEDGING INSTRUMENT	CIRS transactions where the Group pays coupons based on 3M EURIBOR rate, and receives coupons based on 3M WIBOR rate on the nominal value for which the transaction was concluded
HEDGED POSITION	the portfolio of floating interest rate mortgage loans denominated in EUR and the portfolio of short-term negotiated term deposits, including renewals in the future (high probability of occurrence). The Group designated the hedged position according to the regulations of IAS 39 AG 99C as adopted by the European Union.
	Period in which cash flows are expected and in which they should have an impact on the financial result: January 2017 – March 2021

(IN PLN MILLION)

FINANCIAL INFORMATION

Carrying amount/fair value of derivative instruments hedging cash flows associated with the interest rate and/or foreign exchange rate	31.12.2016 Assets	31.12.2016 Liabilities	31.12.2015 Assets	31.12.2015 Liabilities
IRS	90.4	32.3	269.1	-
CIRS	291.7	1 102.9	239.6	998.5
Total	**382.1**	**1 135.2**	**508.7**	**998.5**

Nominal value of hedging instruments by maturity as at 31 December 2016	up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	over 5 years	Total
IRS PLN fixed - float	-	250.0	9 030.0	6 845.6	-	**16 125.6**
IRS EUR fixed - float (original currency)	-	-	-	-	498.5	**498.5**
CIRS float CHF/float PLN						
float CHF	300.0	-	-	1 720.0	25.0	**2 045.0**
float PLN	1 098.6	-	-	6 170.7	88.1	**7 357.5**
CIRS fixed USD/float CHF						
fixed USD	-	-	-	-	875.0	**875.0**
float CHF	-	-	-	-	814.5	**814.5**
CIRS float EUR/float PLN						
float EUR	-	-	-	125.0	-	**125.0**
float PLN	-	-	-	545.2	-	**545.2**

Nominal value of hedging instruments by maturity as at 31 December 2015	up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	over 5 years	Total
IRS PLN fixed - float	1 680.0	2 910.0	984.0	4 670.0	-	**10 244.0**
IRS EUR fixed - float (original currency)	35.0	368.0	58.0	-	-	**461.0**
IRS CHF fixed - float (original currency)	-	-	250.0	-	-	**250.0**
CIRS float CHF/float PLN						
float CHF	150.0	-	250.0	1 520.0	300.0	**2 220.0**
float PLN	465.8	-	914.6	5 421.6	1 039.0	**7 841.0**
CIRS fixed USD/float CHF						
fixed USD	-	-	-	-	875.0	**875.0**
float CHF	-	-	-	-	814.5	**814.5**
CIRS float EUR/float PLN						
float EUR	-	-	-	200.0	-	**200.0**
float PLN	-	-	-	851.7	-	**851.7**

Change in other comprehensive income related to cash flow hedges	31.12.2016	31.12.2015
Other comprehensive income at the beginning of the period, gross	**(71.2)**	**6.4**
Gains/losses transferred to other comprehensive income in the period	(50.5)	(689.1)
Amount transferred from other comprehensive income to the income statement, of which:	(12.2)	611.5
- interest income	(340.1)	(450.9)
- net foreign exchange gains	327.9	1 062.4
Accumulated other comprehensive income at the end of the period, gross	**(133.9)**	**(71.2)**
Tax effect	25.4	13.5
Accumulated other comprehensive income at the end of the period, net	**(108.5)**	**(57.7)**
Impact on other comprehensive income in the period, gross	**(62.7)**	**(77.6)**
Tax effect	11.9	14.7
Impact on other comprehensive income in the period, net	**(50.8)**	**(62.9)**

(IN PLN MILLION)

CALCULATION OF ESTIMATES

Estimated change in valuation with parallel shift of yield curves:	31.12.2016		31.12.2015	
	+50 b.p. scenario	-50 b.p. scenario	+50 b.p. scenario	-50 b.p. scenario
IRS	(143)	146	(61)	63
CIRS	(88)	91	(95)	99
Total	**(231)**	**237**	**(156)**	**162**

24. FINANCIAL INSTRUMENTS DESIGNATED UPON INITIAL RECOGNITION AT FAIR VALUE THROUGH PROFIT AND LOSS

ACCOUNTING POLICIES

The Group classifies financial instrument to this category when:

1) it is a hybrid instrument which includes one or more embedded derivatives qualifying for separate recognition, and the embedded derivative financial instrument cannot significantly change the cash flows resulting from the host contract or its separation from the hybrid instrument is forbidden;
2) such classification of an instrument eliminates or significantly reduces the inconsistency in measurement or recognition (the so-called accounting mismatch resulting from different measurement methods of assets and liabilities and different recognition of the related gains or losses), e.g. financial instruments economically hedged without applying hedge accounting;
3) the results on a category of financial instruments are assessed on a fair value basis, pursuant to the Group's risk management principles or investment strategy.

The Group has a policy of financial assets and liabilities management according to which financial assets and liabilities classified as held for trading portfolio and financial assets and liabilities designated upon initial recognition at fair value through profit and loss portfolio are managed separately.

Financial instruments classified in this category are designated at fair value with changes in fair value recognised in profit and loss in net income from financial instruments at fair value through profit and loss.

FINANCIAL INFORMATION

Financial instruments designated upon initial recognition at fair value through profit and loss	31.12.2016	31.12.2015
Debt securities	12 204.1	13 337.4
NBP money market bills	9 078.8	10 036.9
Treasury bonds PLN	1 811.9	1 934.8
foreign currency Treasury bonds	1 074.8	1 118.0
municipal bonds PLN	110.9	115.9
foreign currency municipal bonds	127.7	131.3
corporate bonds PLN	-	0.5
Participation units in ICF (insurance capital funds) related to insurance products belonging to the group of investment products where the risk is borne by the policyholder	1 733.1	1 816.7
Total	**13 937.2**	**15 154.1**

(IN PLN MILLION)

Debt securities by maturity (in carrying amount)	31.12.2016	31.12.2015
up to 1 month	9 088.9	10 073.0
1 month - 3 months	-	6.5
3 months - 1 year	171.5	371.9
1 year - 5 years	2 836.8	2 510.2
over 5 years	106.9	375.8
Total	**12 204.1**	**13 337.4**

25. Loans and advances to customers

Accounting policies

Loans and advances to customers include financial assets which are not derivatives, with determined or possible to be determined payments, which are not quoted on an active market. The group includes loans and advances granted, financial lease receivables, corporate and municipal debt securities which based on the entity's decision are classified to this category, and receivables due from repurchase agreements, where the bank is not a counterparty to the transaction.

At initial recognition they are measured at fair value plus transaction costs, which can be directly attributed to purchase or issuance of a financial asset.

After initial recognition, these assets are measured at amortized cost using the effective interest rate method, less impairment allowances. In case of loans and advances for which it is not possible to reliably estimate the schedule of future cash flows and the effective interest rate, they are measured at amount due.

Finance lease receivables are recognised as receivables in the amount equal to the current contractual value of the lease payments plus the potential unguaranteed residual value attributed to the lessor, determined as at the date of inception of the lease. Lease payments on financial leases are divided between interest income and a reduction in the balance of receivables in a manner enabling achieving a fixed interest rate on the remaining receivables.

Buy-sell-back securities are recognised under amounts due from customers if a counterparty to the transaction is other than a bank. Receivables due from repurchase agreements are measured at amortized cost. The difference between the purchase price and the repurchase (sale) price is recognised as interest income and it is settled over the term of the contract using the effective interest rate.

Estimates and judgements – impairment allowances

An impairment loss is incurred when there is objective evidence of impairment due to one or more events that occurred after the initial recognition of the asset ('a loss event'), and the event has a reliably measurable impact on the expected future cash flows from the financial asset or a group of financial assets. Future cash flows are assessed by the Group on the basis of estimates based on historical parameters.

The Group performs a monthly review of loan exposures in order to identify loan exposures exposed to potential impairment, measure the impairment of loan exposures and recognise impairment allowances on loans and advances or provisions for off-balance sheet exposures.

The process of determining impairment allowances on loans and advances and provisions includes the following stages:

- identifying impairment triggers and events significant from the perspective of identifying those triggers,
- registering in the Group's IT systems the events that are significant from the perspective of identifying impairment trigger of loan exposures,
- determining the method of measuring impairment,
- measuring impairment and determining an impairment allowance or provision,
- verifying and aggregating the results of the impairment measurement,
- recording the results of impairment measurement.

The method of determining the amount of impairment allowances depends on the type of impairment triggers identified and the individual significance of a given loan exposure. The loss events considered as impairment triggers are, in particular, as follows:

- breach of the contract by the borrower, i.e. for example, delay in the payment of principal or interest longer than 90 days (when determining the loan overdue period, the Group takes into account the amounts of overdue interest or principal instalments exceeding the fixed threshold values),
- a decline in debtor's rating to a level indicating a significant threat to the repayment of debt (with respect to non-financial clients 'H1' rating, with respect to financial institutions – G, H rating) resulting from significant financial difficulties of the debtor,
- entering into restructuring agreement or granting a concession concerning debt repayment (the impairment trigger is recognised if the concessions are granted to the client for legal or economic reasons resulting from financial difficulties),
- high probability of bankruptcy or reorganization of the debtor,
- the debt being declared as due and payable,
- enforcement proceedings against the debtor,
- declaration of the debtor's bankruptcy or filling a motion to declare bankruptcy,
- the amount of the debt being challenged by the debtor,
- commencement of corporate recovery proceedings against the debtor,
- establishing imposed administration over the debtor or suspending the debtor's activities,
- additional impairment triggers identified for exposures to housing cooperatives arising from housing loans of the 'old portfolio', covered by State Treasury guarantees.

The Group categorizes its loans and advances based on the exposure amounts. The Group applies three methods of estimating impairment:

- **an individual basis** applied in respect of individually significant loans, for which the objective evidence of impairment was identified or requiring individual assessment due to the transactions specifics and resulting from events determining the repayment of exposure. In the portfolio of individually significant loan exposures, each individual loan exposure is subject to individual assessment on impairment triggers and the level of recognised loss.
- **a portfolio basis** applied in respect of individually insignificant loans, for which the objective evidence of individual impairment was identified. For individually insignificant exposures recognition and measurement of loss are made using portfolio risk parameters estimated with statistical methods. If loss is recognised for an individual loan exposure, the adequate impairment allowance is recognised.

- **a group basis** (IBNR) applied in respect of the loans, for which the objective evidence of impairment was not identified, but there is a possibility of losses incurred but not recognised. If for individual loan exposure loss is not recognised, the exposure is classified to a portfolio of assets with similar characteristics which is assessed on a group basis and is a subject to impairment allowance set up for the given group due to incurred but not reported losses (IBNR allowance).

  Loan exposures, in respect of which no objective evidence of individual impairment was identified, or in spite of their occurrence no impairment loss was recognised, are assessed for impairment on a basis of exposures with the same characteristics.

Impairment allowance in respect of a loan exposure corresponds to the difference between the carrying amount of the exposure and the present value of the expected future cash flows from a given exposure:

- while assessing **impairment allowances on an individual basis**, the expected future cash flows are estimated for each loan exposure individually, taking into account the possible scenarios relating to contract execution, weighted by the probability of their realization,
- an impairment allowance in respect of loan exposures **assessed on portfolio basis or a group basis** corresponds to the difference between the carrying amount of the exposures and the present value of the expected future cash flows (excluding future credit losses that have not been incurred).

Future cash flows of a group of financial assets assessed for impairment on a collective basis are estimated on the basis of cash flows resulting from loan agreements and historical recovery parameters generated from assets with similar risk characteristics.

Historical recovery parameters are adjusted on the basis of data from current observations, so as to take into account the impact of current conditions and exclude factors that were relevant in the past but which currently do not occur. In subsequent period, if the amount of impairment loss is reduced because of an event subsequent to the impairment loss being recognised (e.g. improvement in debtor's credit rating) the impairment loss that was previously recognised is reversed by making an appropriate adjustment to impairment allowances balance. The amount of the reversal is recognised in the income statement.

IBNR allowance is estimated using the portfolio parameters. These parameters are estimated for the group of exposures with the same risk characteristics.

The calculation of the present value of estimated cash flows relating to financial assets for which collateral is held takes into account cash flows arising from the foreclosure of the collateral, less costs to foreclose and sell.

The adopted methodology used for estimating impairment allowances will be developed in line with the further possibilities of gathering information on impairment from the existing and implemented applications and information systems. As a consequence, new data obtained could influence the level of impairment allowances in the future. The methodology and assumptions used in the estimates are reviewed on a regular basis to minimise the differences between the estimated and actual loss amount.

(IN PLN MILLION)

FINANCIAL INFORMATION

Loans and advances to customers	31.12.2016			31.12.2015		
	Gross	Impairment allowances	Net	Gross	Impairment allowances	Net
Loans	**189 736.2**	**(7 478.1)**	**182 258.1**	**183 176.5**	**(8 013.4)**	**175 163.1**
housing	108 321.5	(2 200.2)	106 121.3	103 005.8	(2 337.2)	100 668.6
corporate	56 722.0	(3 807.1)	52 914.9	56 641.6	(4 106.9)	52 534.7
consumer	24 692.7	(1 470.8)	23 221.9	23 529.1	(1 569.3)	21 959.8
Debt securities	**4 948.2**	**(77.5)**	**4 870.7**	**5 356.3**	**(71.7)**	**5 284.6**
debt securities (corporate)	2 352.1	(69.3)	2 282.8	2 660.9	(69.0)	2 591.9
debt securities (municipal)	2 596.1	(8.2)	2 587.9	2 695.4	(2.7)	2 692.7
Receivables due from repurchase agreements	**1 339.0**	**-**	**1 339.0**	**4 432.2**	**-**	**4 432.2**
Finance lease receivables	**12 585.8**	**(447.1)**	**12 138.7**	**5 735.9**	**(202.1)**	**5 533.8**
Total	**208 609.2**	**(8 002.7)**	**200 606.5**	**198 700.9**	**(8 287.2)**	**190 413.7**

Loans and advances to customers by method of calculating impairment allowances	31.12.2016			31.12.2015		
	Gross	Impairment allowances	Net	Gross	Impairment allowances	Net
individual basis, of which:	6 550.7	(2 608.3)	3 942.4	7 549.7	(2 895.8)	4 653.9
impaired	5 048.9	(2 593.9)	2 455.0	5 412.8	(2 882.4)	2 530.4
not impaired	1 501.8	(14.4)	1 487.4	2 136.9	(13.4)	2 123.5
portfolio basis	7 183.0	(4 765.8)	2 417.2	7 688.1	(4 822.2)	2 865.9
impaired	7 171.2	(4 765.6)	2 405.6	7 688.1	(4 822.2)	2 865.9
not impaired	11.8	(0.2)	11.6	-	-	-
group basis (IBNR)	194 875.5	(628.6)	194 246.9	183 463.1	(569.2)	182 893.9
Total	**208 609.2**	**(8 002.7)**	**200 606.5**	**198 700.9**	**(8 287.2)**	**190 413.7**

Loans and advances to customers - the Group's exposure to credit risk	31.12.2016			31.12.2015		
	Gross	Impairment allowances	Net	Gross	Impairment allowances	Net
impaired, of which	12 220.1	(7 359.5)	4 860.6	13 100.9	(7 704.6)	5 396.3
assessed on an individual basis	5 048.9	(2 593.9)	2 455.0	5 412.8	(2 882.4)	2 530.4
not impaired, of which	196 389.1	(643.2)	195 745.9	185 600.0	(582.6)	185 017.4
with recognised individual impairment trigger	1 452.0	(14.6)	1 437.4	2 043.1	(13.4)	2 029.7
not past due	1 199.1	(13.3)	1 185.8	1 605.4	(11.9)	1 593.5
past due	252.9	(1.3)	251.6	437.7	(1.5)	436.2
without recognised individual impairement trigger/IBNR	194 937.1	(628.6)	194 308.5	183 556.9	(569.2)	182 987.7
not past due	190 628.1	(436.1)	190 192.0	180 382.1	(357.2)	180 024.9
past due	4 309.0	(192.5)	4 116.5	3 174.8	(212.0)	2 962.8
Total	**208 609.2**	**(8 002.7)**	**200 606.5**	**198 700.9**	**(8 287.2)**	**190 413.7**

(IN PLN MILLION)

Loans and advances to customers by client segment	31.12.2016	31.12.2015
Loans and advances to customers, gross, of which:	208 609.2	198 700.9
mortgage banking	101 389.1	96 060.7
corporate	53 170.1	51 171.5
retail and private banking	24 700.6	23 529.1
small and medium enterprises	27 997.1	23 497.2
receivables due from repurchase agreements	1 339.0	4 432.2
other receivables	13.3	10.2
Impairment allowances on loans and advances	(8 002.7)	(8 287.2)
Loans and advances to customers, net	**200 606.5**	**190 413.7**

Loan quality ratios (in %)	31.12.2016	31.12.2015
share of impaired loans	5.9%	6.6%
coverage ratio of impaired loans*	65.5%	63.3%
share of loans overdue more than 90 days in relation to the gross amount of loans and advances	4.4%	4.9%

* The coverage ratio of impaired loans and advances to customers is calculated as the ratio of total impairment allowance (both on impaired loans and advances to customers and IBNR) to the total gross exposure of impaired loans and advances to customers.

Impairment allowances on loans and advances to customers - reconciliation of movements in 2016	Value at the beginning of the period	Recognised during the period	Reversed during the period	Derecognition of assets and settlement	Other, of which arising from business combinations	Value at the end of the period	Net- impact on the income statement
housing loans	2 337.2	1 239.7	(893.9)	(487.6)	4.8	2 200.2	(345.8)
corporate loans	4 106.9	2 271.0	(1 483.9)	(967.3)	(119.6)	3 807.1	(787.1)
consumer loans	1 569.3	1 143.1	(798.2)	(397.3)	(46.1)	1 470.8	(344.9)
debt securities (corporate)	69.0	0.2	-	-	0.1	69.3	(0.2)
debt securities (municipal)	2.7	5.5	-	-	-	8.2	(5.5)
finance lease receivables	202.1	121.4	(101.3)	(14.5)	239.4	447.1	(20.1)
Total	8 287.2	4 780.9	(3 277.3)	(1 866.7)	78.6	8 002.7	(1 503.6)

Impairment allowances on loans and advances to customers - reconciliation of movements in 2015	Value at the beginning of the period	Recognised during the period	Reversed during the period	Derecognition of assets and settlement	Other, of which arising from business combinations	Value at the end of the period	Net- impact on the income statement
housing loans	2 307.7	1 137.3	(846.1)	(368.8)	107.1	2 337.2	(291.2)
corporate loans	4 111.3	2 601.0	(1 837.5)	(729.9)	(38.0)	4 106.9	(763.5)
consumer loans	1 322.9	1 045.2	(707.2)	(396.3)	304.7	1 569.3	(338.0)
debt securities (corporate)	92.9	2.7	(25.7)	-	(0.9)	69.0	23.0
debt securities (municipal)	2.8	-	(0.1)	-	-	2.7	0.1
finance lease receivables	184.8	103.2	(77.6)	(8.3)	-	202.1	(25.6)
Total	8 022.4	4 889.4	(3 494.2)	(1 503.3)	372.9	8 287.2	(1 395.2)

RECLASSIFICATION OF SECURITIES

In 2012 due to the change of intention as regards holding of the selected portfolio of non-treasury securities classified upon initial recognition as available for sale, the Group reclassified them to loans and advances to customers category. As a result of the reclassification of the portfolio, the valuation methods for the portfolio have changed, i.e. from measured at fair value to measured at amortized cost.

(IN PLN MILLION)

Portfolio reclassified in 2012 as at	31.12.2016		31.12.2015	
	fair value	carrying amount	fair value	carrying amount
Municipal bonds	622.7	628.0	741.7	747.7
Corporate bonds	8.2	8.2	591.4	537.7
Total	**630.9**	**636.2**	**1 333.1**	**1 285.4**

Portfolio reclassified in 2012 as at the reclassification date	nominal value	fair value	carrying amount
Municipal bonds	1 219.2	1 237.4	1 237.4
Corporate bonds	1 288.8	1 293.5	1 293.5
Total	**2 508.0**	**2 530.9**	**2 530.9**

Change in fair value which would have been recognised in the income statement and/or in other comprehensive income if there was no reclassification, would amount to PLN (39) million for the period from the date of reclassification until 31 December 2016 (31 December 2015 PLN (4.7) million). As at 31 December 2016, the average effective interest rate for the debt securities portfolio was 3.30% (as at 31 December 2015 was 3.26%).

CALCULATION OF ESTIMATES – IMPAIRMENT ALLOWANCES

The impact of an increase/decrease in cash flows for the Group's loans and advances portfolio assessed for impairment on the basis of individual analysis of future cash flows arising both from own payments and foreclosure of collaterals, i.e. the exposures for which an individual method is applied and the impact of an increase/decrease in the portfolio parameters for the Group's loans and advances portfolio assessed on a portfolio and group basis is presented in the table below:

Estimated change in impairment allowances on loans and advances resulting from:	31.12.2016		31.12.2015	
	+10% scenario	-10% scenario	+10% scenario	-10% scenario
change in the present value of estimated cash flows for the Bank's loans and advances portfolio assessed on an individual basis (individually determined to be impaired)	(196)	320	(204)	364
change in probability of default	49	(49)	60	(60)
change in recovery rates	(353)	353	(435)	435

FINANCE LEASE RECEIVABLES

The Group conducts lease activities through the entities from the PKO Leasing SA Group.

Gross lease investments and minimum lease payments as at 31 December 2016	Gross lease investment	Present value of minimum lease payments	Unrealized income
Gross lease receivables:			
up to 1 year	5 120.5	4 651.1	469.4
from 1 year to 5 years	7 858.5	7 286.8	571.7
over 5 years	710.0	647.9	62.1
Gross total	13 689.0	12 585.8	1 103.2
Impairment allowances	(447.1)	(447.1)	-
Net total	**13 241.9**	**12 138.7**	**1 103.2**

(IN PLN MILLION)

Gross lease investments and minimum lease payments as at 31 December 2015	Gross lease investment	Present value of minimum lease payments	Unrealized income
Gross lease receivables:			
up to 1 year	2 317.1	2 100.2	216.9
from 1 year to 5 years	3 483.8	3 204.2	279.6
over 5 years	477.4	431.5	45.9
Gross total	6 278.3	5 735.9	542.4
Impairment allowances	(202.1)	(202.1)	-
Net total	**6 076.2**	**5 533.8**	**542.4**

As at 31 December 2016 and 31 December 2015, there are no unguaranteed residual values attributable to the lessor.

26. Investment securities available for sale

Accounting policies

Accounting policies
Estimates and judgements
Financial information:
- Investment securities available for sale
- Investment debt securities available for sale – the Group's exposure to credit risk
- Debt securities available for sale by maturity (by carrying amount)
- Impairment allowances – reconciliation of movements in 2016 and in 2015
- Significant transaction

Accounting policies

Investment securities available for sale are debt and equity securities which have been designated as available for sale.

At initial recognition these assets are measured at fair value plus direct transaction costs and then remeasured to fair value and the effects of fair value changes (with the exception of impairment losses) are recognised in other comprehensive income until a given asset is derecognised from the statement of financial position when the accumulated gain/loss is recognised in profit or loss as the result on investment securities. Interest accrued using the effective interest rate on available-for-sale assets is recognised in net interest income.

Impairment allowances on assets classified as available for sale are recognised in the income statement under net impairment allowance and write-downs, which results in derecognition from other comprehensive income accumulated losses on valuation which were previously recorded there and to recognise them in the income statement.

In subsequent periods, if the fair value of debt securities increases, and the increase may be objectively related to an event subsequent to the impairment loss being recognised in the income statement, the impairment loss is reversed and the amount of the reversal is recognised in the income statement.

Impairment losses recognised on equity instruments are not reversed through profit and loss.

Estimates and judgements:

Impairment allowances

At each balance sheet date, the Group makes an assessment, whether there is objective evidence that a given financial asset classified to financial assets available for sale is impaired. If such evidence exists, the Group determines the amounts of impairment allowances.

(IN PLN MILLION)

Objective evidence that a financial asset or group of assets available for sale is impaired includes the following events:

1) significant financial difficulties of the issuer,
2) breach of a contract by the issuer, such as lack of contracted payments of interest or principal or late payments,
3) granting a concession by the lender to the issuer, for economic or legal reasons relating to the borrower's financial difficulty, that the lender would not otherwise consider ('forbearance practices'),
4) deterioration of the issuer's financial condition in the period of maintaining the exposure,
5) high probability of bankruptcy or other financial reorganization of the issuer,
6) an increase in risk of a certain industry in the period of maintaining a significant exposure, in which the issuer operates, reflected by the industry being qualified by the Group as elevated risk industry.

The Group firstly assesses if impairment on an individual basis for individually significant receivables exists.

If there are objective indicators of impairment on financial assets classified as debt securities available for sale not issued by the State Treasury, an impairment allowance is calculated as the difference between the asset's carrying amount and the present fair value estimated as value of future cash flows discounted using the original effective interest rate.

CVA AND DVA ADJUSTMENTS

The fair value non-quoted debt securities available for sale is determined using valuation models based on discounted cash flows expected to be received from the given financial instrument. In the valuation of non-quoted debt securities available for sale, assumptions are also made about the counterparty's credit risk, which may have an impact on the valuation of the instruments. The credit risk of the securities, for which there is no reliable market price available, is included in the margin, for which the valuation methodology is consistent with the calculation of credit spreads to determine CVA and DVA adjustments.

FINANCIAL INFORMATION

Investment securities available for sale	**31.12.2016**	**31.12.2015**
Debt securities, gross	36 419.6	27 661.8
Treasury Bonds PLN	25 743.9	17 920.0
foreign currency Treasury bonds	678.5	437.9
municipal bonds PLN	4 551.8	4 613.7
corporate bonds PLN	4 800.0	4 097.5
foreign currency corporate bonds	645.4	592.7
Impairment allowances	(277.2)	(56.9)
corporate bonds PLN	(209.4)	(23.0)
foreign currency corporate bonds	(67.8)	(33.9)
Total net debt securities	**36 142.4**	**27 604.9**
Equity securities available for sale, gross	284.6	567.4
not admitted to public trading	128.9	346.9
admitted to public trading	155.7	220.5
Impairment allowances	(67.0)	(75.6)
Total net equity securities	**217.6**	**491.8**
Participation units in investment funds and shares in joint investment institutions	315.6	212.8
Total net investment securities available for sale	**36 675.6**	**28 309.5**

(IN PLN MILLION)

Investment debt securities available for sale - the Group's exposure to credit risk	Exposure 31.12.2016	31.12.2015
impaired, assessed on an individual basis	1 296.8	397.4
not impaired, not past due	35 122.8	27 264.4
with external rating	30 034.7	21 726.0
with internal rating	5 088.1	5 538.4
Gross total	**36 419.6**	**27 661.8**
Impairment allowances	(277.2)	(56.9)
Net total	**36 142.4**	**27 604.9**

Debt securities available for sale by maturity (by carrying amount)	31.12.2016	31.12.2015
up to 1 month	27.9	80.4
1 - 3 months	36.5	88.2
3 months - 1 year	1 869.4	591.7
1 - 5 years	20 176.8	12 283.2
over 5 years	14 031.8	14 561.4
Total	**36 142.4**	**27 604.9**

Impairment allowances - reconciliation of movements in 2016	Value at the beginning of the period	Recognised during the period	Reversed during the period	Derecognition of assets and settlement	Other	Value at the end of the period	Net- impact on the income statement
Debt securities	56.9	52.0	-	-	168.3	277.2	(52.0)
Equity instruments	75.6	-	-	(9.7)	1.1	67.0	-
Total	132.5	52.0	-	(9.7)	169.4	344.2	(52.0)

Impairment allowances - reconciliation of movements in 2015	Value at the beginning of the period	Recognised during the period	Reversed during the period	Derecognition of assets and settlement	Other	Value at the end of the period	Net- impact on the income statement
Debt securities	-	56.7	-	-	0.2	56.9	(56.7)
Equity instruments	129.4	4.7	(3.6)	(54.9)		75.6	(1.1)
Total	129.4	61.4	(3.6)	(54.9)	0.2	132.5	(57.8)

SIGNIFICANT TRANSACTION

On 29 January 2016, the Management Board of PKO Bank Polski SA accepted the conditions of the Group's participation in acquisition of Visa Europe Ltd. by Visa Inc. presented to the Group by Visa Europe Ltd. On 16 June 2016, the final amounts due to the Group were confirmed. On 21 June 2016, the Group obtained from Visa Europe Ltd. information on completing the acquisition of Visa Europe Ltd. by Visa Inc.

The final Group's participation in above-mentioned transaction includes:

- the amount of EUR 70.5 million in cash, paid on the Group's account on 21 June 2016 (equivalent to PLN 309.9 million according to NBP average exchange rate of 21 June 2016),
- the number of 25 612 preference C-series shares of Visa Inc., the value of which as at the transaction date was estimated at the amount of USD 20.9 million (equivalent to PLN 81 million according to NBP average exchange rate of 21 June 2016),

(IN PLN MILLION)

- the receivable due to deferred payment in cash equivalent to 0.5435987989% from the amount of EUR 1.12 billion, i.e. the amount attributable to all transaction participants, paid on the 3rd anniversary of the transaction, unless potential adjustments, in case of occurrence of situation described in the transaction terms; the value of above-mentioned receivable as at 21 June 2016 amounted to EUR 6.1 million (equivalent to PLN 26.7 million according to NBP average exchange rate of 21 June 2016).

The Group recognised in the income statement due to settlement of the transaction the total amount of PLN 417.6 million (the profit before taxation). Within this amount, the amount settled in the other comprehensive income due to valuation of Visa Europe Ltd. shares amounted to PLN 336.7 million.

Received preference C-series shares will be converted to ordinary Visa Inc. shares, and terms of transaction provide progressive shares conversion. The conversion of all preference shares shall occur not later than in 2028. Current conversion ratio equals to 13.952 and may be reduced in the period until 2028, which is depended on potential liabilities due to legal claims in that period relating to acquired company, i.e. Visa Europe Ltd.

Preference shares of Visa Inc. have been classified to the portfolio of securities available for sale and they are measured at its fair value based on the market price of quoted ordinary shares, taking into consideration discount due to the limited liquidity of the preference shares and the conditions of shares conversions (adjustments resulting from court proceedings).

The fair value of the mentioned above shares as at 31 December 2016 was estimated at USD 22.1 million (equivalent to PLN 92.4 million according to NBP average exchange rate of 30 December 2016 applicable as of the end of 2016).

27. Investments securities held to maturity

Accounting policies

Financial assets held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the intention and ability to hold to maturity other than those that the Group designates upon initial recognition at fair value through profit and loss, those that the Group designates as available for sale, those that meet the definition of loans and receivables.

These assets are measured at amortized cost using the effective interest rate method and impairment losses.

Financial information

Investment securities held to maturity by carrying amount, gross	31.12.2016	31.12.2015
Debt securities		
Treasury bonds PLN	198.8	37.4
foreign currency Treasury bonds	266.8	172.9
Total	**465.6**	**210.3**

As at 31 December 2016 and 2015, debt securities held to maturity comprise treasury bonds which are not overdue, with an external rating and not impaired.

(IN PLN MILLION)

Debt securities in the portfolio of instruments held to maturity by maturity	31.12.2016	31.12.2015
up to 1 month	3.2	23.1
1 - 3 months	4.9	61.2
3 months - 1 year	89.4	101.0
1 - 5 years	342.1	11.5
over 5 years	26.0	13.5
Total	**465.6**	**210.3**

28. NON-CURRENT ASSETS HELD FOR SALE

ACCOUNTING POLICIES

As non-current assets held for sale the Group classifies only assets available for immediate sale in the current condition, when such sale is highly probable, i.e. the entity has determined to sell the asset, started to seek actively for a buyer and finish the sale process. In addition, such assets are offered for sale at a price which is reasonable with respect to their current fair value and it is expected that the sale will be recognised as completed within one year from the date of classification of the asset into this category.

These assets are recognised at the lower of their carrying amount and fair value less costs to sell. Impairment allowances on non-current assets held for sale are recognised in the income statement for the period in which the allowances were made. Amortization is not charged on assets classified to this category.

When the classification criteria to this category are no longer met, the Bank reclassifies them from non-current assets held for sale to appropriate other asset categories. Non-current assets withdrawn from assets held for sale are measured at the lower of: 1) the carrying amount from before the moment of their classification to non-current assets held for sale, less amortization/depreciation that would have been recorded had the asset (or disposal group) not been classified as held for sale, 2) the recoverable amount as at the date of the decision to discontinue the sale.

FINANCIAL INFORMATION

Non-current assets held for sale	31.12.2016	31.12.2015
Land and buildings	14.3	217.4
Other	0.1	2.6
Total	**14.4**	**220.0**

29. INVENTORIES

Inventories	31.12.2016	31.12.2015
Goods	190.2	150.4
Finished goods	28.5	63.9
Building investments for sale	54.6	201.4
Materials	11.4	22.4
Impairment allowances on inventories	(24.8)	(37.2)
Total	**259.9**	**400.9**

30. INTANGIBLE ASSETS AND TANGIBLE FIXED ASSETS

ACCOUNTING POLICIES

INTANGIBLE ASSETS

SOFTWARE - Acquired computer software licenses are recognised in the amount of costs incurred on the purchase and preparation of the software for use, taking into consideration accumulated amortization and impairment allowances. Further expenditure related to the maintenance of the computer software is recognised as expense when incurred.

GOODWILL - Goodwill is recognised as the excess of consideration paid over the amount of acquired identifiable assets and liabilities measured at fair value as at the acquisition date. It is recognised at cost, less accumulated impairment. Following the initial recognition, goodwill is measured at the initial value less any cumulative impairment allowances. Goodwill arising on acquisition of subsidiaries is recognised under ‘Intangible assets’ and goodwill arising on acquisition of associates and joint ventures is recognised under ‘Investments in associates and joint ventures’. The test for goodwill impairment is carried out at least at the end of each year. Impairment is calculated by estimating the recoverable amount of the cash-generating unit to which the given goodwill relates. If the recoverable amount of the cash-generating unit is lower than its carrying amount, an impairment allowance is recognised.

CUSTOMER RELATIONSHIPS AND VALUE IN FORCE - As a result of a settlement of the transaction in accordance with IFRS 3, two components of intangible assets that are recognised separately from goodwill, i.e. customer relationships and value in force, representing the present value of future profits from concluded insurance contracts, were identified. These components of intangible assets are amortized by declining balance method based on the rate of economic benefits consumption arising from their use.

OTHER INTANGIBLE ASSETS - Other intangible assets acquired by the Group are recognised at acquisition cost or production cost, less accumulated amortization and impairment allowances.

DEVELOPMENT COSTS - Research and development costs are included in intangible assets in connection with future economic benefits and meeting specific terms and conditions, i.e. if there is a possibility and intention to complete and use the internally generated intangible asset, there are appropriate technical and financial resources to finish the development and to use the asset and it is possible to measure reliably the expenditure attributable to the intangible asset during its development which can be directly associated to the creation of the intangible asset.

TANGIBLE FIXED ASSETS

TANGIBLE FIXED ASSETS - are valued according to the purchase price or cost of production, less accumulated depreciation and impairment allowances.

INVESTMENT PROPERTY - are valued according to accounting policies applied to tangible fixed assets

CAPITAL EXPENDITURE ACCRUED - Carrying amount of tangible fixed assets and intangible assets is increased by additional expenditures incurred during their useful life.

Depreciation/amortization

Depreciation/amortization is charged on all non-current assets, whose value decreases due to usage or passage of time, using the straight-line method over the estimated useful life of the given asset. The adopted depreciation/amortization method and useful lives are reviewed at least on an annual basis.

Depreciation of tangible fixed assets, investment properties and amortization of intangible assets begins on the first day of the month following the month in which the asset has been brought into use, and ends no later than at the time when:

1) the amount of depreciation or amortization charges becomes equal to the initial cost of the asset, or
2) the asset is designated for liquidation, or
3) the asset is sold, or
4) the asset is found to be missing, or
5) it is found - as a result of verification - that the expected residual value of the asset exceeds its (net) carrying amount, taking into account the expected residual value of the asset upon scrapping, i.e. the net amount that the Group expects to obtain at the end of the useful life of the asset, net of its expected costs to sell should the expected present value on scrapping be not lower than 15% of the purchase price or cost of manufacture of the asset, and on condition that the residual value is not higher than PLN 10 000.

For non-financial non-current assets it is assumed that the residual value is nil, unless there is an obligation of a third party to buy back the asset, or if there is an active market which will continue to exist at the end of the asset's period of use and when it is possible to determine the value of the asset on this market.

Costs related to acquisition or construction of buildings are allocated to significant parts of the building (components), when such components have different useful lives or when each of the components generates benefits for the Group in a different manner. Each component of the building is depreciated separately. Intangible assets with indefinite useful lives, which are subject to an annual impairment test are not amortized.

Impairment allowance on non-financial non-current assets

An impairment allowance is recognised if the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment allowances in respect of cash generating units first and foremost reduce the goodwill relating to those cash generating units (groups of units), and then they reduce proportionally the book value of other assets in the unit (group of units).

An impairment allowance in respect of goodwill cannot be reversed. In respect of other assets, the impairment allowance may be reversed if there was a change in the estimates used to determine the recoverable amounts. An impairment allowance may be reversed only to the level at which the book value of an asset does not exceed the book value – less depreciation/amortization – which would be determined should the impairment allowance not have been recorded.

If there are impairment triggers for common assets, which do not generate cash inflows irrespective of other assets or asset groups, and the recoverable amount of a single asset included in common assets cannot be determined, the Group determines the recoverable amount at the level of the cash generating unit to which the asset belongs.

Operating lease – lessor

Initial direct costs that are incremental and directly attributable to negotiating and arranging a lease, are added to the carrying value of the leased asset during the period fixed in the lease agreement, on the same basis as in the case of lease income. Conditional lease payments constitute income when they are due. Lease payments receivable in respect of operating leases are recognised as revenues in the income statement on a straight-line basis over the period of the lease. The average agreement period is usually 36 months. The lessee bears service and insurance costs.

ESTIMATES AND JUDGEMENTS

USEFUL ECONOMIC LIVES OF TANGIBLE FIXED ASSETS, INTANGIBLE ASSETS AND INVESTMENT PROPERTIES

In estimating useful economic lives of particular types of tangible fixed assets, intangible assets and investment properties, the following factors are considered:

1) expected physical wear and tear, estimated based on the average useful life recorded to date, reflecting the normal physical wear and tear rate, intensity of use etc.,
2) technical or market obsolescence,
3) legal and other limitations on the use of the asset,
4) expected use of the asset assessed based on the expected production capacity or volume,
5) other factors affecting useful lives of such assets.

When the period of use of a given asset results from a contract term, the useful life of such an asset corresponds to the period defined in the contract. If the estimated useful life is shorter than the period defined in the contract, the estimated useful life is applied.

The adopted depreciation/amortization method and useful lives of tangible fixed assets, investment properties and intangible assets applied by the Group are reviewed at least on an annual basis.

Periods of amortization for the above groups used in the PKO Bank Polski SA Group.

Tangible fixed assets	**Periods**
Buildings, premises, cooperative rights to premises (including investment properties)	from 10 to 75 years
Leaseholds improvements (buildings, premises)	from 1 to 20 years (or the period of the lease, if shorter)
Machinery and equipment	from 2 to 15 years
Computer hardware	from 2 to 11 years
Means of transport	from 3 to 8 years
Intangible assets	**Periods**
Software	from 2 to 20 years
Other intangible assets	from 1 to 20 years

IMPAIRMENT ALLOWANCES

At each balance sheet date, the Group makes an assessment of whether there is objective evidence of impairment of any non-financial non-current assets (or cash-generating units). If any such evidence exists and annually in case of intangible assets which are not amortized and goodwill the Group estimates the recoverable amount being the higher of the fair value less costs to sell or the value in use of a non-current asset (or a cash-generating unit), if the carrying amount of an asset exceeds its recoverable amount, the Group recognises an impairment loss in the income statement. The estimation for the above-mentioned values requires making assumptions, i.a. about future expected cash flows that the Group may receive from the continued use or disposal of the non-current asset (or a cash-generating unit). The adoption of different assumptions with reference to the valuation of future cash flows could affect the carrying amount of certain non-current assets.

(IN PLN MILLION)

FINANCIAL INFORMATION

INTANGIBLE ASSETS

For the year ended 31 December 2016	Software	Goodwill	Future profits on concluded insurance contracts	Customer relationships	Other, including capital expenditure	Total
Gross carrying amount at the beginning of the period	4 068.2	1 368.4	140.6	86.5	321.0	5 984.7
Purchase	13.9	-	-	-	468.9	482.8
Transfers from capital expenditure	326.6	-	-	-	(326.6)	-
Liquidation and sale	(8.9)	-	-	-	(1.6)	(10.5)
Other, including taking up control over subsidiaries	59.9	57.4	-	64.0	(15.5)	165.8
Gross carrying amount at the end of the period	4 459.7	1 425.8	140.6	150.5	446.2	6 622.8
Accumulated amortisation at the beginning of the period	(2 379.8)	-	(41.4)	(38.3)	(62.9)	(2 522.4)
Amortisation for the period	(429.1)	-	(18.0)	(13.9)	(8.5)	(469.5)
Liquidation and sale	0.5	-	-	-	-	0.5
Other, including taking up control over subsidiaries	(23.2)	-	-	-	9.3	(13.9)
Accumulated amortisation at the end of the period	(2 831.6)	-	(59.4)	(52.2)	(62.1)	(3 005.3)
Impairment allowances at the beginning of the period	(15.5)	(169.7)	-	-	(6.1)	(191.3)
Recognised during the period	-	(4.1)				(4.1)
Other, including taking up control over subsidiaries	(0.4)	-	-	-	0.5	0.1
Impairment allowances at the end of the period	(15.9)	(173.8)	-	-	(5.6)	(195.3)
Net carrying amount at the beginning of the period	1 672.9	1 198.7	99.2	48.2	252.0	3 271.0
Net carrying amount at the end of the period	1 612.2	1 252.0	81.2	98.3	378.5	3 422.2

For the year ended 31 December 2015	Software	Goodwill	Future profits on concluded insurance contracts	Customer relationships	Other, including capital expenditure	Total
Gross carrying amount at the beginning of the period	3 700.0	1 312.0	140.6	86.5	429.4	5 668.5
Purchase	28.9	-	-	-	351.2	380.1
Transfers from capital expenditure	354.6	-	-	-	(354.6)	-
Liquidation and sale	-	-	-	-	(55.2)	(55.2)
Other, including taking up control over subsidiaries	(15.3)	56.4	-	-	(49.8)	(8.7)
Gross carrying amount at the end of the period	4 068.2	1 368.4	140.6	86.5	321.0	5 984.7
Accumulated amortisation at the beginning of the period	(1 972.7)	-	(18.3)	(19.2)	(138.9)	(2 149.1)
Amortisation for the period	(417.9)	-	(22.4)	(19.1)	(8.3)	(467.7)
Other, including taking up control over subsidiaries	10.8	-	(0.7)	-	84.3	94.4
Accumulated amortisation at the end of the period	(2 379.8)	-	(41.4)	(38.3)	(62.9)	(2 522.4)
Impairment allowances at the beginning of the period	(15.4)	(118.2)	-	-	(6.1)	(139.7)
Recognised during the period	(0.2)	-	-	-	-	(0.2)
Other, including taking up control over subsidiaries	0.1	(51.5)	-	-	-	(51.4)
Impairment allowances at the end of the period	(15.5)	(169.7)	-	-	(6.1)	(191.3)
Net carrying amount at the beginning of the period	1 711.9	1 193.8	122.3	67.3	284.4	3 379.7
Net carrying amount at the end of the period	1 672.9	1 198.7	99.2	48.2	252.0	3 271.0

To the Group, a significant item of intangible assets relates to expenditures on the Integrated Information System (IIS). The total capital expenditures incurred for the IIS system during the years 2006–2016 amounted to PLN 1 079 million. Net carrying amount amounted to PLN 679.1 million as at 31 December 2016 (PLN 717.4 million as at 31 December 2015). The expected useful life of the IIS system is 17 years. As at 31 December 2016, the remaining useful life is 7 years.

GOODWILL

Net goodwill	31.12.2016	31.12.2015
Nordea Polska entities	985.2	985.2
Raiffeisen Leasing Polska SA and its subsidiaries	57.4	-
PKO Towarzystwo Funduszy Inwestycyjnych SA	149.6	149.6
PKO BP BANKOWY PTE SA	51.2	51.2
Qualia 2 spółka z o.o. - Nowy Wilanów Sp.k.	0.8	4.9
Assets taken over from Centrum Finansowe Puławska Sp. z o.o.	7.8	7.8
Total	**1 252.0**	**1 198.7**

As at 31 December 2016 the Group performed mandatory impairment tests in respect of goodwill on the acquisition of Nordea Bank Polska SA, in accordance with the model developed based on the guidance of IAS 36. The impairment test is conducted by comparing the carrying amounts of Cash Generating Units ('CGUs') with their recoverable amounts. Two CGUs were identified to which goodwill on acquisition of Nordea Bank Polska SA was allocated – the retail and corporate CGU. The recoverable amount is estimated based on the value in use of the CGUs. The value in use is the present estimated value of future cash flows in 10 years, taking into consideration the residual value of the CGUs. The residual value of a CGU has been calculated by extrapolating the cash flow projections beyond the period of the forecast, using the growth rate adopted at a level of 1.5%. Cash flow projections are based on the assumptions included in the financial plan of the Group for 2017. For the discounting of the future cash flows the discount rate of 8.4% was used, taking into account the risk-free rate and risk premium. The impairment test performed as at 31 December 2016 showed a surplus of the recoverable amount over the carrying amount of each CGU and therefore no CGU impairment was recognised.

The remaining goodwill arising from the acquisition of companies Nordea Polska concerns the acquisition of the company 'Nordea Polska Towarzystwo Ubezpieczeń SA' (currently PKO Życie Towarzystwo Ubezpieczeń SA) and Nordea Finance Polska SA. This amount was assigned to the corporate and investment segment – cash generating units are as follow: entire company PKO Życie Towarzystwo Ubezpieczeń SA, and the entire company PKO Leasing SA (as the direct parent entity took over the assets of Nordea Finance Polska SA).

The impairment test of PKO Życie Towarzystwo Ubezpieczeń SA has been developed on the basis of the present value of expected future cash flows for PKO Bank Polska SA including the residual value. Future cash flows were estimated on the basis prepared by the Company's 10 year financial forecast.

The impairment test of PKO Leasing SA was carried out on the basis of the present value of expected future cash flows for 5 years, developed on the basis of the financial projections of the Company.

The impairment test of goodwill arising from the acquisition of PKO Towarzystwo Funduszy Inwestycyjnych SA was carried out on the basis of the present value of expected future cash flows for PKO Bank Polski SA, prepared by the Company's management on the basis of three-year financial forecast. The test takes into account the 2 variants of financial flows: only dividend as well as dividend and distribution fee for the sale of fund units of PKO TFI SA in the network of PKO Bank Polski SA, and in both cases includes the residual value.

The impairment test of the goodwill of PKO BP BANKOWY PTE SA was carried out using the embedded value method according to which the value in use of the Company's shares was established. The key parameters which determined the value of goodwill as at 31 December 2016 were the assumptions relating to the Act on the amendments to the act on pensions from the Social Insurance Fund and certain other acts, passed by the Sejm (the Polish Parliament) on 16 November 2016, which introduced a reduction in the compulsory minimum retirement age, establishing the right to retire at the age of 60 years for women and 65 years for men. The Act will come into force as from 1 October 2017.

In the above-mentioned impairment tests concerning the subsidiaries of PKO Bank Polski SA, the future cash flows were discounted using a discount rate of 9.13%, taking into account a risk-free rate equal to the yield on 10-year treasury bonds as of the valuation date as well as the market risk premium and risk ratio determined for projects in PKO Bank Polski SA.

The test for impairment of goodwill related to the assets acquired company Centrum Finansowe Puławska Sp. z o.o was carried out based on the fair value of the acquired property as a cash-generating unit to which goodwill has been allocated.

The above-mentioned tests indicated no need for the recognition of impairment.

At the same time in 2016, consistently as in previous years, an impairment loss was recognised on goodwill resulting from the acquisition of shares of the company Qualia 2 Spółka z ograniczoną odpowiedzialnością – Nowy Wilanów Sp. k. in the amount of PLN 4.1 million, i.e. in proportion to the sold part of the cash-generating units to which goodwill has been allocated.

In 2015, as a result of acquisition of the credit union 'Wesoła' (SKOK 'Wesoła') the Group recognised goodwill and impairment loss of PLN 451 thousand.

(IN PLN MILLION)

TANGIBLE FIXED ASSETS

For the year ended 31 December 2016	Land and buildings	Machinery and equipment	Assets under construction	Other	Total
Gross value of tangible fixed assets at the beginning of the period	**2 712.6**	**1 849.8**	**264.7**	**906.4**	**5 733.5**
Purchase	2.2	22.2	213.7	96.5	334.6
Transfers from capital expenditure	122.5	193.2	(369.3)	53.6	-
Liquidation and sale	(93.8)	(474.5)	-	(59.1)	(627.4)
Other, including taking up control over subsidiaries	208.8	19.8	(2.7)	184.1	410.0
Gross carrying amount at the end of the period	**2 952.3**	**1 610.5**	**106.4**	**1 181.5**	**5 850.7**
Accumulated depreciation at the beginning of the period	(1 005.8)	(1 419.8)	-	(468.7)	(2 894.3)
Depreciation for the period	(100.2)	(157.6)	-	(73.4)	(331.2)
Other, including taking up control over subsidiaries	68.9	455.4	-	2.5	526.8
Accumulated depreciation at the end of the period	(1 037.1)	(1 122.0)	-	(539.6)	(2 698.7)
Impairment allowances at the beginning of the period	**(33.3)**	**(2.6)**	**(4.0)**	**(17.1)**	**(57.0)**
Recognised during the period	(12.3)	-	-	(0.3)	(12.6)
Reversed during the period	16.0	2.1		4.4	22.5
Other, including taking up control over subsidiaries	(21.3)	-	0.2	1.9	(19.2)
Impairment allowances at the end of the period	**(50.9)**	**(0.5)**	**(3.8)**	**(11.1)**	**(66.3)**
Net carrying amount at the beginning of the period	**1 673.5**	**427.4**	**260.7**	**420.6**	**2 782.2**
Net carrying amount at the end of the period	**1 864.3**	**488.0**	**102.6**	**630.8**	**3 085.7**

For the year ended 31 December 2015	Land and buildings	Machinery and equipment	Assets under construction	Other	Total
Gross value of tangible fixed assets at the beginning of the period	**2 574.3**	**2 042.4**	**171.0**	**824.9**	**5 612.6**
Purchase	30.7	17.7	337.3	107.4	493.1
Transfers from capital expenditure	77.9	116.4	(246.8)	52.5	-
Liquidation and sale	(91.6)	(240.4)	(0.5)	(32.4)	(364.9)
Other, including taking up control over subsidiaries	121.3	(86.3)	3.7	(46.0)	(7.3)
Gross carrying amount at the end of the period	**2 712.6**	**1 849.8**	**264.7**	**906.4**	**5 733.5**
Accumulated depreciation at the beginning of the period	(967.0)	(1 542.5)	-	(439.5)	(2 949.0)
Depreciation for the period	(99.1)	(175.6)	-	(76.2)	(350.9)
Other, including taking up control over subsidiaries	60.3	298.3	-	47.0	405.6
Accumulated depreciation at the end of the period	(1 005.8)	(1 419.8)	-	(468.7)	(2 894.3)
Impairment allowances at the beginning of the period	**(4.5)**	**(0.1)**	**(5.5)**	**-**	**(10.1)**
Rrecognised during the period	(46.0)	(3.2)	-	(4.1)	(53.3)
Reversed during the period	34.3	0.8	-	0.3	35.4
Other, including taking up control over subsidiaries	(17.1)	(0.1)	1.5	(13.3)	(29.0)
Impairment allowances at the end of the period	**(33.3)**	**(2.6)**	**(4.0)**	**(17.1)**	**(57.0)**
Net carrying amount at the beginning of the period	**1 602.8**	**499.8**	**165.5**	**385.4**	**2 653.5**
Net carrying amount at the end of the period	**1 673.5**	**427.4**	**260.7**	**420.6**	**2 782.2**

(IN PLN MILLION)

	31.12.2016	31.12.2015
Compensation from third parties for impairment or loss of tangible fixed assets	27.0	18.9
Off balance sheet value of plant and machinery used based on operating lease agreements and lease agreements with a purchase option	77.1	74.9
Capital expenditure related to purchases of tangible fixed assets and intangible assets	819.1	787.3

Operating lease – lessor

Total value of future lease payments under irrevocable operating lease	31.12.2016	31.12.2015
For the period:		
up to 1 year	50.1	43.3
from 1 year to 5 years	106.2	16.4
over 5 years	9.7	4.9
Total	**166.0**	**64.6**

The average agreement period for operating lease agreements where the Group is a lessor is usually 36 months. The lessee bears service and insurance costs.
As at the balance sheet date the assets in lease under operating lease are as follows:

For the year ended 31 December 2016	Vehicles under operating lease	Real estate under operating lease	Plant and machinery under operating lease	Total
Gross amount as at the beginning of the period	33.7	2.7	0.9	37.3
Taking up control over subsidiaries	182.3	13.0	7.6	202.9
Changes in the period	49.1	61.4	(0.9)	109.6
Gross amount	265.1	77.1	7.6	349.8
Accumulated depreciation as at the beginning of the period	0.8	(0.2)	(0.4)	0.2
Taking up control over subsidiaries	(48.7)	(0.9)	-	(49.6)
Depreciation charge for the period	(10.7)	(1.3)	(0.3)	(12.3)
Other changes in depreciation, including foreign exchange differences	4.7	(3.2)	(0.7)	0.8
Accumulated depreciation	(53.9)	(5.6)	(1.4)	(60.9)
Impairment allowances as at the beginning of the period	-	(0.9)	-	(0.9)
Taking up control over subsidiaries	(3.9)	-	-	(3.9)
Impairment allowances recorded during the period	-	(0.4)	-	(0.4)
Impairment allowances	(3.9)	(1.3)	-	(5.2)
Net amount	**207.3**	**70.2**	**6.2**	**283.7**

(IN PLN MILLION)

for the year ended 31 December 2015	Vehicles under operating lease	Real estate under operating lease	Plant and machinery under operating lease	Total
Gross amount as at the beginning of the period	39.1	5.0	0.9	45.0
Changes in the period	(5.4)	(2.3)	-	(7.7)
Gross amount	33.7	2.7	0.9	37.3
Accumulated depreciation as at the beginning of the period	(6.0)	(0.4)	(0.2)	(6.6)
Depeciation charge for the period	(5.4)	-	(0.2)	(5.6)
Transfers	-	-	-	-
Other changes in depreciation, including foreign exchange differences	12.2	0.2	-	12.4
Accumulated depreciation	0.8	(0.2)	(0.4)	0.2
Impairment allowances as at the beginning of the period	-	(0.6)	-	(0.6)
Impairment allowances recorded during the period	-	(0.3)	-	(0.3)
Impairment allowances	-	(0.9)	-	(0.9)
Net amount	**34.5**	**1.6**	**0.5**	**36.6**

CALCULATION OF ESTIMATES

The impact of change in economic useful life of assets being subject to depreciation and classified as land and buildings, resulting in the change in the financial result is presented in the table below:

Change in useful economic life of assets being subject to depreciation and classified as land and buildings	31.12.2016		31.12.2015	
	+10 years scenario	-10 years scenario	+10 years scenario	-10 years scenario
Depreciation expense	(45)	313	(38)	233

31. OTHER ASSETS

ACCOUNTING POLICIES

Financial assets recognised in this item are measured at the amount due which also includes potential interest on those assets, less impairment allowances. Non-financial assets are measured in accordance with the measurement policies binding for particular asset categories recognised in this item.

FINANCIAL INFORMATION

Other assets	31.12.2016	31.12.2015
Settlements of payment cards transactions	1 235.6	384.3
Settlements of financial instruments	382.2	178.7
Receivables in respect of cash settlements	125.1	120.3
Receivables and settlements due to securities turnover	79.5	17.4
Assets for sale	178.5	178.1
Prepayments	291.2	264.3
Trade receivables	172.6	150.0
VAT receivables	102.1	80.2
Reinsurance receivables	377.2	-
Other	89.5	37.6
Total	**3 033.5**	**1 410.9**
of which financial assets	2 247.1	875.2

(IN PLN MILLION)

Other financial assets - the Group's exposure to credit risk	31.12.2016	31.12.2015
impaired	107.5	108.3
not impaired, of which:	2 246.7	875.0
not past due	2 234.9	868.2
past due	11.8	6.8
Gross total	**2 354.2**	**983.3**
Impairment allowances	(107.1)	(108.1)
Net total by carrying amount	**2 247.1**	**875.2**

MANAGEMENT OF FORECLOSED COLLATERAL– ITEM 'ASSETS FOR SALE'

Foreclosed collaterals as a result of restructuring or debt collection activities are either designated for sale or used by the Group for internal purposes. Details of the foreclosed assets are analysed in order to determine whether they can be used by the Group for internal purposes. All of the assets foreclosed as a result of restructuring and debt collection activities in the years ended 31 December 2016 and 31 December 2015, respectively, were designated for sale. Activities undertaken by the Group are aimed at selling assets as soon as possible. Primary procedure for sale of assets is open tender. In justified cases, the sale follows different procedure dependent on the specifics of the sold property.

32. AMOUNTS DUE TO BANKS

ACCOUNTING POLICIES

Amounts due to banks constitute financial liabilities measured at amortized cost using effective interest rate method. In case of financial liabilities for which it is not possible to estimate the schedule of future cash flows and the effective interest rate, they are measured at amount due.

This item also includes sell-buy-back transactions with a repurchase or resale clause specifying a contractual date and price. Securities subject to sell-buy-back transactions are not derecognised from the statement of financial position and are measured at the terms and conditions specified for particular securities portfolios. The difference between the sale price and the repurchase price is recognised as interest expense, as appropriate, and it is settled over the term of the contract using the effective interest rate.

FINANCIAL INFORMATION

	31.12.2016	31.12.2015
Loans and advances received*	17 566.9	16 418.1
Bank deposits	800.3	1 168.4
Amounts due from repurchase agreements	205.9	197.0
Current accounts	592.9	473.8
Other money market deposits	42.4	31.5
Total	**19 208.4**	**18 288.8**

* Financing of the loan portfolio acquired in merger transaction with Nordea Bank Polska

(IN PLN MILLION)

33. AMOUNTS DUE TO CUSTOMERS

ACCOUNTING POLICIES

Amounts due to customers are measured at amortized cost using the effective interest rate method. If the time schedule of cash flows from a financial liability cannot be determined, and thus the effective interest rate cannot be determined fairly, this liability is measured at amount due.

FINANCIAL INFORMATION

AMOUNTS DUE TO CUSTOMERS	31.12.2016	31.12.2015
Amounts due to retail clients	148 000.4	135 410.4
Current accounts and overnight deposits	72 365.4	64 039.6
Term deposits	75 303.9	71 079.6
Other liabilities	331.1	291.2
Amounts due to corporate entities	48 657.1	51 213.7
Current accounts and overnight deposits	30 986.6	22 447.2
Term deposits	11 946.7	23 032.7
Loans and advances received	4 662.4	3 924.1
Amounts due from repurchase agreements	-	829.1
Other liabilities	1 061.4	980.6
Amounts due to budget entities	8 408.9	9 134.4
Current accounts and overnight deposits	8 163.2	5 679.4
Term deposits	187.0	3 435.5
Other liabilities	58.7	19.5
Total	**205 066.4**	**195 758.5**

AMOUNTS DUE TO CUSTOMERS BY CLIENT SEGMENT	31.12.2016	31.12.2015
Amounts due to customers, of which:		
retail and private banking	140 021.1	128 269.1
corporate	37 638.8	42 606.6
small and medium enterprises	22 734.5	20 122.7
loans and advances received	4 662.4	3 924.1
amounts due from repurchase agreements	-	829.1
other liabilities	9.6	6.9
Total	**205 066.4**	**195 758.5**

34. LIABILITIES DUE TO INSURANCE OPERATIONS

Liabilities due to insurance operations	31.12.2016	31.12.2015
Technical provisions	542.8	114.6
Liabilities due to insurer's investment contracts divided into:	2 400.8	2 285.9
Unit-Linked insurance financial products	2 130.3	2 246.1
safe capital product	267.9	-
other	2.6	39.8
Total	**2 943.6**	**2 400.5**

(IN PLN MILLION)

Liabilities due to insurance operations	31.12.2016	31.12.2015
Provisions for life insurance	442.5	110.2
Provisions for unpaid claims and benefits	90.0	85.3
Technical provisions for life insurance if a policyholder bears the deposit (investment) risk	2 025.5	2 089.0
Provisions for premiums and provisions for unexpired risk	385.6	116.0
Total	**2 943.6**	**2 400.5**

Majority of insurance products refer to investment products, in which risk is borne by a policyholder.

35. Debt securities in issue

Accounting policies

Liabilities due to the issuance of securities are measured at amortized cost using the effective interest rate method, or – in respect of banking securities – at fair value through profit or loss.

In case of financial liabilities measured at amortized cost for which it is not possible to estimate the schedule of future cash flows and the effective interest rate, they are measured at amount due.

Financial information

DEBT SECURITIES IN ISSUE	31.12.2016	31.12.2015
Financial instruments measured at amortised cost	14 493.2	9 361.2
bonds issued by PKO Finance AB	6 704.6	7 332.3
bonds issued by PKO Bank Polski SA	1 693.0	1 645.9
bonds issued by the PKO Leasing SA Group*	1 742.0	363.1
bonds issued by PKO Bank Hipoteczny SA	1 151.3	-
mortgage-covered bonds issued by PKO Bank Hipoteczny SA	3 202.3	19.9
Banking securities issued by PKO Bank Polski SA	-	71.7
Total	**14 493.2**	**9 432.9**

* including the bonds taken up by the PKO Leasing SA Group as part of the acquisition of Raiffeisen Leasing Polska SA.

DEBT SECURITIES IN ISSUE BY MATURITY	31.12.2016	31.12.2015
up to 1 month	375.8	46.4
from 1 month to 3 months	985.9	482.5
from 3 months to 1 year	2 343.2	2 649.9
from 1 year to 5 years	4 194.6	2 149.6
over 5 years	6 593.7	4 104.5
Total	**14 493.2**	**9 432.9**

(IN PLN MILLION)

ADDITIONAL INFORMATION	2016	2015
issuance of debt securities in the period (nominal value)		
in PLN	5 131.9	4 875.0
in original currency (EUR)	700.0	200.0
redemption of debt securities in the period (nominal value)		
in PLN	3 204.6	5 070.6
in original currency (EUR)	200.0	-
in original currency (CHF)	250.0	-

Bonds issued by PKO Finance AB

Issuance date	Nominal value	Currency	Maturity date	Carrying amount as at 31.12.2016	Carrying amount as at 31.12.2015
07.07.2011	250.0	CHF	07.07.2016	-	1 003.1
25.07.2012	50.0	EUR	25.07.2022	222.0	214.6
26.09.2012	1 000.0	USD	26.09.2022	4 223.5	3 938.5
23.01.2014	500.0	EUR	23.01.2019	2 259.1	2 176.1
Total				**6 704.6**	**7 332.3**

Bonds issued by the PKO Leasing SA Group

Issuance date	Nominal value	Currency	Maturity date	Carrying amount as at 31.12.2016	Carrying amount as at 31.12.2015
01.12.2014*	1 253.7	PLN	02.10.2025	1 260.7	-
27.11.2015	135.0	PLN	26.02.2016	-	134.4
04.12.2015	35.0	PLN	30.04.2016	-	34.8
11.12.2015	130.0	PLN	11.03.2016	-	129.3
18.12.2015	65.0	PLN	18.03.2016	-	64.6
01.06.2016*	300.0	PLN	01.06.2019	300.3	-
08.11.2016	19.5	PLN	16.01.2017	19.5	-
10.11.2016	67.1	PLN	10.02.2017	67.0	-
14.11.2016	64.7	PLN	16.01.2017	64.6	-
06.12.2016	30.0	PLN	06.03.2017	29.9	-
Total				**1 742.0**	**363.1**

* the bonds taken up by the PKO Leasing SA Group as part of the acquisition of Raiffeisen Leasing Polska SA. Bonds are secured with securitized lease receivables (see the note Information on securitization of the lease portfolio and portfolio sale of receivables).

Mortgage-covered bonds issued by PKO Bank Hipoteczny SA

Issuance date	Nominal value	Currency	Maturity date	Carrying amount as at 31.12.2016	Carrying amount as at 31.12.2015
11.12.2015	30.0	PLN	11.12.2020	16.4	19.9
27.04.2016	500.0	PLN	28.04.2021	486.3	-
17.06.2016	500.0	PLN	18.06.2021	498.0	-
24.10.2016	500.0	EUR	24.06.2022	2 201.6	-
Total				**3 202.3**	**19.9**

(IN PLN MILLION)

36. SUBORDINATED LIABILITIES

ACCOUNTING POLICIES

Subordinated liabilities are measured at amortized cost using the effective interest rate method.

FINANCIAL INFORMATION

	Nominal value in currency	Currency	Period	Special terms	Balance in PLN	
					31.12.2016	31.12.2015
Subordinated bonds	1 600.7	PLN	14.09.2012-14.09.2022	right of early redemption within 5 years from the issue date	1 616.6	1 616.7
Subordinated loan from Nordea Bank AB (publ)	224.0	CHF	24.04.2012 - 24.04.2022		922.4	882.5
Total					**2 539.0**	**2 499.2**

Both subordinated bonds and the subordinated loan were earmarked, with the consent of the Polish Financial Supervision Authority, for increasing the Group's supplementary funds.

37. OTHER LIABILITIES

ACCOUNTING POLICIES

Liabilities included in this item are measured at amounts due which cover potential interest on the liabilities, and the accrual for future payments in reliably estimated, justified amounts necessary to meet the present obligation as at the end of the reporting period. Non-financial liabilities are measured in accordance with the measurement policies binding for particular liability categories recognised in this item.

FINANCIAL INFORMATION

	31.12.2016	31.12.2015
Accounts payable	573.2	658.2
Deferred income	588.9	501.1
Liability due to tax on certain financial institutions	76.7	-
Other liabilities:	2 748.3	2 196.9
interbank settlements	813.1	245.4
liabilities relating to investment activities and internal operations	255.6	141.8
liabilities due to suppliers	206.0	242.6
liabilities and settlements due to securities turnover	209.7	484.9
financial instruments settlements	355.4	135.6
social and legal settlements	98.5	103.2
liabilities arising from foreign currency activities	217.3	198.6
liabilities related to the purchase of plant and machinery and materials, labour and services relating to the construction of fixed assets and investment activities	94.4	141.9
liabilities related to payment cards	111.4	11.5
liabilities due to insurance companies	146.3	22.3
liabilities of the Brokerage House due to share subscription	-	306.5
other	240.6	162.6
Total	**3 987.1**	**3 356.2**
of which financial liabilities	3 059.1	2 282.8

As at 31 December 2016 and as at 31 December 2015, the Group had no overdue contractual liabilities.

38. Provisions

Accounting policies
Estimates and judgements
Financial information
Calculation of estimates

Accounting policies

Provision for legal claims

It is a provision for disputes with employees, business partners, clients and external institutions (e.g. UOKiK), which is created on obtaining information from the competent person in the Legal Department or another person representing the Group before courts and other adjudicating bodies as part of providing legal assistance with a high probability of a court case being lost (litigation pending has been discussed in detail in the note 'Legal claims').

Provisions for legal claims are created in the amount of expected outflow of economic benefits.

Provision for retirement benefits

The provision for retirement and pension benefits resulting from the Labour Code is created individually for each employee on the basis of an actuarial valuation. The basis for calculation of these provisions are internal regulations, and especially the Collective Labour Agreement being in force at the Group.

Provision for loan commitments and guarantees granted

A provision for off-balance sheet loan exposures is recognised in an amount equal to the resulting from them, expected (possible to estimate) loss of economic benefits. When determining a provision for off-balance sheet loan exposures the Group:

- assesses on individual basis in respect to the individually significant credit exposures on unconditional liabilities with the evidence of individual impairment or those relating to debtors whose other exposures fulfil such evidence, and the individually significant exposures which do not fulfil the evidence of individual impairment, for which determining provisions using the portfolio parameters would not be reasonable,
- assesses on portfolio basis (for exposures with identified impairment trigger) or a group basis (if an exposure does not fulfil evidence of impairment) - in respect to the remaining off-balance sheet loan exposures.

The provision is determined as the difference between the expected amount of exposure in the statement of financial position, which will arise as a result of an off-balance sheet liabilities granted (from the date at which the assessment is performed till the date of overdue amounts treated as individual impairment trigger) and the present value of the expected future cash flows obtained from the exposure in the statement of financial position arising out of the liability.

When assessing a provision on an individual basis, the expected future cash flows are estimated for each loan exposure separately.

When assessing a provision on a portfolio basis or a group basis, the portfolio parameters are used, estimated using statistical methods, based on historical observation of exposures with the same characteristics.

Other provisions

Other provisions mainly include restructuring provision and provisions for potential claims on sale of impaired loans, which have been described in the note "Information on securitisation of lease portfolio and portfolio sale of receivables".

Provisions for future payments are measured at reliably estimated, justified amounts necessary to meet the present obligation as at the end of the reporting period. All provisions are recognised in the profit and loss account, excluding actuarial gains and losses recognised in other comprehensive income.

If the effect of the time value of money is material, the amount of the provision is determined by discounting the estimated future cash flows to their present value, using the discount rate before tax which reflects the current market assessments of the time value of money and the potential risk related to a given obligation.

(IN PLN MILLION)

ESTIMATES AND JUDGEMENTS:

Valuation of the employee benefit provisions is performed using actuarial techniques and assumptions. The calculation of the provision includes all retirement and pension benefits expected to be paid in the future. The provision was created on the basis of a list of persons including all the necessary details of employees, in particular the length of their service, age and gender. The provisions calculated equate to discounted future payments, taking into account staff turnover, and relate to the period ending on the balance sheet date.

FINANCIAL INFORMATION

For the year ended 31 December 2016	Provision for legal claims	Provisions for retirement benefits	Provisions for loan commitments and guarantees granted	Other provisions*	Total
As at 1 January 2016, of which:	22.4	46.0	82.7	100.9	252.0
Short term provision	22.0	3.6	64.0	100.9	190.5
Long term provision	0.4	42.4	18.7	-	61.5
Taking up control over subsidiaries	0.3	0.2	-	-	0.5
Increase/reassessment of provision	30.9	3.8	238.0	23.1	295.8
Release of provision	(22.8)	-	(255.2)	(13.5)	(291.5)
Use of provision	(6.8)	(1.5)	-	(18.6)	(26.9)
Other changes and reclassifications	-	(2.4)	1.1	-	(1.3)
As at 31 December 2016, of which:	**24.0**	**46.1**	**66.6**	**91.9**	**228.6**
Short term provision	24.0	7.3	50.4	100.8	182.5
Long term provision	-	38.8	16.2	(8.9)	46.1

* The item 'Other provisions' comprises, i.a. a restructuring provision of PLN 59.3 million and a provision for potential claims related to sale of receivables in the amount of PLN 2.9 million, provisions for disputes, including litigation related to remuneration of PLN 0.3 million.

For the year ended 31 December 2015	Provision for legal claims	Provisions for retirement benefits	Provisions for loan commitments and guarantees granted	Other provisions*	Total
As at 1 January 2015, of which:	47.5	39.8	103.8	132.7	323.8
Short term provision	47.2	3.1	73.7	132.7	256.7
Long term provision	0.3	36.7	30.1	-	67.1
Acquisition of an entity	2.3	0.1	-	-	2.4
Increase/reassessment of provision	21.6	3.5	286.2	3.4	314.7
Release of provision	(33.5)	(1.8)	(304.2)	(7.7)	(347.2)
Use of provision	(29.3)	-	-	(27.5)	(56.8)
Currency translation differences	-	-	(0.1)	-	(0.1)
Other changes and reclassifications	13.8	4.4	(3.0)	-	15.2
As at 31 December 2015, of which:	**22.4**	**46.0**	**82.7**	**100.9**	**252.0**
Short term provision	22.0	3.6	64.0	100.9	190.5
Long term provision	0.4	42.4	18.7	-	61.5

* The item 'Other provisions' comprises, i.a. restructuring provision of PLN 67.4 million and a provision for potential claims related to the sale of receivables in the amount of PLN 2.1 million, provisions for disputes, including litigation related to remuneration of PLN 0.4 million.

(IN PLN MILLION)

CALCULATION OF ESTIMATES

The Group performed a reassessment of its estimates as at 31 December 2016, on the basis of calculation conducted by an independent external actuary. The provisions calculated equate to discounted future payments, taking into account staff turnover, and relate to the period ending on the balance sheet date. An important factor affecting the amount of the provision is the adopted financial discount rate which was adopted by the Group at the level of 3.50%. In 2015 the adopted financial discount rate amounted to 2.75%.

The impact of an increase/decrease in the financial discount rate and basic actuarial assumptions by 1 pp. on decrease/increase in the amount of the provision for retirement and pension benefits as at 31 December 2016 and as at 31 December 2015 is presented in the table below:

Estimated change in provision as at 31.12.2016	Financial discount rate		Planned increase in base salary	
	+1pp scenario	-1pp scenario	+1pp scenario	-1pp scenario
Provision for retirement and pension benefits	(4)	4	5	(3)

Estimated change in provision as at 31.12.2015	Financial discount rate		Planned base increases	
	+1pp scenario	-1pp scenario	+1pp scenario	-1pp scenario
Provision for retirement and pension benefits	(5)	6	6	(5)

39. EQUITY AND SHAREHOLDING STRUCTURE OF THE BANK

ACCOUNTING POLICIES

Equity constitutes capital and reserves created in accordance with the legal regulations.

The classification to particular components, discussed below, results from the Polish Commercial Companies Code, the Banking Law and the requirements of IAS 1.7, IAS 1.78.e, IAS 1.54.q-r and IAS 1.79.b.

Equity components of the subsidiaries, other than share capital, in a proportion equal to the interest in the subsidiary held by the parent company, are added to respective equity components of the parent company. The Group's equity includes only those parts of the equity of the subsidiaries which arose after the acquisition of shares by the parent company. In accordance with the legislations which are in force in Poland, only the equity of the parent company and the equity of specific subsidiaries, determined on the basis of stand-alone financial statements, are distributable.

Components of the equity:

- Share capital comprises solely the share capital of the parent company and is stated at nominal value in accordance with the Memorandum of Association and entry to the Register of Entrepreneurs.
- Reserve capital is created according to the Memorandum of Association of the Group entities, from the distribution of profits and from share premium less issue costs and it is to cover the potential losses of the Group entities.
- General banking risk fund in PKO Bank Polski SA is created from profit after tax in accordance with the Banking Law and it is to cover unidentified risks of the Bank's operations.
- Other reserves are created from the appropriation of net profits. Other reserves are to cover the potential losses in the statement of financial position.

(IN PLN MILLION)

- Non-controlling interests represent the part of capital in a subsidiary, which cannot be directly or indirectly assigned to the parent company.
- Other comprehensive income comprises the effects of valuation of financial assets available for sale, the effective part of cash flow hedges resulting from hedge accounting as well as actuarial gains and losses. Deferred tax on those items is recognised in other comprehensive income. Moreover, the item includes the share of the parent company in the total other comprehensive income of associates and joint ventures and currency translation differences on translation to Polish currency of the net result of the foreign operation at a rate constituting the arithmetical average of foreign exchange rates for the currency as at the day ending each of the months in the financial year published by the National Bank of Poland.

FINANCIAL INFORMATION

Equity	31.12.2016	31.12.2015
Share capital	1 250.0	1 250.0
Reserve capital	24 490.6	20 711.2
General banking risk fund	1 070.0	1 070.0
Other reserves	3 607.5	3 536.4
Other comprehensive income, of which:	(467.2)	100.2
Share in other comprehensive income of associates and joint ventures	(0.8)	(0.2)
Financial assets available for sale	(347.4)	170.6
Cash flow hedges	(108.5)	(57.7)
Actuarial gains and losses	(10.5)	(12.5)
Currency translation differences from foreign operations	(221.5)	(216.5)
Undistributed profits	(18.6)	1 222.4
Net profit for the period	2 874.0	2 609.5
Non-controlling interests	(16.2)	(18.3)
Total	**32 568.6**	**30 264.9**

The decrease in other comprehensive income in respect of revaluation of financial assets available for sale in 2016 of PLN 636.1 million (before tax) related mainly to settling the Visa Ltd. transaction (described in detail in the note 'Investment securities available for sale').

THE SHAREHOLDING STRUCTURE OF THE BANK

According to the information available as at 31 December 2016 the Bank's shareholding structure is as follows:

Name of entity	Number of shares	Number of votes %	Nominal value of 1 share	Share in equity %
As at 31 December 2016				
The State Treasury	367 918 980	29.43	PLN 1	29.43
Aviva Otwarty Fundusz Emerytalny[1]	83 952 447	6.72	PLN 1	6.72
Nationale Nederlanden Otwarty Fundusz Emerytalny[2]	64 594 448	5.17	PLN 1	5.17
Other shareholders	733 534 125	58.68	PLN 1	58.68
Total	**1 250 000 000**	**100.00**	---	**100.00**
As at 31 December 2015				
The State Treasury	367 918 980	29.43	PLN 1	29.43
Aviva Otwarty Fundusz Emerytalny[1]	83 952 447	6.72	PLN 1	6.72
Nationale Nederlanden Otwarty Fundusz Emerytalny[2]	64 594 448	5.17	PLN 1	5.17
Other shareholders	733 534 125	58.68	PLN 1	58.68
Total	**1 250 000 000**	**100.00**	---	**100.00**

1) Number of shares held as at 29 January 2013, reported by Aviva OFE after exceeding the threshold of 5% share in PKO Bank Polski SA's shareholding structure after settlement the transaction of sale of 153.1 million of PKO Bank Polski SA's shares by BGK and the State Treasury.
2) Number of shares held as at 24 July 2012, reported by Nationale-Nederlanden OFE after exceeding the threshold of 5% share in PKO Bank Polski SA's shareholding structure after settlement the transaction of sale of 95 million shares of PKO Bank Polski SA by the State Treasury.

(IN PLN MILLION)

All the shares of PKO Bank Polski SA carry the same rights and obligations. Shares are not preference shares, in relation to voting rights and dividends. However, the Memorandum of Association of PKO Bank Polski SA restricts the voting rights of shareholders holding more than 10% of the total number of votes at the General Shareholders' Meeting and forbids those shareholders to execute more than 10% of the total number of votes at the General Shareholders' Meeting. The above does not apply to:

1) those shareholders who on the date of passing the resolution of the General Shareholders' Meeting introducing the limitation of the voting rights had rights from the shares representing more than 10% of the total number of votes at the Bank (i.e. the State Treasury and BGK),
2) shareholders who have the rights from A-series registered shares (the State Treasury), and
3) shareholders acting jointly with the shareholders referred to in point (2) based on an agreement concerning the joint execution of voting rights from shares. Moreover, limitation of the voting rights shall expire when the share of the State Treasury in the Bank's share capital drops below 5%.

In accordance with § 6 clause 2 of the PKO Bank Polski SA's Memorandum of Association, the conversion of A-series registered shares into bearer shares and the transfer of these shares requires an approval of the Council of Ministers in the form of a resolution. Conversion into bearer shares or transfer of A-series registered shares, after getting the above-mentioned approval, results in the expiry of the above-mentioned restrictions in respect of shares subject to conversion into bearer shares or transfer, to the extent to which this approval was given.

The Bank's shares are listed on the Warsaw Stock Exchange.

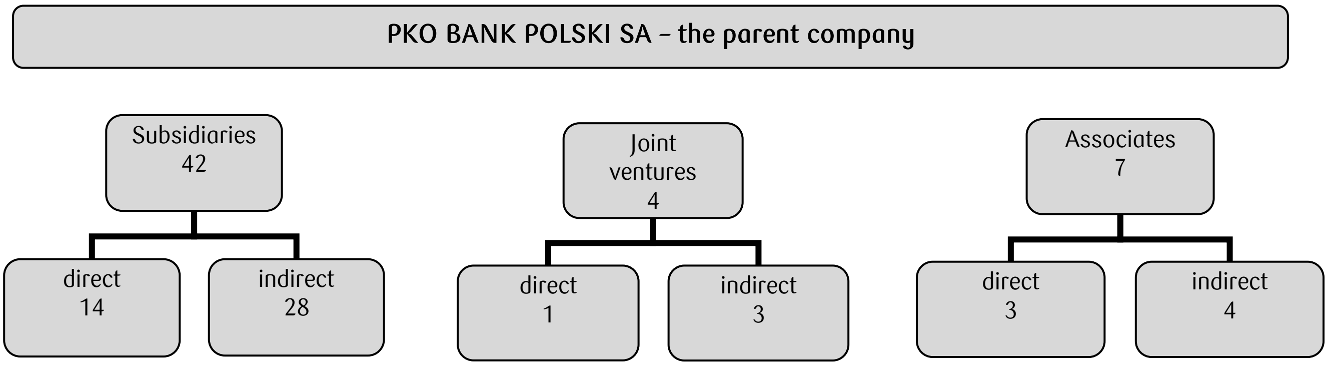
THE STRUCTURE OF PKO BANK POLSKI SA'S SHARE CAPITAL:

Series	Type of shares	Number of shares	Nominal value of 1 share	Series amount by nominal value
Series A	registered ordinary shares	312 500 000	PLN 1	PLN 312 500 000
Series A	bearer ordinary shares	197 500 000	PLN 1	PLN 197 500 000
Series B	bearer ordinary shares	105 000 000	PLN 1	PLN 105 000 000
Series C	bearer ordinary shares	385 000 000	PLN 1	PLN 385 000 000
Series D	bearer ordinary shares	250 000 000	PLN 1	PLN 250 000 000
Total	---	**1 250 000 000**	---	**PLN 1 250 000 000**

In 2016 and in 2015, there were no changes in the amount of the share capital of PKO Bank Polski SA. Issued shares of PKO Bank Polski SA are not preferred shares and are fully paid.

(IN PLN MILLION)

INFORMATION ABOUT THE ENTITIES OF THE PKO BANK POLSKI SA GROUP, JOINT VENTURES AND ASSOCIATES



40. Structure of the PKO Bank Polski SA Group and the scope of activities of the Group entities

The PKO Bank Polski SA Group consists of the following subsidiaries:

Lp.	NAME OF ENTITY	HEADQUARTERS	% SHARE IN EQUITY *	
	DIRECT SUBSIDIARIES		31.12.2016	31.12.2015
1	PKO Towarzystwo Funduszy Inwestycyjnych SA	Warsaw	100	100
2	PKO BP BANKOWY PTE SA	Warsaw	100	100
3	PKO Leasing SA	Łódź	100	100
4	PKO BP Finat Sp. z o.o.	Warsaw	100	100
5	PKO Życie Towarzystwo Ubezpieczeń SA	Warsaw	100	100
6	PKO Towarzystwo Ubezpieczeń SA	Warsaw	100	100
7	PKO Bank Hipoteczny SA	Gdynia	100	100
8	PKO Finance AB	Stockholm, Sweden	100	100
9	KREDOBANK SA	Lviv, Ukraine	99.6293	99.5655
10	„Inter-Risk Ukraine" Spółka z dodatkową odpowiedzialnością	Kiev, Ukraine	100	100
11	Finansowa Kompania „Prywatne Inwestycje" Sp. z o.o.[1]	Kiev, Ukraine	95.4676	95.4676
12	Qualia Development Sp. z o.o.	Warsaw	100	100
13	Merkury - fizan[2]	Warsaw	100	100
14	NEPTUN - fizan[2]	Warsaw	100	100

1) The second shareholder of the entity is 'Inter-Risk Ukraina' Additional Liability Company;
2) PKO Bank Polski SA has investment certificates of the Fund; the share of possessed investment certificates of the Fund is presented in the position 'Share in equity'.

(IN PLN MILLION)

Lp.	NAME OF ENTITY	HEADQUARTERS	% SHARE IN EQUITY *	
	INDIRECT SUBSIDIARIES		31.12.2016	31.12.2015
	The PKO Leasing SA GROUP			
	PKO Bankowy Leasing Sp. z o.o.[1]	Łódź	-	100
1	PKO Leasing Sverige AB	Stockholm, Sweden	100	100
2	PKO Faktoring SA[2]	Warsaw	100	100
3	Raiffeisen-Leasing Polska SA[3]	Warsaw	100	-
	Raiffeisen-Leasing Real Estate Sp. z o.o.	Warsaw	100	-
	„Raiffeisen Insurance Agency" Sp. z o.o.	Warsaw	100	-
	Raiffeisen-Leasing Service Sp. z o.o.	Warsaw	100	-
	ROOF Poland Leasing 2014 DAC[4]	Dublin, Ireland	-	-
	The PKO Życie Towarzystwo Ubezpieczeń SA GROUP			
4	Ubezpieczeniowe Usługi Finansowe Sp. z o.o.	Warsaw	100	100
	The KREDOBANK SA GROUP			
5	Finansowa Kompania „Idea Kapitał" Sp. z o.o.	Lviv, Ukraine	100	100
	The Qualia Development Sp. z o.o. GROUP[5]			
6	Qualia 3 Sp. z o.o.	Warsaw	100	100
7	Qualia 2 Sp. z o.o.	Warsaw	100	100
8	Qualia Sp. z o.o.	Warsaw	100	100
9	Qualia 3 spółka z ograniczoną odpowiedzialnością – Neptun Park Sp. k.	Warsaw	99.9975	99.9975
10	Qualia sp. z o.o. – Sopot Sp. k.	Warsaw	99.9787	99.9902
11	Qualia 2 spółka z ograniczoną odpowiedzialnością – Nowy Wilanów Sp. k.	Warsaw	99.9750	99.9750
12	Qualia spółka z. ograniczoną odpowiedzialnością – Zakopane Sp. k.	Warsaw	99.9123	99.9123
13	Qualia Hotel Management Sp. z o.o.	Warsaw	100	100
14	Qualia - Residence Sp. z o.o.	Warsaw	100	100
15	Sarnia Dolina Sp. z o.o.	Warsaw	100	100
16	Giełda Nieruchomości Wartościowych Sp. z o.o.	Warsaw	100	100
17	FORT MOKOTÓW Sp. z o.o. in liquidation	Warsaw	51	51
18	Qualia spółka z ograniczoną odpowiedzialnością – Projekt 1 Sp. k.	Warsaw	50	50
	Qualia spółka z ograniczoną odpowiedzialnością – Pomeranka Sp. k.[6]	Warsaw	-	99.8951
	Qualia – Rezydencja Flotylla Sp. z o.o.[6]	Warsaw	-	100
	„Fort Mokotów Inwestycje" Sp. z o.o.[7]	Warsaw	-	100
	Qualia spółka z ograniczoną odpowiedzialnością – Jurata Sp. k.[7]	Warsaw	-	99.9770
	Qualia spółka z ograniczoną odpowiedzialnością – Władysławowo Sp. k.[8]	Warsaw	-	50
	Merkury - fiz an			
19	„Zarząd Majątkiem Górczewska" Sp. z o.o.	Warsaw	100	100
20	Molina Sp. z o.o.	Warsaw	100	100
21	Molina spółka z ograniczoną odpowiedzialnością 1 S.K.A.	Warsaw	100	100
22	Molina spółka z ograniczoną odpowiedzialnością 2 S.K.A.	Warsaw	100	100
23	Molina spółka z ograniczoną odpowiedzialnością 3 S.K.A.	Warsaw	100	100
24	Molina spółka z ograniczoną odpowiedzialnością 4 S.K.A.	Warsaw	100	100
25	Molina spółka z ograniczoną odpowiedzialnością 5 S.K.A.	Warsaw	100	100
26	Molina spółka z ograniczoną odpowiedzialnością 6 S.K.A.	Warsaw	100	100
	NEPTUN - fizan			
27	Bankowe Towarzystwo Kapitałowe SA	Warsaw	100	100
28	„CENTRUM HAFFNERA" Sp. z o.o.	Sopot	72.9766	72.9766
	„Sopot Zdrój" Sp. z o.o.	Sopot	100	100
	„Promenada Sopocka" Sp. z o.o.	Sopot	100	100

* share in equity of direct parent entity

1) In 2016, there was a business combination between PKO Bankowy Leasing Sp. z o.o. (as the acquiree) and PKO Leasing SA (as the acquirer).
2) Previous name PKO BP Faktoring SA.
3) The company was acquired on 1 December 2016.
4) Pursuant to IFRS 10, Raiffeisen-Leasing Polska SA exercises control over the Company, even though it does not have an equity interest in the Company.
5) In the limited partnerships belonging to the Qualia Development Sp. z o.o. Group, the item 'equity interest' presents the share of the limited partner Qualia Development Sp. z o.o. in the amount of the contributions made.
6) In 2016, there was a business combination between Qualia spółka z ograniczoną odpowiedzialnością – Pomeranka Sp.k. and Qualia - Rezydencja Flotylla Sp. z o.o. (as the acquirees) with Qualia Hotel Management Sp. z o.o. (as the acquirer).
7) In 2016, the company was sold.
8) In 2016, the company was dissolved without conducting a liquidation procedure.

NAME OF THE SUBSIDIARY	THE CORE BUSINESS
PKO TOWARZYSTWO FUNDUSZY INWESTYCYJNYCH SA	The core business of the company is the creation, representation towards third parties and the management of open and closed investment funds and management of clients portfolio, which include one or more financial instruments. The company also offers specialized investment programs and conducts employee pension programs (PPE).
PKO BP BANKOWY PTE SA	The Company operates in the area of pension funds. It manages PKO BP Bankowy Otwarty Fundusz Emerytalny (OFE) and PKO Dobrowolny Fundusz Emerytalny (DFE), within which Individual Retirement Account (Indywidualne Konto Emerytalne - IKE) and Individual Retirement Security Account (Indywidualne Konto Zabezpieczenia Emerytalnego - IKZE) is offered.
PKO BANK HIPOTECZNY SA	The company specializes in granting mortgage housing loans to individual clients and it also purchases receivables relating to such loans from PKO Bank Polski SA. The issuance of mortgage bonds shall constitute the main source of long-term financing of loans secured with mortgage.
PKO LEASING SA	The company together with its subsidiaries, including Raiffeisen-Leasing Polska SA acquired in December 2016 – provides lease services. Companies offers financial and operating leasing: cars, trucks, machinery and equipment, technological lines, medical equipment, real estate, IT hardware and software, ships, aircraft and railway equipment. The offer includes a fleet management service. Moreover, the companies belonging to the Raiffeisen-Leasing Polska SA Group deal with keeping, preparation and active selling of ‘post-leasing’ post-debt-collection, post-contract objects; they provide specialist services within the scope of creating insurance products and programmes for clients of financial institutions, and conduct lending activities. The Group also includes a special purpose company with its registered office in Ireland, formed for the purpose of securitization of lease receivables carried out within the Raiffeisen-Leasing Polska SA Group; the company issues bonds in order to obtain funds for purchasing receivables from Raiffeisen-Leasing Polska SA. The PKO Leasing SA Group also includes PKO Faktoring SA, which provides services of domestic and export factoring with assuming the risk and without assuming the risk, reverse factoring and service of factoring program for the suppliers as also PKO Leasing Sverige AB.
PKO BP FINAT SP. Z O.O.	PKO BP Finat Sp. z o.o. provides comprehensive services to companies in the financial sector – including transfer agent, fund and companies accounting. It also specializes in competency outsourcing of IT specialists, project teams and IT processes. On the basis of the authorization of the Polish Financial Supervision Authority, the Company also provides services as a national payment institution. Its clients are both companies of the Group, as well as companies outside the Group. In 2016, the Company began to handle group insurance dedicated to the products offered by the Bank.
PKO ŻYCIE TOWARZYSTWO UBEZPIECZEŃ SA	The basic scope of the Company’s operations comprises insurance activities in the area of life insurance. The Company offers a wide range of insurance products, from protection to investment products. It focuses on life and health insurance for its clients. It has both separate products and products supplementing the banking products offered by the Bank.

PKO Towarzystwo Ubezpieczeń SA	The core business of the Company is an insurance activity within the scope of section II of insurance – other personal insurance and property insurance. The Company commenced operating activities in January 2016 by launching the first offer of life insurance for individual customers of the Bank, who are holders of credit cards. At present, the Company's offer also includes individual insurance against loss of income for borrowers of cash loans in the Bank and a comprehensive offer of property insurance, immovable property insurance, private third party liability insurance and Assistance, and insurance against loss of income for clients of PKO Bank Polski SA and PKO Bank Hipoteczny SA who draw mortgage loans.
PKO Finance AB	The business of the Company is the acquisition of the Bank's financial resources from international markets through bond issues.
Qualia Development Sp. z o.o.	The core business of the companies from the Qualia Development Sp. z o.o. Group is to carry out developer activity and in particular the implementation of construction projects, building installations and finishing construction works. Moreover, the Group is engaged in the hotel business, and intermediary activity in real estate turnover. In 2016, the Group continued activities related to the execution of current projects and selling selected property and companies.
KREDOBANK SA	KREDOBANK SA is a universal bank, focused on customer service of retail clients and small and medium-sized enterprises running the business mainly in the western part of Ukraine and in Kiev. At the same time Company strives to attract corporate customers with high creditworthiness. The company offers services including maintaining bank accounts of individuals and businesses, collecting deposits, lending, issuing warrantees and guarantees, checks and bills trading, operations on the currency market, as well as operations on the securities market. The core business of Finansowa Kompania 'Idea Kapitał' Sp. z o.o. – a subsidiary of KREDOBANK SA – is providing various financial services, including factoring services consisting in acquisition of rights to the assignment of monetary claims under the loan agreements according to Ukrainian law.
'Inter-Risk Ukraina' Spółka z dodatkową odpowiedzialnością	The company operates in the area of debt collection in Ukraine, i.e. is carrying out activities to recover the debts of other entities without acquiring them on their own account (negotiations with debtors, restructuring activities, litigation and enforcement proceedings and participation in the process of foreclosure of collateral). Its customers are Finansowa Kompania 'Prywatne Inwestycje' Sp. z .o.o. and companies from KREDOBANK SA Group. The company also manages commercial real estate in Lviv.
Finansowa Kompania 'Prywatne Inwestycje' Sp. z o.o.	The Company's business is to provide various financial services, including factoring services which according to Ukrainian law consist of the acquisition of rights to the assignment of monetary claims under the loan agreements.
Merkury - FIZ AN	The core business of the Fund is to invest in the funds collected by non-public offering of investment certificates. The Fund is managed by PKO TFI SA. Fund conducts investment activities through subsidiaries whose business is buying and selling real estate for its own account and property management.
NEPTUN - FIZAN	The core business of the Fund is to invest in the funds collected by non-public offering of investment certificates. The Fund is managed by PKO TFI SA. PKO Bank Polski SA sells to the Fund shares of companies whose business is not complementary to the offer of financial services offered by the Bank.

(IN PLN MILLION)

41. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Selected information on associates and joint ventures
Financial information:
- Joint ventures
- Associates
- Change in the value of investments in joint ventures
- Change in the value of investments in associates
- Impairment allowances

SELECTED INFORMATION ON ASSOCIATES AND JOINT VENTURES

The Group holds the following associates and joint ventures:

Lp.	NAME OF ENTITY	HEADQUARTERS	% SHARE IN EQUITY *	
			31.12.2016	31.12.2015
	Joint Ventures of PKO Bank Polski SA			
1	Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	Warsaw	34	34
	1 EVO Payments International Sp. z o.o.	Warsaw	100	100
	2 EVO Payments International s.r.o.	Prague, Czech Republic	100	100
	Joint Ventures of NEPTUN - fizan			
	3 'Centrum Obsługi Biznesu' Sp. z o.o.	Poznań	41.44	41.44
	Associates of PKO Bank Polski SA			
1	Bank Pocztowy SA	Bydgoszcz	25.0001	25.0001
	1 Centrum Operacyjne Sp. z o.o.	Bydgoszcz	100	100
	2 Spółka Dystrybucyjna Banku Pocztowego Sp. z o.o.	Warsaw	100	100
2	'Poznański Fundusz Poręczeń Kredytowych' Sp. z o.o	Poznań	33.33	33.33
3	FERRUM SA	Katowice	22.14	20.97
	3 FERRUM MARKETING Sp. z o.o.	Katowice	100	100
	4 Zakład Konstrukcji Spawanych FERRUM SA	Katowice	100	100
	Walcownia Blach Grubych Batory Sp. z o.o.	Katowice	100	-

* Share in equity of direct parent entity / entity exercising significant influence

NAME OF JOINT VENTURES AND ASSOCIATES	THE CORE BUSINESS
CENTRUM ELEKTRONICZNYCH USŁUG PŁATNICZYCH ESERVICE SP. Z O.O.	Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o. offers services which consist of processing transactions involving payment instruments conducted both through POS terminals in Poland and abroad and online, lease of POS terminals, top-ups of mobile phone cards and servicing of gift cards. PKO Bank Polski SA, together with the Company, offer comprehensive services which involve attracting and servicing entities which use POS terminals and settling transactions conducted with payment instruments using such terminals. The cooperation is governed by agreements on, i.a.: • servicing cashless transaction concluded using payment instruments for bilateral agreements with merchants, • marketing cooperation as regards services of fundamental importance to the functioning of the products and services offered both by the Bank and the Company, • the provision of services relating to withdrawals of cash in the Bank's agent and branch offices and in post offices using Visa and MasterCard payment cards using POS terminals, • cooperation in providing services associated with attracting retail outlets which accept payment instruments. The Company has two direct subsidiaries and exerts full control over these subsidiaries.

'Centrum Obsługi Biznesu' Sp. z o.o.	'Centrum Obsługi Biznesu' Sp. z o.o. is the joint project of PKO Bank Polski SA, Buildco Poznań SA and the City of Poznań which consists of building a hotel in Poznań. PKO Bank Polski SA is a member of a syndicate of banks which granted the Company an investment loan for the execution of the said project. The hotel was completed and started operating in 2007. The operating results generated by the Company are insufficient to ensure the current, full servicing of the liabilities arising from the loan agreement. At the Company's request, as part of the restructuring of the loans, the syndicate temporarily modified the repayment schedule of principal and interest instalments which is valid until 30 June 2017. Since June 2015, the Company's shares are included in the portfolio of a Bank's subsidiary, NEPTUN – fizan.
Bank Pocztowy SA	Bank Pocztowy SA specializes in standard banking products offered to retail clients and a supplementary offer for micro-businesses and institutional clients. The Bank also operates in the segment of settlements and treasury. As part of the strategic partnership with Poczta Polska SA (shareholder with 75% minus 10 shares of the Company) uses a potential of a shareholder and develops a range of products in collaboration with stakeholders across the Poczta Polska Group. Bank Pocztowy SA is also a client of the Bank and uses the selected services provided by PKO Bank Polski SA. The Company has two direct subsidiaries and exerts full control over these subsidiaries.
'Poznański Fundusz Poręczeń Kredytowych' Sp. z o.o.	'Poznański Fundusz Poręczeń Kredytowych' Sp. z o.o is a specialized entity supporting the development of small and medium-sized enterprises by providing guarantees and provision services. The company guarantees loans, advances and the guarantees granted by banks, including PKO Bank Polski SA, as well as leasing and factoring transaction. The entity cooperates with PKO Leasing SA. The Company's offer also includes guarantees for small and medium-sized enterprises, under the JEREMIE (Join European Resources for Micro to Medium Enterprises), which are re-underwritten mutually at 70% or 80% from the Wielkopolski Regionalny Program Operacyjny, managed by Bank Gospodarstwa Krajowego. Bid bond guarantees are a novelty in the guarantee market and in the Company's offer.
FERRUM SA	The Company's operations comprise manufacturing welded steel tubes, hollow profiles and insulating tubes. The Company has two direct subsidiaries and exerts full control over these subsidiaries. The Company's shares were taken up under the debt recovery actions (foreclosure of collateral). The Company is a public company whose shares are listed on the Warsaw Stock Exchange.

A summary of the financial data separately for each joint venture and each associate of the Group was presented below. The amounts presented are derived from the financial statements of the specific entities prepared in accordance with IFRS or Polish Accounting Standards (PAS). The data for 2015 has been derived from audited financial statements.

Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o. (in accordance with IFRS)	**31.12.2016**	**31.12.2015**
Current assets	124.4	103.4
Non-current assets	212.1	132.7
Short-term liabilities	103.9	70.5
Long-term liabilities	33.8	37.2
	01.01-31.12.2016	**01.01-31.12.2015**
Revenues	473.7	456.5
Profit (loss) for the year	102.8	88.4
Total comprehensive income	102.8	88.4
Dividends received from an entity classified as joint venture	11.0	25.6

(IN PLN MILLION)

„Centrum Obsługi Biznesu" Sp. o.o. (in accordance with PAS)	31.12.2016	31.12.2015
Current assets	10.5	9.5
Non-current assets	85.4	87.2
Short-term liabilities	18.2	12.9
Long-term liabilities	73.6	77.5
	01.01-31.12.2016	01.01-31.12.2015
Revenues	23.1	20.5
Profit (loss) for the year	(2.2)	(3.2)

Bank Pocztowy SA (in accordance with IFRS, data published by the Company)	30.06.2016	31.12.2015
Total assets	7 238.2	7 213.0
Total liabilities	6 698.2	6 670.5
	01.01-30.06.2016	01.01-31.12.2015
Revenues	248.3	474.2
Profit (loss) for the year	9.6	33.9
Other comprehensive income	(11.8)	9.0
Total comprehensive income	(2.2)	42.9

„Poznański Fundusz Poręczeń Kredytowych" Sp. z o.o. (in accordance with PAS)	31.12.2016	31.12.2015
Current assets	23.5	23.2
Non-current assets	0.1	-
Short-term liabilities	3.0	4.0
Long-term liabilities	2.5	1.6
	01.01-31.12.2016	01.01-31.12.2015
Revenues	2.7	2.4
Profit (loss) for the year	0.4	0.6

FERRUM SA (in accordance with IFRS, data published by the Company)	30.09.2016	31.12.2015
Current assets	105.2	90.9
Non-current assets	171.2	171.8
Short-term liabilities	129.1	115.4
Long-term liabilities	94.2	99.3
	01.01-30.09.2016	01.01-31.12.2015
Revenues	242.3	314.0
Profit (loss) for the year	5.1	(49.7)
Other comprehensive income	-	-
Total comprehensive income	5.1	(49.7)

Financial information

Joint ventures	31.12.2016	31.12.2015
'Centrum Obsługi Biznesu' Sp. z o.o.	-	-
Purchase price	17.5	17.5
Change in share of net assets	(16.1)	(14.8)
Impairment allowance	(1.4)	(2.7)
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o. Group	226.8	206.2
Value of shares as at the date of obtaining joint control	197.3	197.3
Change in share of net assets	29.5	8.9
Total	**226.8**	**206.2**

(IN PLN MILLION)

Associates	31.12.2016	31.12.2015
Bank Pocztowy SA Group	132.4	161.5
Purchase price	161.5	161.5
Change in share of net assets	83.7	81.4
Impairment allowance	(112.8)	(81.4)
'Poznański Fundusz Poręczeń Kredytowych' Sp. z o.o.	-	-
Purchase price	1.5	1.5
Change in share of net assets	4.4	4.2
Impairment allowance	(5.9)	(5.7)
FERRUM SA Group	26.4	24.1
Purchase price	25.3	24.1
Change in share of net assets	1.1	-
Total	**158.8**	**185.6**

Change in investments in joint ventures	2016	2015
Investments in joint ventures as at the beginning of the period	206.2	204.8
Share in profits and losses	30.3	29.6
Net impairment allowance	1.3	(2.7)
Dividend	(11.0)	(25.5)
Investments in joint ventures as at the end of the period	**226.8**	**206.2**

Change in investments in associates	2016	2015
Investments in associates as at the beginning of the period	185.6	117.6
Net impairment allowance	(31.6)	21.6
Share in profits and losses	4.2	8.5
Share in other comprehensive income of an associate	(0.6)	(1.2)
Increase in equity investment in an associate	1.2	39.1
Investments in associates as at the end of the period	**158.8**	**185.6**

IMPAIRMENT ALLOWANCES

In 2016 in its investment valuation of 'Centrum Obsługi Biznesu' Sp. z o.o the Group included its share in the net loss of PLN 1.3 million and reduced the impairment allowance on the Company's shares by the same amount.

In 2016 the Group increased the impairment allowance on investment in Bank Pocztowy SA by PLN 31.4 million and the impairment allowance on investment in 'Poznański Fundusz Poręczeń Kredytowych' Sp. z o.o. by PLN 0.2 million.

As at 31 December 2016 and 31 December 2015, the parent company had no share in contingent liabilities of associates acquired jointly with other investor.

Impairment allowances – reconciliation of movements	2016	2015
Value at the beginning of the period	89.8	108.7
Recognised during the period	31.6	2.7
Reversed during the period	(1.3)	(21.6)
Value at the end of the period	**120.1**	**89.8**
Net impact in the income statement	(30.3)	18.9

42. Acquisition of Raiffeisen-Leasing Polska SA by PKO Leasing SA

Description of the transaction

On 2 November 2016, PKO Bank Polski SA (as the guarantor), Raiffeisen Bank International AG (as the seller) and PKO Leasing SA (as the acquirer) signed an agreement on the sale of 100% of shares in Raiffeisen-Leasing Polska SA (RLPL) by Raiffeisen Bank International AG (RBI AG) to PKO Leasing SA. The transaction was closed on 1 December 2016 after the conditions precedent had been met, including, i.a., gaining the required anti-monopoly consents in Poland and Ukraine.

As a result of the aforementioned transaction, PKO Leasing SA purchased 1 500 038 ordinary shares in Raiffeisen-Leasing Polska SA with a nominal value of PLN 100 each, representing 100% of the Company's share capital and entitling to 100% of the voting rights at the General Meeting of the Company. The purchase price amounted to PLN 850 million. The purchase of the shares was financed entirely with a loan granted by PKO Bank Polski SA.

The business operations of the acquired company consist of conducting leasing activities and granting loans.

Due to the purchase of RLPL, its subsidiaries joined the PKO Leasing SA Group:

- Raiffeisen-Leasing Real Estate Sp. z o.o. – the Company's business activities consist of financing real estate in the form of leases; as at 31 December 2016, the Company's share capital amounted to PLN 50 000 and consisted of 100 shares with a nominal value of PLN 500 each,
- 'Raiffeisen Insurance Agency' Sp. z o.o. – an insurance agency whose activities consist of creating insurance products and programmes for the customers of financial institutions; as at 31 December 2016, the Company's share capital amounted to PLN 200 000 and consisted of 4 000 shares with a nominal value of PLN 50 each,
- Raiffeisen-Leasing Service Sp. z o.o. – the Company's business activities consist of storing, preparing and active sales of post-debt-collection or post-contractual objects purchased from RLPL as well as granting loans; as at 31 December 2016, the Company's share capital amounted to PLN 200 000 and consisted of 4 000 shares with a nominal value of PLN 50 each; the Company's sole shareholder is 'Raiffeisen Insurance Agency' Sp. z o.o.,
- ROOF Poland Leasing 2014 DAC, with its registered office in Ireland – a special purpose vehicle established to service the securitization of lease receivables conducted within the RLPL Group; the Company issues bonds to raise funds for the purchase of receivables from Raiffeisen-Leasing Polska SA; as at 31 December 2016, the Company's share capital amounted to EUR 1 and equals 1 share taken up by BADB Charitable Trust Ltd.; RLPL controls the aforementioned Company in accordance with IFRS 10, despite the fact that it does not hold any shares in it.

As part of the transaction PKO Bank Polski SA replaced the financing granted to RLPL and its subsidiaries by Raiffeisen Bank International AG or by its Group entities (i.e. it granted loans to RLPL Group companies, the funds from which were earmarked for repayment of the loans granted to the companies by Raiffeisen Bank International AG companies) in the total amount of PLN 2 412 million and EUR 255.6 million. The transaction was financed with PKO Bank Polski SA's own funds. At the same time, PKO Bank Polski SA issued a guarantee up to EUR 52 million on behalf of the Council of Europe Development Bank (CEB) with reference to the repayment of the loan granted to RLPL, and signed a loan facility agreement with RLPL for PLN 300 million, which will be earmarked for repurchase of the Company's bonds from Raiffeisen Bank Polska SA and from other bondholders.

In 2017, both companies, i.e. PKO Leasing and Raiffeisen-Leasing Polska SA, are planned to be merged, including the performance of a legal merger in April 2017.

Settlement of the acquisition transaction

The transaction was settled under the acquisition method in accordance with IFRS 3, which requires identifying the acquirer, determining the acquisition date, recognizing and measuring the identifiable acquired assets and assumed liabilities measured at fair value as at the acquisition date, and all non-controlling shares in the acquired entity, and disclosure and measurement of goodwill or gain on a bargain purchase.

Taking into consideration the fact that the control over RLPL and its companies was assumed as of 1 December 2016, the acquisition transaction was settled based on consolidated financial statements of RLPL as at 30 November 2016 and updated in respect of material transactions which took place between 30 November 2016 and 1 December 2016, i.e. the date of assuming control.

The consideration transferred and the value of all non-controlling shares in the acquired company

The acquisition price of RLPL has been determined provisionally at the amount of the cash paid, due to the fact that PKO Leasing SA has the right to bring, within 3 months of the acquisition date, claims against RBI AG with regard to financial and other transactions stipulated in the agreement for the purchase of shares in RLPL SA which may result In an outflow of cash and conducted within the RLPL Group between 1 July 2016 and the acquisition date. As at the date of these financial statements, the identification of these transactions has not been completed and the amount of the potential claims against RBI AG, which affects the final acquisition price, has not been determined. For the purposes of preparing the financial statements for 2016, the amount of PLN 850 million was adopted as the consideration paid, to be adjusted in future should any outflows be identified.

The consideration paid for the shares of the Raiffeisen – Leasing Polska SA Group entities	number of shares	in PLN million
- acquired from Raiffeisen Bank International AG	1 500 038	850.0
Total	**1 500 038**	**850.0**

PKO Leasing SA holds 100% shares in the acquired companies; therefore, there are no non-controlling shares in the acquired entities.

Recognition and measurement of the identifiable acquired assets and assumed liabilities measured in accordance with IFRS

As at the date of preparing these financial statements, an initial, provisional valuation and purchase price allocation was performed, especially with respect to the portfolio of lease receivables and loans granted, and the identification and valuation of contingent liabilities. The final settlement may differ from the initial settlement described in these financial statements.

In accordance with IFRS 3.45, the Group has to determine the final amounts within 12 months, i.e. by 30 November 2017.

The data presented below, relating to the measurement of identifiable assets and assumed liabilities at their fair values, is based on an identification conducted from the perspective of the whole RLPL Group.

Statement of financial position - ASSETS	Data of the RLPL Group as at the acquisition date, 1.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement and customer relationships	Fair value of assets acquired
Amounts due from banks	279.4		279.4
Loans and advances to customers	6 058.7	24.6	6 083.3
Inventories	78.1	-	78.1
Intangible assets	14.3	64.0	78.3
Tangible fixed assets	159.3	-	159.3
Current income tax receivables	16.8		16.8
Deferred income tax assets	432.6	(16.8)	415.8
Other assets	59.1	-	59.1
TOTAL ASSETS	**7 098.3**	**71.8**	**7 170.1**

(IN PLN MILLION)

Statement of financial position - LIABILITIES AND NET ASSETS	Data of the RLPL Group as at the acquisition date, 1.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement and customer relationships	Fair value of liabilities assumed
Amounts due to other banks	4 005.9	-	4 005.9
Amounts due to customers	696.5	-	696.5
Debt securities in issue	1 557.2	-	1 557.2
Other liabilities	112.9	-	112.9
Current income tax liabilities	4.4		4.4
Provisions	0.5	-	0.5
LIABILITIES TOTAL	**6 377.4**	**-**	**6 377.4**
NET ASSETS	**720.9**	**71.8**	**792.7**

Information on assumptions and valuation methods adopted for identified assets acquired and liabilities assumed as at 1 December 2016

- **Loans and advances to customers**

The tables below present loans and advances to customers acquired at fair values as at 1 December 2016.

Loans and advances to customers	Data of the RLPL Group as at the acquisition date, 1.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement	Fair value of assets acquired
Loans and advances to customers gross, of which:	6 353.3	24.6	6 377.9
corporate, of which:	6 234.5	24.6	6 259.1
finance lease receivables	5 655.5	24.6	5 680.1
consumer, of which:	118.8	-	118.8
finance lease receivables	7.1	-	7.1
Impairment allowances on loans and advances, of which:	(294.6)	-	(294.6)
impairment allowances on finance lease receivables	(239.5)	-	(239.5)
Loans and advances to customers, net	**6 058.7**	**24.6**	**6 083.3**

Loans and advances to customers by method of calculating impairment allowances	Data of the RLPL Group as at the acquisition date, 1.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement	Fair value of assets acquired
individual basis, impaired, of which:	378.8		378.8
finance lease receivables	331.1		331.1
group basis (IBNR), of which:	5 974.5	24.6	5 999.1
finance lease receivables	5 331.5	24.6	5 356.1
Loans and advances to customers gross, of which:	**6 353.3**	**24.6**	**6 377.9**
finance lease receivables gross	**5 662.6**	**24.6**	**5 687.2**
Impairment allowances - individual basis, impaired, of which:	(220.3)		(220.3)
lease receivables	(186.8)		(186.8)
Impairment allowances - group basis (IBNR), of which:	(74.3)		(74.3)
lease receivables	(52.7)		(52.7)
Impairment allowances on loans and advances, of which:	**(294.6)**	**-**	**(294.6)**
lease receivables	**(239.5)**	**-**	**(239.5)**
Loans and advances to customers net	**6 058.7**	**24.6**	**6 083.3**
lease receivables net	**5 423.1**	**24.6**	**5 447.7**

(IN PLN MILLION)

Loans and advances to customers by client segment	Data of the RLPL Group as at the acquisition date, 1.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement	Fair value of assets acquired
Loans and advances to customers gross, of which:	**6 353.3**	**24.6**	**6 377.9**
corporate	1 891.2	5.4	1 896.6
retail and private banking	118.8	-	118.8
small and medium enterprises	4 343.3	19.2	4 362.5
Impairment allowances on loans and advances	**(294.6)**	**-**	**(294.6)**
Loans and advances to customers net	**6 058.7**	**24.6**	**6 083.3**

Loans and advances to customers - exposure to credit risk	Data of the RLPL Group as at the acquisition date, 1.12.2016 (amounts derived from the financial statements)	Adjustments due to fair value measurement	Fair value of assets acquired
Loans and advances impaired, assessed on an individual basis	378.8	-	378.8
Loans and advances not impaired, without recognised individual impairment, of which:	5 974.5	24.6	5 999.1
not past due	5 266.1	16.0	5 282.1
past due	708.4	8.6	717.0
Loans and advances to customers, gross	**6 353.3**	**24.6**	**6 377.9**
Impairment allowances on loans and advances to customers	(294.6)	-	(294.6)
on impaired exposures	(220.3)	-	(220.3)
on non-impaired exposures and with no impairment trigger recognized	(74.3)	-	(74.3)
Loans and advances to customers, net	**6 058.7**	**24.6**	**6 083.3**

- **Loans and advances to customers – lease receivables**

The fair value of the portfolio of finance lease receivables and loans was determined using the discounted cash flow method (an income approach) based on discounted cash flows from contracts concluded. The expected cash flows were determined as the sum of contractual principal instalments, including residual values of the leased assets, and interest payments determined based on forward rates of the variable interest components and effective contractual margins.

The expected cash flows were discounted using effective market rates calculated as the sum of the relevant forward rate and the effective market margin. The effective market margins were calculated as the arithmetic means of the margins on homogeneous product groups in transactions concluded during the last month by Raiffeisen-Leasing Polska SA and PKO Leasing SA. They were determined taking into account the product type, period of financing, any downpayment made and the condition of the leased asset. In the Group's opinion, the arithmetic mean of the margins realized in the last month by Raiffeisen-Leasing Polska SA and PKO Leasing SA represents a good approximation of the market margins as at the measurement date.

During the valuation, it has been concluded that net carrying amounts represent a good approximation of the fair value for impaired exposures, exposures denominated in USD and CHF, exposures for which the leased assets have not been disposed and groups of exposures for which it has been concluded that RLPL margins are at the market level as at the valuation date (the portfolio of loans and receivables and lease receivables financing real estate).

The total amount of adjustments resulting from the fair value measurement of finance lease receivables and loans amounted to PLN 24.6 million.

- **Intangible assets**

As part of accounting for the acquisition transaction, customer relationships were identified resulting from the lease agreements concluded, amounting to PLN 64 million. Customer relationships in the area of lease agreements were analysed separately for the corporate segment and the retail segment. The excess rate of return valuation method was used to measure customer relationships.

(IN PLN MILLION)

Under this method, the value is determined based on the discounted future cash flows resulting from an additional income generated by the company which has a given intangible asset in excess of the income generated by a company which does not have such an asset. The method also involves considering the costs and investments associated with the intangible asset, marketing expenses, etc. To estimate the fair value of customer relationships, relationships with key customers are identified for individual CGU, the expected period of their further existence is estimated, as well as income from and costs directly associated with the relationships. From cash flows so determined, the general expenses in each year (including amortization) are deducted. Next, the Contributory Asset Charge ('CAC') which represents other assets contributing to generating income from customer relationships (impact of fixed assets, trademark, and organized workforce) is deducted. Contributory asset charges correspond to the required return from individual tangible and intangible assets used to generate income from customer relationships. The required return is calculated, respectively, for fixed assets, trademark, the organized workforce and the capital requirement, and is included in income from customer relationships.

Cash flows calculated for individual years are then discounted using the discount rate, increased by an appropriate premium for intangible assets. The value of discounted cash flows derived in this manner is the estimated value of the intangible asset.

In accordance with the RLPL acquisition agreement, any trademarks held by the Raiffeisen-Leasing SA Group will be excluded from the assets acquired by PKO Leasing SA. PKO Leasing SA has the right to use the 'Raiffeisen' trademark in the transition period without incurring any related costs.

Goodwill arising on the Transaction

As a result of the acquisition of shares in RLPL, goodwill was recognised as the difference between the consideration paid and the net value of identifiable assets acquired and liabilities assumed, measured in accordance with IFRS.

	Total RLPL Group companies
Consideration paid	850.0
Net identifiable amount of acquired assets and liabilities assumed	792.7
Goodwill	**57.3**
of which attributable to the following segments:	
corporate segment	16.2
retail segment	41.1

The purpose of acquiring shares in RLPL was for the Group to achieve economic benefits by increasing the customer base for the lease portfolio. The synergies resulting from the takeover of Raiffeisen-Leasing Polska SA and its subsidiaries will include strengthening the position of the leader in the lease services segment and expanding the distribution network. Moreover, the acquisition of a company which operates as an insurance agent will accelerate the achievement of the strategic goals in the area of bancassurance.

Additional information

Due to the fact that the merger took place during the reporting period, the income statement of the acquired entities jointly, from the acquisition date to 31 December 2016, and the income statement of the Group for 2016 is presented below, as if the date of acquisition was 1 January 2016.

The table below presents the amounts of revenues and expenses and profits or losses of the RLPL Group since the acquisition date, i.e. 1 December 2016.

(IN PLN MILLION)

Income statement	Data of the RLPL Group from the acquisition date to 31.12.2016
Interest income	27.0
Interest expense	(12.4)
Net interest income	**14.6**
Fee and commission income	4.7
Fee and commission expense	0.4
Net fee and commission income	**5.1**
Other operating income	4.7
Other operating expense	(0.9)
Net other operating income and expense	**3.8**
Net impairment allowance and write-downs	(9.2)
Administrative expenses	(11.9)
Operating profit	2.4
Profit before income tax	**2.4**
Income tax expense	(0.4)
Net profit (including non-controlling shareholders)	**2.0**
Profit (loss) attributable to equity holders of the parent company	**2.0**

The table below presents the amounts of profit and loss account of the Group, including the RLPL Group, for the current reporting period, calculated as if the acquisition date was the beginning of the annual reporting period, i.e. 1 January 2016.

	2016
Interest and similar income	10 251.7
Interest expense and similar charges	(2 354.8)
Net interest income	**7 896.9**
Fee and commission income	3 632.7
Fee and commission expense	(901.4)
Net fee and commission income	**2 731.3**
Dividend income	10.3
Net income from financial instruments measured at fair value	4.4
Gains less losses from investment securities	506.1
Net foreign exchange gains (losses)	502.9
Other operating income	739.1
Other operating expense	(338.9)
Net other operating income and expense	**400.2**
Net impairment allowance and write-downs	(1 653.3)
Administrative expenses	(5 706.8)
Tax on certain financial institutions	(828.9)
Operating profit	**3 863.1**
Share in profit (loss) of associates and joint ventures	34.5
Profit before income tax	**3 897.6**
Income tax expense	(945.4)
Net profit (including non-controlling shareholders)	2 952.2
Profit (loss) attributable to non-controlling shareholders	2.1
Net profit attributable to equity holders of the parent company	**2 950.1**

43. OTHER CHANGES TO THE ENTITIES OF THE GROUP

In 2016 the following events affecting the structure of the Group:

OTHER CHANGES IN THE PKO LEASING SA GROUP

On 31 October 2016, the merger of PKO Leasing SA (as the acquiring company) and PKO Bankowy Leasing Sp. z o.o. (as the acquired company) was registered with the National Court Register. The merger was accomplished through the transfer of all the assets of PKO Bankowy Leasing Sp. z o.o. to PKO Leasing SA (a merger by acquisition), without increasing the share capital of PKO Leasing SA and without a share exchange. Therefore, PKO Leasing SA assumed all the rights and obligations of PKO Bankowy Leasing Sp. z o.o. On 8 December 2016, a change of name of PKO BP Faktoring SA was registered with the National Court Register – the current name: PKO Faktoring SA.

PKO BANK HIPOTECZNY SA

In 2016 (on 22 April, 28 July and 1 December respectively), an increase in the share capital of PKO Bank Hipoteczny SA totaling PLN 500 million was registered with the National Court Register. All the shares in the increased capital were taken up by PKO Bank Polski SA. As at 31 December 2016 the share capital of the Company is PLN 800 million and is divided into 800 million shares with nominal value of PLN 1 each.

THE QUALIA DEVELOPMENT SP. Z O.O. GROUP

- **QUALIA HOTEL MANAGEMENT SP. Z O.O., INCLUDING THE ACQUISITION OF QUALIA - REZYDENCJA FLOTYLLA SP. Z O.O. AND QUALIA SPÓŁKA Z OGRANICZONĄ ODPOWIEDZIALNOŚCIĄ - POMERANKA SP. K**

On 29 February 2016, the merger of Qualia Hotel Management Sp. z o.o. (as the acquiring company) with Qualia - Rezydencja Flotylla Sp. z o.o. and Qualia spółka z ograniczoną odpowiedzialnością - Pomeranka Sp. k. (as the acquired companies) was registered with the National Court Register with jurisdiction over the acquiring company. The merger was accomplished through the transfer of all of the assets of the acquired companies to the acquiring company. Therefore, the acquirer assumed all the rights and obligations of the acquired companies. On 13 April 2016, Qualia Sp. z o.o. sold 3 shares of the Qualia Hotel Management Sp. z o.o. to Qualia Development Sp. z o.o. As at 31 December 2016 the share capital of Qualia Hotel Management Sp. z o.o. amounts to PLN 261 800 and is divided into 5 236 shares with a nominal value of PLN 50 each.

- **QUALIA SPÓŁKA Z OGRANICZONĄ ODPOWIEDZIALNOŚCIĄ – WŁADYSŁAWOWO SP. K.**

On 13 July 2016 the shareholders of Qualia spółka z ograniczoną odpowiedzialnością – Władysławowo Sp. k. adopted the resolution on dissolution of the Company without liquidation procedure. On 5 September 2016 the Company was deleted from the entrepreneurs register.

- **'FORT MOKOTÓW INWESTYCJE' SP. Z O.O.**

On 28 July 2016 Qualia Development Sp. z o.o. and Dom Development SA signed an agreement on sale 100% of shares of Fort Mokotów Inwestycje Sp. z o.o., which is the usufructuary of land located in the area of Żwirki i Wigury Street and Racławicka Street in Warsaw. The amount of the transaction including price of shares and loan repayment, which was provided to Fort Mokotów Inwestycje Sp. z o.o. by Qualia Development Sp. z o.o., equals to PLN 133.5 million. Since 28 July 2016 Fort Mokotów Inwestycje Sp. z o.o. has been no longer subsidiary of Qualia Development Sp. z o.o.

- **QUALIA SPÓŁKA Z OGRANICZONĄ ODPOWIEDZIALNOŚCIĄ – JURATA SP. K. (COMPANY JURATA)**

On 24 August 2016, the Company Qualia Development Sp. z o.o. sold all rights and obligations of the limited partner in the company Jurata and the company Qualia Sp. z o.o. sold all the rights and obligations of the general partner of the Company Jurata and no longer is a subsidiary of the Qualia Development Sp. z o.o.

- **QUALIA – RESIDENCE SP. Z O.O.**

On 24 August 2016, Qualia - Residence Sp. z o.o. sold two plots of land located in Jurata at Mestwina 32 Street and Mestwina 34 and 38 Street.
On 15 November 2016, the Extraordinary Shareholders' Meeting of Qualia – Residence Sp. z o.o. passed a resolution to repay PLN 34.7 million representing a part of the repayable contribution made by the sole shareholder – Qualia Development Sp. z o.o. The funds were transferred on 23 December 2016.

- **OTHER EVENTS CONTRIBUTING TO CHANGES IN THE EQUITY OF THE GROUP ENTITIES**

On 27 October 2016, the Extraordinary Shareholders' Meeting of Qualia Hotel Management Sp. z o.o. passed a resolution to increase the Company's share capital by PLN 1 149 700, i.e. to PLN 1 411 500, by establishing 22 994 new shares with a nominal value of PLN 50 each. All the newly established shares were taken up by the existing shareholder – Qualia Development Sp. z o.o. for PLN 111 million – the difference between the acquisition cost and the nominal value was recognised in the supplementary capital. The funds were transferred to the Company on 28 October 2016. The aforementioned increase in the capital was registered with the National Court Register on 6 February 2017.

On 1 December 2016, the partners in a limited partnership, Qualia sp. z o.o. - Sopot Sp. k., passed a resolution concerning the repayment to the limited partner – Qualia Development Sp. z o.o. – a part of the cash contribution made, in the amount of PLN 5.5 million, as a result of which the limited partner's contribution decreased from PLN 10.2 million to PLN 4.7 million. The funds were transferred on 1 December 2016. The part of the contribution was repaid without lowering the limited partnership sum. The change was registered with the National Court Register on 18 January 2017.

PKO BP FINAT SP. Z O.O.

On 29 January 2016 the National Court Register recorded a decrease of the share capital of PKO BP Finat Sp. z o.o. from the amount of PLN 107 302 500 to PLN 32 302 500 through the redemption of 750 000 shares with a nominal value of PLN 100 each. As at 31 December 2016 the share capital of the company is PLN 32 302 500 and is divided into 323 025 shares with a nominal value of PLN 100 each.

PKO TOWARZYSTWO UBEZPIECZEŃ SA

On 19 April 2016 the National Court Register recorded an increase of the share capital of the Company by PLN 5 million. Within the above-mentioned increase the Bank acquired 5 000 shares (i.e. all newly issued shares) with a nominal value of PLN 1 000 each and an issue price amounting to PLN 4 400 each, i.e. for a total amount equal to PLN 22 million, remaining sole shareholder of the Company. As at 31 December 2016 the share capital of the Company is PLN 25 million and is divided into 25 000 shares with nominal value of PLN 1 000 each.

KREDOBANK SA

On 24 May 2016 in the Uniform National Register of Legal Entities, Individual Entrepreneurs and Public Organizations of Ukraine was recorded a change of the Statute of KREDOBANK SA taking into account, i.a. an increase of the share capital by UAH 330 million. All shares in the increased capital were acquired and paid in November 2015 by PKO Bank Polski SA.

As at 31 December 2016 the share capital of the Company is UAH 2 248 969 469.16 and is divided into 224 896 946 916 shares with nominal value of UAH 0.01 each.

THE FERRUM SA GROUP

On 18 January 2016, of Bank took over within debt collection activities (foreclosure of collateral) another block of 286 918 shares of FERRUM SA, increasing its stake in the share capital and votes at the General Meeting of the company from 20.97% to 22.14%. The company is an associate of the Bank.

In 2016, PKO Bank Polski SA showed, within the structure of the FERRUM SA Group, a new company, Walcownia Blach Grubych Batory Sp. z o.o., with its registered office in Katowice, with share capital amounting to PLN 5 000. According to the consolidated report for the third quarter of 2016 of the aforementioned Group, the Company did not commence operating activities.

THE CENTRUM ELEKTRONICZNYCH USŁUG PŁATNICZYCH ESERVICE SP. Z O.O. GROUP

In 2016 Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.:

- took up shares as part of three increases in the share capital of its subsidiary, EVO Payments International Sp. z o.o., with a total nominal value of PLN 414 400 and with a total issue value of PLN 20 720 000; on 19 August 2016, an increase in the share capital with a nominal value of PLN 50 000 was registered with the National Court Register; the other increases in the capital as at 31 December 2016 were not registered,
- made a payment towards the supplementary capital of its subsidiary, EVO Payments International s.r.o., with a registered office in the Czech Republic in the amount of CZK 209.8 million; the aforementioned funds were used for financing, i.a. the acquisition of an organized part of the enterprise comprising Merchant Acquiring Business.

OTHER NOTES

44. Dividends per share

On 30 June 2016 the Ordinary General Shareholders' Meeting of the Bank adopted resolution (No. 7/2016) on distribution of the net profit for the period from 1 January 2015 to 31 December 2015 in the amount of PLN 2 571.1 million and retained earnings from previous years in the amount of PLN 1 250 million, in the total amount of PLN 3 821.1 million as follows:

1) dividend for shareholders PLN 1 250 million (which represents PLN 1.00, gross, per share),
2) reserve capital in the amount of PLN 2 500 million,
3) other reserves in the amount of PLN 71.1 million.

The appropriation of the profit described above was dependent on meeting, by 8 December 2016 inclusive, the following conditions ('Meeting the Conditions for the Dividend Payment'):

- Bank shall not take over control of a bank or other entity of the financial sector by a direct or indirect acquisition of a block of shares and shall not acquire a right or incur an obligation to take over control in the manner specified above, and
- There shall not occur any regulatory changes or changes of the supervisory recommendations affecting the requirements for the Bank's own funds that – according to the level of capital adequacy ratios recognised in the financial statements of the Bank for Q3 2016 – would cause a lack of possibility to pay dividend in accordance with the regulatory requirements and supervisory recommendations.

The Bank's Management Board was put under an obligation to pass, no later than by 9 December 2016, a resolution on Meeting the Conditions for the Dividend Payment or failure to meet them.

On 1 December 2016, a transaction comprising the acquisition of 100% of shares in Raiffeisen Leasing Polska SA by PKO Leasing was closed. Furthermore, the Bank's Management Board passed a resolution stating a failure in Meeting the Conditions for the Dividend Payment. In consequence, the Bank's profit earned in 2015 and undistributed profits from previous years were appropriated in the manner specified in § 2 of the resolution on the Appropriation of Profit, which assumes that the entire profit be earmarked for transfer to the reserve capital the other reserves, without providing for the payment of a dividend.

45. Contingent liabilities and off-balance sheet liabilities received and granted

Accounting policies

As part of its operating activities the Group concludes transactions which, at the time of conclusion, are not recognised as assets or liabilities in the statement of financial position, but which give rise to contingent liabilities. Pursuant to IAS 37 a contingent liability is:

1) a potential obligation resulting from past events whose existence will be confirmed at the moment of occurrence or non-occurrence of one or more uncertain future events which are not fully under the Group's control; or
2) a current obligation which arises as a result of past events but is not recognised in the statement of financial position because it is not probable that cash or other assets would have to be expended to meet the obligation or the amount of the liability could not be assessed reliably.

(IN PLN MILLION)

In accordance with IAS 37 upon initial recognition a financial guarantee agreement is measured at fair value.

FINANCIAL INFORMATION

SECURITIES COVERED WITH UNDERWRITING AGREEMENTS (MAXIMUM LIABILITY OF THE GROUP TO ACQUIRE SECURITIES)

Issuer of securities underwritten	Type of underwritten securities	Off-balance sheet liabilities resulting from underwriting agreement	Contract period
As at 31 December 2016			
Company A	corporate bonds	1 125.7	31.12.2020
Company B	corporate bonds	1 055.0	31.07.2020
Company C	corporate bonds	512.0	15.06.2022
Company D	corporate bonds	69.4	31.12.2022
Company E	corporate bonds	9.0	31.12.2026
Total		**2 771.1**	

Issuer of securities underwritten	Type of underwritten securities	Off-balance sheet liabilities resulting from underwriting agreement	Contract period
As at 31 December 2015			
Company A	corporate bonds	1 950.0	31.12.2020
Company B	corporate bonds	1 055.0	31.07.2020
Company C	corporate bonds	342.7	15.06.2022
Company D	corporate bonds	80.6	31.12.2022
Company F	corporate bonds	60.0	23.11.2021
Company G	corporate bonds	28.2	31.12.2029
Company E	corporate bonds	17.9	31.12.2026
Company H	corporate bonds	4.4	31.01.2016
Company I	corporate bonds	3.4	30.09.2030
Total		**3 542.2**	

All contracts relate to the Agreement for Organization, Conducting and Servicing of the Bond Issuance Programme. All securities of the Group under the underwriting programme have an unlimited transferability, are not listed on the stock exchange and are not traded on a regulated OTC market.

CONTRACTUAL COMMITMENTS

Value of contractual commitments concerning:	31.12.2016	31.12.2015
intangible assets	36.5	178.9
tangible fixed assets	23.6	50.3

(IN PLN MILLION)

LOAN COMMITMENTS GRANTED

Nominal value of loan commitments granted	31.12.2016	31.12.2015
Credit lines and limits		
to financial entities	2 763.3	2 306.2
to non-financial entities	39 525.0	36 157.8
to public entities	3 856.3	4 080.4
Total	**46 144.6**	**42 544.4**
of which: irrevocable loan commitments	31 077.9	30 513.9

GUARANTEE LIABILITIES GRANTED

Guarantees and pledges	31.12.2016	31.12.2015
Guarantees in domestic and foreign trading	6 060.2	7 555.8
Guarantees and pledges granted – domestic corporate bonds	3 768.6	4 930.6
Letters of credit granted	1 599.5	1 838.1
Guarantees and pledges granted - payment guarantee to financial entities	150.9	143.6
Guarantees and pledges granted - domestic municipal bonds	351.3	59.3
Total	**11 930.5**	**14 527.4**
of which performance guarantees granted	2 446.9	2 378.4

Information about the provisions recognised for off-balance sheet financial and guarantee liabilities is presented in note 'Provisions'.

LIABILITIES GRANTED BY MATURITY

Off-balance sheet liabilities granted by maturity - 31.12.2016	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Loan commitments granted	13 809.8	2 542.6	12 354.3	10 993.0	6 444.9	46 144.6
Guarantee liabilities granted	265.5	575.9	3 722.1	6 667.9	699.1	11 930.5
Total	14 075.3	3 118.5	16 076.4	17 660.9	7 144.0	58 075.1

Off-balance sheet liabilities granted by maturity - 31.12.2015	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Loan commitments granted	28 969.3	814.8	3 746.7	2 897.4	6 116.2	42 544.4
Guarantee liabilities granted	1 415.1	1 604.0	2 220.1	8 613.5	674.7	14 527.4
Total	30 384.4	2 418.8	5 966.8	11 510.9	6 790.9	57 071.8

(IN PLN MILLION)

OFF-BALANCE SHEET LIABILITIES RECEIVED

Off-balance sheet liabilities received by nominal value	31.12.2016	31.12.2015
Financial	303.5	505.3
Guarantees	7 972.3	6 831.1
Total liabilities received	**8 275.8**	**7 336.4**

Due to the provisions of the Agreement which require the Nordea Bank AB Group (publ) to participate in the default risk of the Mortgage Portfolio, on 1 April 2014, PKO Bank Polski SA and Nordea Bank AB (publ) concluded a special indemnity agreement (the 'Special Indemnity Agreement'), according to which Nordea Bank AB (publ) covers, for a period of 4 years following the Closing Date, 50% of the excess of the Mortgage Portfolio cost of risk over the annual cost of risk set at 40 basis points for each year of the above-mentioned four-year contract period of the Special Indemnity Agreement.

As a part of works related to the settlement of the transaction, the Group has made a valuation of the Special Indemnity Agreement on the basis of conducted analysis of probability of cash flows arising from the Agreement. The estimated expected value is zero.

RIGHT TO SELL OR PLEDGE COLLATERAL ESTABLISHED FOR THE GROUP

As at 31 December 2016 and as at 31 December 2015, there was no collateral established for the Group which the Group was entitled to sell or encumber with another pledge in the event of fulfilment of all obligations by the owner of the collateral.

46. LEGAL CLAIMS

As at 31 December 2016, the total amount in litigation where the Bank is the defendant, and litigation in which other PKO Bank Polski SA Group companies are defendants (suits) was PLN 448.7 million, including PLN 43.8 million in respect of litigation in Ukraine (as at 31 December 2015 the total amount of the said litigations was PLN 638 million), and the total amount of litigations (suits) as at 31 December 2016 where the Bank is the plaintiff and litigations where other PKO Bank Polski SA Group companies are plaintiffs was PLN 1 232.3 million, including PLN 42.2 million in respect of litigations in Ukraine (as at 31 December 2015 the total amount under the said litigations was PLN 697 million).

The most significant legal claims of the PKO Bank Polski SA and the PKO Bank Polski SA Group entities are described below:

a) UNFAIR COMPETITION PROCEEDING

PROCEEDING AGAINST PRACTICES THAT LIMIT COMPETITION IN THE PAYMENTS MARKET USING PAYMENT CARDS IN POLAND:

The Bank is a party to proceeding initiated by President of the Competition and Consumer Protection Office (Urząd Ochrony Konkurencji i Konsumentów - UOKiK) on the basis of a decision dated 23 April 2001 upon the request of the Polish Trade and Distribution Organization – Employers Association (Polska Organizacja Handlu i Dystrybucji - Związek Pracodawców) against the operators of the Visa and Europay payment systems and the banks issuing Visa and Europay/Eurocard/Mastercard banking cards. The claims under these proceedings relate to the use of practices limiting competition on the market of banking card payments in Poland, consisting of applying pre-agreed 'interchange' fees for transactions made using mentioned above cards as well as limiting access to this market by external entities. On 29 December 2006, UOKiK decided that the practices, consisting of joint establishment of 'interchange' fee, did limit market competition and ordered that any such practices should be discontinued, and imposed a fine on, i.a., PKO Bank Polski SA, in the amount of PLN 16.6 million.

The Bank appealed against the decision of the President of UOKiK to CCCP (Court for the Competition and Consumer Protection / Sąd Ochrony Konkurencji i Konsumentów - SOKiK) and on 20 December 2011 a hearing was held during which no factual resolution of the appeals was reached. The SOKiK obligated MasterCard to submit explanations concerning the issue and scheduled the date of the next meeting for 9 February 2012. The date was postponed for 24 April 2012, and next SOKiK postponed announcing the court's decision on request for suspension until 8 May 2012. On 8 May 2012, SOKiK suspended proceedings until the final conclusion of proceedings before the European Union Court in the case MasterCard against the European Commission. On 24 May 2012, the European Union Court upheld the decision of the European Commission banning multilaterally agreed 'interchange' fees applied by MasterCard. On 28 May 2012 the participant to the proceedings, Visa Europe Ltd, and on 29 May 2012 the plaintiffs' attorney, including PKO Bank Polski SA, filed a complaint against the decision of SOKiK dated 8 May 2012. In August 2012, the European Court of Justice received the appeal of MasterCard against the verdict of the EU Court of 24 May 2012 rejecting the appeal of mentioned above. On 25 October 2012, the Court of Appeal in Warsaw changed the decision of 8 May 2012 and dismissed the motion of MasterCard for suspending the proceedings. By judgment of 21 November 2013 SOKiK reduced the penalty imposed on the Bank to the amount of PLN 10.4 million. On 7 February 2014 the judgment was appealed on behalf of the Bank and eight plaintiffs represented by the Bank's attorney. The judgment was also appealed by other participants of the proceedings, i.e. by the President of the Competition and Consumer Protection Office (UOKiK) and of the Polish Trade and Distribution Organization (POHiD) (appeals aimed to impose on the participants of the agreements stricter financial penalties), and: Visa Europe Ltd., Bank Pocztowy S.A., Bank Gospodarki Żywnościowej S.A., mBank S.A. (formerly: BRE Bank S.A.), Deutsche Bank PBC S.A., HSBC Bank Polska S.A. (appeals aimed at imposing more strict fines on participants to the agreement). The Court of Appeal in Warsaw in its verdict of 6 October 2015, dismissed the appeal of banks and Visa, while the appeal of the UOKiK. The Court restored the original amount of the imposed penalties stipulated in the decision of the UOKiK, i.e. the penalty in the amount of PLN 16.6 million – penalty imposed on PKO Bank Polski and the penalty in the amount of PLN 4.8 million (penalty imposed on Nordea Bank Polska SA). The penalties were paid by the Bank in October 2015. On 28 April 2016, the Bank filed a cassation complaint along with the other participants in the proceedings. On 28 November 2016, the Bank's plenipotentiary filed an application for filing a pleading with a respective statement of grounds and a pleading. By decision dated 5 December 2016, the Supreme Court allowed the Bank to file the pleading. The hearing before the Supreme Court has not yet been scheduled.

As at 31 December 2016 the Bank is also a party to i.a. following proceedings:

- **BEFORE THE COURT OF APPEL – AS A RESULT OF AN APPEAL FROM THE VERDICT OF SOKIK ISSUED IN RESULT OF THE COMPLAINT FROM THE PRESIDENT OF UOKIK DUE TO SUSPICION OF USING OF UNFAIR CONTRACTUAL PROVISIONS IN FORMS OF CONSUMER LOAN AGREEMENTS, WITH THE EXCLUSION OF CREDIT CARD AGREEMENTS.**

  By decision of 31 December 2013, the Bank's activities were considered as practices violating collective interests of consumers and a fine in the amount of PLN 29 million was imposed on the Bank. The Bank appealed against this decision. By judgment of 9 July 2015 SOKiK fully annulled the decision of the President of the UOKiK. On 28 August 2015 the President of UOKiK appealed against that judgment. On 11 September 2015 the Bank responded to the appeal rejecting the allegations of the President of the UOKiK. No trial date has been set. By a decision of 22 November 2016, the Court of Appeal suspended the proceedings. As at 31 December 2016 the Bank had no provision due to this proceeding.

- **INITIATED BY BANK - AT THE CONCLUSION OF THE APPEAL PROCEEDING BROUGHT BY THE BANK TO SOKIK AGAINST THE DECISION OF THE PRESIDENT OF UOKIK IN CONNECTION WITH THE USE OF UNFAIR CONTRACTUAL TERMS IN TEMPLATES OF INDIVIDUAL CONTRACTS (IKE)**

  On 19 December 2012, the President of UOKiK imposed a fine on the Bank in a total amount of PLN 14.7 million, of which:

  1) PLN 7.1 million for not indicating in the IKE agreements responsibilities of the Bank for timely and proper carrying out the monetary settlements and compensation for the delay in execution of a holder instruction;
  2) PLN 4.7 million for application in the form of IKE agreements, an open list of termination conditions;
  3) PLN 2.9 million for application a clause, entered in the register, defining for disputes with customers a court with jurisdiction over the seat of PKO Bank Polski SA's branch, carrying the IKE deposit account.

  The Bank appealed against the decision of the President of UOKiK on 2 January 2013. SOKiK reduced the penalty imposed on the Bank to the amount of PLN 4 million by the court judgement of 25 November 2014, as regards to:

  - the practice described in the point 1 above, it reduced the penalty to the amount of PLN 2.5 million,
  - the practice described in the point 2 above, it reduced the penalty to the amount of PLN 1.5 million,

- the practice described in the point 3 above, the penalty was repealed, as the Court considered that the practice of the Bank did not violate collective interests of consumers.

In January 2015 both the Bank and the President of the UOKiK appealed against the judgment. The Court of Appeal in its judgment of 10 February 2016 dismissed the appeal of the Bank and the appeal of the President of UOKiK. Since the judgment is final, the Bank paid a fine in the amount of PLN 4 million on 23 February 2016 year. On 26 September of 2016 bank appealed a cassation complaint to the Supreme Court. The case is pending.

- **BEFORE SOKIK (COURT OF COMPETITION AND CONSUMER PROTECTION) SEVEN PROCEEDINGS INSTITUTED BY INDIVIDUALS:**

1) on the recognition as abusive and prohibiting the respondent from using in trading with customers the provisions in forms of agreements for loans denominated in CHF, indicating that the currency conversion rules used by the Bank for the purpose of loan payment and for the purpose of conversion of instalments as well as decisions concerning the amount of interest rate were against good practice and highly violated consumer interest (proceeding suspended),
2) to establish invalidity of the clauses contained in the mortgage loan agreement by regarding them as illegal (non-existent) and prohibiting the Bank from using in trading with customers the provisions in forms of agreements used by the defendant in the exercising economic activity,
3) for recognition as illegal of the provisions in forms of mortgage loan agreement Nordea - Habitat and the surety agreement,
4) for recognition as illegal of the provisions of a standard loan agreement. Plaintiff (appraiser) accuses the Bank that it only accepts real estate valuations prepared by designated appraisers which seriously violates the interests of consumers by imposing on consumers, as the weaker party to the contract, onerous conditions by eliminating the right to obtain the valuation services from the chosen company,
5) for recognition as illegal of the provisions in forms of mortgage loan agreement product Własny Kąt hipoteczny;
6) for recognition as illegal of the provisions related to low downpayment insurance of mortgage loan Własny Kąt hipoteczny repaid in annuity granted instalments in PLN,
7) for recognition as illegal of the provisions of a standard agreement (A Policy for Issuing and Using Credit Cards and a Table of fees and commissions in respect of reminders and phone call intervention relating to delays in the repayment of debt, which, in the plaintiff's opinion, are against good practices and severely violate consumer interests)

As at 31 December 2016 the Group had no provisions for above-mentioned proceeding due to the fact, that the justify probability of unfavourable result of these proceedings is assessed as remote.

- **BEFORE THE PRESIDENT OF UOKIK**

Two proceedings are in progress before the President of the Office of Competition and Consumer Protection (UOKiK) on PKO Bank Polski SA's practices which allegedly violated the consumers' collective interests:

1) proceedings instigated *ex officio* by the President of the Office of Competition and Consumer Protection (UOKiK) on applying practices which violate collective consumers' interests by PKO Bank Polski SA. The practices consisted of informing in marketing communications and conditioning the exemption of consumers from paying monthly fees for servicing debit cards on settling cashless transactions using the card (a quota or number limit) in the period for which the monthly fee for the card is collected, when the settlement of the cashless transactions in the said period does not depend on the consumer, but on receiving the settlement of the transactions by the Bank from the settlement agent. The decision to instigate proceedings against the Bank was delivered to the Bank on 4 January 2017. In the letter dated 3 March 2017 addressed to the President of UOKiK the Bank's plenipotentiary signaled that the Bank will apply for the consent decree referred to in Article 28 of the Act on protection of competition and consumers;
2) the proceedings instigated *ex officio* by the President of UOKiK in respect of the alleged practices applied by PKO Bank Polski SA which violate the collective interests of consumers who are party to an agreement for payment services and have access to the electronic banking system, by informing of the proposed changes to the conditions of the agreement for the payment services during its performance exclusively using electronic communications sent through electronic banking channels, which do not constitute a permanent information carrier, and not including in the information appendices in the form of electronic documents (regulations and banking fee and commission tariffs for individuals) sent to consumers on changes introduced to PKO Bank Polski SA and Inteligo branded products, i.e.: bank accounts and debit cards, credit cards, payment cards, and thus making the verification of admissibility of changing the conditions of an agreement by consumers impossible. The decision to instigate proceedings against the Bank was delivered to the Bank on 17 October 2016. The Bank's position on the case is being prepared.

Moreover, there are twelve investigation procedures pending before the President of UOKiK, relating to the Bank's activities and one contact by the President of UOKiK without instituting proceedings (in accordance with Article 49a of the Act on Competition and Consumer Protection).

As at 31 December 2016 PKO Życie Towarzystwo Ubezpieczeń SA – a subsidiary of the Bank – is a party to:

1) six proceedings before SOKiK initiated by individuals to determine some of provisions in the forms of life insurance agreements to be illegal.

   In all cases PKO Życie responded to the lawsuit and applied for its dismiss due to bringing legal action after 6 months since the day of giving up their application; in these cases there is no risk of imposing financial penalty on the Company,

2) proceeding connected to the cassation complaint brought by PKO Życie Towarzystwo Ubezpieczeń SA against the judgment of the Court of Appeal in relation to the fine imposed on the Company in 2010 by the President of UOKiK for the violation of the collective interests of consumers by the Company (fine was paid in 2013).

   The Supreme Court issued in 2015 the verdict repealing the appealed judgment concerning the amount of the fine and referred the case for reconsideration to the court of second instance. The second instance upheld its previous position not taking into account the guidelines of the Supreme Court. PKO Życie Towarzystwo Ubezpieczeń SA made another cassation complaint to the Supreme Court.

At the same time in 2016 PKO Życie Towarzystwo Ubezpieczeń SA implemented the obligations resulting from the decision, made in October 2015 by the President of UOKiK, regarding amendments to 25 forms of insurance agreements with insurance capital funds, concerning surrender fees. The Company's liability resulting from the above-mentioned decision consist in particular with regard to these 25 forms:

a) surrender fees incurred by the existing customers for insurance with regular premium will not be higher than 25% of the value of premiums paid, and 4% in the case of contracts with one-off premium,

b) the Company will provide consumers with a proposal of an annex to the contract of insurance, or equivalent agreement,

c) the Company will inform customers about the availability of new conditions through the website, applications for customers and directly customer - every time the customer indicates that it intends to terminate the contract.

The Company implemented the obligations resulted from the decision til 17 May 2016. On 12 August 2016 the Company submitted to the President of UOKiK report of the implementation of the obligations arising from the decision. The decision does not exhaust the possibility of a pursuing by the existing customers of their rights through civil law issued for particular insurance companies.

In the third quarter of 2016 the insurance industry within Polska Izba Ubezpieczeń (PIU) took the initiative to develop with UOKiK and PFSA compromise solution about regulating issue concerning fees from insurance capital fund products to support clients currently not covered with decisions issued by the President of UOKiK to particular insurance companies without changing the law.

As a result of the arrangements referred to above, on 19 December 2016 PKO Życie Towarzystwo Ubezpieczeń SA concluded an agreement with the President of the UOKiK under which the terms and conditions of the UOKiK decision described above was extended to the whole active (as at 1 December 2016) portfolio of insurance products with insurance capital funds held by the Company's customers, and analogous solutions were adopted for customers who concluded insurance contracts with insurance capital funds after 1 January 2008, who were more than 61 years old and whose contracts were terminated after they turned 65.

Similar agreements were concluded with the President of UOKiK by 15 other insurance companies.

As at 31 December 2016, PKO Życie Towarzystwo Ubezpieczeń SA does not have a provision for administrative penalties in respect of proceedings relating to insurance products with an insurance capital fund (a provision of PLN 8.1 million in connection with the consent decree of the President of the UOKiK becoming final and binding was released in 2015). At the same time, the Company maintains an adequate (in respect of the consent decree and the agreement) level of claims provisions.

In 2016 the Group's entities (other than PKO Bank Polski SA) were the parts to three proceedings conducted by the President of UOKiK related to advertising used by insurers for the sale of life insurance contracts with insurance capital funds, mortgage loan-related research and market research about investment products for customers.

(IN PLN MILLION)

b) RE-PRIVATIZATIONS CLAIMS RELATING TO PROPERTIES HELD BY THE GROUP

As at the date of these financial statements there are:

1) twelve administrative proceedings, of which five are suspended, in relation to properties owned by the Bank, regarding: the invalidation of administrative decisions refusing to grant the right to temporary ownership, giving the property under management and on acquisition in accordance with law the perpetual usufruct of land and ownership title to the building, the return of the property, remuneration for property usage without contractual basis as well as regulation of legal status of the properties.
2) fourteen proceedings, of which one is suspended, in relation to properties of other Group entities, regarding the invalidation of administrative decisions or return of the property.

In the opinion of the Management Board of PKO Bank Polski SA the probability of significant claims against the Bank in relation to the above mentioned proceedings is remote.

47. SUPPLEMENTARY INFORMATION TO THE STATEMENT OF CASH FLOWS

Cash and cash equivalents
Restricted cash
Cash flows from interests and dividends, both received and paid
Cash flow from operating activities – other adjustments
Explanation of differences between the statement of financial position and the changes of those items presented under operating activities in the statement of cash flows

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on hand, cash on nostro accounts and deposit with the National Bank of Poland, current amounts due from banks, as well as other cash equivalents with maturities up to 3 months from the date of acquisition.

Cash and cash equivalents	31.12.2016	31.12.2015
Cash and balances with the Central Bank	11 645.1	13 743.9
Deposits with the Central Bank	1 680.0	-
Current amounts due from banks	4 627.9	3 504.9
Cash and cash equivalents with restricted availability for use	13.3	15.9
Total	**17 966.3**	**17 264.7**

RESTRICTED CASH

Cash of PLN 13.3 million (as at 31 December 2015: 15.9 million, including PLN 5.8 million collateral for currency SWAP transaction with KREDOBANK SA) pledged as collateral for securities' transactions conducted by the Brokerage House of PKO Bank Polski SA are deposited in the National Depository for Securities (KDPW_CCP), as part of the Guarantee Fund for the Settlement of Stock Exchange Transactions. Each direct participant who holds the status of settlement-making participant is obliged to make payments to the settlement fund which guarantees a proper settlement of the stock exchange transactions covered by that fund. The amount of the payments depends on the value of transactions made by each participant and is updated by KDPW_CCP on a daily basis. In the statement of cash flows, these funds are presented as restricted cash.

(IN PLN MILLION)

CASH FLOWS FROM INTERESTS AND DIVIDENDS, BOTH RECEIVED AND PAID

Interest income – received from:	2016	2015
Loans and advances granted	6 562.3	6 183.6
Investment securities	777.7	696.0
Securities designated upon initial recognition at fair value through profit and loss	226.9	243.7
Deposits	141.6	134.4
Trading financial assets	68.5	55.9
Hedging instruments	461.8	476.8
Other (mainly interest income on current accounts, purchased debt, realised guarantees)	895.2	1 128.9
Total	**9 134.0**	**8 919.3**

Interest expense – paid on:	2016	2015
Deposits	(1 471.0)	(1 757.7)
Debt securities in issue	(361.8)	(520.5)
Loans and advances received	(119.2)	(102.2)
Other (mainly interest expense on current accounts, premium from debt securities, interest expense on cash collateral liabilities)	(520.1)	(587.9)
Total	**(2 472.1)**	**(2 968.3)**

Dividend income - received	2016	2015
Dividend income from joint ventures and associates - received*	11.0	25.6
Dividend income from other entities - received	10.3	10.7
Total	**21.3**	**36.3**

* The item relates to a dividend received from entities accounted for under the equity meth

CASH FLOW FROM OPERATING ACTIVITIES – OTHER ADJUSTMENTS

Other adjustments	2016	2015
Changes resulting from acquisitions	(126.8)	6.1
Revaluation of financial assets available for sale, net	(518.0)	139.6
Interest accrued, discount, premium on debt securities	(19.5)	(1 084.6)
Hedge accounting	(50.8)	(62.9)
Actuarial gains and losses	2.0	(4.5)
Valuation and impairment allowances on investments in joint ventures and associates and other changes	(54.1)	(69.4)
Currency translation differences from foreign operations	(5.0)	(23.9)
Disposal and impairment allowances on tangible fixed assets and intangible assets	(65.1)	(107.4)
Total	**(837.3)**	**(1 207.0)**

(IN PLN MILLION)

EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF FINANCIAL POSITION AND THE CASH FLOW STATEMENT

CHANGES OF ITEMS PRESENTED UNDER OPERATING ACTIVITIES IN THE STATEMENT OF CASH FLOWS

(Gains) losses on investment activity due to sale and disposal of tangible fixed assets	2016	2015
Gains on sale and disposal of tangible fixed assets and intangible assets	(85.6)	(103.7)
Gain on disposal of subsidiaries	(133.5)	-
Losses on sale and disposal of tangible fixed assets and intangible assets	32.9	90.2
Total	**(186.2)**	**(13.5)**

Interests and dividends	2016	2015
Interest received from investment securities presented under investing activities	(687.4)	(727.4)
Dividends received presented under investing activities	(21.3)	(36.2)
Interest paid on loans received and issuance of debt securities, presented under financing activities	472.7	653.1
Total	**(236.0)**	**(110.5)**

Change in amounts due from banks	2016	2015
Change in the balance of the statement of financial position	(792.4)	(2 066.3)
Changes resulting from acquisitions	0.5	33.1
Change in impairment allowances on amounts due from banks	0.2	(0.3)
Exclusion of a change in the balance of cash and cash equivalents	1 117.2	1 004.3
Total	**325.5**	**(1 029.2)**

Change in loans and advances to customers	2016	2015
Change in the balance of the statement of financial position	(10 192.8)	(10 916.3)
Changes resulting from an acquisition	6 083.2	571.4
Change in the impairment allowances on amounts due from customers	284.5	(264.7)
Exclusion of the change in the balance of cash and cash equivalents	3.2	-
Total	**(3 821.9)**	**(10 609.6)**

Change in other assets, inventories and non-current assets held for sale	2016	2015
Change resulting from balances as at the balance sheet date and reclassification to other items	(1 430.0)	(46.6)
Changes resulting from an acquisition	137.2	45.8
Change in impairment allowances on other receivables	(18.5)	(78.2)
Total	**(1 311.3)**	**(79.0)**

(IN PLN MILLION)

Change in amounts due to banks	2016	2015
Change in the balance of the statement of financial position	919.5	(1 105.9)
Changes resulting from an acquisition	(4 005.9)	-
Recognition of drawing/repayment of long-term loans from banks under financing activities	44.1	2 696.2
Total	**(3 042.3)**	**1 590.3**

Change in amounts due to customers	2016	2015
Change in the balance of the statement of financial position	9 307.9	21 371.7
Changes resulting from an acquisition	(696.5)	(595.1)
Recognition of long-term loans and advances received from financial institutions other than banks/repayments of these loans and advances in financing activities	(19.3)	(81.4)
Total	**8 592.1**	**20 695.2**

Change in debt securities in issue	2016	2015
Change in the balance of the statement of financial position	5 060.3	(3 867.6)
Changes resulting from an acquisition	(1 557.2)	-
Recognition of drawing/repayment of long-term liabilities from issuance under financing activities	(3 059.9)	4 519.6
Total	**443.2**	**652.0**

Change in provisions and impairment allowances	2016	2015
Change in the balance of the statement of financial position	(24.3)	(71.7)
Changes resulting from an acquisition	(0.5)	(334.8)
Change in impairment allowances on amount due from banks	(0.2)	0.3
Change in impairment allowances on amount due from customers	(284.5)	264.7
Change in impairment allowances on other receivables	18.5	78.2
Total	**(291.0)**	**(63.3)**

Change in other liabilities, liabilities related to insurance operations and subordinated liabilities	2016	2015
Change in the balance of the statement of financial position	1 213.8	207.5
Changes resulting from an acquisition	(112.9)	(5.8)
Total	**1 100.9**	**201.7**

(IN PLN MILLION)

48. TRANSACTIONS WITH THE STATE TREASURY AND RELATED PARTIES

TRANSACTIONS WITH THE STATE TREASURY

The State Treasury has control over the Group as it holds a 29.43% interest in the Bank's share capital. The Bank's shareholding structure is described in detail in the note 'Equity and shareholding structure of the Bank' to these financial statements.

Receivables, securities and liabilities arising from transactions conducted with the State Treasury, budgetary units and entities in which the State Treasury is the shareholder are disclosed in the Group's statement of financial position.

In accordance with the 30 November 1995 Act in relation to State support in the repayment of certain housing loans, reimbursement of guarantee premium paid and amendments of several acts, PKO Bank Polski SA receives payments from the State budget in respect of redemption interest receivable on housing loans.

Income due to temporary redemption by the State Treasury of interest on housing loans from the "old" portfolio	**2016**	**2015**
Income recognised for this period	65.3	85.0
Income received in cash	24.8	34.8
Difference –'Loans and advances to customers'	**40.5**	**50.2**

The Act on the coverage of repayment of certain housing loans by State Treasury guarantees was passed on 29 November 2000 and came into force on 1 January 2001. In execution of the provisions of the Act, on 3 August 2001 PKO Bank Polski SA signed an agreement with the Minister of Finance acting on behalf of the State Treasury under which the Bank was granted a pledge of repayment of debt arising from housing loans in the so-called 'old' portfolio. On 29 December 2011, the validity period of the agreement (originally until 31 December 2011) was extended until 31 December 2017. The coverage of the so-called 'old' portfolio housing loan receivables by the guarantees of the State Treasury results in the neutralization of the default risk on these loans.

The State Treasury guarantees are executed when a borrower fails to repay the loan on the dates specified in the loan agreement. The responsibility of the State Treasury is of an auxiliary nature and is effective if the recovery of the unpaid part of principal and interest which the Bank is obliged to commence, before the Group lays claims to the State Treasury, becomes ineffective. The above-mentioned law covers 90% of unpaid loans taken out by housing cooperatives. As a consequence of the realization of the State Treasury's responsibilities as guarantor, the State Treasury itself enters into the rights of the satisfied creditor (the Group) and thus becomes a creditor towards the borrower, in line with the concept of guarantee.

PKO Bank Polski SA receives commission for settlements relating to redemption of interest by the State Treasury on housing loans – in 2016 PLN: 3.1 million, in 2015 PLN 3.1 million.

As of 1 January 1996 the Bank became the general distributor of court fee stamps. The Bank receives commissions in this respect from the State Treasury – in 2016 PLN 12.4 million, in 2015 PLN 12.3 million.

The Brokerage House of PKO Bank Polski SA performs the role of an agent for the issue of retail treasury bonds under the agreement signed with the Ministry of Finance on 11 February 2003. Under this agreement, the Brokerage House of PKO Bank Polski SA receives a fee for providing the services of an agent for the issue of bonds- in 2016 PLN 37.2 million, in 2015 PLN 23.2 million.

(IN PLN MILLION)

SIGNIFICANT TRANSACTIONS WITH THE STATE TREASURY'S RELATED ENTITIES

The transactions were concluded at arm's length terms. The Group's exposure and the value of the Group's liabilities to 10 entities related to the State Treasury are presented below.

	Balance sheet exposure, including the exposure due to loans and debt instruments		Off-balance sheet exposure		Liabilities due to deposits	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
counterparty 1	-	-	2 450.0	2 080.0	-	-
counterparty 2	385.6	250.0	1 676.6	2 471.0	270.7	240.5
counterparty 3	332.4	-	1 205.9	1 549.0	533.5	1 046.5
counterparty 4	1 327.1	1 504.0	1 529.4	2 569.0	3.3	19.2
counterparty 5	46.5	250.0	1 521.4	559.0	350.4	0.4
counterparty 6	-	-	1 069.3	1 811.0	1 085.3	501.0
counterparty 7	261.0	468.0	621.5	403.0	394.0	380.5
counterparty 8	1 502.6	1 146.0	868.6	696.0	126.2	606.3
counterparty 9	253.4	113.0	451.4	658.0	147.8	197.0
counterparty 10	215.7	215.0	402.5	534.0	6.9	63.8

In 2016, interest and commission income on the transactions with the 10 counterparties referred to above amounted to PLN 7.3 million (in 2015: PLN 27 million), and the respective interest expense amounted to PLN 11.5 million (in 2015: PLN 68 million). As at 31 December 2016 and as at 31 December 2015 respectively, no impairment allowances were recognised on an individual basis for the above-mentioned receivables.

In addition, on 7 December 2016, the Group issued to its customer a promise based on which the Group is obliged to grant the customer a loan of up to PLN 3 200 million intended for financing the customer's investment activities. The promise agreed by the Group and the customer provides that the loan will be granted on the basis of a loan agreement whose contents will be finally negotiated by 30 April 2017. The framework terms of the loan agreement were set out in an appendix to the promise and provide for, i.a., securing the Group's receivables in the form of financial and registered pledges, as well as the Group receiving a declaration of submission to enforcement proceedings from the customer.

The principles for issuing the promise and the terms of the loan agreement do not differ from the standard ones used in the Group or from the arm's length terms used in financing with a comparable credit risk profile. The promise is the Group's first exposure to the customer and its subsidiaries in respect of agreements concluded over the past 12 months.

Other transactions with entities related to the State Treasury in 2016 and in 2015 comprised loans and advances granted, credit lines, guarantees granted and deposits placed.

EQUITY RELATED PARTY TRANSACTIONS

Transactions of the parent company with associates and joint ventures accounted for under the equity method.

All transactions with subsidiaries, joint ventures and associates presented below were arm's length transactions. Repayment terms are within a range from one month to fifteen years.

As of 31 December 2016/Entity	Receivables	of which loans	Liabilities	Off-balance sheet liabilities granted
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	10.4	10.4	18.4	20.5
'Centrum Obsługi Biznesu' Sp z o.o.	27.6	27.6	9.7	-
Bank Pocztowy SA	-	-	0.8	1.1
'Poznański Fundusz Poręczeń Kredytowych' Sp. z o.o.	-	-	8.0	-
Walcownia Blach Grubych Batory Sp. z o.o.	-	-	2.1	-
Total joint ventures and associates	**38.0**	**38.0**	**39.0**	**21.6**

(IN PLN MILLION)

For the year ended 31 December 2016 / Entity	Total income	of which interest and fee and commission	Total expense	of which interest and fee and commission
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	40.6	0.3	0.4	0.1
'Centrum Obsługi Biznesu' Sp z o.o.	0.8	0.8	-	-
Total joint ventures and associates	**41.4**	**1.1**	**0.4**	**0.1**

As of 31 December 2015 / Entity	Receivables	of which loans	Liabilities	Off-balance sheet liabilities granted
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	6.0	-	31.1	2.0
'Centrum Obsługi Biznesu' Sp. z o.o.	27.4	27.4	8.6	-
Bank Pocztowy SA	14.1	-	0.9	1.1
'Poznański Fundusz Poręczeń Kredytowych' Sp. z o.o.	-	-	2.8	-
Total joint ventures and associates	**47.5**	**27.4**	**43.4**	**3.1**

For the year ended 31 December 2015 / Entity	Total income	of which interest and fee and commission	Total expense	of which interest and fee and commission
Centrum Elektronicznych Usług Płatniczych eService Sp. z o.o.	189.5	189.3	107.6	105.5
'Centrum Obsługi Biznesu' Sp. z o.o.	0.8	0.8	0.1	0.1
Bank Pocztowy SA	0.2	0.2	0.2	-
Total joint ventures and associates	**190.5**	**190.3**	**107.9**	**105.6**

Personal related party transactions

As at 31 December 2016 and 31 December 2015, one entity was related to the Group through the key management personnel of PKO Bank Polski SA or close family members of the key management personnel. In 2016 and in 2015, no transactions were conducted between the Group and that entity.

49. Remuneration of the PKO Bank Polski SA key management

Accounting policies

Short-term employee benefits are employee benefits, which are settled in full within 12 months from the end of the annual reporting period, in which the employees performed work related to them. As a short-term employee benefits next to the base salary, not deferred part at the variable remuneration component paid in cash was recognised.

The deferred part of the variable remuneration component paid in cash was recognised as other long-term benefit.

Non-deferred and deferred remuneration components in the form of the financial instrument i.e. phantom shares (for which conversion into cash is carried out after an additional period of retention) are recognised as share-based payments settled in cash in accordance in accordance principles described below.

The principles for determining the variable remuneration components policy for key management personnel in the Group

In order to fulfil the requirements of the Resolution No. 258/2011 of the Polish Financial Supervision Authority of 4 October 2011 on detailed principles for functioning of the risk management system and internal control system and detailed terms of estimating internal capital by banks and reviewing the process of estimating and maintaining internal capital, and the principles for determining the variable remuneration components policy for key management personnel at the Group (Resolution of PFSA No. 258/2011), the Group implemented by resolutions of:

- the Supervisory Board of the Bank: 'The variable remuneration components policy for key management personnel at the Bank' (constituting the basis of further regulation issue) and 'The variable remuneration components policy for the Management Board members',
- the Management Board of the Bank: 'The variable remuneration components policy for key management personnel',

Cited Principles and Regulations issued on their basis describe the procedure of granting variable remuneration components associated with the results and effects of work to the above-mentioned persons. In accordance with the requirements of the cited resolution of the PFSA and in proportion specified in it, the variable remuneration components are granted in the form of:

- non-deferred (in the first year after the calendar year constituting a period of assessment),
- deferred (for the next three years after the first year of the assessment period),

both the non-deferred and deferred remuneration, is awarded in equal parts in cash and in the form of the financial instrument, i.e. the phantom shares (for which conversion into cash is carried out after an additional period of retention).

Component of remuneration in the form of the financial instrument is converted into phantom shares after granting a particular component - including the median of the daily average prices of the Bank's shares (Volume Weighted Average Price) on the Warsaw Stock Exchange, published in the Thomson Reuters or Bloomberg information system - from the fourth quarter of the assessment period. Next, after a period of retention and deferral period, shares are converted into cash - including the median of the daily average prices of the Bank's shares (Volume Weighted Average Price) on the Warsaw Stock Exchange from the period of a third quarter preceding the payment (the Management Board) and a third quarter of a calendar year, in which the payment is made (other persons on managerial positions), published in the Thomson Reuters or Bloomberg information system.

The deferred remuneration may be reduced in the event of deterioration in the financial performance of the Bank or a Group Entity respectively, the loss of the Bank / Company or deterioration of other variables related to the effects of work during the evaluation of key management personnel and results of the performance of organizational units/cells supervised or managed by these persons, which were revealed after a period of evaluation.

Additionally, in 2016 regulations determining the policy of variable remuneration components functioned in selected Group entities. 'Regulations of the variable components of remuneration for the members of the Management Board' were binding in PKO Leasing SA, PKO Towarzystwo Funduszy Inwestycyjnych SA, PKO BANKOWY PTE SA, PKO Życie Towarzystwo Ubezpieczeń SA, PKO Towarzystwo Ubezpieczeń SA and in PKO Bank Hipoteczny SA. Additionally, in PKO Życie Towarzystwo Ubezpieczeń SA, PKO Towarzystwo Ubezpieczeń SA and PKO Bank Hipoteczny SA employees holding selected managerial positions were also covered by the variable remuneration policies.

At the same time, in connection with the amended regulations for investment fund management companies – in particular in connection with Article 47a, section 1 of the Act of 27 May 2004 on investment funds and on managing alternative investment funds, and the Regulation of the Minister of Finance dated 30 August 2016 on detailed requirements to be met by remuneration policies of investment fund management companies – on 2 December 2016 the Supervisory Board of PKO Towarzystwo Funduszy Inwestycyjnych SA adapted the remuneration policies in respect of variable remuneration components both for Members of the Management Board and for the Investment Fund Management Company employees to the new requirements.

In 2016 in Raiffeisen-Leasing Polska SA the policies related to variable remuneration components introduced by the document 'Corporate guidelines – Remuneration policies based on CRD IV, Raiffeisen-Leasing Polska SA' were binding, in accordance with the principles in force in the Raiffeisen Bank International AG Group, based on EU regulations and the Austrian Banking Act. Members of the Company's Management Board were covered by the said principles.

FINANCIAL INFORMATION

REMUNERATION RECEIVED BY MEMBERS OF THE SUPERVISORY BOARD FROM PKO BANK POLSKI SA (IN PLN THOUSAND)

	2016	2015
The Supervisory Board	982	120
Remuneration of the Supervisory Board Members who ceased to perform their functions in 2015 or 2016*	286	1 078
Total	**1 268**	**1 198**

* including post-employment benefits

EMPLOYEE BENEFITS FOR MEMBERS OF THE MANAGEMENT BOARD DUE OR POTENTIALLY DUE FROM PKO BANK POLSKI SA (IN PLN THOUSAND)

	Total short-term employee benefits (in PLN thousand)		Other long-term benefits - variable remuneration in cash (in PLN thousand)[3]		Total share-based payments settled in cash (in PLN thousand)		
	remuneration in 2016[1]	other received in 2016[2]	received in 2016	potential as at 31.12.2016	received in 2016	due as at 31.12.2016	potential as at 31.12.2016
The Management Board of the Bank	9 129	1 276	702	1 640	1 151	1 692	1 640
Management Board Members who ceased to perform their functions in 2016	2 104	785	480	994	802	1 076	994
Total	**11 233**	**2 061**	**1 182**	**2 634**	**1 953**	**2 768**	**2 634**

[1] Includes basic remuneration and additional benefits due to employee pension programs (PPE), additional insurance, medical care and company social benefits fund (ZFŚS).
[2] Non-deferred component of variable remuneration (in cash form).
[3] Deferred component of variable remuneration (in cash form).

	Total short-term employee benefits (in PLN thousand)		Other long-term benefits - variable remuneration in cash (in PLN thousand)[3]		Total share-based payments settled in cash (in PLN thousand)		
	remuneration in 2015[1]	other received in 2015[2]	received in 2015	potential as at 31.12.2015	received in 2015	due as at 31.12.2015	potential as at 31.12.2015
Total	11 311	1 694	804	2 360	2 240	1 952	2 360

[1] Includes basic remuneration and additional benefits due to employee pension programs (PPE), additional insurance, medical care and company social benefits fund (ZFŚS).
[2] Non-deferred component of variable remuneration (in cash form).
[3] Deferred component of variable remuneration (in cash form).

Post-employment benefits for the Members of the Management Board who ceased to perform their functions in 2016 (in PLN thousand)	**2016**
Management Board Members who ceased to perform their functions in 2016	1 166

Termination benefits for the Members of the Management Board who ceased to perform their functions in 2016 (in PLN thousand)	**2016**
Management Board Members who ceased to perform their functions in 2016	3 313

REMUNERATION RECEIVED FROM RELATED ENTITIES (OTHER THAN THE STATE TREASURY AND ENTITIES RELATED TO THE STATE TREASURY) (IN PLN THOUSAND)

In 2016 Mr. Jakub Papierski received PLN 22 thousand as remuneration received from the Bank's associate (remuneration for 2015 amounted to PLN 42 thousand).

REMUNERATION RECEIVED BY MEMBERS OF THE MANAGEMENT BOARDS AND THE SUPERVISORY BOARDS OF THE PKO BANK POLSKI SA GROUP SUBSIDIARIES (IN PLN MILLION)

Remuneration received by members of the Management Boards and the Supervisory Boards of the PKO Bank Polski SA Group		
	2016	**2015**
The Supervisory Board	0.5	0.3
The Management Board	20.5	20.4
Total	**21.0**	**20.7**

LOANS AND ADVANCES GRANTED BY THE BANK TO THE MANAGEMENT (IN PLN THOUSAND)

Loans and advances granted by the Bank to the management (in PLN thousand)		
	31.12.2016	31.12.2015
The Supervisory Board of the Bank	608	1 093
The Management Board	930	946
Total	**1 538**	**2 039**

(IN PLN MILLION)

Interest conditions and repayment periods of receivables do not differ neither from arm's length nor from repayment period set up for similar bank products.

VARIABLE REMUNERATION COMPONENTS

Provision for variable remuneration components	31.12.2016 (for the years 2012-2016)	31.12.2015 (for the years 2012-2015)
The Bank's Management Board (including members of the Bank's Management Board who ceased to perform their functions in 2016)	16.7	14.2
Other Risk Takers (persons holding managerial positions other than members of the Bank's Management Board)	31.3	26.7
Group entities	14.2	10.0
Total provision	**62.2**	**50.9**
Remuneration paid during the year	**2016 (for the years 2012-2016)**	**2015 (for the years 2012-2015)**
- granted in cash	**15.2**	**10.8**
The Bank's Management Board (including members of the Bank's Management Board who ceased to perform their functions in 2016)	3.2	2.5
Other Risk Takers	8.1	6.4
Group entities	3.9	1.9
- granted in the form of financial instruments	**9.7**	**8.4**
The Bank's Management Board (including members of the Bank's Management Board who ceased to perform their functions in 2016)	2.0	2.2
Other Risk Takers	6.9	5.1
Group entities	0.8	1.1
Total remuneration paid	**24.9**	**19.2**

50. FAIR VALUE HIERARCHY

ACCOUNTING POLICIES AND ESTIMATES AND JUDGEMENTS

The fair value is the price that would be received for the sale of an asset or paid for transfer a liability in a transaction carried out under regular conditions on the main (or most advantageous) market at the valuation date in the current market conditions (i.e. output price), regardless of whether this price is directly observable or estimated using another valuation technique.

Depending on category of classification of financial assets and liabilities to hierarchy, different methods of fair value valuation are used.

LEVEL 1: PRICES QUOTED ON THE ACTIVE MARKETS

Financial assets and liabilities whose fair value is stated directly at prices quoted (not adjusted) from active markets for identical assets and liabilities. The Group classifies to this category financial and equity instruments measured at fair value through profit and loss and available for sale, for which there is an active market and for which the fair value is determined with reference to market value, which is a bid price:

- debt securities valued using fixing from Bondspot platform or Bloomberg and Reuters information service,
- debt and equity securities which are traded on regulated market, including in the Brokerage House of PKO Bank Polski SA portfolio,
- derivative instruments, which are traded on a regulated market.

LEVEL 2: VALUATION TECHNIQUES BASED ON OBSERVABLE MARKET DATA

Financial assets and liabilities whose fair value is determined with use of valuation models where all significant entry data are observable on the market directly (as prices) or indirectly (based on prices). The Group classifies to that category financial instruments for which there is no active market:

FINANCIAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	VALUATION METHOD (TECHNIQUE)	OBSERVABLE INPUTS
DERIVATIVE FINANCIAL INSTRUMENTS – CIRS, IRS, FRA	The discounted future cash flows model based on the yield curves.	Yield curves are built based on market rates, market data of the money market, market transactions of FRA, IRS, basis swap.
DERIVATIVE FINANCIAL INSTRUMENTS – CURRENCY OPTION, INTEREST RATE OPTIONS, EQUITY EXOTIC OPTIONS, FX FORWARD, FX SWAP TRANSACTIONS	Specified valuation models for a given type of a currency option. The model of discounted future cash flows based on yield curves for FX forward and FX swap transactions. The prices of equity exotic options embedded in structured products are obtained from the market (market prices).	Yield curves built based on money market rates, market rate of swap points, volatility levels for specific currency pairs, NBP fixing exchange rates. For the purpose of valuation of equity exotic options embedded in structured products, market prices of these options are obtained.
NBP MONEY MARKET BILLS	Yield curve method	Yield curves are built based on money market data and OIS (overnight index swap) transactions market.
CURRENCY MUNICIPAL BONDS	Accepted valuation model	Market rates, market data from the money market, IRS transactions market, CDS transactions market, volatility of interest rate options market.
MUNICIPAL BONDS PLN	Yield curve and a risk margin	Yield curves are built based on market rates, money market data, IRS transactions market.
CORPORATE BONDS	Yield curve and a risk margin	Yield curves are built based on market rates, money market data, IRS transactions market.
COMMODITY SWAP TRANSACTIONS	Commodity price yield curve	Commodity price yield curves are built based on money market data, market rate SWAP points.

LEVEL 3: OTHER VALUATION TECHNIQUES

Financial assets and liabilities, whose fair value is determined with use of valuation models, for which available input data are not derived from observable markets (unobservable input data).
The Group classified financial instruments, which are valued with internal valuation models:

FINANCIAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	VALUATION METHOD (TECHNIQUE)	UNOBSERVABLE INPUTS
PARTICIPATION UNITS IN MUTUAL FUND	Method of the net asset value of the Fund (NAV - Net Asset Value) i.e. the fair value of investment projects (of the companies) in the Fund, which are subject to semi-annual review or audit performed the registered auditor.	Value of the Fund's net assets.
C-SERIES PREFERENCE SHARES OF VISA INC.	Estimating the fair value based on the current market value of the listed ordinary shares of Visa Inc., including a discount which takes into account the limited liquidity of C-series shares and the terms and conditions of the conversion of C-series shares into ordinary shares.	Discount taking into account the limited liquidity of C-series shares and the terms of converting the C-series shares into ordinary shares.
CORPORATE BONDS	Yield curve and a risk margin. Yield curves are built based on market rates, money market data, IRS transactions market.	Credit spread (credit margins determined on the basis of initial margins modified by credit indices quotes ascribed to issuers based on their ratings and business sector).

(IN PLN MILLION)

FINANCIAL INFORMATION

Assets and liabilities measured at fair value as at 31.12.2016	Note	Carrying amount	Level 1 Prices quoted on the active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Trading assets	21	326.4	326.4	-	-
Debt securities		311.6	311.6	-	-
Shares in other entities		11.3	11.3	-	-
Investment certificates, shares rights and pre-emptive rights		3.5	3.5	-	-
Derivative financial instruments	22	2 900.6	3.0	2 897.6	-
Hedging instruments		382.1	-	382.1	-
Trading instruments		2 518.5	3.0	2 515.5	-
Financial instruments designated upon initial recognition at fair value through profit and loss	24	13 937.2	4 619.8	9 317.4	-
Debt securities		12 204.1	2 886.7	9 317.4	-
Participation units		1 733.1	1 733.1	-	-
Investment securities available for sale	26	36 675.6	27 345.1	5 921.8	3 408.7
Debt securities		36 142.4	27 236.1	5 921.8	2 984.5
Equity securities		217.6	91.1	-	126.5
Participation units in investment funds and shares in joint investment institutions		315.6	17.9	-	297.7
Financial assets measured at fair value - total		**53 839.8**	**32 294.3**	**18 136.8**	**3 408.7**
Derivative financial instruments	22	4 197.9	1.0	4 196.9	-
Hedging instruments		1 135.2	-	1 135.2	-
Trading instruments		3 062.7	1.0	3 061.7	-
Financial liabilities measured at fair value - total		**4 197.9**	**1.0**	**4 196.9**	-

Financial instruments designated upon initial recognition at fair value through profit and loss as at 31.12.2016	Carrying amount	Level 1	Level 2	Level 3
Debt securities	12 204.1	2 886.7	9 317.4	-
NBP money market bills	9 078.8	-	9 078.8	-
Treasury bonds PLN	1 811.9	1 811.9	-	-
foreign currency Treasury bonds	1 074.8	1 074.8	-	-
municipal bonds PLN	110.9	-	110.9	-
foreign currency municipal bonds	127.7	-	127.7	-
Units in ICF (insurance capital funds) related to insurance products belonging to the group of investment poducts where the risk is borne by the policyholder	1 733.1	1 733.1	-	-
TOTAL	**13 937.2**	**4 619.8**	**9 317.4**	-

Investment securities available for sale as at 31.12.2016	Carrying amount	Level 1	Level 2	Level 3
Debt securities available for sale	36 142.4	27 236.1	5 921.8	2 984.5
Treasury bonds PLN	25 743.9	25 743.9	-	-
foreign currency Treasury bonds	678.5	457.1	221.4	-
municipal bonds PLN	4 551.8	-	4 551.8	-
corporate bonds PLN	4 590.6	692.5	1 148.6	2 749.5
foreign currency corporate bonds	577.6	342.6	-	235.0
Equity securities	217.6	91.1	-	126.5
Participation units in investment funds and shares in joint investment institutions	315.6	17.9	-	297.7
TOTAL	**36 675.6**	**27 345.1**	**5 921.8**	**3 408.7**

(IN PLN MILLION)

Assets and liabilities measured at fair value as at 31.12.2015	Note	Carrying amount	Level 1 Prices quoted on active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Trading assets	21	783.2	783.2	-	-
Debt securities		766.7	766.7	-	-
Shares in other entities		9.9	9.9	-	-
Investment certificates, shares rights, pre-emptive rights		6.6	6.6	-	-
Derivative financial instruments	22	4 347.3	2.2	4 345.1	-
Hedging instruments		508.7	-	508.7	-
Trading instruments		3 838.6	2.2	3 836.4	-
Financial instruments designated upon initial recognition at fair value through profit and loss	24	15 154.1	4 837.4	10 316.7	-
Debt securities		13 337.4	3 020.7	10 316.7	-
Participation units		1 816.7	1 816.7	-	-
Investment securities available for sale	26	28 291.3	19 255.4	5 401.3	3 634.6
Debt securities		27 604.9	19 093.2	5 401.3	3 110.4
Equity securities		473.6	146.0	-	327.6
Participation units in investment funds and shares in joint investment institutions		212.8	16.2	-	196.6
Financial assets measured at fair value – total		**48 575.9**	**24 878.2**	**20 063.1**	**3 634.6**
Derivative financial instruments	22	4 624.8	1.5	4 623.3	-
Hedging instruments		998.5	-	998.5	-
Trading instruments		3 626.3	1.5	3 624.8	-
Debt securities in issue	35	71.7	-	71.7	-
Financial instruments designates upon initial recognition at fair value through profit and loss		71.7	-	71.7	-
Financial liabilities measured at fair value - total		**4 696.5**	**1.5**	**4 695.0**	**-**

Financial instruments designated upon initial recognition at fair value through profit and loss as at 31.12.2015	Carrying amount	Level 1	Level 2	Level 3
Debt securities	13 337.4	3 020.7	10 316.7	-
NBP money market bills	10 036.9	-	10 036.9	-
Treasury bonds PLN	1 934.8	1 934.8	-	-
foreign currency Treasury bonds	1 118.0	1 085.4	32.6	-
municipal bonds PLN	115.9	-	115.9	-
foreign currency municipal bonds	131.3	-	131.3	-
corporate bonds PLN	0.5	0.5	-	-
Units in ICF (insurance capital funds) related to insurance products belonging to the group of investment poducts where the risk is borne by the policyholder	1 816.7	1 816.7	-	-
TOTAL	**15 154.1**	**4 837.4**	**10 316.7**	**-**

Investment securities available for sale as at 31.12.2015	Carrying amount	Level 1	Level 2	Level 3
Debt securities available for sale	27 604.9	19 093.2	5 401.3	3 110.4
Treasury bonds PLN	17 920.0	17 920.0	-	-
foreign currency Treasury bonds	437.9	310.6	127.3	-
municipal bonds PLN	4 613.7	-	4 613.7	-
corporate bonds PLN	4 074.5	541.8	660.3	2 872.4
foreign currency corporate bonds	558.8	320.8	-	238.0
Equity securities	473.6	146.0	-	327.6
Participation units in investment funds and shares in joint investment institutions	212.8	16.2	-	196.6
TOTAL	**28 291.3**	**19 255.4**	**5 401.3**	**3 634.6**

(IN PLN MILLION)

Impact of estimated parameters on fair value measurement of financial instruments at Level 3	31.12.2016 Fair value in positive scenario	31.12.2016 Fair value in negative scenario	31.12.2015 Fair value in positive scenario	31.12.2015 Fair value in negative scenario
Investment securities available for sale				
Participation units in investment fund[1]	312.7	282.9	206.5	186.8
Shares of Visa Inc./Visa Europe Limited[2]	99.7	70.4	378.7	282.0
Corporate bonds[3]	2 991.9	2 977.0	3 122.2	3 098.7

[1] Scenario assuming an increase/decrease in the Fund's net assets value of +/- 5% respectively.
[2] Scenario assuming a discount ratio of 0%/100% respectively.
[3] Scenario assuming a change in the credit spread of +/-10%.

Reconciliation of changes in the period in fair value at level 3 of fair value hierarchy	31.12.2016	31.12.2015
Opening balance at the beginning of the period	3 634.6	203.3
Total gains or losses	**146.6**	**334.4**
recognised in financial result	101.9	(3.6)
recognised in other comprehensive income	44.7	338.0
Foreign exchange differences	-	(1.0)
Settlement of Visa Europe Limited shares sale transaction	(337.0)	-
Acquisition of Visa Inc shares	81.0	-
Acquisition of new shares in the Fund	67.6	-
Sale of shares of a listed company	-	(12.0)
Settlements	(183.9)	(0.5)
Transfers from Level 2 to Level 3	-	3 110.4
Closing balance as the end of the period	**3 408.9**	**3 634.6**

In 2016 the Group did not reclassify financial instruments to level 3 of the fair value hierarchy. In 2015 the Group partially transferred corporate bonds recognised in investment securities available for sale from level 2 to levels 1 and 3 of the fair value hierarchy.

51. FINANCIAL ASSETS AND LIABILITIES NOT PRESENTED AT FAIR VALUE IN THE STATEMENT OF FINANCIAL POSITION

The Group holds financial assets and liabilities which are not presented at fair value in the statement of financial position.

Where there is no market value of financial instruments available, their fair values have been estimated with the use of various valuation techniques. The fair value of financial instruments was measured using a model based on estimating the present value of future cash flows by discounting them using relevant discount rates.

All model calculations include certain simplifying assumptions and therefore are sensitive to those assumptions. Set out below is a summary of the main methods and assumptions used for estimation of fair values of financial instruments which are not measured at fair value.

For certain categories of financial instruments it has been assumed that their carrying amount equals approximately their fair values, which is due to lack of expected material differences between their carrying amount and their fair value resulting from the features of these groups (such as short term character, high correlation with market parameters, unique character of the instrument). This applies to the following groups of financial instruments:

- loans and advances to customers: a portion of the housing loans portfolio ('old' housing loans portfolio), loans with no specified repayment schedule, loans payable at the moment of valuation,
- amounts of the Group due to customers: liabilities with no specified payment schedule, other specific products for which no active market exists,
- deposits and interbank placements with maturity date up to 7 days or with a variable interest rate,
- loans or advances granted and taken on interbank market at a variable interest rate (change of interest rate maximum on a 3 month basis),

(IN PLN MILLION)

- cash and balances with the Central Bank and amounts due to the Central Bank,
- other financial assets and liabilities.

For non-impaired loans and advances to customers, present value of discounted cash flow model was used that includes current interest rate with credit margin risk and real maturities that steam from loan agreements. The current level of margins was calculated based on financial instrument transactions with similar risk level that took place in the last quarter that ended on the balance sheet date. For currency loans, the current loan margin for PLN loans was used and it was adjusted with the cost of currency acquisition in basis-swap transaction. The valuation does not take into consideration proposed system solutions which might result in losses being incurred be the Group on the mortgage loan portfolio denominated in CHF. For impaired loans, it is assumed that fair value equals their carrying value.

The fair value of deposits and other amounts due to customers other than banks, with specified maturities has been calculated using the discounted expected future cash flows and applying current interest rates for given deposit products. The fair value is calculated for each deposit and liability, then the fair values of the entire deposit portfolio are grouped by type of product and customer segment. For demand deposits, it is assumed that for them, the fair value equals their carrying amount.

The fair value of the subordinated debt of the Group has been estimated based on the expected future cash flows discounted using the yield curve.

The fair value of debt securities issued by PKO Bank Polski SA has been estimated based on the expected future cash flows discounted using the current interbank interest rates.

The fair value of debt securities issued by PKO Finance AB has been estimated using Bloomberg data.

The fair value of interbank placements and deposits have been estimated based on the expected future cash flows discounted using the current interbank interest rates.

Finance lease receivables have been estimated based on expected cash flows discounted using internal rate of return for lease transactions of the same kind, concluded by the Group in the period directly preceding the balance sheet date.

	level of fair value hierarchy	valuation method	31.12.2016 carrying amount	fair value
Cash and balances with the Central Bank	n/a	value at cost to pay	13 325.1	13 325.1
Amounts due from banks	2	discounted cash flows	5 345.4	5 344.4
Loans and advances to customers			**200 606.5**	**199 125.5**
housing loans	3	discounted cash flows	106 121.3	102 351.1
corporate loans	3	discounted cash flows	52 914.9	53 731.5
consumer loans	3	discounted cash flows	23 221.9	24 700.7
debt securities (corporate)	3	discounted cash flows	2 282.8	2 209.2
debt securities (municipal)	3	discounted cash flows	2 587.9	2 587.9
receivables due from repurchase agreements	3	discounted cash flows	1 339.0	1 339.0
finance lease receivables	3	discounted cash flows	12 138.7	12 206.1
Investment securities held to maturity	3	discounted cash flows	465.6	466.1
Other financial assets	3	value at cost to pay less impairment allowance	2 247.1	2 247.1
Amounts due to the Central Bank	2	value at cost to pay	4.1	4.1
Amounts due to banks	2	discounted cash flows	19 208.4	19 211.1
Amounts due to customers			**205 066.4**	**205 005.3**
due to corporate entities	3	discounted cash flows	48 657.1	48 650.3
due to public entities	3	discounted cash flows	8 408.9	8 408.9
due to retail clients	3	discounted cash flows	148 000.4	147 946.1
Debt securities in issue	1, 2	market quotations / discounted cash flows	14 493.2	14 752.5
Subordinated debt	2	discounted cash flows	2 539.0	2 525.8
Other financial liabilities	3	value at cost to pay	3 059.1	3 059.1

(IN PLN MILLION)

	level of fair value hierarchy	valuation method	31.12.2015 carrying amount	fair value
Cash and balances with the Central Bank	n/a	value at cost to pay	13 743.9	13 743.9
Amounts due from banks	2	discounted cash flows	4 553.0	4 553.0
Loans and advances to customers			**190 413.7**	**183 613.8**
housing	3	discounted cash flows	100 668.6	93 429.7
corporate	3	discounted cash flows	58 068.5	58 759.7
consumer	3	discounted cash flows	21 959.8	21 815.6
debt securities (corporate)	3	discounted cash flows	2 591.9	2 483.9
debt securities (municipal)	3	discounted cash flows	2 692.7	2 692.7
receivables due from repurchase agreements	3	discounted cash flows	4 432.2	4 432.2
Investment securities held to maturity	3	discounted cash flows	210.3	213.6
Other financial assets	3	value at cost to pay less impairment allowance	875.2	875.2
Amounts due to the Central Bank	2	value at cost to pay	4.2	4.2
Amounts due to banks	2	discounted cash flows	18 288.8	18 288.8
Amounts due to customers			**195 758.5**	**195 719.0**
due to corporate entities	3	discounted cash flows	51 213.7	51 214.2
due to public entities	3	discounted cash flows	9 134.4	9 134.4
due to retail clients	3	discounted cash flows	135 410.4	135 370.4
Debt securities in issue	1, 2	market quotations / discounted cash flows	9 361.2	9 637.4
Subordinated debt	2	discounted cash flows	2 499.2	2 486.2
Other financial liabilities	3	value at cost to pay	2 282.8	2 282.8

52. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

ACCOUNTING POLICIES

The Group offsets financial assets and liabilities and shows them in the statement of financial position in net amounts if there is a legally enforceable right to offset the recognised amounts and an intention to settle them on a net basis or to realize a given asset and settle the liability simultaneously. It follows from the provisions of paragraph 42 of IAS 32 that, amongst others, in order for offsetting to be possible, a legal right may not be conditioned on the occurrence of a specific future event.

The Group enters into offsetting arrangements, i.e. International Swaps and Derivatives Association Master Agreements (ISDA) and Global Master Repurchase Agreements (GMRA), which make it possible to offset financial assets and liabilities (the so-called close out netting) in the event of an infringement with respect to one of the parties to the agreement. These agreements are of particular importance to mitigate the risk posed by derivative instruments, because they enable offsetting both matured liabilities (mitigating the settlement risk) and non-matured liabilities of the parties (mitigating the pre-settlement risk). However, these agreements do not meet the requirements set out in IAS 32 because the right to offset the amounts is conditioned on the occurrence of a specific future event (instances of infringement).

Additional collateral for exposures resulting from derivative instruments are collateral deposits escrowed by counterparties as a part of CSA agreements (Credit Support Annex).

(IN PLN MILLION)

FINANCIAL INFORMATION

31.12.2016	Total financial assets	Derivatives	Repurchase agreements
The amount of recognised financial assets (gross)	4 905.2	2 905.0	2 000.2
The amount of financial liabilities, which are offset in accordance with the criteria set out in § 42 of IAS 32 (gross)	(4.4)	(4.4)	-
The value of financial assets recognised in the statement of financial position (net)	4 900.8	2 900.6	2 000.2
The value of financial instruments not subject to offsetting in the financial statements	2 095.9	2 095.9	-
The value of financial liabilities subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 698.2	1 698.2	-
Cash collateral and in the form of securities received	397.7	397.7	-
The net amount	**2 804.9**	**804.7**	**2 000.2**

31.12.2016	Total financial liabilities	Derivatives	Repurchase agreements
The amount of recognised financial liabilities (gross)	4 408.2	4 202.3	205.9
The amount of financial assets, which are offset in accordance with the criteria set out in § 42 of IAS 32 (gross)	(4.4)	(4.4)	-
The value of financial liabilities recognised in the statement of financial position (net)	4 403.8	4 197.9	205.9
The value of financial instruments not subject to offsetting in the financial statements	3 021.2	2 987.0	34.2
The value of financial assets subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	1 698.2	1 698.2	-
Cash collateral and in the form of securities received	1 323.0	1 288.8	34.2
The net amount	**1 382.6**	**1 210.9**	**171.7**

31.12.2015	Total financial assets	Derivatives	Repurchase agreements
The amount of recognised financial assets (gross)	9 767.1	4 354.2	5 412.9
The amount of financial liabilities, which are offset in accordance with the criteria set out in § 42 of IAS 32 (gross)	(6.9)	(6.9)	-
The value of financial assets recognised in the statement of financial position (net)	9 760.2	4 347.3	5 412.9
The value of financial instruments not subject to offsetting in the financial statements	3 631.7	3 631.7	-
The value of financial liabilities subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	2 794.9	2 794.9	-
Cash collateral and in the form of securities received	836.8	836.8	-
The net amount	**6 128.5**	**715.6**	**5 412.9**

31.12.2015	Total financial liabilities	Derivatives	Repurchase agreements
The amount of recognised financial liabilities (gross)	5 657.8	4 631.7	1 026.1
The amount of financial assets, which are offset in accordance with the criteria set out in § 42 of IAS 32 (gross)	(6.9)	(6.9)	-
The value of financial liabilities recognised in the statement of financial position (net)	5 650.9	4 624.8	1 026.1
The value of financial instruments not subject to offsetting in the financial statements	4 072.6	4 048.5	24.1
The value of financial assets subject to enforceable framework agreement or similar agreement concerning offsetting (excluding financial collateral)	2 794.9	2 794.9	-
Cash collateral and in the form of securities received	1 277.7	1 253.6	24.1
The net amount	**1 578.3**	**576.3**	**1 002.0**

(IN PLN MILLION)

53. ASSETS PLEDGED AS COLLATERAL FOR LIABILITIES AND TRANSFERRED FINANCIAL ASSETS

RECEIVABLES COVERED BY LEASE RECEIVABLES SECURITIZATION

As at 31 December 2016, receivables covered by lease receivables securitization amounted to PLN 1 376.3 million. They are pledged as collateral for the liabilities in respect of debt securities issued by the special vehicle ROOF Poland Leasing 2014 DAC. Securitized lease receivables are presented as the Group's assets because they do not meet the criteria for derecognition from the statement of financial position specified in IAS 39. 19. In particular, the Group is not obliged to pay any amounts to final recipients until it has received the corresponding amounts from lessees. In addition, the criterion of an immediate transfer of cash flows from the securitized assets is not met.

LIABILITIES DUE TO SELL-BUY-BACK TRANSACTIONS

Financial assets which the Group does not derecognise from the financial statements include assets pledged as collateral for liabilities due to sell-buy-back transactions (treasury bonds).

Carrying amount	31.12.2016	31.12.2015
Debt securities	181.8	1 013.0
Amounts due from repurchase agreements	205.9	1 026.1
Net value	(24.1)	(13.1)

LIABILITIES FROM NEGATIVE VALUATION OF DERIVATIVE INSTRUMENTS

Cash deposits with banks include assets held as collateral for own liabilities, inluding settlements due to negative valuation of derivative instruments. The amount of these assets as at 31 December 2016 amounted to PLN 1 288.8 million (as at 31 December 2015 PLN 1 253.6 million).

PRELIMINARY SETTLEMENT DEPOSIT OF THE NATIONAL DEPOSITORY FOR SECURITIES (KDPW)

The Brokerage House of PKO Bank Polski SA holds bonds in the National Depository for Securities as collateral for settlement of transactions with the Clearing House.

Carrying amount/fair value	31.12.2016	31.12.2015
Value of the deposit	8.0	8.0
Nominal value of the pledge	8.0	8.0
Type of the pledge	Treasury bonds	Treasury bonds
Carrying amount of the pledge	8.0	8.0

(IN PLN MILLION)

Bank Deposit Guarantee Fund

	31.12.2016	31.12.2015
Value of the fund	1 005.0	608.5
Nominal value of the pledge	1 060.0	650.0
Type of the pledge	Treasury bonds	Treasury bonds
Maturity of the pledge	25.01.2024	25.01.2024
Carrying amount of the pledge	1 020.8	627.4

Assets include Treasury bonds with maturities sufficient to secure their carrying amount over the period defined by the Act. The Fund is increased or decreased on 1 July of each year, in proportion to the amount providing the basis for calculation of mandatory reserve deposits. Those funds are treated as assets held as collateral for own liabilities.

Legal limitations relating to the Group legal title

In the years ended 31 December 2016 and 31 December 2015, there were no intangible assets and tangible fixed assets which ownership by the Group were subject to restrictions and pledged as collateral for liabilities.

Transferred financial assets

As at 31 December 2016 and as at 31 December 2015 the Group did not have transferred financial assets, which are derecognised from the financial statements in their entirety, for which the Group continues involvement in those assets.

54. Fiduciary activities

Parent Company is a direct participant in the Central Securities Depository of Poland (Krajowy Depozyt Papierów Wartościowych) and the Securities Register (at the National Bank of Poland). The parent entity maintains securities accounts, services transactions on the domestic and foreign markets, and provides fiduciary services and performs depository role for pension and investment funds. Assets held in the parent entity within fiduciary services are not included in these financial statements as they do not meet the criteria of an asset.

55. Information on the entity authorized to audit the financial statements

On 11 March 2015 the Supervisory Board of PKO Bank Polski selected KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa as entity authorized to audit the financial statements of PKO Bank Polski and the consolidated financial statements of the PKO Bank Polski SA Group. KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa, registered in Warsaw, Inflancka 4A Street is registered under the number of 3546 on the list of entities authorized to audit financial statements, kept with the National Chamber of Statutory Auditors. The selection of the entity authorized to audit and review the financial statements was made by the Supervisory Board in accordance with applicable regulations and professional standards, on the basis of §15 section 1, point 4 of the Statue of the Bank.

On 10 April 2015, PKO Bank Polski SA and the KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa. - entity authorized to audit financial statements signed an agreement for the audit and review of the financial statements of the Bank and the PKO Bank Polski SA Group for the years 2015-2016.

Total net remuneration due to KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa for the audit of the stand-alone and consolidated financial statements of PKO Bank Polski SA in 2016 amounted to PLN 1 250 thousand (in 2015 PLN 1 250 thousand) and total net remuneration for the assurance services, including the review of the financial statements in 2016 amounted to PLN 2 381 thousand (in 2015 PLN 974 thousand). In 2016, net fees paid for other services amounted to PLN 68 thousand (in 2015 PLN 34 thousand).

(IN PLN MILLION)

OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT

56. Risk Management in the PKO Bank Polski SA Group

Risk management is one the most important internal processes in PKO Bank Polski SA including the Bank's branch in Germany and in other entities of the PKO Bank Polska SA Group. It aims at ensuring profitability of business activity, with ensuring control of risk level and maintaining it within the risk tolerance and limits system applied by the Bank and the Group, in the changing macroeconomic and legal environment. The level of the risks plays an important role in the planning process.

At the Group, the following types of risk have been identified, which are subject to management and some of them are considered significant[1]:

TYPE OF RISK	CONSIDERED TO BE SIGNIFICANT	SECTION
CREDIT	YES	57, 58, 60, 61
CREDIT CONCENTRATION	YES	59
RISK OF FOREIGN CURRENCY MORTGAGE LOANS	YES	62
INTEREST RATE	YES	63
CURRENCY	YES	64
LIQUIDITY, INCLUDING FINANCING RISK	YES	65
COMMODITY PRICE		66
PRICE OF EQUITY SECURITIES		66
OTHER PRICE RISK		66
DERIVATIVE	YES	67
OPERATIONAL	YES	68
COMPLIANCE AND CONDUCT	YES	69
BUSINESS (INCLUDING STRATEGIC RISK)	YES	69
LOSS OF REPUTATION	YES	69
MODELS	YES	69
MACROECONOMIC CHANGES	YES	69
CAPITAL	YES	69
EXCESSIVE LEVERAGE	YES	69
INSURANCE		69

A detailed description of management policies for particular risks was presented in the Report on Capital Adequacy and other information subject to publication.

[1] The significance of the individual types of risk is established at the Group's level. When determining criteria of classifying a given type of risk as significant, an influence of the significance of the risk on the Group's activities is taken into account, whereas the following risk types are distinguished: risk considered as significant a priori – being managed actively, potentially significant – for which significance monitoring is performed periodically, other non-defined or non-occurring in the Group types of risk (insignificant and non-monitored). Based on quantitative and qualitative information, an assessment of significance of given types of risk is performed in the Group periodically. As a result of assessment, a given type of risk is being classified as significant/insignificant. In particular, monitoring is conducted if significant change in activities took place or the profile of the Group changed.

PURPOSE OF RISK MANAGEMENT

The purpose of risk management by striving to maintain the risk level within the adopted risk tolerance is to:

- protect shareholder value,
- protect customer deposits,
- support the Group in conducting effective operations.

Risk management goals are achieved in particular by providing appropriate information on risk so as to ensure that the decisions are taken in full awareness of the particular risks involved.

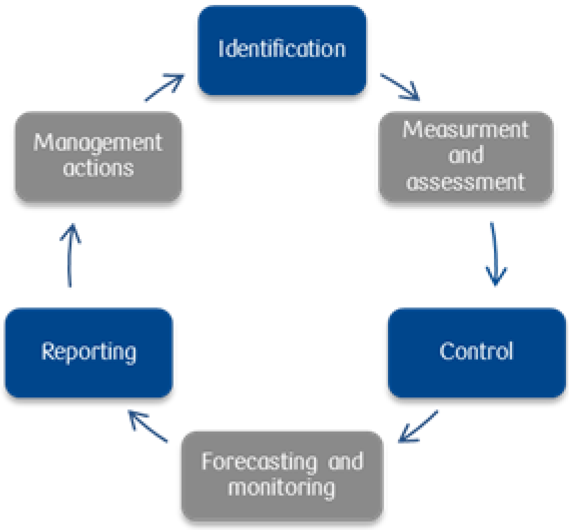
MAIN PRINCIPLES OF RISK MANAGEMENT

Risk management in PKO Bank Polski SA Group is based especially on the following principles:

1) the Group manages all of the identified types of risk,
2) the risk management process is appropriate to the scale of the operations and to the materiality, scale and complexity of a given risk and tailored to new risk factors and sources on a current basis,
3) the risk management methods (in particular the models and their assumptions) and the risk measurement systems are tailored to the scale and complexity of the risk, current and envisaged Group's activity and environment in which the Group operates, and are also verified and validated on a periodical basis,
4) the area of risk management and debt collection remains organizationally independent from business activities,
5) risk management is integrated with the planning and controlling systems,
6) the risk level is monitored on a current basis,
7) the risk management process supports the implementation of the Group's strategy in compliance with the risk management strategy, in particular with regard to the level of tolerance of the risk.

THE RISK MANAGEMENT PROCESS

The process of risk management in Group consists of the following stages:



- **RISK IDENTIFICATION:**

Identification of risk is to recognise actual and potential sources of risk and estimation of the significance of the potential influence on the financial situation of the Group. Within the risk identification process, types of risk perceived as material in the Bank's, particular Group companies or the entire Group activity are identified.

- **RISK MEASUREMENT AND ASSESSMENT:**

Risk measurement covering determination of risk assessment measures adequate to the type and significance of the risk, data availability and quantitative risk assessment by means of determined measures, as well as risk assessment aimed at identifying the scale or scope of risk, taking into account the achievement of goals of risk management. Within risk measurement, valuation of the risks for the purpose of pricing policy and stress-test are being conducted on the basis of assumptions providing a fair risk assessment. Stress-test scenarios cover, i.a. the requirements following from the recommendations of the Polish Financial Supervision Authority. Additionally, complex stress tests are performed in the Group (CST), which constitute an integral element of risk management and supplementary stress tests specific for particular risks. CST also cover an analysis of the impact of changes in the environment (in particular the macroeconomic conditions) and the Bank's operations on the Group's financial position.

- **RISK CONTROL:**

Risk control involves determination of tools used for measuring or reducing the level of risk in specific areas of the Bank's activity, This includes determination of control mechanisms adjusted to the scale and complexity of the Bank's activities especially in the form of strategic tolerance limits for the individual types of risk.

- **RISK FORECASTING AND MONITORING:**

Forecasting and monitoring risk consists of preparing risk level forecasts and monitoring deviations from forecasts or adopted reference points (e.g. limits, thresholds, plans, measurements from the previous period, recommendations and suggestions issued by the supervisory and control authority) and also carrying out stress test (specific and complex). Forecasts of the level of risk shall be reviewed. Risk monitoring is performed with the frequency adequate to the significance and volatility of a specific risk type.

- **RISK REPORTING:**

Risk reporting consists of periodic informing the authorities of the Bank about the results of risk measurement or risk assessment, taken actions and actions recommendations. Scope, frequency and the form of reporting are adjusted to the managing level of the recipients.

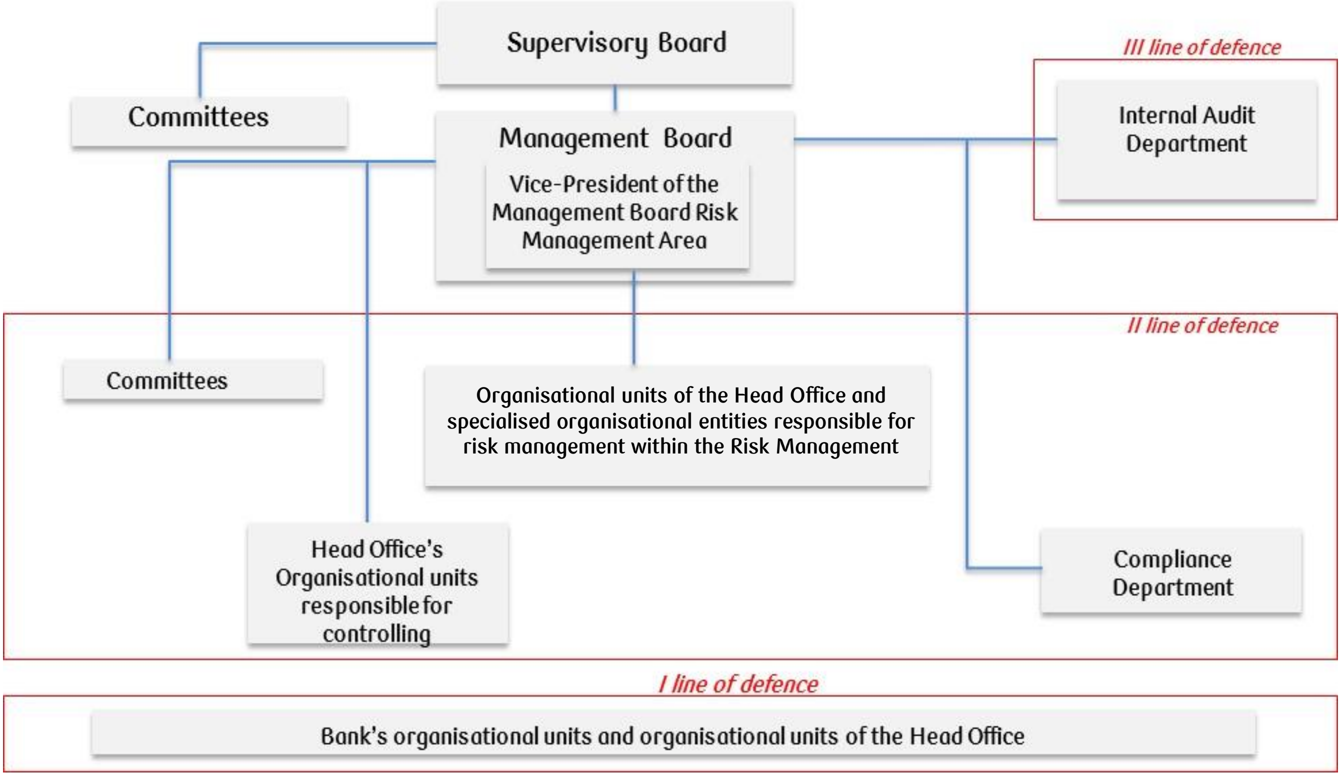
- **MANAGEMENT ACTIONS:**

Management actions consist particularly issuing internal regulations affecting the management process of different types of risk, establishing the level of risk tolerance, establishing limits and thresholds, issuing recommendations, making decisions about the use of tools supporting risk management. The objective of taking management actions is to form the risk management and the risk level.

THE ORGANIZATION OF RISK MANAGEMENT IN THE GROUP

Risk management in the Bank takes place in all of the organizational units of the Bank.

The organization of risk management in PKO Bank Polski SA is presented in the chart below:



The risk management process is supervised by the Supervisory Board of the Bank, which is informed on a regular basis about the risk profile of the Bank as well as of the PKO Bank Polski SA Group and the most important activities taken in the area of risk management. The Bank's Supervisory Board is supported, among other things, by the following committees: the Remuneration Committee of Supervisory Board, the Supervisory Board Risk Committee and the Supervisory Board Audit Committee.

In respect of risk management, the Management Board of PKO Bank Polski SA is responsible for strategic risk management, including supervising and monitoring actions taken by the Bank in respect of risk management. The Board takes the most important decisions affecting the risk profile of the Bank and adopts internal regulations concerning risk management. The Management Board is supported by the following committees operating at the Group:

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

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

THE FIRST LINE OF DEFENCE – risk management within the defined limits based on the Bank's internal regulations, with built-in controls, internal control system and compliance with universally binding legal regulations, the Bank's internal regulations and market standards. This function is realized in all the Bank's organizational entities, in the Head Office's organizational units and in entities of the Group, and covers those aspects of operations of particular entities, units and companies which may generate risk. The Bank's organizational entities, units and group entities are responsible for risk identification, designing and implementing appropriate controls, if they have not been implemented as part of the actions taken as the second line of defence.

At the same time the Group entities are obliged to have comparable and cohesive systems of risk evaluation and control in the Bank and in the Group entities, taking into account the specific business characteristic of each entity and the market on which it operates.

THE SECOND LINE OF DEFENCE – in particular the measurement or assessment, control, monitoring and reporting particular risks important to the Bank, reporting identified threats and irregularities, preparing the Bank's internal regulations determining the risk management principles, methods, tools and procedures, and measuring operating effectiveness. The risk management system, including methods, tools, process and organization of risk management. This function is performed in particular in the Risk Management Area, Compliance Department, respective committees.

THE THIRD LINE OF DEFENCE – internal audit. The function Is being performed as part of internal audit, including the audit of the effectiveness of the system of managing the risk.

The independence of the lines of defence consists of preserving organizational independence in the following areas:

- the function of the second line of defence as regards creating system solutions is independent of the function of the first line of defence,
- the function of the third line of defence is independent of the functions of the first and second lines of defence,
- the function of managing the compliance risk reports directly to the President of the Management Board.

RISK MANAGEMENT OF THE PKO BANK POLSKI SA GROUP

The Bank supervises activities of the individual subsidiaries of the PKO Bank Polski SA Group. As part of this supervision, the Bank supervises the entities' risk management systems and provides support in the development of these systems. Additionally, it reflects business risk level of the particular entities in the risk reporting and monitoring system of the entire Group.

The internal regulations concerning management of certain types of risk in the entities of the Group are defined by internal regulations implemented by those entities, after consulting the Bank's opinion and having taken into account the recommendations issued to the entities by the Bank. The internal regulations of the entities concerning risk management allow for consistent and comparable assessment of particular types of risk within the Bank and entities of the Group, as well as reflect the extent and nature of the relationship of entities included in the Group, the nature and scale of the entity's activity and the market on which it operates.

The risk management in the Group entities is carried out in particular by:

- involving the units in the Bank's Risk Management Area or the Bank's relevant committees in evaluating large transactions of the Group entities,
- giving opinions and reviewing internal regulations concerning risk management in the individual Group entities, carried out by the units in the Bank's Risk Management Area,
- reporting on the Group entities' risks to the Bank's relevant committees or the Management Board,
- monitoring of strategic risk tolerance limits for the Group.

SPECIFIC ACTIVITIES IN THE AREA OF RISK MANAGEMENT IN THE GROUP UNDERTAKEN IN 2016

The PKO Bank Polski SA Group's top priority is to maintain its strong capital position and to further increase in its stable sources of financing underlying the stable development of business activity, while maintaining the priorities of efficiency and effective cost control and appropriate risk assessment.

PKO Bank Polski SA's priority is to maintain its strong equity position, including effective capital adequacy management, counteracting cyberthreats, while maintaining the priorities of efficiency and effective cost control and appropriate risk assessment.

In this respect, the Group took i.a. the following actions in 2016 turned the maturing own short-term bonds on bonds in the amount of PLN 1 billion (in May) and PLN 815 million (in November) and turned the maturing own short-term bonds on bonds with a maturity to one year in the amount of EUR 200 million.

In 2016, the Group conducted operating risk management-related preparatory work for starting operations of the Bank's new branch in the Czech Republic, the opening of which is planned for March 2017. As part of this work, in November 2016, the Group filed an application with the Polish Financial Supervision Authority requesting consent for joint application of advanced measurement approach (AMA) and basic indicator approach (BIA) consisting of the calculating the requirements relating to own funds in respect of operational risk using the BIA method in respect of the operations of the Bank's branch in Germany and in the Czech Republic, and using the AMA approach for the remaining operations of the Bank.

In the fourth quarter of 2016, the Group introduced changes to the process of managing the exposure concentration risk, which constitute the fulfilment of the requirements of Resolution No. 351/2016 of the Polish Financial Supervision Authority dated 24 May 2016 on issuing Recommendation C relating to concentration risk. The amendments include: concentration risk management objectives and process, new measures of tolerance to concentration risk, including internal limits mitigating the risk of excessive concentration, the method of performing stress tests regarding concentration risk.

In the fourth quarter of the year, the Group updated and modified the method of assessing credited entrepreneurs in the formula of specialised lending, which allows an adequate credit risk assessment of large projects involving financing income-generating residential and commercial real estate. In the first half of 2016, the Bank and PKO Bank Hipoteczny SA continued work related to model risk management in the process of adapting to the requirements of Recommendation W on risk management in banks, issued by the Polish Financial Supervision Authority in July 2015.

As of 30 June 2016 the process of model risk management in the Bank and in PKO Bank Hipoteczny SA is conducted pursuant to the requirements of Recommendation W.

Within the Group, mortgage loan portfolios which had been extended by PKO Bank Polski SA are gradually transferred to PKO Bank Hipoteczny SA. The value of the portfolio transferred in 2016 amounted to PLN 5 764 million.

In the first half of 2016, PKO Bank Hipoteczny SA conducted two issues of mortgage bonds addressed to institutional investors, in the total amount of PLN 1 billion, with a maturity period of 5 years and 1 day as of the date of issue. Among the institutions which purchased mortgage bonds are both domestic and foreign investors. Mortgage bonds of PKO Bank Hipoteczny are one of the safest debt instruments on the Polish financial market. Moody's rating of Aa3, which is the highest rating achievable by Polish securities, attests to this.

In the second half of 2016 PKO Bank Hipoteczny SA conducted one benchmark foreign issue of mortgage bonds addressed to institutional investors, with a value of EUR 0.5 billion and period to redemption of 5 years and 8 months. The securities bear an interest rate of 0.125% and yield of 0.178%. Among the institutions which purchased mortgage bonds are both domestic and foreign investors, including the European Bank of Reconstruction and Development.

In November 2016 PKO Leasing SA signed an agreement for the purchase of shares with Raiffeisen Bank International AG constituting 100% of the share capital of Raiffeisen-Leasing Polska SA, with the support of PKO Bank Polski SA acting as the guarantor. On 1 December 2016 the purchase transaction consisting of the purchase of all shares of Raiffeisen-Leasing Polska SA by PKO Leasing SA was finalized. In connection with the transaction the Bank decided not to pay dividend from the Bank's profit earned in 2015 and from retained earnings.

57. Credit risk management

Definition

Credit risk is defined as a risk of occurrence of losses due to counterparty's default of payments to the Group or as a risk of decrease in economic value of amounts due to the Group as a result of deterioration of counterparty's ability to repay amounts due to the Group.

Management objective

The objective of credit risk management is to minimize losses on the loan portfolio as well as to minimize the risk of occurrence of loans exposed to impairment, while keeping expected level of profitability and value of loan portfolio at the same time.

The Bank and subsidiaries of the Group primarily follow the following principles of credit risk management:

- each loan transaction is subject to comprehensive credit risk assessment, which is reflected in an internal rating or credit scoring,
- credit risk relating to loan transactions is measured on the stage of examining loan application and on a regular basis, as part of the monitoring process taking into consideration changes in external conditions and in the financial standing of the borrowers,
- credit risk assessment of exposures which are significant due to their risk levels or its value is subject to additional verification by credit risk assessment teams, which are independent of the business teams

- terms of loan transactions that are offered to a client depend on the assessment of credit risk level or its value generated by the transaction,
- loan granting decisions are made only by authorized persons,
- credit risk is diversified particularly by geographical location, by industry, by product and by clients,
- expected credit risk level is mitigated by collateral received by the Bank, margins from clients and impairment allowances (provisions) on loan exposures.

The above-mentioned principles are executed by the Group through the use of advanced credit risk management methods, both on the level of individual credit exposures and on the level of the whole loan portfolio of the Group. These methods are verified and developed to ensure compliance with the internal rating – based method requirements (IRB), i.e. advanced credit risk measurement method, which can be used while calculating requirements as regards own funds for credit risk after being approved by the Polish Financial Supervision Authority.

The Group entities, which have significant credit risk levels (the KREDOBANK SA Group, the PKO Leasing SA Group, PKO Bank Hipoteczny SA and a subsidiary: Finansowa Kompania 'Prywatne Inwestycje' Sp. z o.o.) manage their credit risk individually, but the methods used by them for credit risk assessment and measurement are adjusted to the methods used by PKO Bank Polski SA, taking into account the specific nature of the activities of these companies.

Any changes to the solutions used by the Group's subsidiaries are agreed every time with the Bank's units responsible for risk management.

The PKO Leasing SA Group, the KREDOBANK SA and subsidiaries: Finansowa Kompania 'Prywatne Inwestycje' Sp. z o.o. and PKO Bank Hipoteczny SA measure credit risk regularly and the results of such measurements are submitted to the Bank.

The KREDOBANK SA Group and the PKO Leasing SA Group have organizational units responsible for risk in their organizational structures, which are in particular responsible for:

- developing methods of credit risk assessment, recognizing provisions and allowances,
- controlling and monitoring credit risk during the lending process,
- the quality and efficiency of restructuring and enforcement of the amounts due from clients.

In these companies, the credit decision limits depend primarily on: the amount of the exposure to a given client, the amount of an individual credit transaction and the period of credit transaction.

The process of credit decision-making in the KREDOBANK SA Group, the PKO Leasing SA Group is supported by credit committees, which are involved in the case of credit transactions which generate increased credit risk level.

Appropriate organizational units of the Risk Management Area participate in managing the credit risk in the Group entities by giving their opinions on projects and periodically reviewing internal regulations of these companies relating to the assessment of credit risk and preparation of recommendations relating to amendments in the drafts of regulations. The Bank supports implementation of the recommended changes in principles for assessing credit risk in the Group entities.

MEASUREMENT AND ASSESSMENT OF CREDIT RISK

- #### CREDIT RISK MEASUREMENT AND ASSESSMENT METHODS

In order to assess the level of credit risk and profitability of loan portfolios, the Group uses different credit risk measurement and valuation methods, including:

- Probability of Default (PD),
- Expected Loss (EL),
- Unexpected Loss (UL),
- Loss Given Default (LGD),
- Credit Value at Risk (CVaR),
- share and structure of impaired loans,
- coverage ratio of impaired loans with impairment allowances,
- cost of credit risk.

The Group extends regularly the scope of credit risk measures used, taking into account the internal rating-based method (IRB) requirements, and extends the use of risk measures to fully cover the whole Group's loan portfolio with these methods.

The portfolio credit risk measurement methods allow i.a. to reflect the credit risk in the price of products, determine the optimum conditions of financing availability and determine rates of impairment allowances.

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

- **RATING AND SCORING METHODS**

The Group assesses the risk of individual credit transactions with the use of scoring and rating methods, which are created, developed and supervised by the Banking Risk Division. These methods are supported by specialist IT application software. The scoring method is defined by Group's internal regulations whose main aim is to ensure uniform and objective assessment of credit risk during the lending process.

The Group assess the credit risk of retail clients in two dimensions: creditworthiness assessed quantitatively and qualitatively. The quantitative assessment of creditworthiness consists of evaluation of the financial situation, whereas the qualitative assessment involves scoring and evaluating the client's credit history obtained from internal records of the Group and external databases.

In the case of corporate clients from the small and medium enterprises segment that meet certain criteria, the Group assesses credit risk using the scoring method. Such assessment refers to low-value, non-complex loan transactions and it is performed in two dimensions: clients' borrowing capacity and his creditworthiness. The assessment of borrowing capacity involves examination of the client's economic and financial situation, whereas the creditworthiness assessment involves scoring and evaluation of the client's credit history obtained from internal records of the Group and external databases.

In other cases, the rating method is used for institutional customers.

The evaluation of credit risk related to financing institutional clients is performed in two dimensions: in respect of the client and of the transaction. The assessment measures comprise the assessment of the credibility of the client, i.e. rating: and the assessment of the transaction, i.e. liability repayment capacity in the specified amount and timing.

Rating models for corporate clients were prepared using internal data of the Group which ensures that they are tailored to the risk profile of the Group's clients. Models are based on a statistical dependence analysis between the default and a customer's risk rating. Rating includes an assessment of the financial indicators, qualitative factors and evaluation of behavioural factors. The client's risk assessment depends on the size of the enterprise for which analysis is made. In addition, the Group uses a model for assessment of credited entrepreneurs in the formula of specialised lending, which allows adequate credit risk assessment of large projects involving real estate financing (e.g. office space, retail areas, industrial areas) and infrastructure projects (e.g. telecommunications, industrial, public utility infrastructure).

The rating models are implemented in the IT tool supporting the Group's credit risk assessment related to financing institutional customers.

In order to examine the correctness of functioning of method applied in the Group, the methodologies of credit risk assessment related to individual loan exposures are subject to periodical reviews.

The credit risk assessment process in Group takes into account the requirements of the Polish Financial Supervision Authority as defined in the Recommendation S, relating to best practices for the management of mortgage-secured loan exposures and Recommendation T relating to best practices for the management of retail credit exposures.

The information about ratings and scoring is widely used in the Group for the purposes of credit risk management, the system of credit decision making powers, determining the conditions in which credit assessment services are activated and in the credit risk assessment and reporting system.

MONITORING OF CREDIT RISK

Monitoring of credit risk is performed at individual loan transaction level and at portfolio level.

Monitoring of credit risk at the individual loan transaction level is governed, in particular, by the Group's internal regulations concerning:

- the principles for the recognition of impairment allowances for loan exposures and impairment allowances on receivables due to unsettled forward transactions;
- the rules of functioning of the Early Warning System at the Bank;
- early monitoring of delays in the collection of receivables;
- the principles for the classification of loan exposures and determining the level of specific provisions.

In order to shorten the time of reaction to the warning signals observed, signaling an increase in the credit risk level, the Group uses and develops an IT application, an Early Warning System (EWS).

Monitoring of credit risk at the portfolio level consists of:

- supervising the level of the portfolio credit risk on the basis of the adopted tools used for measuring credit risk, taking into consideration the identified sources of credit risk and analyzing the effects and actions taken as part of system management,
- recommending preventive measures in the event of identifying an increased level of credit risk.

CREDIT RISK REPORTING

The Group prepares monthly and quarterly credit risk reports. The reporting of credit risk covers specifically cyclic information on the risk exposure of the credit portfolio. In addition to the information concerning the Bank, the reports also contain information about the credit risk level for the Group subsidiaries (i.a. KREDOBANK SA Group and the PKO Leasing SA Group), which have significant credit risk levels.

MANAGEMENT ACTIONS CONCERNING CREDIT RISK

Basic credit risk management tools used by the Group include:

- minimum transaction requirements (risk parameters) determined for a given type of transaction (e.g. minimum LTV value, maximum loan amount, required collateral),
- the principles of defining credit availability, including cut-offs – the minimum number of points awarded in the process of creditworthiness assessment with the use of a scoring system (for retail clients and SMEs) or the client's rating class (for corporate clients), which a client must obtain to receive a loan,
- concentration limits – limits defined in the Regulation of the European Parliament and Council (EU) No. 575/2013 dated 26 June 2013 on prudential requirements for credit institutions and investment firms (Regulation CRR) and the Banking Law.
- industry-related limits – limits which reduce the risk level related to financing institutional clients that conduct business activities in industries characterized by high level of credit risk,
- limits on credit exposures related to the Group's clients – the limits defining the appetite for credit risk as result of among others the recommendations S and T,
- credit limits defining the Group's maximum exposure to a given client or country in respect of wholesale operations and settlement limits and limits for the period of exposure,
- competence limits – they define the maximum level of credit decision-making powers with regard to the Group's clients, the limits depend primarily on the amount of the Bank's exposure to a given client (or a group of related clients) and the loan transaction period, the competence limit depends on the credit decision-making level (in the Bank's organizational structure),
- minimum credit margins – credit risk margins relating to a given credit transaction concluded by the Group with a given corporate client, but the interest rate offered to a client cannot be lower than the reference rate plus credit risk margin.

USE OF CREDIT RISK MITIGATION TECHNIQUES - COLLATERAL

Collateral management policy as regards credit risk plays a significant role in establishing minimum transaction terms. The Group's collateral management is meant to secure properly the credit risk, to which the Bank is exposed, including first of all the fact of establishing collateral that will ensure the highest possible level of recovery in the event of realization of debt collateral activity.

In assessing collateral, the following factors are taken into account in particular:

- the economic and financial or social and financial situation of the entities providing personal guarantees,
- the condition and market value of the assets accepted as collateral and their vulnerability to depreciation in the period of maintaining the collateral (the impact of the technological wear and tear of a collateralized asset on its value),
- potential economic benefits of the Group resulting from a specific method of securing receivables, including, in particular, the possibility of reducing impairment allowances,
- the method of establishing collateral, including the typical duration and complexity of formalities, as well as the necessary costs (the costs of maintaining collateral and the enforcement against the collateral), using the Group's internal regulations concerning the assessment of collateral,
- the complexity, time-consuming nature and economic and legal conditions of the effective realization of collateral, in the context of enforcement restrictions and the applicable principles for the distribution of the sums obtained from individual enforcement or in the course of bankruptcy proceedings, the ranking of claims.

The type of collateral depends on the product and the client segment.

With regard to mortgage loans the obligatory collateral are mortgages on the property.

Until an effective protection is established (depending on the type and amount of a loan) the Group may accept temporary collateral in different form.

With regard to consumer loans, usually personal guarantees are used (a civil law surety/guarantee, a bill of exchange) or collateral is established on the client's bank account, his car or securities.

The collateral for loans intended for financing small and medium-sized enterprises as well as corporate customers is established, i.a.: on institutional debt, bank accounts, movables, real estate or securities or in the form of BGK guarantees (universally used in respect of small and medium enterprises). The policy regarding collateral is defined by the internal regulations of subsidiaries of the Group.

When signing a leasing agreement, the PKO Leasing SA Group, as a proprietor of leased objects, treats them as collateral.

(IN PLN MILLION)

58. Credit risk – Financial information

Level of exposure to credit risk Past due financial assets Financial assets assessed on an individual basis for which individual impairment has been recognised by gross carrying amount Internal rating classes External rating classes

Level of exposure to credit risk

Exposure to credit risk - Items of the statement of financial position	31.12.2016	31.12.2015
Current account in the Central Bank	7 459.7	9 854.1
Amounts due from banks	5 345.4	4 553.0
Trading assets – debt securities	311.6	766.7
Derivative financial instruments	2 900.6	4 347.3
Financial instruments designated upon initial recognition at fair value through profit and loss - debt securities	12 204.1	13 337.4
Loans and advances to customers	200 606.5	190 413.7
corporate	52 914.9	52 534.7
housing	106 121.3	100 668.6
consumer	23 221.9	21 959.8
debt securities (corporate)	2 282.8	2 591.9
debt securities (municipal)	2 587.9	2 692.7
receivables due from repurchase agreements	1 339.0	4 432.2
finance lease receivables	12 138.7	5 533.8
Investment securities - debt securities	36 142.4	27 604.9
Investment securities held to maturity	465.6	210.3
Other assets - other financial assets	2 247.1	875.2
Total	**267 683.0**	**251 962.6**

Exposure to credit risk - Off-balance sheet items	31.12.2016	31.12.2015
Irrevocable liabilities granted	31 077.9	30 513.9
Guarantees issued	6 629.8	7 199.3
Underwriting of securities	3 701.2	5 490.0
Letters of credit issued	1 599.5	1 838.1
Total	**43 008.4**	**45 041.3**

Past due of financial assets

Financial assets gross which are past due but not impaired:	31.12.2016			
	up to 1 month	1 - 3 months	over 3 months	Total
Loans and advances to customers	3 534.5	848.9	178.5	4 561.9
Other assets – other financial assets	0.3	0.1	11.4	11.8
Total	**3 534.8**	**849.0**	**189.9**	**4 573.7**

(IN PLN MILLION)

Financial assets gross which are past due but not impaired:	31.12.2015			
	up to 1 month	1 - 3 months	over 3 months	Total
Loans and advances to customers	2 308.4	1 068.5	235.5	3 612.4
Other assets – other financial assets	0.2	0.1	6.6	6.9
Total	**2 308.6**	**1 068.6**	**242.1**	**3 619.3**

Collaterals for the above receivables include: mortgages, registered pledges, transfers of property rights, account lock-ups, loan exposure insurances, warranties and guarantees.

The conducted assessment proved that for the above-mentioned financial assets the expected cash flows fully cover the carrying amount of these exposures.

FINANCIAL ASSETS ASSESSED ON AN INDIVIDUAL BASIS FOR WHICH INDIVIDUAL IMPAIRMENT HAS BEEN RECOGNISED

Financial assets assessed on an individual basis for which individual impairment has been recognised by carrying amount gross	31.12.2016	31.12.2015
Amounts due from banks	0.2	0.1
Loans and advances to customers	5 048.9	5 412.8
corporate loans	3 962.9	3 896.2
housing loans	788.8	1 104.2
consumer loans	223.6	304.5
debt securities	73.6	107.9
Financial assets available for sale	1 296.8	397.4
Total	**6 345.9**	**5 810.3**

Loans and advances to customers were secured by the following collaterals established for PKO Bank Polski SA Group mortgage, registered pledge, the debtor's promissory note and transfer of receivables.
The financial effect of the collateral held in respect of the amount that best represents the maximum exposure to credit risk as at 31 December 2016 amounts to PLN 2 800.9 million (as at 31 December 2015 the amount was PLN 2 992.4 million, respectively).

INTERNAL RATING CLASSES

Taking the type of the Group's business activity and the amount of credit and leasing debts into consideration, the most important portfolios are managed by the Bank and PKO Leasing SA.

Exposures to corporate clients which are not individually impaired are classified according to customer rating as part of the internal rating classes, from A to G (in respect of financial institutions from A to F).

The following portfolios are covered by the rating system:
- corporate market customers,
- small and medium enterprises (excluding certain product groups which are assessed in a simplified manner).

Loans and advances which are not individually impaired and are not rated, are characterized with a satisfactory level of the credit risk. It concerns, in particular, retail loans (including housing loans) which do not have individually significant exposures and thus do not create significant credit risk.

(IN PLN MILLION)

Financial assets not past due not impaired	31.12.2016	31.12.2015
Loans and advances to customers	**177 240.0**	**164 667.9**
corporate loans	47 029.1	47 556.6
A (first rate)	948.6	989.8
B (very good)	2 065.4	1 408.8
C (good)	6 664.6	5 283.1
D (satisfactory)	7 204.9	7 160.6
E (average)	12 231.7	13 291.5
F (acceptable)	14 245.2	16 546.7
G (poor)	3 668.7	2 876.1
consumer and housing loans	121 435.2	114 282.7
A (first rate)	99 924.5	93 971.1
B (very good)	8 939.5	8 101.6
C (good)	5 481.4	5 344.5
D (average)	4 652.9	4 093.9
E (acceptable)	2 436.9	2 771.6
PKO Leasing SA Group	**8 775.7**	**2 828.6**
A (good)	7 179.8	2 407.8
B (average)	768.0	329.0
C (risky)	827.9	91.8
Investment securities available for sale – debt securities	**5 088.1**	**5 538.4**
A (first rate)	11.9	86.5
B (very good)	353.4	209.5
C (good)	712.2	685.0
D (satisfactory)	1 376.5	1 532.6
E (average)	1 461.6	1 270.2
F (acceptable)	1 069.7	1 030.8
G (poor)	63.2	628.4
G3 (low)	39.6	-
H (bad)	-	95.4
Total	**182 328.1**	**170 206.3**

External rating classes

Structure of debt securities and amounts due from banks, neither past due nor impaired by external rating classes is presented below:

Portfolio/Rating	AAA	AA- to AA+	A- to A+	BBB -to BBB+	BB- to BB+	B- to B+	CCC-to CCC+	Caa3*	31.12.2016
Amounts due from banks	24.3	1 526.6	2 273.3	530.8	21.0	4.6	95.8	-	4 476.4
Debt securities	153.7	1 425.9	38 673.6	1 935.6	38.4	49.0	-	485.5	42 761.7
NBP money market bills	-	-	9 078.8	-	-	-	-	-	9 078.8
Treasury bonds	-	-	29 481.3	-	-	-	-	485.5	29 966.8
municipal bonds	-	14.6	113.5	104.3	38.4	-	-	-	270.8
corporate bonds	153.7	1 411.3	-	1 831.3	-	49.0	-	-	3 445.3
TOTAL	178.0	2 952.5	40 946.9	2 466.4	59.4	53.6	95.8	485.5	47 238.1

* Relates to securities of the KREDOBANK SA Group – according to Moody's rating

Portfolio/Rating	AAA	AA- to AA+	A- to A+	BBB -to BBB+	BB- to BB+	CCC-to CCC+	Caa3*	31.12.2015
Amounts due from banks	45.1	718.2	746.9	515.8	14.4	127.8	-	2 168.2
Debt securities	-	-	33 591.4	1 473.8	435.6	-	330.2	35 831.0
NBP money market bills	-	-	10 036.9	-	-	-	-	10 036.9
Treasury bonds	-	-	21 939.6	-	-	-	330.2	22 269.8
municipal bonds	-	-	148.0	102.2	43.5	-	-	293.7
corporate bonds	-	-	1 466.9	1 371.6	392.1	-	-	3 230.6
TOTAL	45.1	718.2	34 338.3	1 989.6	450.0	127.8	330.2	37 999.2

* Relates to securities of the KREDOBANK SA Group – according to Moody's rating

(IN PLN MILLION)

59. CONCENTRATION OF CREDIT RISK AT THE GROUP

Concentration by the largest entities
Concentration by the largest capital groups
Concentration by industries
Concentration by geographical regions
Concentration of credit risk by currency
Other types of concentration

The Group defines credit concentration risk as one of arising from a considerable exposure to single entities or to group of entities whose repayment capacity depends on a common risk factor.

CONCENTRATION BY THE LARGEST ENTITIES

The Banking Law specifies maximum concentration limits for the Bank which has an influence upon the Group. The risk of concentration of exposures to individual customers and groups of related customers is monitored in accordance with CRR Regulation, according to which the Group does not assume an exposure to a customer or a group of related customers, whose value exceeds 25% of the value of its recognised capital.

As at 31 December 2016 and 31 December 2015, those concentration limits had not been exceeded. As at 31 December 2016, the level of concentration of the Bank risk due to the largest exposure to a single entity was equal to 10.4% of the Bank's recognised capital (as at 31 December 2015 15.2%). Among 20 largest borrowers of the Group there are exclusively clients.

31.12.2016			31.12.2015		
No.	Credit exposure includes loans, advances, purchased debts, discounts on bills of exchange, realised guarantees, interest receivable and off-balance sheet and capital exposures *	Share in loan portfolio, which includes off-balance sheet and capital exposures	No.	Credit exposure includes loans, advances, purchased debts, discounts on bills of exchange, realised guarantees, interest receivable and off-balance sheet and capital exposures *	Share in loan portfolio, which includes off-balance sheet and capital exposures
1.	3 200.0	1.16%	1.	4 107.3	1.55%
2.	2 887.2	1.05%	2.	2 721.7	1.03%
3.	2 450.0	0.89%	3.	2 080.0	0.79%
4.	2 371.1	0.86%	4.	1 910.4	0.72%
5.	2 064.5	0.75%	5.	1 841.9	0.70%
6.	1 582.6	0.57%	6.	1 668.6	0.63%
7.	1 570.7	0.57%	7.	1 593.9	0.60%
8.	1 481.9	0.54%	8.	1 216.6	0.46%
9.	1 435.4	0.52%	9.	1 212.6	0.46%
10.	1 080.9	0.39%	10.	1 007.8	0.38%
11.	992.0	0.36%	11.	965.1	0.37%
12.	955.6	0.35%	12.	964.0	0.36%
13.	882.6	0.32%	13.	894.8	0.34%
14.	871.7	0.32%	14.	870.9	0.33%
15.	828.4	0.30%	15.	852.9	0.32%
16.	773.6	0.28%	16.	811.4	0.31%
17.	761.1	0.28%	17.	790.6	0.30%
18.	704.9	0.26%	18.	771.2	0.29%
19.	671.5	0.24%	19.	748.7	0.28%
20.	618.2	0.22%	20.	704.2	0.27%
Total	**28 183.9**	**10.21%**	**Total**	**27 734.6**	**10.49%**

* Off-balance sheet exposure includes liability resulting from derivative transactions in the amount of their equivalent in the statement of financial position.

(IN PLN MILLION)

CONCENTRATION BY THE LARGEST CAPITAL GROUPS

The greatest exposure of the PKO Bank Polski SA Group towards a capital group of borrowers amounted to 1.14% of the Group's loan portfolio (as at 31 December 2015 1.61%). The 5 largest capital groups include only clients of PKO Bank Polski SA.

As at 31 December 2016 and as at 31 December 2015 the greatest exposure concentration of Group amounted to 10.2% of the Capital Group recognised capital (as at 31 December 2015 15.7%).

31.12.2016			31.12.2015		
No.	Credit exposure includes loans, advances, purchased debts, discounts on bills of exchange, realised guarantees, interest receivable and off-balance sheet and capital exposures *	Share in loan portfolio, which includes off-balance sheet and capital exposures	No.	Credit exposure includes loans, advances, purchased debts, discounts on bills of exchange, realised guarantees, interest receivable and off-balance sheet and capital exposures *	Share in loan portfolio, which includes off-balance sheet and capital exposures
1.	3 160.2	1.14%	1.	4 247.7	1.61%
2.	2 467.7	0.89%	2.	3 288.9	1.24%
3.	2 396.5	0.87%	3.	2 925.7	1.11%
4.	2 118.3	0.77%	4.	2 746.0	1.04%
5.	2 090.6	0.76%	5.	2 045.7	0.77%
Total	**12 233.3**	**4.43%**	**Total**	**15 254.0**	**5.77%**

* off-balance sheet exposure includes liability resulting from derivative transactions in the amount of their equivalent in the statement of financial position.

CONCENTRATION BY INDUSTRIES

As compared with 31 December 2015 the exposure of Capital Group in industry sectors has increased by approx. PLN 12 billion. The increase in exposure results exclusively from the interest of the PKO Leasing SA Group in Raiffeisen-Leasing Polska SA and an increase in exposure in industry sections of the Bank's credit portfolio. The total exposure in the four largest industry groups 'Industrial processing:', 'Maintenance of real estate', 'Wholesale and retail trade (...)', and 'Public administration and national defense' amounted to approx. 54% of the total loan portfolio covered by sector analysis.

Structure of exposure by industry as at 31 December 2016 and as at 31 December 2015 is presented in the table below:

Section	Section name	31.12.2016		31.12.2015	
		Exposure	Number of entities	Exposure	Number of entities
C	Industrial processing	16.95%	11.35%	17.73%	11.34%
L	Maintenance of real estate	14.69%	17.09%	16.62%	19.94%
G	Wholesale and retail trade; repair of motor vehicles	14.88%	23.74%	15.14%	24.13%
F	Construction	5.66%	10.02%	8.17%	10.93%
O	Public administration and national defence, obligatory social security	7.04%	0.36%	9.08%	0.49%
D	Electricity, gas, water vapour, hot water and air to the mechanical systems production and supply	1.85%	0.18%	2.01%	0.18%
Other exposures		38.93%	37.26%	31.25%	32.99%
Total		**100.00%**	**100.00%**	**100.00%**	**100.00%**

The above industry structure does not include exposure arising from debt securities reclassified from the category 'available for sale' to 'loans and advances to customers'.

(IN PLN MILLION)

CONCENTRATION BY GEOGRAPHICAL REGIONS

The Group's loan portfolio is diversified in terms of geographical concentration.

The structure of the loan portfolio by geographical regions is identified in the Capital Group due to Bank's client area – a separate area for the retail market (ORD), a separate area for the corporate and investment banking (OKI).

As at 31 December 2016 the largest concentration of the ORD loan portfolio occurs in region of Warsaw and Katowice (these regions account for 25% of the ORD portfolio).

Concentration of credit risk by geographical regions for Retail Clients	31.12.2016	31.12.2015
warszawski	14.35%	14.02%
katowicki	10.82%	10.78%
poznański	9.85%	9.82%
krakowski	9.06%	9.09%
łódzki	8.76%	8.90%
wrocławski	9.15%	8.87%
gdański	8.64%	8.60%
bydgoski	7.43%	7.56%
lubelski	6.87%	7.05%
białostocki	6.42%	6.51%
szczeciński	6.17%	6.17%
headquarter	0.83%	0.97%
other	0.84%	0.99%
Ukraine	0.81%	0.67%
Total	**100.00%**	**100.00%**

As at 31 December 2016, the largest concentration of the OKI loan portfolio occurs in the headquarter and in the central macroregion (28% and 16% of the ORK portfolio, respectively).

Concentration of credit risk by geographical regions for Corporate Clients	31.12.2016	31.12.2015
headquarter	16.20%	19.64%
central macroregion	28.42%	17.08%
north macroregion	10.11%	13.04%
west macroregion	9.65%	10.60%
south macroregion	9.42%	9.96%
south-east macroregion	7.90%	7.18%
north-east macroregion	4.88%	6.68%
south-west macroregion	6.28%	6.46%
other	6.99%	9.16%
Sweden	0.15%	0.20%
Total	**100.00%**	**100.00%**

CONCENTRATION OF CREDIT RISK BY CURRENCY

As at 31 December 2016, the share of exposure in convertible currencies, other than PLN, in the total loan portfolio of PKO Bank Polski SA Group amounted to 24.2%, which represents a decrease of approximately 1.0 p.p. compared to 31 December 2015.

The greatest part of the Group's currency exposures are those in CHF and they relate mainly to the loan portfolio of the Bank. The share of loans in CHF amounted to 59% of total currency portfolio of the Group in 2016, which represents a decrease of approximately 5 p.p. compared to 31 December 2015. Loans in EUR constitute another group of foreign exchange loans, their share in the whole portfolio amounted to 8% as at the end of 2016, and 34% in the foreign exchange portfolio.

(IN PLN MILLION)

Concentration of credit risk by currency	31.12.2016	31.12.2015
PLN	75.77%	74.73%
Foreign currencies, of which:	24.23%	25.27%
CHF	14.28%	16.12%
EUR	8.28%	7.39%
USD	1.10%	1.32%
UAH	0.38%	0.35%
GBP	0.04%	0.03%
Total	**100.00%**	**100.00%**

OTHER TYPES OF CONCENTRATION

The Group analyses the structure of the housing loan portfolio in terms of LTV levels. As at the end of 2016, as well as in 2015 the largest concentration was in the 71% - 90% LTV range.

The structure of the housing loan portfolio in terms of LTV	31.12.2016	31.12.2015
0% - 50%	25.34%	23.18%
51%-70%	22.35%	19.38%
71% - 90%	32.67%	27.73%
91% - 100%	9.10%	13.54%
over 100%	10.54%	16.17%
Total	**100.00%**	**100.00%**

In accordance with the Recommendations S and T of the Polish Financial Supervision Authority, the Group uses internal limits on credit exposures related to the Group's customers defining the appetite for credit risk.

As at 31 December 2016, these limits have not been exceeded.

60. FORBEARANCE PRACTICES

The Group treats as forbearance actions aimed at making changes in the contract terms agreed with a debtor or an issuer, forced by his difficult financial situation (restructuring activities introducing concessions that otherwise would not be granted). The aim of the forbearance activities is to restore a debtor or an issuer the ability to fulfil its liabilities to the Group and to maximize the efficiency of non-performing loans management, i.e. obtaining the highest recoveries while minimizing the incurred costs.

Forbearance activities include a change in payment terms which is individually agreed on each contract basis. Such changes may concern:

- spreading the due debt into instalments,
- change in a repayment schedule (annuity instalments, decreasing instalments),
- extension of the lending period,
- change in interest rates,
- change in the credit margin,
- loans reduction.

As a result of signing and a timely service of forbearance agreement, the loans becomes undue. Forbearance involves evaluation of the ability of a debtor to fulfil the forbearance agreement conditions (debt repayment according to the agreed schedule). Forbearance agreements are monitored on an on-going basis. If, as regards to the loan exposure the impairment is recognised, the impairment allowances are recognized to reflect identified loss.

(IN PLN MILLION)

Exposures with the status of forbearance, classified as non-performing, are included in the portfolio of performing exposures if the following conditions are met simultaneously:

- a debt does not meet individual impairment triggers and there is no impairment recognised,
- at least 12 months have elapsed from the conclusion of a forbearance agreement,
- forbearance agreement has covered the whole debt,
- a debtor has demonstrated the ability to fulfil the terms of the forbearance agreement.

Exposures cease to be subject of reporting with the forbearance status if the following conditions are met simultaneously:

- at least 24 months have elapsed from the date of including forborne exposition to the portfolio of performing loans (conditional period),
- at the end of the conditional period, discussed above, client does not have a debt overdue more than 30 days,
- timely repayment of at least 12 consecutive instalments occurred.

LOANS AND ADVANCES TO CUSTOMERS

Exposures subject to forbearance in the loan portfolio	**31.12.2016**	**31.12.2015**
Loans and advances to customers gross, of which	208 609.2	198 700.9
subject to forbearance	4 132.1	5 534.7
Impairment allowances on loans and advances to customers, of which:	(8 002.7)	(8 287.2)
subject to forbearance	(987.5)	(986.3)
Loans and advances to customers net, of which:	**200 606.5**	**190 413.7**
subject to forbearance	**3 144.6**	**4 548.4**

Loans and advances to customers subject to forbearance by product type	**Carrying value**	
	31.12.2016	**31.12.2015**
corporate loans	2 262.2	2 861.1
housing loans	1 562.5	2 143.3
consumer loans	307.4	530.3
Impairment allowances on loans and advances to subject to forbearance	**(987.5)**	**(986.3)**
Loans and advances to customers net subject to forbearance	**3 144.6**	**4 548.4**

Loans and advances to customers subject to forbearance by geographical region (gross)	**31.12.2016**	**31.12.2015**
Poland	4 062.7	5 423.9
mazowiecki	699.7	1 133.1
wielkopolski	381.8	499.1
śląsko-opolski	497.1	731.6
małopolsko-świętokrzyski	323.1	434.4
pomorski	302.9	334.0
podlaski	277.8	426.7
łódzki	314.0	474.5
dolnośląski	308.4	380.8
kujawsko-pomorski	376.7	302.2
zachodnio-pomorski	336.9	444.2
lubelsko-podkarpacki	218.8	236.2
warmińsko-mazurski	25.5	27.1
Ukraine	69.4	110.8
Total	**4 132.1**	**5 534.7**

(IN PLN MILLION)

Loans and advances to customers subject to forbearance - the Group's exposure to credit risk	Exposure by gross carrying amount	
	31.12.2016	31.12.2015
Loans and advances impaired	2 250.3	2 418.0
Loans and advances not impaired, of which:	1 881.8	3 116.7
not past due	1 520.2	2 477.6
past due	361.6	639.1
Total gross	**4 132.1**	**5 534.7**

Change in carrying amounts of loans and advances to customers subjected to forbearance at the beginning and at the end of the period

Change in the carrying values of loans and advances granted to customers which are subject to forbearance as at the beginning and end of the period	31.12.2016	31.12.2015
Carrying amount at the beginning of the period, net	4 548.4	5 488.1
Impairment allowance	19.4	(111.8)
Gross book value of loans and advances which ceased to satisfy the forbearance criterion in the period	(1 989.6)	(2 427.2)
Loans and advances recognised in the period, gross	1 083.7	1 964.6
Other changes/repayment	(514.5)	(331.7)
Currency translation differences	(2.8)	(33.6)
Carrying amount at the end of the period, net	**3 144.6**	**4 548.4**

Loans and advances to customers gross subject to forbearance by applied changes in terms of repayment	Gross carrying amount	
	31.12.2016	31.12.2015
Converting due debt into instalments	2 744.9	3 861.5
Change in repayment formula (annuity instalments, diminishing instalments)	1 866.6	2 729.9
Extension of loan period	1 431.0	1 663.3
Change in interest rate	599.7	721.2
Change in margin	535.5	187.7
Reduction	114.1	159.0
Other terms	80.7	70.0

For a given loan exposure subject to forbearance more than one change in terms of repayment may be applied.

The amount of interest income recognised on loans and advances to customers which are subject to forbearance amounted to PLN 160.9 million as at 31 December 2016 (as at 31 December 2015 it amounted to PLN 414.1 million).

(IN PLN MILLION)

INVESTMENT SECURITIES AVAILABLE FOR SALE SUBJECT TO FORBEARANCE

Exposures subject to forbearance in the portfolio of investment securities available for sale	31.12.2016	31.12.2015
Debt securities available for sale, including	36 419.6	27 661.8
subject to forbearance	1 302.6	402.7
Impairment allowances on investment securities available for sale, including:	(277.2)	(56.9)
subject to forbearance	(273.6)	(53.1)
Net investment securities available for sale, including:	**36 142.4**	**27 604.9**
subject to forbearance	**1 029.0**	**349.6**

Investment securities available for sale subject to forbearance - the Bank's exposure to credit risk	Exposure by gross carrying amount	
	31.12.2016	31.12.2015
Investment securities available for sale, impaired	1 302.6	402.7
Gross total	**1 302.6**	**402.7**

Change in carrying amounts of investment securities available for sale subject to forbearance as at the beginning and end of the period	31.12.2016	31.12.2015
Carrying amount at the beginning of the period, net	349.6	8.6
Impairment allowance (change in period)	(220.5)	(53.1)
Investment securities available for sale recognised in the period, gross	899.9	394.1
Carrying amount at the end of the period, net	**1 029.0**	**349.6**

Investment securities gross by applied changes in terms of repayment subject to forbearance	Gross carrying amount	
	31.12.2016	31.12.2015
Converting due debt into instalments	1 203.9	402.7
Change in repayment formula	716.4	402.7
Extension of loan period	716.4	402.7
Change in interest rate	716.4	402.7
Change in margin	716.4	402.7
Debt reduction	129.4	-

(IN PLN MILLION)

61. EXPOSURE TO THE COUNTERPARTY CREDIT RISK

CREDIT RISK OF FINANCIAL INSTITUTIONS IN THE WHOLESALE MARKET

Credit risk concentration – interbank market – Interbank market exposure as at 31.12.2016*

Counterparty	Country	Rating	Type of instrument			Total
			Deposit (nominal value)	Derivative instruments (market valuation, in case of positive valuation excl. collateral)	Securities (nominal value)	
Counterparty 1	Poland	A	-	0.4	900.0	900.4
Counterparty 2	Switzerland	AA	494.1	-	-	494.1
Counterparty 3	Belgium	BBB	398.2	7.0	-	405.2
Counterparty 4	Switzerland	AA	397.0	-	-	397.0
Counterparty 5	Luxembourg	A	323.0	-	-	323.0
Counterparty 6	Austria	BBB	287.6	-	-	287.6
Counterparty 7	Norway	A	167.2	-	-	167.2
Counterparty 8	Luxembourg	AAA	-	(19.4)	155.0	155.0
Counterparty 9	USA	AA	-	132.1	-	132.1
Counterparty 10	United Kingdom	A	-	110.4	-	110.4
Counterparty 11	Poland	A	100.7	(36.4)	-	100.7
Counterparty 12	Poland	BBB	-	64.6	-	64.6
Counterparty 13	Germany	A	-	44.7	-	44.7
Counterparty 14	United Kingdom	A	-	40.2	-	40.2
Counterparty 15	France	A	-	38.1	-	38.1
Counterparty 16	Poland	BB	-	33.5	-	33.5
Counterparty 17	Poland	NO RATING	20.0	0.6	-	20.6
Counterparty 18	Poland	BB	0.3	11.7	-	12.0
Counterparty 19	United Kingdom	AAA	-	10.0	-	10.0
Counterparty 20	Poland	BBB	-	9.6	-	9.6

* Without accounting for the exposure to the State Treasury and the National Bank of Poland.

Credit risk concentration – interbank market – Interbank market exposure as at 31.12.2015*

Counterparty	Country	Rating	Type of instrument			Total
			Deposit (nominal value)	Derivative instruments (market valuation, in case of positive valuation excl. collateral)	Securities (nominal value)	
Counterparty 1	Poland	A	800.0	1.2	942.6	1 743.8
Counterparty 20	Poland	BBB	319.6	15.4	-	335.0
Counterparty 9	USA	AA	-	139.8	-	139.8
Counterparty 13	Germany	A	-	98.2	-	98.2
Counterparty 10	United Kingdom	A	-	95.1	-	95.1
Counterparty 28	France	A	-	69.9	-	69.9
Counterparty 12	Poland	BBB	-	55.5	-	55.5
Counterparty 15	France	A	-	52.4	-	52.4
Counterparty 16	Poland	BB	-	48.9	-	48.9
Counterparty 24	Germany	BBB	-	35.8	-	35.8
Counterparty 29	Switzerland	A	-	31.4	-	31.4
Counterparty 25	United Kingdom	AA	-	20.8	-	20.8
Counterparty 32	Canada	AA	-	19.6	-	19.6
Counterparty 3	Belgium	A	-	19.4	-	19.4
Counterparty 18	Poland	BB	-	18.9	-	18.9
Counterparty 2	Switzerland	AA	16.0	-	-	16.0
Counterparty 30	Denmark	A	-	14.0	-	14.0
Counterparty 33	Poland	No rating	14.0	(0.9)	-	14.0
Counterparty 27	United Kingdom	BBB	-	13.8	-	13.8
Counterparty 26	Germany	A	-	12.6	-	12.6

* Without accounting for the exposure to the State Treasury and the National Bank of Poland.

(IN PLN MILLION)

As at 31 December 2016, the Group had access to two clearing houses (in one as an indirect participant, as a direct in the other), through which settled the defined in EMIR Regulation (Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories), derivative transactions on interest rate with selected national and foreign partners. In nominal terms, the share of transactions cleared centrally in case of IRS amounted to 57% of the total portfolio of IRS, in the case of the FRA – all the transactions were transactions submitted to the clearing houses for clearing.

As at 31 December 2016 the Group had signed framework agreements, in accordance with ISDA/PBA standards, with 23 local banks and 62 foreign banks and credit institutions and collateral agreements CSA/PBA with 21 local banks and 52 foreign banks and credit institutions. Additionally, the Group was a party of 22 agreements on repo (for standard GMRA/PBA).

CREDIT RISK OF FINANCIAL INSTITUTIONS ON A NON-WHOLESALE MARKET

In addition to the interbank market exposure, as at 31 December 2016 the Bank had an exposure to financial institutions on the non-wholesale market (e.g. loans granted, bonds purchased outside interbank market).

The structure of exposures over PLN 10 million is presented in the table below:

2016	Nominal exposure amount		Country of the counterparty's registered office
	Balance sheet	Off-balance sheet	
Counterparty 1	500.0		Poland
Counterparty 21	89.1		Poland
Counterparty 22	50.0		Poland
Counterparty 23	0.0	20.5	Denmark
Counterparty 9	-	60.0	USA

For comparison, the structure of exposure over PLN 10 million as at 31 December 2015 is presented in the table below:

2015	Nominal exposure amount		Country of the counterparty's registered office
	Balance sheet	Off-balance sheet	
Counterparty 1	500.0	-	Poland
Counterparty 9	0.5	59.5	USA
Counterparty 22	50.0	-	Poland
Counterparty 33	18.5	11.0	Sweden
Counterparty 23	2.7	17.8	Denmark
Counterparty 21	89.1	-	Poland

In 2016, the risk of adjustment of the value of derivatives in respect of counterparty credit risk (CVA) was distinguished from counterparty credit risk.

62. RISK MANAGEMENT OF FOREIGN CURRENCY MORTGAGE LOANS FOR INDIVIDUALS

As the result of the abandonment of EUR/CHF peg by the Swiss National Bank in January 2015 there was a significant appreciation of the Swiss franc against foreign currencies, including the Polish zloty. In 2016 Swiss franc exchange rate maintained a similar level as in 2015. The Group constantly analyses the impact of these events on the financial results including the risk of deterioration in the quality of the portfolio of mortgage loans denominated in CHF. The risk is partly mitigated by a decline in reference interest rates, CHF LIBOR.

(IN PLN MILLION)

Due to the fact that the significant appreciation of the CHF against Polish zloty results in risk of an excessive burden for household which took mortgage loans indexed to CHF, thus timely debt service, from the beginning of 2015 the public debate continues on how to reduce the risk of insolvency of these borrowers. Emerging proposals for system solutions, submitted in form of civil or parliamentary bills, as well as presented by the public and supervisory authorities, may result in incurring losses by the Group on this portfolio in the future periods.

The Group has taken a number of actions designed to help the clients and at the same time to reduce the growth of the credit risk associated with the appreciation of the CHF – among other, lowering transaction exchange rates CHF/PLN at which amount payable in CHF is converted (i.e. currency spread) and taking into account the negative LIBOR for all customers.

The Group analyses its portfolio of foreign currency mortgage loans to households in a specific manner. The Bank constantly monitors the quality of the portfolio on a current basis and analyses the risk of deterioration of the quality of the portfolio. Currently, the quality of the portfolio is at an acceptable level. The Bank takes into consideration the risk of foreign currency mortgage loans for households in the capital adequacy and own fund management.

The following tables present qualitative analysis of the loans denominated in CHF

Loans and advances to customers in CHF by impairment calculation method (translated into PLN)	31.12.2016			
	Financial institutions	Corporates	Households	Total
Assessed on an individual basis, of which:	-	247.4	165.8	413.2
impaired	-	220.3	137.2	357.5
Assessed on a portfolio basis, impaired	-	26.0	1 184.5	1 210.5
Assessed on a group basis (IBNR)	4.8	360.7	29 361.2	29 726.7
Loans and advances to customers gross	**4.8**	**634.1**	**30 711.5**	**31 350.4**
Impairment allowances on exposures assessed on an individual basis, of which:	-	(89.6)	(64.4)	(154.0)
impaired	-	(63.4)	(64.1)	(127.5)
Impairment allowances on exposures assessed on a portfolio basis	-	(19.5)	(792.7)	(812.2)
Impairment allowances on exposures assessed on a group basis (IBNR)	-	(2.2)	(69.3)	(71.5)
Allowances - total	**-**	**(111.3)**	**(926.4)**	**(1 037.7)**
Loans and advances to customers net	**4.8**	**522.8**	**29 785.1**	**30 312.7**

CHF exchange rate as at 31 December 2016 was equal to PLN 4.1173.

(IN PLN MILLION)

Loans and advances to customers in CHF by impairment calculation method (translated into PLN)	31.12.2015			
	Financial institutions	Corporates	Households	Total
Assessed on an individual basis, of which:	-	171.0	223.6	394.6
impaired	-	134.7	208.1	342.8
Assessed on a portfolio basis, impaired	-	32.0	1 126.5	1 158.5
Assessed on a group basis (IBNR)	6.1	372.3	30 309.1	30 687.5
Loans and advances to customers gross	**6.1**	**575.3**	**31 659.2**	**32 240.6**
Impairment allowances on exposures assessed on an individual basis, of which:	-	(45.6)	(95.9)	(141.5)
impaired	-	(45.2)	(93.7)	(138.9)
Impairment allowances on exposures assessed on a portfolio basis	-	(18.2)	(699.2)	(717.4)
Impairment allowances on exposures assessed on a group basis (IBNR)	(0.2)	(2.7)	(100.4)	(103.3)
Allowances - total	**(0.2)**	**(66.5)**	**(895.5)**	**(962.2)**
Loans and advances to customers net	**5.9**	**508.8**	**30 763.7**	**31 278.4**

CHF exchange rate as at 31 December 2015 was equal to PLN 3.9394.

Loans and advances to customers assessed on a group basis (IBNR)	31.12.2016		
	PLN	CHF	Other currencies
Gross loans and advances to customers	147 632.2	29 726.7	17 516.6
past due	3 149.2	657.6	509.9
not past due	144 483.0	29 069.1	17 006.7
Impairment on exposures assessed on a group basis (IBNR)	(457.6)	(71.5)	(99.5)
past due	(147.8)	(34.6)	(10.7)
not past due	(309.8)	(36.9)	(88.8)
Net loans and advances to customers	**147 174.6**	**29 655.2**	**17 417.1**

Loans and advances to customers assessed on a group basis (IBNR)	31.12.2015		
	PLN	CHF	Other currencies
Gross loans and advances to customers	137 684.3	30 687.4	15 091.4
past due	2 215.4	719.7	241.2
not past due	135 468.9	29 967.7	14 850.2
Impairment on exposures assessed on a group basis (IBNR)	(414.3)	(103.2)	(51.7)
past due	(153.2)	(49.8)	(8.4)
not past due	(261.1)	(53.4)	(43.3)
Net loans and advances to customers	**137 270.0**	**30 584.2**	**15 039.7**

Loans and advances to customers assessed on a group basis (IBNR) subject to forbearance by currencies	31.12.2016		
	PLN	CHF	Other currencies
Gross loans and advances to customers forbearance	941.1	557.0	162.0
Impairment on exposures assessed on a group basis (IBNR) forbearance	(33.5)	(20.7)	(6.7)
Net loans and advances to customers subject to forbearance	**907.6**	**536.3**	**155.3**

(IN PLN MILLION)

Loans and advances to customers assessed on a group basis (IBNR) subject to forbearance by currencies	31.12.2015		
	PLN	CHF	Other currencies
Gross loans and advances to customers forbearance	1 718.8	776.5	67.8
Impairment on exposures assessed on a group basis (IBNR) forbearance	(51.6)	(35.9)	(2.2)
Net loans and advances to customers subject to forbearance	**1 667.2**	**740.6**	**65.6**

As at 31 December 2016, the average LTV for loan portfolio in CHF amounted to 82.7% - compared to the average LTV for the whole portfolio amounting to 69.5%.

The share of foreign currency denominated housing loans extended in the years 2007 and 2008 in the foreign currency denominated housing loans for the household portfolio of the PKO Bank Polski Group as at 31 December 2016 amounted to 44.02% and related to the portfolio of companies operating in the territory of the Republic of Poland.

On 13 January 2017 the Financial Stability Committee adopted Resolution No. 14/2017 on the recommendation relating to restructuring of the housing loan portfolio in foreign currencies and recommended:

1) The Minister responsible for financial institutions:
   - an increase in risk weight to 150% for foreign currency exposures fully secured with mortgage on residential property,
   - an increase of the minimum LGD parameter by banks which apply IRB for foreign exposures secured with mortgage on residential property,
   - a change in the principles of operation of the Borrowers' Support Fund,
   - neutralization of tax effects for borrowers and banks which decide to convert housing loans into another currency,
   - imposing a systemic risk buffer of 3%.

2) Polish Financial Supervision Authority:
   - updating the supervisory review and evaluation process (SREP) methodology and expanding it by principles which enable attributing an appropriate level of capital charge,
   - supplementing the additional capital requirements currently used under Pillar 2, related to operations, market and credit risk,
   - issuing a supervisory recommendation on best practices in restructuring the portfolios of foreign currency housing loans.

3) The Bank Guarantee Fund: accounting for the risks related to foreign currency housing loans in the method for determining contribution to the bank guarantee fund.

63. INTEREST RATE RISK MANAGEMENT

Interest rate risk management
Financial information:
Repricing gap
Sensitivity measures

INTEREST RATE RISK MANAGEMENT

DEFINITION

The interest rate risk is a risk of incurring losses on the Bank's statement of financial position and off-balance sheet items sensitive to interest rate fluctuations, as a result of changes in the interest rates on the market.

MANAGEMENT OBJECTIVE

Mitigate the risk of incurring potential losses arising from market interest rate changes to an acceptable level by appropriate shaping the structure of statement of financial position and off-balance sheet items.

RISK IDENTIFICATION AND MEASUREMENT

The Group utilizes such interest rate risk measures as: sensitivity of interest income, sensitivity of economic value, value at risk (VaR), stress tests and repricing gap.

CONTROL

Control over interest rate risk covers determining interest rate risk limits and thresholds tailored to the scale and complexity of the Group's operations, in particular the strategic limit of tolerance to interest rate risk.

FORECASTING AND MONITORING OF RISK

The following are monitored by the Group on a regular basis:

- the level of interest rate risk,
- the degree of utilization of the strategic limit of interest rate risk tolerance,
- the degree of utilization of internal limits and threshold values relating to interest rate risk.

REPORTING

The reports on interest rate risk are developed on a daily, weekly, monthly and quarterly basis.

MANAGEMENT ACTIONS

The main tools used in interest rate risk management in the Group include: procedures for interest rate risk management, limits and thresholds for interest rate risk.

The Group established limits and thresholds for interest rate risk comprising i.a. the following: price sensitivity, sensitivity of the economic value and loss.

FINANCIAL INFORMATION

THE REPRICING GAP

The repricing gap shows the difference between the present value of assets and liabilities exposed to interest rate risk, subject to revaluation in a given time range, and these balances are recognised on the transaction date.

Repricing Gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
PLN (in PLN million)								31.12.2016
The Group - Period gap	57 494.7	15 015.7	(16 037.3)	(7 718.7)	(12 247.3)	(25 600.4)	5 938.7	16 845.4
The Group - Cumulative gap	57 494.7	72 510.4	56 473.0	48 754.3	36 507.0	10 906.6	16 845.4	-
PLN (in PLN million)								31.12.2015
The Group - Period gap	42 011.9	47 479.4	(20 914.6)	(22 134.4)	(9 126.2)	(17 943.5)	3 141.7	22 514.3
The Group - Cumulative gap	42 011.9	89 491.3	68 576.7	46 442.3	37 316.1	19 372.6	22 514.3	-

Repricing Gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
USD (in USD million)								31.12.2016
The Group - Period gap	731.0	(828.9)	(159.4)	104.5	175.1	7.7	(123.4)	(93.4)
The Group - Cumulative gap	731.0	(97.9)	(257.3)	(152.8)	22.3	30.0	(93.4)	-
USD (in USD million)								31.12.2015
The Group - Period gap	300.1	(376.1)	(51.9)	137.3	15.0	(17.8)	(127.4)	(120.8)
The Group - Cumulative gap	300.1	(76.0)	(127.9)	9.4	24.4	6.6	(120.8)	-

Repricing Gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
EUR (in EUR million)								31.12.2016
The Group - Period gap	2 640.7	(959.7)	(611.0)	(116.9)	(132.6)	(833.6)	70.1	57.0
The Group - Cumulative gap	2 640.7	1 681.0	1 070.0	953.1	820.6	(13.0)	57.0	-
EUR (in EUR million)								31.12.2015
The Group - Period gap	(21.3)	416.1	214.5	(191.6)	(381.8)	(825.8)	212.4	(577.5)
The Group - Cumulative gap	(21.3)	394.8	609.3	417.7	35.9	(789.9)	(577.5)	-

Repricing Gap	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
CHF (in CHF million)								31.12.2016
The Group - Period gap	119.2	2 961.8	159.5	(1 839.3)	1.6	(324.9)	(676.7)	401.2
The Group - Cumulative gap	119.2	3 081.0	3 240.5	1 401.2	1 402.8	1 077.9	401.2	-
CHF (in CHF million)								31.12.2015
The Group - Period gap	(370.1)	3 651.3	124.2	(1 808.4)	(74.7)	(416.7)	(715.9)	389.7
The Group - Cumulative gap	(370.1)	3 281.2	3 405.4	1 597.0	1 522.3	1 105.6	389.7	-

As at the end of 2016 and 2015, PKO Bank Polski SA Group had a positive cumulative gap in PLN in all the time horizons.

SENSITIVITY MEASURES

Exposure of PKO Bank Polski SA Group to interest rate risk was within accepted limits as at 31 December 2016. The Group was mainly exposed to PLN interest rate risk. Among all applied stress tests by the Group involving a parallel shift of interest rate curves, the most unfavourable for the Bank was the scenario of a parallel shift of interest rate curves in PLN.

Interest rate risk generated by the Group entities with regard to PLN, EUR and CHF did not have a significant effect on the interest rate risk of the entire Group and therefore did not significantly affect its risk profile. Interest rate risk with regard to USD was significantly altered by exposure of the Group entities, in which the biggest part has the exposure of KREDOBANK SA.

VaR of the Bank and stress-tests analysis of the Group's exposure to the interest rate risk are presented in the table below:

Name of sensitivity measure	31.12.2016	31.12.2015
VaR for a 10-day time horizon at the confidence level of 99% (in PLN million)*	268.8	271.7
Parallel movement of interest rate curves by 200 b.p. (in PLN million) (stress-test)**	2 058.8	2 013.8

* Due to the nature of the activities carried out by the other Group entities generating significant interest rate risk as well as a the specific nature of the market on which they operate, the Group does not calculate consolidated VaR. These companies apply their own risk measures in the interest rate risk management. KREDOBANK SA uses the 10-day interest rate VaR for the main currencies, which amounted to approx. PLN 8.9 million as at 31 December 2016 and PLN 11.5 million as at 31 December 2015.

** The table presents the value of the most adverse stress-test of the scenarios: movement of interest rate curves in particular currencies by 200 b.p. up and by 200 b.p. down.

As at 31 December 2016, the Bank's interest rate VaR for the 10-day time horizon (10-day VaR) amounted to PLN 268.8 million, which accounted for approximately 0.9% of the Bank's own funds. As at 31 December 2015, VaR for the Bank amounted to PLN 271.6 million, which accounted for approximately 1.00% of the Bank's own funds.

64. CURRENCY RISK MANAGEMENT

CURRENCY RISK MANAGEMENT

DEFINITION

Currency risk is the risk of incurring losses due to unfavourable exchange rate changes. The risk is generated by maintaining open currency positions in a given foreign currency.

MANAGEMENT OBJECTIVE

Mitigate the risk of incurring potential losses arising from exchange rate fluctuations to an acceptable level by appropriate shaping the structure of statement of the financial position and off-balance sheet items.

RISK IDENTIFICATION AND MEASUREMENT

The Group utilizes the following currency rate risk measures: value at risk (VaR) and stress tests.

CONTROL

Control over currency rate risk covers determining currency risk limits and thresholds tailored to the scale and complexity of the Group's operations, in particular the strategic limit of tolerance to currency risk.

FORECASTING AND MONITORING OF RISK

The following are monitored by the Group on a regular basis:

- the level of currency risk,
- the degree of utilization of the strategic limit of currency risk tolerance,
- the degree of utilization of internal limits and threshold values relating to currency risk.

REPORTING

The reports on currency risk are developed on a daily, weekly, monthly and quarterly basis.

MANAGEMENT ACTIONS

Main tools used in currency risk management in the Group include:

- procedures for currency risk management,
- limits and thresholds for currency risk,
- defining allowable types of transactions in foreign currencies and the exchange rates used in such transactions.

The Group has set limits and threshold values for currency risk for i.a.: currency positions, Value at Risk calculated for a 10-day time horizon and daily loss from transactions on currency market.

FINANCIAL INFORMATION

SENSITIVITY MEASURES

VaR of the Bank and stress-tests analysis of the Bank's exposure to currency risk are stated cumulatively for all currencies in the table below:

Name of sensitivity measure	31.12.2016	31.12.2015
VaR for a 10-day time horizon at the confidence level of 99% (in PLN million)*	9.5	25.4
Change in CUR/PLN by 20% (in PLN million) (stress-test)**	24.6	1.9

* Due to the nature of the activities carried out by the other Group entities generating significant interest rate risk as well as a the specific nature of the market on which they operate, the Parent company does not calculate consolidated VaR. These companies apply their own risk measures in the interest rate risk management. KREDOBANK SA uses the 10-day interest rate VaR for the main currencies, which amounted to approx. PLN 0.35 million as at 31 December 2016 and PLN 4.8 million as at 31 December 2015.
** The table presents the value of the most adverse stress-test of the scenarios: PLN appreciation by 20% and PLN depreciation by 20%.

CURRENCY POSITION

The Group's currency positions are presented in the table below:

Currency position	31.12.2016	31.12.2015
EUR	(170.1)	94.1
USD	29.9	(87.3)
CHF	(36.5)	(72.5)
GBP	8.6	(1.8)
Other (Global Net)	88.7	171.1

The volume of currency positions is a key factor determining the level of currency risk on which the Group is exposed (except for volatility of foreign exchange rates). The level of currency positions is determined by all foreign currency transactions, which are concluded by the Group, both in the statement of financial position and off-balance sheet transactions. The Bank's exposure to currency risk is low (with reference to own funds, VaR for a 10-day time horizon for the Bank's currency position as at 31 December 2016 amounted to ca. 0.03% and as at 31 December 2015 0.09% respectively).

CURRENCY STRUCTURE

	Currency translated to PLN - 31.12.2016				
	PLN	EUR	CHF	Other	Total
Cash and balances with the Central Bank	11 928.1	718.2	78.7	600.1	13 325.1
Amounts due from banks	1 980.1	2 160.3	502.8	702.4	5 345.6
Loans and advances to customers	158 630.8	15 407.7	31 268.4	3 302.3	208 609.2
Securities	48 216.5	1 532.3	1 031.4	968.8	51 749.0
Tangible assets	12 843.2	-	-	150.4	12 993.6
Other assets and derivative financial instruments	7 933.7	222.2	3.2	132.2	8 291.3
Total assets (gross)	241 532.4	20 040.7	32 884.5	5 856.2	300 313.8
Depreciation / amortisation / impairment	(12 891.6)	(313.3)	(1 005.1)	(531.1)	(14 741.1)
Total assets (net)	**228 640.8**	**19 727.4**	**31 879.4**	**5 325.1**	**285 572.7**
Amounts due to the Central Bank	4.1	-	-	-	4.1
Amounts due to banks	1 220.4	2 682.8	15 238.8	66.4	19 208.4
Amounts due to customers	180 146.5	14 079.6	2 550.3	8 290.0	205 066.4
Liabilities related to insurance activities	2 942.1	1.4	-	0.1	2 943.6
Debt securities in issue	4 678.3	5 571.7	-	4 243.2	14 493.2
Subordinated liabilities	1 616.6	-	922.4	-	2 539.0
Provisions	215.9	5.3	1.2	6.2	228.6
Other liabilities and derivative financial instruments	7 857.1	443.3	2.8	217.6	8 520.8
Equity	32 568.6	-	-	-	32 568.6
Total liabilities and equity	**231 249.6**	**22 784.1**	**18 715.5**	**12 823.5**	**285 572.7**
Off-balance sheet liabilites granted	50 440.1	4 001.1	188.9	3 445.0	58 075.1

(IN PLN MILLION)

	Currency translated to PLN - 31.12.2015				
	PLN	EUR	CHF	Other	Total
Cash and balances with the Central Bank	12 562.5	727.3	61.9	392.2	13 743.9
Amounts due from banks	1 949.9	1 677.0	113.0	813.1	4 553.0
Loans and advances to customers	149 855.3	13 527.6	32 243.8	3 074.2	198 700.9
Securities	41 330.1	1 674.8	993.6	591.1	44 589.6
Tangible assets	12 072.8	-	-	127.0	12 199.8
Other assets and derivative financial instruments	7 287.4	216.4	41.8	84.2	7 629.8
Total assets (gross)	225 058.0	17 823.1	33 454.1	5 081.8	281 417.0
Depreciation / amortisation / impairment	(12 024.0)	(276.2)	(963.7)	(1 213.2)	(14 477.1)
Total assets (net)	**213 034.0**	**17 546.9**	**32 490.4**	**3 868.6**	**266 939.9**
Amounts due to the Central Bank	4.2	-	-	-	4.2
Amounts due to banks	1 068.1	2 522.9	14 372.3	325.5	18 288.8
Amounts due to customers	175 739.5	10 993.3	2 453.2	6 572.5	195 758.5
Liabilities related to insurance activities	2 396.5	3.9	-	0.1	2 400.5
Debt securities in issue	1 251.2	3 240.7	1 000.0	3 941.0	9 432.9
Subordinated liabilities	1 616.6	-	882.6	-	2 499.2
Provisions	242.9	5.4	1.0	2.7	252.0
Other liabilities and derivative financial instruments	7 424.4	459.1	24.7	130.7	8 038.9
Equity	30 264.9	-	-	-	30 264.9
Total liabilities and equity	**220 008.3**	**17 225.3**	**18 733.8**	**10 972.5**	**266 939.9**
Off-balance sheet liabilites granted	48 406.6	3 970.9	187.9	4 506.4	57 071.8

65. LIQUIDITY RISK MANAGEMENT

LIQUIDITY RISK MANAGEMENT

DEFINITION

The liquidity risk is defined as the lack of possibility to pay the debts on time due to the lack of liquid assets. Lack of liquidity may arise from inappropriate structure of the statement of financial position, mismatch of cash flows, not received payments from counterparties, sudden withdrawal of cash by clients or other market events.

The Group manages the financing risk, which takes into account the risk of loss of financing sources and the lack of opportunities to renew matured funding, or loss of access to new financing sources.

MANAGEMENT OBJECTIVE

Ensure the necessary level of the funds to pay present and future debts (also potential) on time, taking into account the nature of performed activities and requirements which may occur due to changes in market environment, by shaping the structure of statement of financial position and off-balance sheet liabilities.

RISK IDENTIFICATION AND MEASUREMENT

The Group makes use of the following liquidity risk measures:

- the contractual and adjusted liquidity gap in real terms,
- liquidity reserve,
- liquidity surplus,
- ratio of stable funding to illiquid assets,
- liquidity coverage ratio (LCR),
- national supervisory liquidity measures (M1-M4),
- measure of stability of deposit and loan portfolios,
- stress-tests (liquidity stress-tests).

CONTROL

Control over liquidity risk covers determining liquidity risk limits and thresholds tailored to the scale and complexity of the Group's operations, in particular the strategic limit of tolerance to liquidity risk.

FORECASTING AND MONITORING

The Group regularly monitors:

- utilization level of strategic tolerance risk losses limit,
- the degree of utilization of supervisory liquidity standards,
- the degree of utilization of internal limits and threshold values relating to liquidity risk,
- concentration of sources of financing,
- early warning signals – monitoring their level is aimed at the early discovery of unfavourable events which could have a negative impact on the Group's or the financial sector's liquidity position (which, when exceeded, launch liquidity contingency plans).

The Group also performs cyclic forecasts of liquidity risk levels, in consideration of the current developments in the Group's operations. Liquidity forecasts account mainly for the level of particular liquidity risk measures in conditions of realizing the Group's statement of financial position forecasts and realizing selected stress-test scenarios.

REPORTING

Liquidity reports are developed on a daily, weekly, monthly and quarterly basis and once a year an in-depth long-term liquidity analysis is conducted.

MANAGEMENT ACTIONS/ TOOLS FOR RISK MANAGEMENT

The main tools for liquidity risk management in the Group are as follows:

- procedures for liquidity risk management, in particular emergency plans,
- limits and thresholds mitigating for short, medium and long-term liquidity risk,
- national and European supervisory liquidity measures,
- deposit, investment and derivative transactions, including structural currency transactions and transactions for sale or purchase of securities,
- transactions ensuring long-term financing of the lending activities.

The Group policy concerning liquidity is based on keeping a portfolio of appropriate level of liquidity surplus through an increase in portfolio of liquid securities and stable sources of financing (stable deposit base, in particular). In liquidity risk management money market instruments, including NBP open market operations are also used.

FINANCIAL INFORMATION

LIQUIDITY GAPS

Liquidity gaps presented below include the sum of Bank's adjusted liquidity gap (adjusted in terms of the following: permanent balances on deposits of non-financial sector and their maturity, permanent balances on loans in current accounts for non-financial entities and their maturity and liquid securities and their maturity) and contractual liquidity gap of the other Group entities.

	a'vista	0 - 1 months	1 - 3 months	3 - 6 months	6 - 12 months	12 - 24 months	24 - 60 months	over 60 months
31.12.2016								
The Group - realigned periodic gap	11 982.6	28 501.1	493.1	579.4	6 581.5	11 193.5	24 592.2	(83 923.4)
The Group - realigned cumulative periodic gap	11 982.6	40 483.6	40 976.7	41 556.2	48 137.7	59 331.2	83 923.4	-
31.12.2015								
The Group - realigned periodic gap	13 974.6	19 405.6	(346.9)	3 590.9	7 972.0	8 034.7	12 600.3	(65 231.2)
The Group - realigned cumulative periodic gap	13 974.6	33 380.2	33 033.3	36 624.2	44 596.2	52 630.9	65 231.2	-

In all time horizons, the Group's cumulative adjusted liquidity gap in real terms , which has been determined as a sum of adjusted liquidity gap in real terms of the Bank and contractual liquidity gaps of the remaining Group entities, as at 31 December 2016 and as at 31 December 2015 was positive. This means a surplus of assets receivable over liabilities payable.

LIQUIDITY RESERVE AND LIQUIDITY SURPLUS

Name of sensitivity measure	31.12.2016	31.12.2015
Liquidity reserve up to 1 month * (in PLN billion)	31.2	30.2
Liquidity surplus in a horizon of up to 30 days** (in PLN billion)	13.0	14.5

* Liquidity reserve – gap between the most liquid assets and expected and potential liabilities which mature in a given period of time.
** Excess liquidity – excess liquidity determines the Bank's ability to maintain liquidity on each day during the period called the 'horizon of survival' if predefined stress test scenarios occur.

SUPERVISORY LIQUIDITY MEASURES

Measure	31.12.2016	31.12.2015
M1	24 464	18 907
M2	1.89	1.65
M3	11.63	9.87
M4	1.19	1.15
LCR	136.3%	131,5%

In the period from 31 December 2015 to 31 December 2016 ratios supervisory measures remained above the supervisory limits. LCR indicator shows the value for the Group in the table above.

PERMANENT BALANCES ON DEPOSITS

As at 31 December 2016 the level of permanent balances on deposits constituted approx. 93.8% of all deposits in the Bank (excluding interbank market), which means an increase by approximately 0.3 p.p. as compared to the end of 2015.

(IN PLN MILLION)

STRUCTURE OF THE BANK'S SOURCES OF FINANCING

	31.12.2016	31.12.2015
Total deposits (excluding interbank market)	76.50%	75.96%
Interbank market deposits	0.30%	0.67%
Equity	12.40%	11.99%
Market financing	10.80%	11.38%
Total	**100.00%**	**100.00%**

THE CONTRACTUAL CASH FLOWS OF THE GROUP'S LIABILITIES EXCLUDING DERIVATIVE FINANCIAL INSTRUMENTS

The tables below show the contractual maturity analysis presenting the outstanding contractual maturity dates by individual categories of statement of financial position and off-balance sheet liabilities, excluding derivative financial instruments.

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2016 and as at 31 December 2015. The amounts disclosed comprise non-discounted future cash flows, both in respect of principal and interest (if applicable), in accordance with the contract, for the entire period to the date of the liability's maturity. In situations where the party to whom the Group has a liability is able to select the settlement deadline, it has been assumed that the earliest date on which the Group is obliged to settle the liability shall be taken into account. In situations where the Group is obliged to settle the liabilities in instalments, each instalment is allocated to the earliest period in which the Group might be obligated to settle. In the case of liabilities where the instalment is not fixed, the terms binding as at the reporting date have been adopted.

Contractual flows of the Group's liabilities as at 31 December 2016 and as at 31 December 2015 by maturity

Group's liabilities as of 31 December 2016 by maturity	Up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Contractual amount	Carrying amount
Liabilities:							
Amounts due to the Central Bank	4.1	-	-	-	-	4.1	**4.1**
Amounts due to banks	1 136.5	126.2	235.1	17 515.9	-	19 013.7	**19 208.4**
Amount due to customers	135 960.1	19 168.4	35 333.8	13 862.9	8 296.3	212 621.5	**205 066.4**
Debt securities in issue	301.2	948.4	2 487.4	4 148.0	7 814.6	15 699.6	**14 493.2**
Subordinated liabilities	-	33.0	46.0	351.0	2 604.0	3 034.0	**2 539.0**
Other liabilities	3 006.4	136.4	320.5	329.2	194.6	3 987.1	**3 987.1**
Off-balance sheet liabilities:						-	
granted financial	13 608.4	5 858.8	13 705.8	11 233.4	6 432.7	50 839.1	-
granted guarantee	265.6	569.8	3 704.5	8 582.7	1 537.5	14 660.1	-

Group's liabilities as of 31 December 2015 by maturity	Up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Contractual amount	Carrying amount
Liabilities:							
Amounts due to the Central Bank	4.2	-	-	-	-	4.2	**4.2**
Amounts due to banks	1 907.8	0.1	37.4	240.6	16 385.1	18 571.0	**18 288.8**
Amount due to customers	126 532.3	21 867.5	34 840.3	10 564.6	6 191.7	199 996.4	**195 758.5**
Debt securities in issue	50.6	152.3	2 771.6	3 058.7	4 492.4	10 525.6	**9 432.9**
Subordinated liabilities	-	33.0	44.2	319.3	2 650.3	3 046.8	**2 499.2**
Other liabilities	2 697.8	7.5	302.2	147.4	201.3	3 356.2	**3 356.2**
Off-balance sheet liabilities:							
granted financial	28 675.0	814.8	3 898.2	3 102.4	6 269.7	42 760.2	-
granted guarantee	1 415.3	1 604.0	2 456.4	9 783.6	1 294.7	16 554.1	-

(IN PLN MILLION)

THE CONTRACTUAL CASH FLOWS RELATED TO DERIVATIVE FINANCIAL INSTRUMENTS

DERIVATIVE FINANCIAL INSTRUMENTS SETTLED IN NET AMOUNTS

Derivative financial instruments settled by the Group on a net basis include:

- interest rate swaps (IRS),
- Forward Rate Agreements (FRA),
- Non Deliverable Forwards (NDF),
- options.

The tables below show the contractual maturity analysis presenting the outstanding contractual maturity dates by individual categories of derivative financial instruments in respect of which the valuation as at the balance sheet date was negative (a liability).

The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2016 and as at 31 December 2015. In case of IRS transactions, non-discounted future net cash flows in respect of interest have been presented and in case of the remaining derivative instruments settled on a net basis, the amount of the valuation as at 31 December 2015 and as at 31 December 2014 respectively was adopted as the value of a cash flow.

31 December 2016	Up to 1 month	1-3 months	3 months- 1 year	1-5 years	Over 5 years	Contractual amount
Derivative financial instruments - liabilities:						
- Interest Rate Swap (IRS) transactions	(22.4)	(16.1)	(325.5)	(769.5)	(179.9)	(1 313.4)
- other derivative instruments: options, FRA, NDF	(110.0)	(72.9)	(624.4)	(524.4)	(0.2)	(1 331.9)

31 December 2015	Up to 1 month	1-3 months	3 months- 1 year	1-5 years	Over 5 years	Contractual amount
Derivative financial instruments - liabilities:						
- Interest Rate Swap (IRS) transactions	(208.3)	(263.3)	(602.6)	(1 625.7)	(363.1)	(3 063.0)
- other derivative instruments: options, FRA, NDF	(153.8)	(122.9)	(507.3)	(886.0)	(0.3)	(1 670.3)

DERIVATIVE FINANCIAL INSTRUMENTS SETTLED IN GROSS AMOUNTS

Derivative financial instruments settled by the Bank on a gross basis include:

- foreign currency swaps,
- foreign currency forwards,
- Cross Currency IRS (CIRS).

The tables below show the contractual maturity analysis, presenting the outstanding contractual maturity dates by individual categories of derivative financial instruments (inflows and outflows) in respect of which valuation the balance sheet date was negative (a liability). The amounts denominated in foreign currencies have been translated using the average NBP exchange rate as at 31 December 2016 and as at 31 December 2015. The amounts disclosed comprise non-discounted future cash flows, both in respect of principal and interest (if applicable).

31 December 2016	Up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Contractual amount
- outflows	(7 030.1)	(2 243.3)	(4 699.8)	(3 089.5)	(40.5)	(17 103.2)
- inflows	8 057.7	2 593.3	4 944.0	9 907.8	141.7	25 644.5

(IN PLN MILLION)

31 December 2015	Up to 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Contractual amount
- outflows	(6 078.1)	(1 991.9)	(2 657.2)	(3 522.8)	(507.6)	(14 757.6)
- inflows	6 027.8	1 676.5	2 983.2	9 679.8	1 336.0	21 703.3

SHORT-TERM AND LONG-TERM ASSETS AND LIABILITIES

The Group classifies an asset as short-term when:

- it expects to realize the asset or intends to sell or consume it in the course of the normal operating cycle,
- is in possession of the asset primarily for the purpose of trading,
- it expects that the asset will be realized within twelve months after the reporting period or
- the asset is cash or a cash equivalent (as defined in IAS 7) unless it is restricted from being exchanged or used to settle a liability for at least twelve months from the end of reporting period.

All other assets of the unit are classified as long-term assets.

The Group classifies a liability as short-term when:

- it expect that it will be settled in the normal operating cycle,
- it holds the liability for the purpose of trading,
- its maturity is within twelve months from the end of the reporting period,
- the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

All other liabilities are classified as long-term liabilities.

31.12.2016	Short-term	Long-term	Impairment allowances	Total carrying amount
Cash and balances with the Central Bank	13 325.1	-	-	13 325.1
Amounts due from banks	5 333.1	12.5	(0.2)	5 345.4
Trading assets	326.4	-	-	326.4
Derivative financial instruments	997.6	1 903.0	-	2 900.6
Financial instruments designated upon initial recognition at fair value through profit and loss	10 993.4	2 943.8	-	13 937.2
Loans and advances to customers	48 221.7	160 387.5	(8 002.7)	200 606.5
Investment securities available for sale	1 924.1	35 095.7	(344.2)	36 675.6
Investment securities held to maturity	97.5	368.1	-	465.6
Inventories	284.7	-	(24.8)	259.9
Other assets	5 510.8	6 884.8	(665.2)	11 730.4
Total assets	87 014.4	207 595.4	(9 037.1)	285 572.7
Amounts due to the Central Bank	4.1	-	-	4.1
Amounts due to banks	3 562.2	15 646.2	-	19 208.4
Derivate financial instruments	1 627.8	2 570.1	-	4 197.9
Amounts due to customers	186 904.7	18 161.7	-	205 066.4
Liabilities related to insurance activities	161.4	2 782.2	-	2 943.6
Debt securities in issue	3 704.9	10 788.3	-	14 493.2
Subordinated liabilities	-	2 539.0	-	2 539.0
Other liabilities	3 945.8	605.7	-	4 551.5
Total liabilities	**199 910.9**	**53 093.2**	-	**253 004.1**
Equity	-	32 568.6	-	32 568.6
Total liabilities and equity	**199 910.9**	**85 661.8**	-	**285 572.7**

(IN PLN MILLION)

31.12.2015	Short-term	Long-term	Impairment allowances	Total carrying amount
Cash and balances with the Central Bank	13 743.9	-	-	13 743.9
Amounts due from banks	4 553.4	-	(0.4)	4 553.0
Trading assets	783.2	-	-	783.2
Derivative financial instruments	1 400.1	2 947.2	-	4 347.3
Financial instruments designated upon initial recognition at fair value through profit and loss	12 268.2	2 885.9	-	15 154.1
Loans and advances to customers	49 020.4	149 680.5	(8 287.2)	190 413.7
Investment securities available for sale	1 154.6	27 287.4	(132.5)	28 309.5
Securities held to maturity	185.3	25.0	-	210.3
Inventories	172.6	265.5	(37.2)	400.9
Other assets	3 866.9	5 760.5	(603.4)	9 024.0
Total assets	**87 148.6**	**188 852.0**	**(9 060.7)**	**266 939.9**
Amounts due to the Central Bank	4.2	-	-	4.2
Amounts due to banks	4 062.8	14 226.0	-	18 288.8
Derivate financial instruments	1 185.0	3 439.8	-	4 624.8
Amounts due to customers	182 754.3	13 004.2	-	195 758.5
Liabilities related to insurance activities	120.4	2 280.1	-	2 400.5
Debt securities in issue	3 107.1	6 325.8	-	9 432.9
Subordinated liabilities	-	2 499.2	-	2 499.2
Other liabilities	3 255.0	411.1	-	3 666.1
Total liabilities	**194 488.8**	**42 186.2**	**-**	**236 675.0**
Equity	-	30 264.9	-	30 264.9
Total liabilities and equity	**194 488.8**	**72 451.1**	**-**	**266 939.9**

66. Other market risks

Commodity price risk management

Definition - Commodity price risk is the risk of incurring a loss due to changes in commodity prices, generated by maintaining open positions on particular types of goods.

Management objective - The objective of commodity price risk management is to reduce potential losses resulting from changes in commodity prices to the acceptable level by shaping the appropriate structure of these items.

Risk identification and measurement - In respect of the measurement of the prices of commodities, information on the positions taken by the Group in particular commodities is utilized, and stress-test analyses are performed.

Control - Control of commodity prices covers determining respective limits and threshold levels tailored to the scale and complexity of the Group’s operations.

Forecasting and monitoring - In respect of the commodity price risk the Group regularly monitors, in particular: open commodity positions, results of stress-tests and the degree of utilization of external limits imposed on the risk.

Reporting - Reports on commodity price risks are developed on a daily, weekly, monthly and quarterly basis.

Management actions - Commodity price risk is managed by imposing limits on instruments generating the commodity price risk, monitoring their use and reporting the risk level. The effect of commodity price risk on the Group's financial position is immaterial.

PRICE RISK OF EQUITY SECURITIES MANAGEMENT

DEFINITION - The price risk of equity securities is the risk of incurring a loss due to changes in the prices of equity securities on the public market or stock exchange indices, generated by maintaining open positions in instruments sensitive to changes in these market parameters. The risk results from operations conducted as part of trading activities of the Brokerage House of PKO Bank Polski SA, investing activities and from other operations as part of banking activities generating a position in equity securities.

MANAGEMENT OBJECTIVE - Managing the price of risk equity securities is aimed at limiting possible losses due to changes in the prices of equity securities on the public market or stock exchange indices to acceptable level, by optimizing the positions taken in instruments sensitive to changes in these market parameters.

RISK IDENTIFICATION AND MEASUREMENT - For the purpose of equity securities price risk management the Group utilizes:

- analyses of stress tests, in consideration of changes in market prices of the base instrument and changes in its volatility,
- information on the utilization of limits of positions taken in the equity securities portfolio.

CONTROL - Control over equity securities risk covers determining equity securities risk limits and thresholds tailored to the scale and complexity of the Group's operations.

FORECASTING AND MONITORING - The Group regularly monitors the level of price risk of equity securities and the level of utilization of the limits on positions taken in the equity securities portfolio.

REPORTING - Reports on the risk of equity securities are prepared on a monthly and quarterly basis.

MANAGEMENT ACTIONS - The risk is managed by imposing limits on the activities of the Brokerage House of PKO Bank Polski SA and by monitoring the utilization thereof. The effect of the price risk of equity securities on the financial position of the Group was assessed as immaterial. The positions taken in equity securities and index instruments are limited, and are not expected to increase significantly.

OTHER PRICE RISK

Taking into consideration other price risks, at the end of the year 2016, the Group was exposed to price risk of investment fund participation units in collective investment funds. Influence of this risk to the Group's financial situation is immaterial.

67. DERIVATIVE INSTRUMENTS RISK MANAGEMENT

DEFINITION

The risk of derivative instruments is a risk resulting from the Group's taking up a position in derivative financial instruments.

MANAGEMENT OBJECTIVE

Limiting potential losses in respect of changes in factors specific for derivatives (other than foreign currency rates or interest rates) to acceptable levels by appropriate formation of the structure of positions taken in those instruments.

RISK IDENTIFICATION AND MEASUREMENT

For the purpose of managing derivatives risk, the Group uses:

- the Value at Risk (VaR) model,
- analyses of stress tests, in consideration of changes in market prices of the base instrument, changes in its volatility, and changes in interest rates,
- sensitivity ratios of options.

Control

Control over derivatives risk covers determining derivatives risk limits and thresholds tailored to the scale and complexity of the Group's operations.

Forecasting and monitoring

Monitoring the risk of derivative instruments takes place as part of monitoring of other types of financial and credit risk. The Group puts particular emphasis to monitor financial risk related to the maintenance of currency options portfolio and customer credit risk resulting from amounts due to the Group in respect of derivative instruments.

Reporting

The reports on derivatives risk are developed on a daily, weekly, monthly and quarterly basis.

Management actions

The main tools used in derivative risk management are as follows:

- written procedures for derivative risk management,
- limits and thresholds set for the risk related to derivative instruments,
- master agreements specifying, i.a. settlement mechanisms,
- collateral agreements, under which selected clients of the Bank are required to establish a collateral on exposures due to derivative instruments.

Risk management is carried out by imposing limits on the derivative instruments, monitoring limits and reporting risk level.

The derivative risk management process is integrated in the Bank with management of the following types of risk: interest rate, currency, liquidity and credit risk. However, due to the specific nature of derivatives it is subject to special control specified in the internal regulations of the Bank.

Methods of derivative risk management in the Group subsidiaries are defined by internal regulations implemented by these entities which take up a position in derivative instruments or plan to take positions in such instruments. These regulations are developed after consultation with the Bank and take into account the recommendations issued by the Bank for the Group entities.

Positions taken by the other Group entities in particular derivative instruments are determined using similar methods to those used for positions taken by the Bank in such derivative instruments, taking into account the specific nature of the business conducted by the Group entities.

68. Operational risk management

Definition

Operational risk is defined as the risk of occurrence of a loss due to non-compliance or unreliability of internal processes, people and systems or external events. Operational risk takes into account legal risk, and does not include reputational risk and business risk.

Management objective

The objective of operational risk management is to enhance collateral of the operational activity pursued by the Bank by improving the efficient, tailored to the profile and the scale of operations mechanisms of identification, assessment and measurement, controlling, monitoring reduction and reporting of operational risk.

Risk identification and measurement

Operational risk management comprises the identification of operational risk in particular through collecting data about the operational risk and the self-assessment of operational risk.
In order to manage the operational risk, the Bank gathers internal and external data about operational events and the causes and consequences of their occurrence, data on the factors of the business environment, results of operational risk self-assessment, data on KRI and data related to the quality of internal functional controls.

The operational risk self-assessment comprises identification and assessment of operational risk for Bank's products, processes and applications as well as organizational changes and it is conducted cyclically and before the introduction of new or changed Bank's products, processes and applications.
The measurement of operational risk comprises:

- calculation of Key Risk Indicators (KRI),
- requirement calculation of own funds for operational risk under the AMA (the Bank) and BIA (Branch in Germany and the Group companies included in precautionary consolidation),
- stress-tests,
- calculation of Group internal capital.

CONTROL

Control of operational risk includes setting tailored to the scale and complexity of the Bank's activities risk controls in the form of limits on operational risk, in particular the strategic limits of tolerance and operational risk, losses limits, KRI with thresholds and critical values.

FORECASTING AND MONITORING

The Group regularly monitors:

- utilization level of strategic tolerance and operational risk losses limits for the Bank,
- operational events and their consequences,
- results of operational risk self-assessment,
- requirement in respect of own funds as regards to operational risk in accordance with the BIA approach in the activities of the branch of the Bank in the Federal Republic of Germany and in accordance with the AMA approach with respect to the remaining activity of the Bank and the Group companies included in prudential consolidation, in accordance with the BIA approach,
- the results of stress tests,
- the level of risk, areas and tools for operational risk management,
- key Risk Indicators (KRI), in relations to threshold and critical values,
- effectiveness and timeliness of actions undertaken to reduce or transfer the operational risk,
- management activities, related to the presence of elevated or high levels of operational risk and their effectiveness in reducing the level of operational risk.

In 2016, the dominant impact on the operational risk profile of the Group was exercised by the following entities: PKO Bank Polski SA, the PKO Leasing SA Group and the KREDOBANK SA Group. Other Group entities, considering their significantly smaller scale and type of activity, generate only reduced operational risks.

REPORTING

Reporting of information concerning operational risk is performed for the needs of the senior management staff, the ORC, the RC, the Management Board and the Supervisory Board. Each month, information about operational risk is prepared and forwarded to the senior management staff, the organizational units of the Head Office and specialist organizational units responsible for system-based operational risk management. The scope of the information is diversified and tailored to the scope of responsibilities of the individual recipients of the information.

MANAGEMENT ACTIONS

Management actions are taken in the following cases:

- on ORC's initiative or Management Board,
- on the initiative of organizational units and cells of the Bank managing operational risk,
- when operational risk exceeded levels described by Management Board or ORC.

In particular when the risk level is elevated or high, the Bank uses the following approach and instruments to manage the operational risk:

- risk reduction – mitigating the impact of risk factors or the consequences of its materialization by introducing or strengthening various types of instruments for managing operational risk such as: control instruments, human resources management instruments, determination or verification of threshold values and critical KRIs, determination or verification of operational risk levels and contingency plans,
- risk transfer – transfer of responsibility for covering potential losses on a third-party: insurance and outsourcing,
- risk avoidance – resignation from activity that generates risk or elimination the probability of the occurrence of a risk factor.

69. OTHER RISK

Compliance risk management and conduct risk management Business risk management Reputation risk management Model risk management Macroeconomic changes risk management Capital risk management Insurance risk management Management of the risk of excessive leverage

COMPLIANCE RISK AND CONDUCT RISK MANAGEMENT

DEFINITION	Compliance risk is defined as the risk of legal sanctions, incurring financial losses or losing reputation due to failure of the Group, its employees or entities acting on its behalf to comply with the provisions of the law, internal regulations, standards adopted by the Group, including market standards. Conduct risk means a risk which arises on the part of: 1) the customer, 2) the Group, including its credibility, 3) financial markets, with regard to their credibility, as a result of inappropriate action (also unintentional) or any omission by the Group, its staff or related entities, with regard to offering purchase and provision of financial services.
MANAGEMENT OBJECTIVE	The objectives of the compliance risk and conduct risk management are as follows: • strengthening the image of the Group as an institution acting in accordance with the law and the accepted market standard, trustworthy, reliable and fair, among the Group's shareholders, customers, employees, business partners and other market participants; • preventing financial losses, legal penalties or the loss or reputation which may result from breaching the law, the Group's internal regulations and the market standards adopted by the Group. • countervailing losses on the part of the Group, which can result from inappropriate conduct (also unintentional) or omission by the Group, its staff or related entities, with regard to offering purchase and provision of financial services.
IDENTIFICATION	To identify and assess the compliance and conduct risks, information on the compliance incidents and their reasons is used, including information resulting from internal audits, internal controls and external inspections. Identification and assessment of the compliance and conduct risks is based mainly on the following:

1) estimating the potential impact of non-compliance,
2) the results of operational risk self-assessment,
3) the results of a review and assessment of the adequacy and effectiveness of control mechanisms,
4) information on irregularities identified within the internal control,
5) an evaluation of the existence of additional risk of non-compliance with the law.

During the assessment, the nature and the potential scale of losses is identified and the possible ways of mitigating or eliminating the compliance risk. The assessment is conducted in the form of workshops.

MONITORING

Monitoring of the compliance and conduct risk is performed using information provided by the Bank's organizational units and consists in:

- analyzing compliance incidents occurring in the Group and in the banking sector, their reasons and effects,
- evaluating changes in the key legal regulations affecting the operations of the Bank and its Group,
- evaluating actions undertaken by the Bank and the Group companies as part of compliance risk management,
- evaluating the effectiveness and adequacy of the controls relating to mitigation of the compliance risk,
- analyzing information on the status of the major projects conducted within the Bank to adjust to the universally applicable provisions of the law, market standards adopted by the Bank and communication from external regulatory and control bodies,
- analyzing information on operational events, security incidents, disputes (including court cases) against the Bank, complaints and irregularities relating to conduct risk.

REPORTING

The reporting of compliance risk and conduct risk takes the form of quarterly reports addressed to the Risk Committee, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board and information submitted for the purposes of external regulatory and control bodies.

MANAGEMENT ACTIONS

Compliance risk management covers, in particular, the following issues:

- preventing the Group from engaging in illegal activities;
- promoting ethical standards and monitoring their operation;
- managing conflicts of interests;
- preventing situations in which the Group's employees could be perceived as pursuing their own interest in a professional context;
- professional, fair and transparent formulation of the product offer, advertising and marketing communication;
- ensuring data protection;
- prompt, fair and professional consideration of the customers' complaints, suggestions and claims.
- preventing situations in which a product which does not meet a customer's needs is offered,
- determining an adequate manner and form of offering a product, depending on the product's character,
- monitoring sales and the fair execution of the agreements concluded with customers.

The Bank has adopted a zero tolerance policy against compliance risk, which means that the Bank focuses its actions on eliminating this risk.

BUSINESS RISK MANAGEMENT

DEFINITION	Business risk is the risk of incurring losses due to adverse changes in the business environment, taking bad decisions, the incorrect implementation of decisions taken, or not taking appropriate actions in response to changes in the business environment. This includes in particular strategic risk.
MANAGEMENT OBJECTIVE	Maintaining, on an acceptable level, the potential negative financial consequences resulting from adverse changes in the business environment, making adverse decisions, improper implementation of adopted decisions or lack of appropriate actions, which would be a response to changes in the business environment.
RISK IDENTIFICATION AND MEASUREMENT	Identification is to recognise and determine factors both current and potential, resulting from current and planned activities of the Group and which may significantly affect the financial position of the Group, generating or change in the Group's income and expense. Business risk identification is performed by identifying and analyzing the factors that had an impact on the significant deviations of realization of income and expense from their forecasted values. Measurement of business risk is aimed at defining the scale of threats related to the existence of business risk with the use of defined risk measures. The measurement of business risk includes: calculation of internal capital, conducting stress-tests.
CONTROL	Control of the business risk is aimed at striving to maintain the business risk at an acceptable level. It involves setting and periodic review of the risk controls in the form of tolerance limits on the business risk along with its thresholds and critical values, adequate to the scale and complexity of the Group.
FORECASTING AND MONITORING	Forecasting of the business risk is aimed at determining an anticipated scenario of changes in the income and expense items in the income statement. The forecast is prepared once a quarter on a yearly basis and includes forecasting the level of business risk and internal capital. Once a quarter, the verification of a business risk forecast (so-called backtesting) is performed. Monitoring of the business risk is aimed at diagnosing the areas which require management actions. Monitoring of business risk includes: • strategic levels of business risk tolerance – on a quarterly basis, • stress-tests results – on an annual basis, • reverse stress-tests results – on an annual basis, • internal capital level – on a quarterly basis, • deviations from the implementation of business risk forecast – on a quarterly basis, • results of a survey conducted among senior management staff of the Bank - on an annual basis.
REPORTING	Reporting is performed on a quarterly basis. The reports on the business risk level are addressed to the ALCO, the RC, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board.
MANAGEMENT ACTIONS	Management actions consist of, in particular: • verifying and updating quarterly financial forecasts, including actions aimed at lowering the business risk level in accordance with the limits, • monitoring the level of the strategic limit of tolerance to business risk.

REPUTATION RISK MANAGEMENT

DEFINITION	The reputation risk is understood as the risk of deterioration of reputation among clients, counterparties, investors, supervisory and control authorities, and the general public as a result of the business decisions, operating events, instances of non-compliance or other events.
MANAGEMENT OBJECTIVE	The objective of managing the reputation risk is to protect the Group's reputation by counteracting the occurrence of reputation and limiting the negative effect of image-related events on the Group's reputation.
IDENTIFICATION	Identification of the reputation risks covers the developments observed in the Group's internal processes and in its external environment, including in particular: image-related events and factors related to the business environment, i.e. quantitative and qualitative information, including especially the data which describes the Group and its external environment, which suggest the existence of the reputation risk.
ASSESSMENT	An assessment of the reputation risk involves evaluating the impact of image-related events on the Group's reputation, and in particular, quantifying and determining the severity of reputation losses. The evaluation of a reputation loss includes the impact, credibility and the opinion-forming potential of the disclosure of an image-related event to the public.
MONITORING	Monitoring reputation risk consists of a regular assessment of the value of reputation risk measures compared with the adopted threshold values. The level of reputation risk is determined based on the value of reputation risk measures.
REPORTING	Information on the reputation risk is reported in the form of: 1) a semi-annual management report addressed to the Risk Committee, the Management Board, the Risk Committee of the Supervisory Board and the Supervisory Board. 2) ad-hoc information on current events having a material impact on the Bank's reputation, addressed to the President of the Management Board and to his Office. 3) information included in the Bank's and the Group's financial statements and provided at the request of the external supervisory and control bodies.
MANAGEMENT ACTIONS	Based on the specific level of reputation risk management actions are taken which may cover: 1) an analysis of the reasons for a given level of risk occurring; 2) assessment of the effects of such a level of risk occurring; 3) preparation of proposed management actions aimed at reducing the level of reputation risk or justification of the lack of the need to take such action, e.g. in the event of incidental extraordinary events occurring.

MODEL RISK MANAGEMENT

DEFINITION	Model risk is the risk of incurring negative financial effects or reputation as a result of making incorrect business decisions on the basis of the models functioning. Within the Group, model risk is managed both on the part of a given Group entity (an owner of a model) and at the level of the Bank as a parent company of the Group
MANAGEMENT OBJECTIVE	The objective of model risk management is to mitigate the level of risk of incurring losses as a result of making incorrect business decisions on the basis of existing models in the Group through a well-defined and implemented process of models management. One of the elements of the model management process is to cover all significant models in the Group with regular, independent validation.

RISK IDENTIFICATION AND MEASUREMENT	Identification of the model risk consists of, in particular, collecting information about the existing models and models planned to be implemented as well as determining the materiality of the models on a periodical basis. The model risk evaluation is aimed at determining the scale of the threats associated with the occurrence of the model risk. The evaluation is made at the level of each model as well as on an aggregate basis at the level of the Group.
CONTROL	Control of the model risk is aimed at maintaining an aggregated evaluation of the model risk at a level which is acceptable to the Group. Control of the model risk consists of determining the mechanisms used to diagnose the model risk level and tools for reducing the level of this risk. The tools used to diagnose the model risk include, in particular, a strategic limit of tolerance to the model risk and the threshold values of the model risk.
MONITORING	Monitoring of the model risk on a periodical basis is aimed at diagnosing the areas requiring management actions and includes, in particular: • updating the model risk level, • evaluating the utilization of the strategic limit of tolerance to the model risk and the threshold values of the model risk, • verifying the stage of implementation and evaluating the effectiveness of the implementation of the activities as part of the mitigation of the model risk.
REPORTING	The results of monitoring the model risk are presented periodically in the reports addressed to the RC, the Management Board, and the Supervisory Board.
MANAGEMENT ACTIONS	The purpose of management actions is to form a model risk management process and to affect the level of this risk, in particular by determining acceptable risk levels and making decisions about the use of tools supporting model risk management.

MACROECONOMIC CHANGES RISK MANAGEMENT

DEFINITION	Risk of macroeconomic changes is a risk of deterioration of the financial situation of the Group as a result of the adverse impact of changes in macroeconomic conditions.
MANAGEMENT OBJECTIVE	The purpose of risk of macroeconomic changes management is to identify macroeconomic factors having a significant impact on the Group's activities and taking actions to reduce the adverse impact of potential changes in the macroeconomic situation on the financial situation of the Group.
RISK IDENTIFICATION AND MEASUREMENT	Identification of risk of macroeconomic changes involves determination of scenarios of the potential macroeconomic changes and to determine risk factors having the greatest impact on the financial situation of the Group. Risk of macroeconomic changes results from interaction of factors dependent and independent of the Group's activities. The Group identifies the factors affecting the level of risk of macroeconomic changes during carrying out comprehensive stress-tests. The risk of macroeconomic changes materializes indirectly through other risks affecting the Group's operations. For the purpose of measuring the risk of macroeconomic changes the Group uses risk measures based on the results of comprehensive stress-tests, in particular: • financial result and its components, • capital adequacy measures and their components, • selected liquidity measures, • data on the quality of the loan portfolio.

CONTROL	Control of the risk of macroeconomic changes is aimed at striving to mitigate the adverse effect of potential changes in the macroeconomic situation on the financial position of the Group. Control of the risk of macroeconomic changes consists of determining the acceptable risk level tailored to the scale of the Group's operations, with the level of the risk of macroeconomic changes being assessed on the basis of the results of comprehensive stress tests. An acceptable level of the risk of macroeconomic changes is a situation in which stress test results do not point to the need to take any remedial measures.
MONITORING	Monitoring consists of, among other things, analyzing macroeconomic factors and the economic situation on a current basis and includes in particular: changes in the macroeconomic situation, the macroeconomic factors to which the Group is sensitive, stress test results, the level of the risk of macroeconomic changes.
REPORTING	Reporting is provided in the form of additional information about the risk of macroeconomic changes which accompanies a quarterly report on capital adequacy, in which the stress tests were conducted. The reports are addressed to the ALCO, the RC, the Management Board and the Supervisory Board.
MANAGEMENT ACTIONS	Management actions in particular consist of: • issuing internal regulation, • determining acceptable levels of risk, • proposals of actions aimed at reducing the level of risk in the event of elevated or high risk of macroeconomic changes occurrence

CAPITAL RISK MANAGEMENT	
DEFINITION	Capital risk is the risk of failing to ensure an appropriate level and structure of own funds, with respect to the scale of the Group operations and risk exposure and, consequently, insufficient for the absorption of unexpected losses, taking into account development plans and extreme situations.
MANAGEMENT OBJECTIVE	The objective of managing the capital risk is to ensure an appropriate level and structure of own funds, with respect to the scale of the operations and risk exposure of the Group and the Group, taking into account of the assumptions of the Group's dividend policy as well as supervisory instructions and recommendations concerning capital adequacy.
RISK MEASUREMENT	The capital risk level for the Group is determined based on the minimum, threshold and maximum values of capital adequacy measures, amongst others, the total capital ratio and basic capital (Tier 1) ratio. In addition, threshold and maximum values are determined for capital adequacy measures, as an excess over the minimum values constituting strategic tolerance limits for the capital adequacy measures. The capital risk level is determined as follows: 1) low level – when all capital adequacy measures exceed the threshold values, 2) raised level – when at least one adequacy measure is lower than a threshold value and no capital adequacy measure is lower than the strategic tolerance limit, 3) high level – when at least one capital adequacy measure is lower than the strategic tolerance limit.
MONITORING	The Group regularly monitors the level of capital adequacy measures in order to determine the degree of compliance with supervisory standards, internal strategic limits, and to identify instances which require taking capital contingency actions. Should a high level of capital risk be identified, the Group takes measures to bring capital adequacy measures to a lower level, taking into account of the assumptions of the dividend policy as well as the supervisory instructions and recommendations concerning capital adequacy.

INSURANCE RISK MANAGEMENT

DEFINITION	Insurance risk is a risk of loss or of adverse change in value of insurance liabilities, due to inadequate pricing and provisioning assumptions (in particular for technical provisions).

IDENTIFICATION, MEASUREMENT AND RISK ASSESSMENT

The exposure to insurance risks in the Group related to insurance companies is monitored and shaped in accordance with the adopted risk management strategy.

In PKO Życie Towarzystwo Ubezpieczeń SA (PKO Życie), the dominant type of insurance risk depends on the type of product in the Company's portfolio:

- products with Insurance Capital Funds (UFK) – mainly the contracts withdrawal risk (a relatively short period of time after implementation of the UOKiK decision),
- protection products: mortality and claims risks as well as negative selection (decreasing risk),
- for all products – the risk associated with comparing expenses with income (unit costs).

The Company mitigates its exposure to the risks through:

- reinsurance of the mortality and claims risks in excess of a specified amount per risk and per insurance contract,
- retention campaigns,
- monitoring the quality of sales in order to achieve an improvement in the quality of sales,
- increasing the scope of cover for investment and protection products.

In 2015 and 2016, the risk of changes in the approach to surrender fees materialized partially. As a result of the proceedings of the UOKiK and the agreements concluded in 2015 and 2016 as a result of these proceedings, the Company estimated the changes in the distribution of future withdrawals. The amounts of the future surrender fees were also adjusted in accordance with the above agreement. The decisions made constitute the continuation of activities conducted by the PKO Życie so far, with regard to reducing the total surrender value of selected life insurance contracts with insurance capital funds. Up until the date of this report, no increase in contract withdrawals in excess of the assumptions for determining the Best Reserve Estimate was observed.

PKO Towarzystwo Ubezpieczeń S.A. (PKO TU) is exposed to the following types of insurance risk:

- unearned premium and reserve risk – mitigated through proportionate reinsurance, product structure,
- catastrophic risk – mitigated through catastrophic reinsurance,
- contract withdrawal risk – mitigated through retention measures.
- The dominant type of risk is dependent on the type of product:
- multi-year loss of source of income insurance contracts – unearned premium and reserve risk,
- property insurance – catastrophic risk (flood).

The measurement of the insurance risk in insurance companies is performed, among other things, as part of the analysis of contract withdrawals, claims ratio analysis, the analysis of the amounts of assets to cover technical reserves (APR), and an annual analysis of shock scenarios – stress tests as part of the process of self-assessment of risk and solvency.

The companies have implemented the requirements arising from changes in regulations Solvency II system and have been calculating capital ratios under the new regime as from 1 January 2016, maintaining own funds at an adequate level.

MONITORING	As to mitigate the insurance risk exposure, PKO Życie uses among others: reinsurance of risks (mortality, morbidity), grace periods, exemptions and retention activities. Ceded reinsurance of PKO Życie is performed on the basis of: • obligatory-optional, quota share - surplus reinsurance treaties, on the basis of risk – premium, • optional reinsurance treaties, on the basis of risk – premium, • obligatory, proportionate reinsurance treaties, • obligatory catastrophic reinsurance treaties, • obligatory excess of loss reinsurance treaties. Facultative reinsurance is applied for all insurance agreements and risks not covered by obligatory – facultative reinsurance agreements, in which the sum on the gross risk exceeds agreed amount. In case of the new products and the risks, PKO Życie choses reinsurer, level of protection, conditions of the reinsurance, changes in concluded reinsurance contracts and concluding new reinsurance contracts in relation to the newly introduced to offer or modified insurance products and new risks.
REPORTING	In PKO Życie and in PKO TU, the reporting on insurance risk is provided in the form of periodical reports to the Management Board and for the Asset and Liabilities Committee, the Risk Committee, and the Risk Committee of the Supervisory Board.

The assets to cover technical reserves (APR) remained at a sufficient level (over 100%) and had an appropriate structure. As at the end of 2016, the aggregate assets to reserves ratio amounted to 103% for PKO Życie and 140% for PKO TU.

MANAGEMENT OF THE RISK OF EXCESSIVE LEVERAGE

DEFINITION	The risk of excessive financial leverage is the risk resulting from vulnerability to threats due to financial leverage or conditional financial leverage that may require taking unintended action to adjust business plans, including an emergency sale of assets which could result in losses or result in the need for valuation adjustments of other assets.
MANAGEMENT OBJECTIVE	The objective of managing the risk of excessive leverage is to ensure an appropriate relationship between the amount of the core capital (Tier 1) and the total of balance sheet assets and off-balance sheet liabilities granted by the Group.
IDENTIFICATION AND MEASUREMENT	The risk of excessive leverage materializes as a mismatch of scale of activities and structure of the sources of financing and insufficient equipment of Group's own funds. For the purpose of measuring the risk of excessive financial leverage, a leverage ratio is calculated as a measure of Tier 1 capital divided by the measure of total exposure and is expressed as a percentage rate. The leverage ratio is calculated on the reporting reference date. The leverage ratio is calculated both with reference to Tier 1 capital and in accordance with the transitional definition of Tier 1 capital.
FORECASTING AND MONITORING	A forecast is made regularly, on a quarterly basis, using the leverage ratio. The following parameters are in particular subject to monitoring of the risk of excessive leverage: • value of the leverage ratio, • threshold of the risk of excessive leverage, • deviation of the leverage ratio from forecasts.
CONTROL	The objective of the control of the risk of excessive leverage is to strive to maintain the Group's risk of excessive leverage at an acceptable level. It covers a periodical review of the risk control mechanisms in the form of a tolerance limit, including its threshold value.

REPORTING	Reporting is performed on a quarterly basis. The reports on the level of the risk of excessive leverage are addressed to the RC, the Management Board, the Risk Committee of the Supervisory Board, and the Supervisory Board.
MANAGEMENT ACTIONS	The management actions concerning the risk of excessive financial leverage are identical to the management actions concerning capital risk. In the event of an increased risk, actions are taken to bring capital adequacy measures to a proper level, taking into account the assumptions of the dividend policy as well as supervisory suggestions and recommendations concerning capital adequacy.

70. COMPLEX STRESS-TESTS

Complex stress-tests are an integral part of the Group's risk management and are complementary to stress-tests specific to particular types of risks. They collectively include the types of risk considered by the Group to be significant. They include an analysis of the impact of changes in the environment and the functioning of the Group on the Group's financial position, in particular: the income statement, statement of financial position, own funds, capital adequacy and selected liquidity measures.

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

71. CAPITAL ADEQUACY

Capital adequacy is a process whose objective is to ensure that the level of risk which the Group takes in relation to the development of its business activities may be covered with its capital, taking into account a specific risk tolerance level and time horizon. The process of managing capital adequacy comprises, in particular, compliance with the applicable regulations of the supervisory and control authorities, as well as the risk tolerance level determined within the Group and the capital planning process, including the policy concerning the sources of acquisition of capital.

The objective of capital adequacy management is to maintain own funds at a level that is adequate to the scale and profile of the risk relating to the Group's activities continuously.

The process of managing the Group's capital adequacy comprises:

- specifying and pursuing the Group's capital objectives,
- identifying and monitoring significant types of risk,
- assessing internal capital to cover the individual risk types and total internal capital,
- establishing internal capital adequacy limits,
- forecasting, monitoring and reporting the level and structure of equity and capital adequacy,
- managing the structure of the statement of financial position paying attention to optimizing the quality of the Group's own funds,
- capital emergency action,

- allocating own funds and internal capital requirements to business areas and customer segments in the Bank as well as the individual Group companies,
- assessing the profitability of the individual business areas and customer segments.

The main capital adequacy measures are:

- total capital ratio,
- the relation of own funds to internal capital,
- Tier 1 core capital ratio,
- Tier 1 capital ratio,
- leverage ratio.

The objective of monitoring the level of capital adequacy measures is to determine the degree of compliance with supervisory standards and to identify cases which require taking capital emergency action.

The basic regulations applicable in the capital adequacy assessment process are:

- the CRR Regulation,
- the Banking Law,
- the Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system (hereinafter referred to as 'the Act on macroprudential supervision').

In 2016, the levels of capital ratios were dependent, among other things, on the following supervisory decisions:

- on 10 October 2016, the Bank received the decision of the Polish Financial Supervision Authority on the identification of the Bank as other systemically important institution ('O-SII') on the basis of the assessment of the Bank's systemic importance in accordance with the Act on macroprudential supervision and on the imposition of a buffer on the Bank of 0.75% of its total risk exposure calculated in accordance with CRR Regulation;
- on 18 October 2016, the Bank received the decision of the Polish Financial Supervision Authority on the recommendation to comply with an additional own funds requirement in excess of the value arising from the requirements calculated in accordance with the detailed principles set out in the CRR. The PFSA recommended that the Bank should maintain its own funds to cover the additional capital requirement in order to hedge the risk arising from foreign currency mortgage loans to households, at the standalone level of 0.83 p.p., in excess of the total capital ratio, which should comprise at least 75% of Tier1 capital (which corresponds to a capital requirement of 0.62 p.p. in excess of the value of the Tier 1 capital ratio) and at least 56% of Tier 1 core capital (which corresponds to a capital requirement of 0.46 p.p. in excess of the value of the Tier 1 core capital ratio);
- on 5 December 2016, the Financial Stability Committee passed a resolution on a recommendation concerning maintaining the countercyclical buffer ratio at 0% and also decided to provide the European Systemic Risk Board with appropriate information about this buffer;
- on 30 December 2016, the Polish Financial Supervision Authority provided the Bank with information about the value of an additional own funds requirement in excess of the value arising from the requirements calculated in accordance with the detailed principles set out in the CRR. The level of the additional capital requirement to hedge the risk arising from foreign currency mortgage loans to households was set at the consolidated level of: 0.79 p.p., for the total capital ratio; 0.59 p.p. for the Tier 1 capital ratio and 0.44 p.p. for the Tier 1 core capital ratio.

In 2016 and in 2015, the Group maintained a secure capital base in excess of the supervisory and regulatory limits.

In accordance with the CRR, for prudential consolidation purposes the Group consists of: PKO Bank Polski SA, the PKO Leasing SA Group, PKO BP BANKOWY PTE SA, PKO Towarzystwo Funduszy Inwestycyjnych SA, the KREDOBANK SA Group, PKO Finance AB, Finansowa Kompania 'Prywatne Inwestycje' Sp. z o.o., PKO BP Finat Sp. z o.o. and PKO Bank Hipoteczny SA.

(IN PLN MILLION)

OWN FUNDS FOR CAPITAL ADEQUACY PURPOSES

In 2016, the Group's capital adequacy level remained at a secure level, well above the supervisory limits.

As at 31 December 2016, the Group's own funds calculated, for capital adequacy purposes, included the Bank's net profit for 2015 (in the amount of PLN 2 571 million) and undistributed profits from previous years (in the amount of PLN 1 250 million). This amount increased the Group's other reserves (the reserve capital and other reserves).

Additionally, after receiving adequate approvals from PFSA, the Group included in its Tier 1 capital the Bank's net profit generated for three quarters of 2016 (reduced by expected financial burdens) in the amount of PLN 1 589 million.

REQUIREMENTS AS REGARD OWN FUNDS (PILLAR I)

The Group calculates own funds requirements for the following types of risk:

CREDIT RISK	under the standard approach, using the following formulas with regard to: STATEMENT OF FINANCIAL POSITION ITEMS - a product of a carrying amount (considering value of adjustments for specific credit risk), a risk weight of the exposure calculated according to the standardized method of credit risk requirement as regards own funds and 8% (considering recognised collaterals), OFF-BALANCE SHEET LIABILITIES GRANTED - a product of value of liability (considering value of adjustments for specific credit risk), a risk weight of the product, a risk weight of off-balance sheet exposure calculated according to the standardized method of credit risk requirement for own funds and 8% (considering recognised collaterals), OFF-BALANCE SHEET TRANSACTIONS (DERIVATIVE INSTRUMENTS) – a product of risk weight of the off-balance sheet transaction calculated according to the standardized method of credit risk requirement for own funds, equivalent in the statement of financial position of off-balance sheet transaction and 8% (the value of the equivalent in the statement of financial position is calculated in accordance with the mark-to-market method).
OPERATIONAL RISK	• in accordance with the AMA approach – with respect to the Bank's activities, excluding the Bank's branch in Germany, • in accordance with the BIA approach – with respect to the activities of the Bank's branch in Germany
MARKET RISK	• currency risk – calculated under the core approach, • commodity risk – calculated under the simplified approach, • equity instruments risk – calculated under the simplified approach, • specific risk of debt instruments – calculated under the core approach, • general risk of debt instruments – calculated under the duration-based approach, • other types of risk, other than delta risk (non-delta risk) calculated under the scenario approach in the case of options for which the Bank uses its own valuation models and under the delta plus approach for other options,
OTHER RISK	• settlement risk and delivery risk – calculated under the approach specified in Title V, 'Own funds requirements for settlement risk' of the CRR Regulation, • counterparty credit risk – calculated under the approach set out in Chapter 6, 'Counterparty credit risk' of Title II, 'Capital requirements for credit risk' of the CRR Regulation, • credit valuation adjustment risk – calculated under the approach set out in Title VI, 'Own funds requirements for credit valuation adjustment risk' in of the CRR Regulation, • exceeding a large exposure limit – calculated under the approach set out in Articles 395-401 of the CRR Regulation, • for exposures to a central counterparty, a requirement for transactions and contributions made to the default fund of a qualifying central counterparty is calculated.

(IN PLN MILLION)

	31.12.2016	31.12.2015
Total own funds	**30 872.9**	**27 091.4**
Tier 1 capital	**28 349.9**	**24 608.3**
Tier 1 capital before regulatory adjustments and reductions, of which:	32 059.3	27 828.6
Share capital	1 250.0	1 250.0
Other reserves	27 969.5	24 118.5
General banking risk fund	1 070.0	1 070.0
Retained earnings	1 769.8	1 390.1
(-) Goodwill	(1 159.9)	(1 102.4)
(-) Other intangible assets	(1 821.3)	(1 690.8)
Accumulated other comprehensive income	(709.4)	(135.8)
Deferred income tax assets, dependent on future profitability, not derived from temporary differences	(1.0)	(2.0)
Adjustments in Tier 1 basic capital due to prudential filters	30.7	(14.4)
Other adjustments in transitional period in Tier 1 basic capital	(48.5)	(274.9)
Tier 2 capital	**2 523.0**	**2 483.1**
Equity instruments and subordinated loans eligible as Tier 2 capital	2 523.0	2 483.1
Requirements as regard own funds	**15 625.7**	**14 836.8**
Credit risk	14 271.1	13 658.3
Operational risk	656.4	662.5
Market risk	651.1	484.5
Credit valuation adjustment risk	47.1	31.5
Total capital adequacy ratio	**15.81%**	**14.61%**
Tier 1 capital ratio	**14.51%**	**13.27%**

INTERNAL CAPITAL (PILLAR II)

In 2016, the Group calculated internal capital in accordance with external regulations:

- the CRR Regulation,
- the Banking Act,
- the Resolution No. 258/2011 of the PFSA,
- The Act on Macro-prudential supervision,

and the internal regulations of the Bank and the Group.

Internal capital is the amount of capital estimated by the Group that is necessary to cover all of the identified significant risks characteristic of the Group's activities and the effect of changes in the business environment, taking account of the anticipated risk level.

The Bank regularly monitors the significance of the individual risk types relating to the Bank's activities and other Group entities.

The estimation of internal capital is aimed at determining the minimum level of own funds which ensures the safety of operations, taking into account changes in the profile and scale of the operations as well as adverse stress conditions.

The internal capital for covering the individual risk types is determined using the methods specified in the internal regulations. In the event of performing internal capital estimates based on statistical models, the annual forecast horizon is adopted and a 99.9% confidence level. The total internal capital of each entity of the Group is the sum of internal capital amount necessary to cover all of the significant risks for the entity. The total internal capital of the Group is the sum of internal capital amount of the Bank and all Group entities. The correlation coefficient for different types of risk and different Group entities used in the internal capital calculation is equal to 1.

In 2016, the relation of the Group's own funds to its internal capital remained on a level exceeding both the threshold set by the law and the Group's internal limits.

(IN PLN MILLION)

Disclosures (Pillar III)

The Group annually announces information, in particular, about risk management and capital adequacy in accordance with: the CRR regulation and the implementing acts thereto, the Banking Act, the Act on Macro-Prudential Supervision, Recommendation M relating to operational risk management in banks and Recommendation P relating to liquidity risk issued by the Polish Financial Supervision Authority.

Details of the scope of information disclosed, the method of its verification and publication are presented in PKO Bank Polski SA Capital Adequacy Information Policies and other information to be published, which are available on the Bank's website (www.pkobp.pl).

72. Information on securitisation of lease portfolio and portfolio sale of receivables

In connection with the acquisition of Raiffeisen-Leasing Polska SA and its subsidiaries (for details, see note Acquisition of Raiffeisen-Leasing Polska SA by PKO Leasing SA), the Group consolidated a special purpose vehicle ROOF Poland Leasing 2014 DAC with its registered office in Ireland. The SPV is buying securitized receivables resulting from lease agreements sold by Raiffeisen-Leasing Polska SA under the securitization plan which was initiated in December 2014. The receivables acquired by the SPV were financed by an issue of securities. The objective and benefit of selling these receivables to the SPV was to obtain and diversify sources of long-term financing.

The carrying values of the financial assets covered by the securitization plan are presented in the table below:

31.12.2016	transaction value	Amount of risk remaining in the Group
Carrying amount of assets	1 376.3	1 376.3
Carrying amount of liabilities	1 260.6	1 260.6
Net balance	115.7	115.7

Moreover, in 2016 the Group performed sales of impaired loan portfolios (balance sheet and off-balance sheet receivables) of more than 38 thousand individual receivables from retail and business customers amounting to approximately PLN 2 103 million. The total carrying amount of the provision for potential claims on sale of impaired loan portfolios as at 31 December 2016 amounted to PLN 2.9 million (as at 31 December 2015 it was PLN 2.1 million). As a result of loan sale all risks and rewards were transferred, hence the Group derecognised these assets. The Group did not receive any securities on account of the above-mentioned transactions.

SUBSEQUENT EVENTS

1. On 26 January 2017, the Supervisory Board of PKO Bank Polski SA selected KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa as the entity authorized to audit and review the financial statements of the Bank and consolidated financial statements of the PKO Bank Polski SA Group for 2017 - 2019.
2. On 2 January 2017, Raiffeisen-Leasing Polska SA received a call from Raiffeisen Bank Polska SA for the early redemption of the bonds issued by the Company and held in the portfolio of said bank. On 31 January 2017, the Company conducted an early redemption of bonds with a nominal value of PLN 227 million. The redemption was financed from funds received from PKO Bank Polski SA in the form of a loan, based on an agreement signed in December 2016.
3. In January 2017, PKO Bank Polski SA acquired 100% of shares in ZenCard Sp. z o.o. and took up shares in the increased capital of the Company. ZenCard Sp. z o.o. is a technology company which has built a platform for retailers enabling them to create discount and loyalty programs which also allows the virtualization of loyalty cards. The platform is integrated with a POS terminal and makes it possible to resign from many separate loyalty cards or separate applications installed on a phone and replace them with a single card which is also a payment card. CEUP eService Sp. z o.o., one of the largest clearing agents in Poland, is the Company's strategic partner. The Bank is interested in using the Company's know-how in the area of developing the solutions produced and using the Company's products in the Bank's Group.
4. On 2 February 2017, PKO Bank Hipoteczny SA issued mortgage bonds denominated in EUR with a value of EUR 25 million and a redemption period of 7 years from the date of issue. Mortgage bonds were taken up under a non-public issue. The mortgage bonds issued will be listed on the Luxembourg Stock Exchange.
5. On 2 February 2017, PKO Bank Hipoteczny SA concluded with PKO Bank Polski SA the Agreement for a revolving working capital loan in the current account up to the limit of PLN 1500 million, to be made available in instalments. The loan was granted for the period to 2 February 2020. On 2 February 2017, PLN 600 million was made available as part of the loan.
6. On 6 February 2017, PKO Bank Hipoteczny SA acquired another portfolio of receivables of mortgage-secured housing loans in the amount of PLN 337.6 million under the Framework Receivables Sale Agreement concluded on 17 November 2015 with PKO Bank Polski SA.
7. An Extraordinary Shareholders Meeting was convened for 13 March 2017 to consider, among other things, draft resolutions submitted by the State Treasury represented by the Minister of Development and Finance executing the rights from shares in PKO Bank Polski SA held by the State Treasury, on the rules for determining the remuneration of the Management and Supervisory Boards. These resolutions are intended to adapt the existing rules for remunerating members of the Bank's Management and Supervisory Boards to the provisions of the Act on determining the remuneration of persons managing certain companies.

The proposed remuneration of the Members of the Bank's Management Board and Supervisory Board was determined in accordance with the provisions of the Act on the principles for determining the salaries of persons managing certain companies. The designed remuneration principles are to replace the principles of remunerating Members of the Bank's Management and Supervisory Board Members currently in force which had been determined by the Bank's Supervisory Board and the Ordinary General Shareholders' Meeting respectively.

SIGNATURES OF ALL MEMBERS OF THE MANAGEMENT BOARD OF THE BANK

21.02.2017	ZBIGNIEW JAGIEŁŁO	PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
21.02.2017	JANUSZ DERDA	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
21.02.2017	BARTOSZ DRABIKOWSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
21.02.2017	MAKS KRACZKOWSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
21.02.2017	MIECZYSŁAW KRÓL	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
21.02.2017	PIOTR MAZUR	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
21.02.2017	JAKUB PAPIERSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)
21.02.2017	JAN EMERYK ROŚCISZEWSKI	VICE-PRESIDENT OF THE MANAGEMENT BOARD	.... (SIGNATURE)

SIGNATURE OF PERSON RESPONSIBLE FOR
MAINTAINING THE BOOKS OF ACCOUNT

21.02.2017

DANUTA SZYMAŃSKA
DIRECTOR OF THE ACCOUNTING DIVISION

....
(SIGNATURE)