Capital Adequacy and Risk Management

(Pillar III)

The Group of PKO Bank Polski SA

as at 31 December 2011

INTRODUCTION

The Report "Capital Adequacy and Risk Management (Pillar III)" (the "Report") of the Group of Powszechna Kasa Oszczędności Bank Polski SA (the "Bank Group" or the "Group") as at 31 December 2011 was prepared in accordance with the provisions of Article 111a clause 1 of the Act of 29 August 1997 – Banking Law[1] and the requirements set forth in Resolution No. 385/2008 of the Polish Financial Supervision Authority of 17 December 2008 *concerning the detailed principles and manner of publication by banks of qualitative and quantitative information relating to capital adequacy and the scope of required disclosure* ("Resolution No. 385/2008 of the Polish Financial Supervision Authority" as amended[2]).

Pursuant to § 6 item 1 of Resolution No. 385/2008 of the Polish Financial Supervision Authority, Powszechna Kasa Oszczędności Bank Polski SA ("PKO Bank Polski SA", "the Bank") which is the controlling entity within the meaning of § 3 of the Resolution, discloses annually information on its capital adequacy in a separate document, which is published no later than within 30 days of the approval of annual financial statements by the Ordinary General Meeting of the Shareholders of the Bank.

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

The Report covers the year ended 31 December 2011. Unless stated otherwise, the Report includes consolidated data of the Bank Group. Since the risk profile of the Bank Group is predominantly affected by PKO Bank Polski SA (94.3%[4] of the Group's consolidated balance sheet total and 94.6%[5] of its consolidated profit/loss on banking activities), some of the information contained in the Report pertains specifically to individual data of PKO Bank Polski SA. Unless stated otherwise, the figures presented in the Report have been expressed in PLN million. Any differences in the totals and proportions result from the rounding off to PLN million and to one decimal place respectively.

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

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

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

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

[4] The share of companies in the consolidated balance sheet total was calculated in relation to the consolidated balance sheet total before consolidation adjustments and exclusions for the year ended 31 December 2011.

[5] The share of companies in the consolidated profit/loss on banking activities was calculated in relation to the consolidated profit/loss on banking activities of the PKO Bank Polski SA Group before consolidation adjustments and exclusions for the year ended 31 December 2011.

TABLE OF CONTENTS

1. INFORMATION ON THE BANK AND THE GROUP ... 4

2. RISK MANAGEMENT ... 5

2.1. IDENTIFYING SIGNIFICANT TYPES OF RISKS ... 7
2.2. CREDIT RISK ... 8
2.3. INTEREST RATE RISK ... 20
2.4. FOREIGN EXCHANGE RISK ... 23
2.5. LIQUIDITY RISK ... 24
2.6. PRICE RISKS OF EQUITY SECURITIES AND OTHER PRICE RISKS ... 26
2.7. OPERATIONAL RISK ... 27
2.8. COMPLIANCE RISK ... 30
2.9. BUSINESS RISK ... 31
2.10. REPUTATION RISK ... 31

3. OWN FUNDS ... 32

4. CAPITAL REQUIREMENTS (PILLAR I) ... 33

4.1. CREDIT RISK ... 34
4.2. MARKET RISK ... 37
4.3. OPERATIONAL RISK ... 37

5. INTERNAL CAPITAL (PILLAR II) ... 38

6. CAPITAL ADEQUACY ... 39

7. GLOSSARY OF TERMS AND ABBREVIATIONS ... 41

1. INFORMATION ON THE BANK AND THE GROUP

The controlling entity of the Group is PKO Bank Polski SA whose share in the consolidated balance sheet total amounts to 94.3%[4], and in the consolidated profit/loss on banking activities – 94.6%[5].

The Group pursues activity mainly in the Republic of Poland and through its subsidiaries KREDOBANK SA, Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. and UKRPOLINWESTYCJE Sp. z o.o. in the territory of Ukraine and through subsidiary PKO Finance AB in the territory of Sweden.

Beside PKO Bank Polski SA, the Bank Group comprises also other subsidiaries; in the subsidiaries of the Bankowy Fundusz Leasingowy SA Group (the "BFL SA Group") and KREDOBANK SA – a significant level of banking risk occurs.

The Bankowy Fundusz Leasingowy SA Group - Bankowy Fundusz Leasingowy SA– together with its subsidiary – operates in the leasing area in the territory of the Republic of Poland. The share of BFL SA Group in the consolidated balance sheet total is 1.6%[4], and in the consolidated profit/loss on banking activities – 1.0%[5].

KREDOBANK SA pursues banking operations in the territory of Ukraine and is subject to Ukrainian banking supervision. The share of KREDOBANK SA in the consolidated balance sheet total is 0.8%[4], and in the consolidated profit/loss on banking activities – 0.8%[5].

Other subsidiaries of the Group covered by the consolidation include:

1) PKO BP BANKOWY Powszechne Towarzystwo Emerytalne SA (management of a pension fund),
2) Centrum Finansowe Puławska Sp. z o.o. in liquidation since 1 July 2011 (management and operation of Centrum Finansowe Puławska),
3) Qualia Development Sp. z o.o., acting earlier under the name of PKO BP Inwestycje Sp. z o.o. (property development activity) – together with its subsidiaries,
4) PKO Towarzystwo Funduszy Inwestycyjnych SA (investment funds' management),
5) Inteligo Financial Services SA (technical servicing of Internet banking),
6) Centrum Elektronicznych Usług Płatniczych „eService" SA (handling and settlement of transactions made with the use of cards),
7) Bankowe Towarzystwo Kapitałowe SA (staffing and payroll as well as bookkeeping services for the subsidiary),
8) Fort Mokotów Inwestycje Sp. z o.o. (property development activity),
9) PKO Finance AB (generating funds for PKO Bank Polski SA from the issue of bonds),
10) PKO BP Finat Sp. z o.o. (financial intermediation),
11) Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o. (factoring activities).

Detailed information on the subsidiaries of the Group, the method of consolidation, and the Bank's interest in the share capital of individual companies is contained in the consolidated financial statements of the Bank Group for the year ended 31 December 2011, published 5 March 2012.

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

1) Bank Pocztowy SA and Poznański Fundusz Poręczeń Kredytowych Sp. z o.o. (associated entities valued under the equity method i.e. not subject to consolidation under the full method) which amounted to the total of PLN 106.7 million as at 31 December 2011,
2) Bank Ochrony Środowiska SA and "2020 European Fund For Energy, Climate Change and Infrastructure" (investment securities available for sale and valued at fair value) which amounted to the total of PLN 111.4 million as at 31 December 2011.

At the individual level, own funds of the Bank are reduced by the Bank's capital exposure direct in KREDOBANK SA, PKO BP Faktoring SA, PKO BP BANKOWY PTE SA, PKO TFI SA, BFL SA, PKO Finance AB, Kompania Finansowa Prywatne Inwestycje" Sp z o.o., Bank Pocztowy SA, Poznański Fundusz Poręczeń Kredytowych Sp. z o.o., Bank Ochrony Środowiska SA and "2020 European Fund For Energy, Climate Change and Infrastructure" and through a non-financial entity in PKO BP Faktoring SA amounting to the total of PLN 1,324.9 million as at 31 December 2011. The revaluation write-off of the Bank's credit exposure in KREDOBANK SA amounted to PLN 423.7 million as at 31 December 2011.

Within the Bank Group, there are limitations on the transfer of funds (dividends) to the investor between KREDOBANK SA and the Bank. In accordance with the resolution of the Extraordinary General Shareholders' Meeting of KREDOBANK SA commenced 29 January 2009 and continued 23 February 2009, a moratorium was introduced with respect to dividend payments. The moratorium is valid until revoked under an appropriate resolution. In 2011 the moratorium on dividend payment remained in force.

2. RISK MANAGEMENT

Banking activity is exposed to many types of risk, including such as credit, interest rate, foreign exchange, liquidity, price risk of equity securities, operational, compliance, business (including strategic risk), reputation and derivatives (due to the specific nature of those instruments it is subject to special control) risks. Controlling the effect of those types of risk on the functioning of the Bank Group is one of the main objectives of the Bank's and the Group's management, and the risk level is an important factor of the planning process.

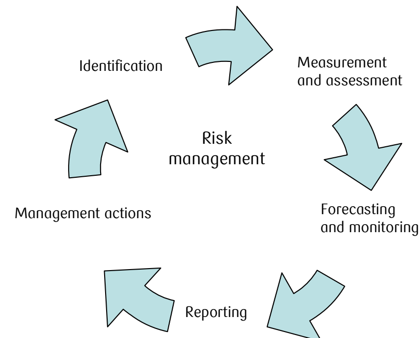
Risk management at the Bank is based in particular on the following principles:

1) the Group manages all identified types of banking 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 adjusted to new risk factors and sources on a current basis,
3) risk management methods (in particular the models and their assumptions) and the risk measurement systems are adjusted to the scale and complexity of risk and they are verified and validated periodical basis,
4) the area of risk and debt recovery remains organisationally independent of business activities,
5) the 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 pursuit of the Group's strategy while being compliant with the risk management strategy, in particular with regard to the level of tolerance of the risk.

The banking risk management process in the Group includes the following activities:

1) risk identification the identification of actual and potential sources of risk and estimation of the significance of the potential impact of a given type of risk on the banking financial situation in the Group; within the risk identification process, types of risk perceived as material in the activity of the Bank, an entity of the Group or the whole Group's,
2) risk measurement and assessment – defining risk assessment tools adequate to the type, significance of the risk, data availability and quantitative risk assessment by means of defined tools, 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, stress-test are being conducted on the basis of assumptions providing a fair risk assessment,
3) risk forecasting and monitoring – consisting in preparation of risk level forecasts and monitoring differences between execution and forecasts or assumed references (e.g. limits, threshold values, plans, previous measurements, issued recommendations and suggestions). Risk monitoring is performed at a frequency appropriate for significance and volatility of a given type of risk,
4) risk reporting – periodic informing the Management of the Bank about the results of risk assessment, taken actions and recommendations. Scope, frequency and the form of reporting is adjusted to the managing level of recipients,
5) management actions – including, among others, issuing internal regulations, establishing the level of risk tolerance, establishing limits and thresholds, issuing recommendations, making decisions about the use of tools supporting risk management. The aim of taking management actions is to form the risk management process and risk level.

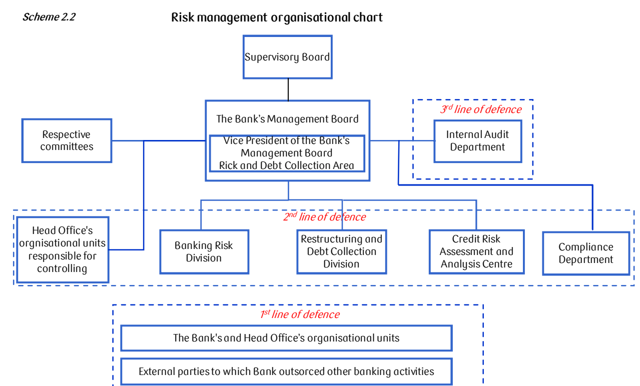
Scheme 2.1



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

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

Scheme 2.2 **Risk management organisational chart**



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

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

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

1) the first line of defence – internal functional control that ensures using risk controls and compliance of the activities

with the generally applicable laws. The function is being performed in the organizational Bank's units, the organizational units of the Head Office and the external entities that are contracted by the Bank to perform actions related to bank activities and it refers to those units and entities that may generate risk;
2) second line of defence – the risk management system, including the risk management methods, tools, process and organisation. This function is performed in particular in the Risk and Debt Collection Area, the Bank's specialist organizational units responsible for credit analyses, the organizational unit of the Head Office managing the compliance risk and as well as the organizational units of the Head Office responsible for controlling;
3) third line of defence – an internal audit. The function performed as part of internal audit, including audit on the effectiveness of the system of managing the risk relating to the Bank's activities.

The independence of the lines of defence consists of preserving organizational independence in the following areas:
1) the function of the second line of defence as regards creating system solutions is independent of the function of the first line of defence,
2) the function of the third line of defence is independent of the functions of the first and second lines of defence,
3) the function of compliance risk management is subordinate directly to the President of the Bank's Management Board.

The Bank's Head Office organizational units that are grouped within in the Banking Risk Division, Restructuring and Debt Collection Division and the Credit Risk Assessment and Analysis Centre manage risk within the limits of competence assigned to them.

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

The purpose of the Restructuring and Debt Collection Division is effective and efficient collection of bad debts from clients through:
1) restructuring of bad debts at every stage of their management,
2) claim assertion in the way of debt collection,
3) sale of bad debts (including specification of debts that are difficult to be sold and looking for best possibilities to sell them),
4) outsourcing of realised tasks (including specification of debts which collections is difficult to be outsourced),
5) taking over and management of the assets taken over as a result of Bank's debt collection, ensuring maximum profits for the Bank in result of overtaken titles to such assets, including through sales of overtaken assets,
6) cooperation with law enforcement and judicial agencies and other institutions for the purpose of efficient debt collection and securing the Bank's interests.

The purpose of the Credit Risk Assessment and Analysis Centre is to assess and verify the credit risk assessment level of individual credit exposures, which require special attention due to the scale of exposure, client segment or the risk level involved. The Credit Risk Assessment and Analysis Centre takes also credit decisions in cases of individual clients.

The market and credit risk management at the Bank is supported by the following committees:
1) the Risk Committee ("RC"),
2) the Assets and Liabilities Committee ("ALCO"),
3) the Bank's Credit Committee ("BCC"),
4) the Head Office's Credit Committee ("HOCC"),
5) the Operational Risk Committee ("ORC"),
6) credit committees which operate in the regional retail and corporate branch offices.

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

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

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

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

ORC supports the Bank's Management Board in the operational risk management processes through:
1) issuing recommendations, for instance as regards the Bank's Management Board's acceptance of the operational risk tolerance levels, operational risk limits reserved for the competence of the Management Board, capital requirement volume and management adjustment, definitions of operational stress tests and

other activities related to systematic management of operational risk,
2) taking decisions process concerning threshold values and critical key risk indicators (KRI), operational risk limits reserved for the competence of KRO, values of key parameters used for the purpose of calculation of operational value at risk and individual approach to outliers.

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

The priority of the Bank Group in 2011 was to keep its strong capital position and increase its financing sources that ensure the basis for stable development of business activities, having maintained at the same time the priorities related to efficient activities and efficient cost control.

As a consequence, in 2011, the Bank:
1) continued its activities to obtain new deposits from its clients,
2) in June the Bank obtained a conditional consent of the Polish Financial Supervision Authority to apply statistical methods to calculate capital requirement for operational risk (AMA) as from 30 June 2011, with a temporary restriction (until PFSA's conditions are fulfilled) on a decrease in capital requirements no more than to the level 75% of the capital requirement calculated by the standardised approach,
3) confirmed the stable position of the Bank Group and significant resistance to negative market scenarios in the results of stress tests conducted by EBA (European Banking Authority),
4) included in its banking risk measurement methods the financial crisis conditions (such as e.g. the stress test scenarios).

In 2011 the Bank implemented new solutions in credit risk management that fulfil the requirements of Recommendation S, including the ones related to:
1) credit rating measurement through a reduction of the maximum crediting period adopted in credit rating assessment, stricter determination of disposable income in case of foreign currency credit transactions secured with mortgages, including probable changes in borrower's income level after their retirement in the credit rating assessment,
2) division of obligations ensuring independence of risk management processes in all client segments that have credit exposures financing real properties,
3) imposing limits on the portfolio of exposures secured with mortgages and financing real properties.

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

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

In Q4 2011 the Bank started to prepare a solution that meets the requirements defined in PFSA's Resolutions no 258/2011 and 259/2011 as regards variable components of remuneration. The works are intended to be completed in June 2012.

The General Shareholders' Meeting of PKO Bank Polski SA in its resolution no 8/2011 dated 30 June 2011 decided that the dividend for 2010 would amount to PLN 2,475 million that is PLN 1.98 gross per share (details are presented in the consolidated financial statement of the PKO Bank Polski SA Group for year ended 31 December 2011 on page 60 in section 16 entitled "Paid Dividends (the Total Amount or Per One Share) as Divided into Ordinary and Other Shares").

2.1. IDENTIFYING SIGNIFICANT TYPES OF RISKS

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

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

Operational and business risks were considered significant in the Group subsidiaries.

The assessment of significance of the individual types of risks is determined on the level of the Bank and particular subsidiaries of the Bank Group level in compliance with the Bank's internal provisions. While determining criteria of classifying a given type of risk as significant, an influence of a given type of risk on the Bank's as well as on a given entity's of the Group and the whole Group`s activities is are taken into account and there are three types of risk are recognised:
1) considered as significant a priori – being managed actively,
2) potentially significant risks – performed for which significance monitoring is being made,
3) other non-defined or non-occurring in the Bank 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 Bank periodically. As a result of assessment, a given type of risk is being classified as significant/insignificant. A similar assessment is conducted periodically in the subsidiaries of the Group. In particular, monitoring is conducted if significant change in activities took place or the profile of the Bank or the Group changed.

2.2. Credit risk

2.2.1. Introduction

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

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

The Bank and the subsidiaries of the Group apply the following credit risk management principles:
1) a credit transaction requires a comprehensive credit risk assessment, expressed in the internal rating or scoring,
2) credit risk measurement of credit transactions is made at the stage of consideration of the loan application and on a cyclical basis as part of monitoring, and takes into account both the changing external conditions and changes in the financial standing of the borrowers,
3) the credit risk assessment of exposures significant for reasons of their risk level or value is additionally verified by credit risk assessment units, irrespective of business units,
4) the terms and conditions of credit transactions offered to clients depend on the assessment of credit risk level generated by the transaction concerned,
5) credit decisions may be taken only by authorised persons,
6) credit risk is diversified by geographical areas, industries, products and clients,
7) the expected level of credit risk is secured by legal collateral accepted by the Bank, credit spreads charged to clients as well as by provisions for impairment of credit exposures.

2.2.1.1. Credit risk of financial institutions

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

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

2.2.1.2. Derivatives risk

The derivatives risk is a risk of incurring losses arising from the Bank taking up a position in financial instruments which meet all of the following conditions:
1) the value of an instrument changes with the change of the underlying instrument,
2) it does not require any initial net investment or requires only a small initial net investment compared with other types of contracts which similarly respond to changes in market terms,
3) it is to be settled at a future date.

The process of derivative instruments risk management is integrated with the process of: interest rate, FX, liquidity as well as credit risk management. However, due to specific nature of derivatives it is subject to special control specified in the integral regulations of the Bank.

During the course of its business activity, the Bank uses various types of financial derivatives to manage the risk resulting from the conducted business activity. The Bank enters into derivative transactions mainly with other banks.

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

Table 2.1

FINANCIAL DERIVATIVES*

	The Bank Group			
	2011			
	Nominal value		Fair value	
	Purchase	Sale	Negative	Positive
Currency transactions (over-the-counter market)	54 021	53 277	687	1 084
FX Swap	20 641	20 354	140	438
FX Forward	4 039	4 000	56	119
Options	7 093	6 197	70	106
Cross Currency IRS	22 248	22 728	421	420
Interest rate transactions	272 572	276 282	1 957	1 979
Interest Rate Swap (IRS)	195 426	195 426	1 925	1 941
Forward Rate Agreement (FRA)	77 146	80 856	32	38
Credit Default Swaps	0	0	0	0
Other (including stock market index de	889	1 243	1	2
Total derivatives	327 482	330 802	2 645	3 065

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

Derivatives are recognized at their fair value from trade date. A derivative becomes an asset if its fair value is positive and it becomes a liability if its fair value is negative.

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

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

In the Bank there are embedded derivatives. In the Bank there are embedded derivatives. An embedded derivative is a component of a hybrid (combined) instrument that includes a non-derivative host contract (of both financial and non-financial nature), with the effect that some of the cash flow of the combined instrument vary in a way similar to a stand-alone derivate. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, price of a financial instrument, price of commodity, foreign exchange rate or other variable, provided that in the case a non-financial variable is not specific for any of the parties of a contract.

An assessment of whether a contract contains an embedded instrument is made at the date of entering into a contract. A reassessment can only be made when there is change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract.

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

A derivative is recognized separately if all the following conditions are fulfilled:
1) a hybrid (combined) instrument is not priced at fair value, with the result recorded in the profit and loss account,
2) the economic characteristics and risks of an embedded derivative instrument are not related to the economic characteristics and the risks of the host contract,
3) a separate instrument with the same characteristics as the embedded derivative would meet the definition of a derivative.

2.2.2. Credit risk measurement and assessment

2.2.2.1. Credit risk measurement methods

In order to assess the level of credit risk and credit portfolio profitability, the Bank uses various credit risk measurement and assessment methods, including the following:
1) probability of default (PD),
2) expected loss (EL),
3) credit value at risk (CVaR),
4) accuracy ratio,
5) share and structure of irregular loans (according to IAS),
4) coverage ratio of credits with impairment recognized with write offs,
5) risk cost.

The Bank systematically extends the scope of its credit risk measures, taking into account the requirements of the IRB approach, as well as the scope of application of risk measures so as to fully cover the Bank's credit portfolio with those methods.

In 2011 the credit risk management process used PD parameters that based on the models developed in the process of the Bank's adjustment to the credit risk requirement calculation by means of the advanced approach (IRB).

The portfolio credit risk methods make it possible i.e. to reflect the credit risk in the price of products; to determine the optimum conditions of financing availability; and to determine impairment allowances.

The Bank carries out analyses and stress tests of the impact of potential changes in its macroeconomic environment on the Bank's credit portfolio quality and reports the results there of to the Bank's Management. The aforementioned information makes it possible to identify the negative effects of unfavourable market conditions on the Bank's result and to take action to limit such effects.

2.2.2.2. Rating and scoring methods

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

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

Credit risk assessment for institutional clients is conducted at two levels: the level of the client and of the transaction. The assessment is expressed in the following ratings: of the client and of the transaction. The synthetic measure of credit risk, reflecting both risk factors, is the joint rating. As of 1 September 2010 the Bank implemented the scoring method of for credit risk evaluation of clients in the SME segment, and a dedicated software application This method is available besides the rating method. Its introduction resulted in a reduction of time of credit application examination and an increase of credit risk management efficiency. Due to a successful assessment of the scoring portfolio of institutional clients, the scope of scoring application was extended in November 2011.

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

In order to reduce the response time to the observed warning signs signalling an increase of the credit risk level, the Bank uses and develops IT application of the Early Warning System (EWS). In 2011, the Bank implemented automatic identification of negative phenomena.
In 2011 in its rating system the Bank took into consideration the identification of default events, achieving consistency between the rating system and the system for identifying individual premises for impairment of credit exposures. Moreover, the scale of rating non-financial customers was also expanded: in place of 8 rating classes, 10 rating classes were introduced and at the same time it was decided that credit exposures which had been classified into the rating class 'G' (due to the low likeliness of default) were not to be automatically considered to be individually

impaired. Moreover, as a rule the terms and conditions for determining availability of financing were maintained.

In the second half of 2011, while determining the write-downs against the portfolio of mortgage loans for individuals, the Bank used the portfolio parameters estimated on the basis of the methodology for estimating parameters for the purpose of calculating the capital requirements using the IRB approach. The new methodology takes into account intense restructuring processes conducted in relation to the portfolio and allows more precise assessment of the related credit risk.

2.2.3. Monitoring of credit risk

2.2.3.1. Exposure amount

Table 2.2 shows the balance sheet and off-balance sheet items taken into account in the calculation of capital adequacy of the Bank Group as at 31 December 2010 and 31 December 2011.

Table 2.2

	The Bank Group		
	2011	2010	Average
ASSETS	190 748	169 661	180 204
Net credits and loans*	141 634	130 668	136 151
Securities	28 172	22 481	25 326
Receivables from banks	2 396	2 307	2 352
Financial fixed assets	123	173	148
Other assets**	18 423	14 031	16 227
OFF-BALANCE SHEET LIABILITIES	36 890	36 785	36 838
Financial	30 456	29 505	29 980
Guarantees granted	6 435	7 280	6 858
DERIVATIVES***	658 284	474 518	566 401

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

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

Table 2.3

CREDITS AND LOANS* - STRUCTURE BY PORTFOLIO

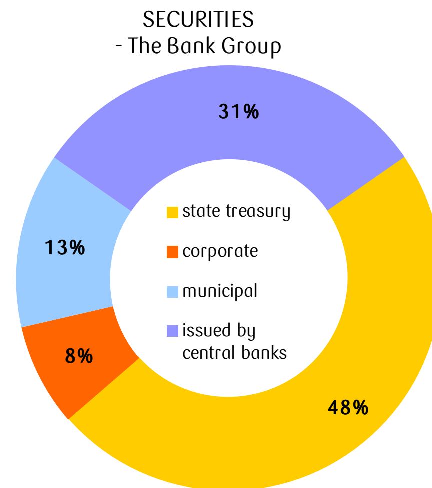
The Bank Group

	2011	2010
Net credits and loans	141 634	130 668
consumer loans	22 873	24 129
housing loans	69 832	61 696
corporate loans	48 929	44 843

* Including financial lease receivables.

A much smaller credit risk level of the Group is related to derivatives, interbank deposits and the Group's holdings of securities (of which 79% are securities issued by the Treasury or the central banks).

Chart 2.1



In 2011, the greatest proportion of the exposure structure of the Group was accounted for by corporate exposures and exposures secured on real property (56.9 % in total). The proportions of other exposure classes range between 0.0% to 15.6% (Table 2.4).

Table 2.4

	The Bank Group 2011	
Exposure class*	Total exposure**	Average exposure**
Corporate	59 463	57 197
Secured on real estate property	55 977	38 706
Retail	31 613	46 632
Central governments and central banks	28 325	24 988
Other exposures	11 612	11 494
Institutions (banks)	7 711	7 418
Regional governments and local authorities	4 990	4 341
Past due	3 264	3 377
Administrative bodies and non-commercial undertakings	0	0
Other classes***	41	71
Total	202 996	194 224

* Pursuant to § 20 of Appendix no 4 to Resolution no 76/2010 of PFSA as amended.

** The value of balance sheet exposures and balance sheet equivalents of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques. The average amount of exposure has been calculated as the arithmetic mean of exposures from individual quarters of 2011.

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

A considerable proportion of the Group's exposures with defined maturity date (74%) are exposures with the maturity of over 1 year; for over 52% of exposures with fixed maturity date, such period exceeds 5 years (Table 2.5).

Table 2.5

EXPOSURE STRUCTURE* BY ORIGINAL MATURITY

The Bank Group 2011

Exposure class	PKO Bank Polski SA, KREDOBANK SA and the BFL SA Group						Other Group subsidiaries	Adjustments and exclusions	Total
	0 - 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Other***			
Corporate	368	694	14 266	21 600	24 917	965	536	-3 884	59 463
Secured on real estate property	5	19	363	1 262	54 339	0	0	-10	55 977
Retail	30	252	7 357	10 060	13 845	67	1	0	31 613
Central governments and central banks	15 956	2 265	1 540	5 675	2 766	4	119	0	28 325
Other exposures	3 053	0	0	0	198	7 250	1 245	-133	11 612
Institutions (banks)	2 834	450	694	2 955	869	625	4 759	-5 475	7 711
Regional governments and local authorities	1	16	174	946	3 852	0	0	0	4 990
Past due	65	60	539	839	1 534	0	236	-7	3 264
Administrative bodies and non-commercial undertakings	0	0	0	0	0	0	0	0	0
Other classes**	0	0	0	0	0	306	8	-273	41
Total	22 312	3 756	24 934	43 336	102 320	9 217	6 903	-9 782	202 996

* The value of balance sheet exposures and balance sheet equivalents of liabilities and off-balance sheet transactions before application of the credit risk mitigation techniques.
** Includes: exposures on account of regulatory high risk categories and exposures on account of claims in the form of collective investment undertakings.
*** Includes items with unspecified maturity (e.g. fixed assets, stocks).

2.2.3.2. Impairment of credit exposures

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

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

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

1) delay in loan repayment of at least 3 months,
2) significant deterioration of a client's internal rating,
3) conclusion of a restructuring agreement or applying concessions as regards debt repayment (a premise is identified if facilities granted to a client have been imposed by economic or legal factors resulting from the client's financial problems).

In determining the period of delay in loan repayment, the outstanding amounts of interest or principal instalments above defined threshold values are taken into account.
The Bank Group uses three methods for impairment assessment:

1) the individualised method for individually significant loans which meet the condition of individual impairment or which require individual assessment due to the specific nature of a transaction from which they result and events that condition repayment of an exposure,
2) the portfolio method, applied in the case of individually insignificant loans for which the condition of individual impairment has been identified,
3) the collective method (IBNR), used in the case of loans where no conditions of individual impairment have been identified, but there is the possibility of occurrence of incurred but not identified losses.

The write-off for impairment of the balance sheet value of a credit exposure is the difference between the balance sheet value of that exposure and the current value of the expected future cash flows from that exposure:

1) when defining the write-off under the individualised method, the expected future cash flows are assessed for each credit exposure individually, the possible scenarios of performance of the agreement taken into account and weighed with the probability of their fulfilment,
2) the write-off for credit exposure impairment defined under the portfolio or collective method equals the difference between the balance sheet value of those exposures and the current value of the expected future cash flows, assessed with statistical methods on the basis of historical monitoring of exposures from homogeneous portfolios.

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

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

1) with respect to individually significant credit exposures that are unconditional off-balance sheet liabilities and meet the conditions of individual impairment or pertaining to debtors whose other exposures meet such conditions – the individualised method is used,
2) with respect to the remaining off-balance sheet credit exposures – the portfolio method (if the exposure meets the conditions of individual impairment) or the collective

method (if the exposure meets only the conditions of collective impairment).

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

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

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

The structure of the credit portfolio and of established write-offs for credit exposure impairment of the Group is shown in Table 2.6. In 2011, the gross value of loans granted by the Group valued under the individualised method decreased by PLN 13 million, while valued using the portfolio method increased by PLN 1,108 million.

As of 31 December 2011 the share of credits with recognized impairment amounted to 8.0% (as of 31 December 2010: 8.0%). A small decrease of the value of credits assessed with the individualised method by 0.2% as of 31 December 2011 resulted mainly from a decrease in the value of corporate loans assessed with the individualised method with recognized impairment. The catalogue of impairment conditions applicable in the Bank complies with Recommendation R.

The increase in the value of loans valued under the portfolio method by 22.2% in 2011 resulted mainly from bigger delays in the repayment in the portfolio of housing loans and commercial credits (mainly extended to small and medium size enterprises).

Table 2.6.

CREDITS AND LOANS*

The Bank Group

	2011	2010
Gross credits and loans	147 293	135 525
individualised method	6 549	6 562
portfolio method	6 096	4 988
collective method (IBNR)	134 648	123 974
Write-offs (balance)	-5 658	-4 857
individualised method	-2 080	-1 766
portfolio method	-2 910	-2 593
collective method (IBNR)	-669	-498
Net credits and loans (gross-write-off)	141 634	130 668

* Including financial lease receivables..

The result of impairment write-offs is a consequence of the conservative policy of PKO Bank Polski SA in regard of credit risk recognition and assessment and of an increase of the credit base. The growth of the impairment write-offs in 2011 in the amount of PLN 802 million in line "Credit and loans" was influenced mainly by a change of write-offs in corporate loans in the amount of PLN 511 million and in mortgage loans in the amount of PLN 341 million. The result of write-offs increased as a consequence of the deterioration of the credit portfolio quality. Impairment write-offs on the exposures in the other groups had an insignificant impact on the profit and loss account (table 2.7).

Table 2.7

IMPAIRMENT WRITE-OFFS

The Bank Group

	Balance as at		Change in	Additional write-offs	Release of write-offs	Decrease resulting from write-offs and settlements of assets	Other changes, including FX differences	Cost of write-offs input to profit and loss account
	2011	2010	2011					
Credits and loans*	5 658	4 857	802	5 518	-3 679	-1 170	133	-1 839
consumer loans	1 464	1 514	-50	2 233	-1 572	-724	13	-661
housing loans	1 324	983	341	1 082	-690	-101	50	-392
corporate loans	2 871	2 360	511	2 204	-1 418	-345	70	-786
Receivables from banks	33	29	4	1	-2	0	4	0
Financial instruments	110	82	27	37	-10	-1	1	-27
Other	481	469	13	254	-190	-53	2	-64
Total	6 282	5 436	846	5 811	-3 881	-1 224	140	-1 930

*Including financial lease receivables.

The coverage ratio (calculated as the shares of impairment write-offs to awarded credits and loans with recognized impairment) amounted to 48.0% as at 31 December 2011 and to 44.6% as at 31 December 2010 (table 2.8).

Table 2.8

EXPOSURES WITH RECOGNISED IMPAIRMENTS AND TOTAL WRITE-OFFS

The Bank Group

	2011	2010
Exposures with recognised impairment	11 959	11 074
receivables from banks	32	29
credits and loans*	11 797	10 887
debt securities (AFS)	18	21
other financial assets	111	137
Write-offs (balance)**	-5 810	-5 037
receivables from banks	-33	-29
credits and loans*	-5 658	-4 857
debt securities (AFS)	-18	-21
other financial assets	-101	-130

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

Table 2.9

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

The Bank Group

2011

	With recognised impairment **	
Country/region	Exposure	Impairment write-offs
Polska (PKO Bank Polski), including:	10 396***	4 330***
mazowiecki****	2 989	1 091
śląsko-opolski	1 119	483
małopolsko-świętokrzyski	893	319
zachodniopomorski	1 030	609
łódzki	702	280
podlaski	236	70
pomorski	506	179
wielkopolski	874	346
dolnośląski	545	205
kujawsko-pomorski	465	180
lubelsko-podkarpacki	330	100
warmińsko-mazurski	206	90
Poland (other subsidiaries)	251	97
Ukraine	1 161	569
Adjustments, exclusions	-11	-6
Total	11 797	4 990

* Including financial lease receivables.
** Applies to exposures with identified impairment (without IBNR and exposures assessed individually with zero
*** The totals include IAS receipts in the amount of ca. PLN 355 million.
**** Includes the Warsaw region and the "head office".
**** Unassigned portfolio (NULL value).

Table 2.10

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

The Bank Group

2011

		With recognised impairment**	
	Type of client/branch	Exposure	Impairment write-offs
Institutional clients, of which:		10 396***	4 330***
C	Industrial processing	1 419	588
G	Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household appliances	1 034	403
L	Real property services	650	171
F	Construction	1 331	298
O	Public administration and national defence, obligatory social security and public health insurance	1	0
D	Generation and supply of power, gas and water vapours, hot water and air for air-conditioning installations	43	29
	Other exposures	1 654	544
Banks		0	0
Governments		7	6
Individuals		3 901	1 935
Poland (other subsidiaries)		251	97
Ukraine		1 161	569
Adjustments, exclusions		-11	-6
Total		11 797	4 990

* Including financial lease receivables.
** Applies to exposures with identified condition of individual impairment (without IBNR)
*** The totals include IAS receipts in the amount of ca. PLN 355 million.

2.2.3.3. Risk concentration

The Bank monitors the credit risk concentration in respect of:

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

In particular, the Bank monitors credit portfolios by:

1) geographical region,
2) loan currency,
3) industry sector,
4) mortgage-backed exposure,
5) largest entities,
6) largest capital groups.

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

As at 31 December 2011, the level of concentration risk of the Bank Group for individual exposures was rather low, the largest exposure to an individual entity not exempt from the exposure concentration limit amounting to 9.2 % of consolidated own funds.

Table 2.11

EXPOSURE TOWARDS THE 10 BIGGEST CLIENTS*

	The Bank Group			
	2011		2010	
No	exposure	% of own funds	value	% of own funds
1	1 689	9,2%	891	5,1%
2	1 417	7,7%	819	4,6%
3	771	4,2%	800	4,5%
4	770	4,2%	645	3,7%
5	696	3,8%	613	3,5%
6	650	3,5%	568	3,2%
7	617	3,4%	530	3,0%
8	600	3,3%	486	2,8%
9	552	3,0%	394	2,2%
10	531	2,9%	340	1,9%
Total	8 292	45,2%	6 086	34,5%

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

As at 31 December 2011 the biggest concentration of exposure of the Bank Group in the group of subsidiaries amounted to 10.5% of its consolidated own funds (entities not exempt from the exposure concentration limit).

Table 2.12

EXPOSURE TOWARD THE 5 BIGGEST CAPITAL GROUPS*

	The Bank Group			
	2011		2010	
No	exposure	% of own funds	exposure	% of own funds
1	1 929	10,5%	1 183	6,7%
2	1 726	9,4%	899	5,1%
3	1 286	7,0%	872	4,9%
4	950	5,2%	849	4,8%
5	803	4,4%	690	3,9%
Total	6 695	36,5%	4 492	25,5%

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

As at 31 December 2011 the biggest concentration of exposure of the Bank Group in the group of subsidiaries amounted to 36.5% of its consolidated own funds (entities not exempt from the exposure concentration limit).

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

1) financial institutions – by the country of origin of the counterparty's head office,
2) for other clients – by regional division of the Bank's organisational units extending the loan.

In order to ensure geographical diversification of the Bank's exposures to financial institutions, the Bank applies limits of joint exposure for individual countries.

As at 31 December 2011, there was no significant geographical concentration level in the Group's credit portfolio (Table 2.13). The KREDOBANK SA portfolio of loans extended to Ukrainian clients accounted for approx. 0.6% of the Group's total portfolio.

Table 2.13

GEOGRAPHICAL STRUCTURE OF EXPOSURES*

The Bank Group

2011

Country/region	No of exposure class**										Total
	A	B	C	D	E	F	G	H	I	Other***	
Poland, of which:	61 186	55 699	31 458	27 952	10 154	3 417	4 990	2 967	0	306	198 129
mazowiecki	14 881	9 448	4 698	74	1	56	296	36	0	0	29 489
śląsko-opolski	6 433	7 131	4 816	0	3	0	516	20	0	0	18 919
wielkopolski	5 634	6 826	3 016	14	0	0	421	21	0	0	15 933
małopolsko-świętokrzyski	5 028	5 397	3 059	45	5	0	731	41	0	0	14 305
dolnośląski	3 410	4 373	2 906	96	4	0	608	12	0	0	11 408
lubelsko-podkarpacki	3 446	4 932	2 043	32	8	0	398	11	0	0	10 871
zachodniopomorski	3 143	4 144	1 820	6	2	0	284	18	0	0	9 417
łódzki	4 268	3 143	2 054	1	1	0	749	17	0	0	10 232
pomorski	3 946	3 303	2 083	0	0	0	131	11	0	0	9 474
kujawsko-pomorski	2 512	2 448	2 054	201	2	0	403	5	0	0	7 625
warmińsko-mazurski	2 195	2 075	1 341	70	3	0	110	4	0	0	5 799
podlaski	2 435	1 637	799	39	0	0	90	12	0	0	5 012
Other ****	3 855	842	769	27 373	10 125	3 361	253	2 758	0	306	49 643
Ukraine	526	111	120	254	346	409	0	65	0	0	1 832
United Kingdom	348	3	1	0	0	1 404	0	0	0	0	1 756
France	216	0	0	0	0	718	0	0	0	0	935
Italy	0	0	0	0	0	0	0	0	0	0	0
Germany	0	137	23	0	0	643	0	2	0	0	805
Austria	0	2	1	0	0	685	0	0	0	0	687
USA	8	0	0	0	0	191	0	0	0	0	199
Norway	444	0	0	0	0	488	0	0	0	0	933
Denmark	0	10	2	0	0	209	0	2	0	0	223
Cyprus	0	4	0	0	0	0	0	1	0	0	4
Luxembourg	82	0	0	0	0	0	0	0	0	0	82
Finland	0	5	0	0	0	117	0	0	0	0	122
Belgium	0	3	1	0	0	61	0	0	0	0	66
Switzerland	0	0	0	0	0	60	0	0	0	0	61
Other	0	11	5	0	0	24	0	0	0	0	40
Total (PKO BP SA, KREDOBANK SA and the BFL SA Group)	62 810	55 986	31 612	28 206	10 501	8 427	4 990	3 036	0	306	205 874
Other subsidiaries	536	0	1	119	1 245	4 759	0	236	0	8	6 903
Adjustments and exclusions	-3 884	-10	0	0	-133	-5 475	0	-7	0	-273	-9 782
Total	59 463	55 977	31 613	28325.47	11 612	7 711	4 990	3 264	0	41	202 996

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

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

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

****Exposures managed at the Head Office level include the following, among other items: cash, tangible fixed assets, intangible assets, assets from securities valuation, securities.

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

As at 31 December 2011, there was no significant credit concentration level with respect to industry sectors (Table 2.14).

Table 2.14

EXPOSURE STRUCTURE BY INDUSTRY*

The Bank Group

2011

Type of client/branch	No of exposure class**										Total
	A	B	C	D	E	F	G	H	I	Other***	
Institutional clients, of which:	52 636	1 704	0	0	0	24	4 737	1 373	0	0	60 474
C Industrial processing	12 451	188	0	0	0	0	0	217	0	0	12 856
G Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household appliances	4 260	212	0	0	0	0	0	170	0	0	4 642
L Real property services	4 159	146	0	0	0	0	0	78	0	0	4 383
F Construction	2 027	91	0	0	0	0	0	139	0	0	2 257
O Public administration and national defence, obligatory social security and public health insurance	35	2	0	0	0	0	2 396	3	0	0	2 437
D Generation and supply of power, gas and water vapours, hot water and air for air-conditioning installations	3 854	60	0	0	0	0	0	77	0	0	3 991
Other exposures	25 849	1 005	0	0	0	24	2 340	690	0	0	29 907
Banks	0	0	0	0	0	8 403	0	0	0	0	8 403
Governments	0	0	0	28 202	0	0	0	0	0	0	28 202
Individuals	7 922	54 283	31 541	0	0	0	0	1 645	0	0	95 391
Other***	2 253	0	71	4	10 501	0	253	18	0	306	13 405
Total (PKO BP SA, KREDOBANK SA and the BFL SA Group)	62 810	55 986	31 612	28 206	10 501	8 427	4 990	3 036	0	306	205 874
Other subsidiaries	536	0	1	119	1 245	4 759	0	236	0	8	6 903
Adjustments and exclusions	-3 884	-10	0	0	-133	-5 475	0	-7	0	-273	-9 782
Total	59 463	55 977	31 613	28 325	11 612	7 711	4 990	3 264	0	41	202 996

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

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

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

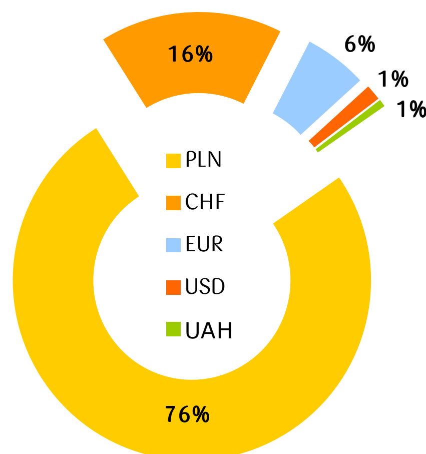
****Exposures managed at the Head Office level include the following, among other items: securities, other assets.

As at 31 December 2011, the share of exposures in convertible currencies other than PLN in the Group's total portfolio amounted to 24.2%. The biggest portion of the Group's currency exposure is the exposure in CHF pertaining to the Bank's credit portfolio. The situation is different in the case of the subsidiaries of the Group, i.e. exposures in EUR prevail in the currency portfolio of the BFL SA Group (88.2% of the foreign currency portfolio), like in case of the portfolio of BTK SA Group – EUR credits (80.9% of the foreign currency portfolio) while in KREDOBANK SA – loans extended in USD account for approximately 76.5% of the foreign currency portfolio and 30.4 % of the total portfolio of the company.

The 2011 increase in the share of loans denominated in foreign currencies resulted mainly from the growth of foreign exchange rates in 2011.

Chart 2.2

CURRENCY STRUCTURE
OF THE CREDIT PORTFOLIO
The Bank Group



2.2.3.4. Monitoring of derivatives

Contracts including embedded derivatives are monitored by the Bank in addition, separated embedded derivatives are subject to periodic valuation.

Derivatives intended for separation from major contracts and separate recognition in the books of account is valued at their fair value. Their valuation is presented in the balance sheet in the line entitled "Financial derivatives". The changes in valuation of the fair value of derivatives are referred to in the profit and loss account in the line entitled "Result of financial instruments valued at fair value".

The separated embedded derivatives were not a significant risk factor for the Bank in 2011.

As at 31 December 2011 the Bank had signed general agreements in ISDA and PBA standard with 27 Polish banks and 51 foreign banks and credit institutions. Moreover, the Bank was a party of 55 CSA (*Credit Support Annexes*) and PBA Collateral Agreements enabling collateral of exposures related to derivatives and 4 ISMA (*International Securities Market Association*) agreements enabling setting off liabilities resulting from REPO and BSB (SBB) transactions. The coverage ratio of the nominal value of transactions on derivatives with General Agreements and Collateral Agreements and CSA was 99.8% and 98.7% respectively.

The positive gross fair value of contracts with financial institutions as at 31 December 2011 was PLN 2,938 million. The above amount was calculated as the total of positive market values of all open transactions. The net credit exposure, after taking into account the netting of transactions, for counterparties with framework agreements was over PLN 890 million. Netting benefits amounted to approx. PLN 2,048 million (these were not accounted for in the calculation of capital requirements for credit risk, as presented in Chapter 4 “Capital requirements (Pillar I)”). The value of collateral accepted from the counterparties within the CSA and Collateral Agreements was ca. PLN 872 million.

As at 31 December 2011, the Bank had no derivative credit transactions.

As at 31 December 2011, the Bank recognized adjustments for credit valuation in the valuation of financial derivatives concluded with non-financial business entities based on an analysis of recoverability of its exposures. The Bank’s adjustment included the market value of credit risk as assessed by the Bank. Analyse covered all significant exposures on account of the Bank’s positive valuation of financial derivatives contracted with non-financial business entities. In particular, the adjustment included the risk of non-performance of agreements executed with the counterparty, based e.g. on the analysis of the business and financial standing of entities, the probability of repayment of specific contracts, and the recoverable value of collateral.

The majority of financial institutions – the Bank’s business partners on an interbank market – were awarded high external ratings – A or AA (Table 2.15).

Table 2.15

THE QUALITY OF EXPOSURES*
TO FINANCIAL INSTITUTIONS**

	PKO Bank Polski SA
Rating	2011
AA	6%
A	80%
BBB	10%
B	2%
No rating	2%
Total	100%

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

** Exposures to institutions from outside the Group.

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

2.2.4. Credit risk reporting

The Bank prepares monthly and quarterly credit risk reports for the following among other recipients: ALCO, RC, BCC and the Management and Supervisory Boards of the Bank. Credit risk reporting comprises periodical information on the exposure level to the credit portfolio risk. Beside information on the Bank, the reports also include the credit risk data for the Group’s two subsidiaries: KREDOBANK SA and the BFL SA Group, which both report significant credit risk level

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

Because the Bank implements the internal rating based (IRB) approach to calculate capital requirement for credit default risk, in 2011 the scope of information covered by quarterly reports was extended to cover credit risk parameters for corporate loans (next to existing analogical information for consumer loans), in particular in respect of PD parameter as divided by the results of rating assessment.

2.2.5. Management actions related to credit risk

2.2.5.1. Collateral policy

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

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

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

When granting retail loans to individual clients, the Bank usually accepts personal collateral (a guarantee under civil law or a bill of exchange) or establishes collateral on the client's bank account, car or securities.

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

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

1) in the case of big loans, the Bank establishes several types of collateral, combining personal and tangible collateral whenever possible,
2) liquid collateral is preferred, such as property collateral, for which there is a high probability that the Bank will quickly satisfy its debt achieving prices approximating the value of assets determined at the time of collateral acceptance,
3) collateral exposed to a risk of significant unfavourable value fluctuations is treated as ancillary,
4) in the case of acceptance of property collateral, as an additional security the Bank accepts transfer of cash receivables under insurance policy for the subject of collateral, or insurance policy issued in favour of the Bank,
5) effective establishment of collateral in accordance with clauses of the agreement is a prerequisite to release of the loan funds.

Established collateral is subject to periodic monitoring in order to determine the current credit risk level of the transaction. The following factors are monitored:

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

Collateral in the form of a mortgage is subject to special assessment. The Bank performs periodic monitoring of real properties accepted as collateral (the LtV ratio taken into account), and monitors the prices on the real estate market. If the analysis shows a significant drop in prices on the real estate market, the Bank activates emergency procedures.

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

Where the liquidity (demand for a given fixed asset on the secondary market), pace of loss of the market value of the asset or client financial standing are not acceptable according to internal procedures, additional legal collateral is accepted in the form intended and used by banks. These include property collateral such as mortgages, registered pledges, transfer of ownership rights, agreements for repurchase of the leased goods concluded with suppliers, and financial collateral such as transfers of receivables, powers of attorney to access bank accounts as well as security deposits.

2.2.5.2. Credit risk management tools

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

1) minimum transaction conditions defined for a given type of transaction (e.g. the minimum value of the LTV rate, the maximum loan amount, the required collateral),
2) the principles 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) or the client's rating class or cumulative rating class (for corporate clients), which a client must obtain to receive a loan,
3) concentration limits – the limits defined in Article 71 clause 1 of the Banking Law,
4) branch limits – limits defining the risk level related to financing of institutional clients that conduct their businesses in branches characterised by a high level of credit risk,
5) limits on credit exposures related of the Bank's clients – limits defining credit risk appetite resulting for instance from recommendations S and T,
6) credit limits defining the Bank's maximum concentration to a given counterparty or country in respect of wholesale operations and settlement limits and limits for the period of exposure,
7) competence limits – they define the maximum level of credit decision-making powers with regard to the Bank's clients; the limits depend mainly on the Bank's credit exposure amount to a given client (or a group of related clients) and the period of loan transaction; the competence limits depend on the credit decision-making level (within the Bank's organisational structure),
8) the minimum credit spreads – credit risk spreads related to the Bank's specific credit transaction concluded with an institutional client, with the provision that the client may not be offered interest rate lower than that resulting from reference rate increased by the credit risk spread.

A particular role in determination of minimum conditions of a transaction is played by the collateral policy within the scope of credit risk. The purpose of the collateral policy followed by the Bank and the subsidiaries of the Group is aimed at ensuring sufficient collateral of credit risk to which the Group is exposed, including in particular an establishment of collateral ensuring possibly highest recovery level in case it is necessary to undertake actions aimed at collection of debts.

Collateral policy was defined in the internal regulations of the subsidiaries of the Group.

The specific types of collateral that are actually established depend on the product and client type. In granting housing loans, collateral is obligatorily established on the financed real property in the form of a mortgage. Until the mortgage is effectively established (depending on the loan type and amount), a raised credit spread is applied and/or a temporary collateral is accepted in the form of a transfer of receivables under the apartment construction agreement, a bill, guarantee or insurance of liabilities.

When granting retail loans to individual clients, the Bank usually accepts personal collateral (a guarantee under civil law or a bill of exchange) or establishes collateral on the client's bank account, car or securities.

Collateral on loans financing small and medium-sized enterprises as well as corporate clients is established, among other things, on business liabilities, bank accounts, movables, immovable or securities. While entering into leasing agreements, the BFL SA Group, being the owner of leased items, treats them as transaction collaterals.

2.2.5.3. Credit risk management in the subsidiaries of the Group

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

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

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

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

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

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

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

In 2011, KREDOBANK SA focused on restructuring of doubtful debts in the credit portfolio. It continued works on the Early Warning System (EWS) and automation of reminding activities (Soft Collection). To ensure reliable information about clients, it developed its cooperation with credit agencies and the process of verification of internal databases of "unreliable" clients was implemented. In December 2011, a separate credit liabilities portfolio of the total value of UAH 1,645 million (that is ca. PLN 700 million) was sold to Finansowa Kompania "Prywatne Inwestycje" Sp. z o.o., a new subsidiary in the Bank Group, that was bought in order to conduct successful restructuring of KREDOBANK SA's credit portfolio. While preparing to the development of the credit action, in 2011 it initiated works to update the credit risk methodology and implement new credit procedures.

In 2011, the BFL SA Group continued activities aimed at mitigating credit risk, which consisted in creation of a safe leasing portfolio that would guarantee positive consolidated results of the BFL SA Group, capital safety and driving at a reduction of the share of debts at risk in the portfolio. It started to implement the scoring system and scoring procedures for transaction risk assessment, modify other leasing risk assessment procedures (so called PORTL) and construct and implement the centralised IT system that will support, for instance, the process of risk assessment and leasing transaction conclusions. At the same time the credit risk policy maintained the criteria of determining branches, clients and entities as not acceptable, as well the concentration limits for individual branches and concentration limits for clients that were defined in 2010. The purpose of the BFL SA Group is the development of the leasing business through the Bank's distribution channel.

2.2.5.4. Management actions related to derivatives

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

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

Collateral agreements signed by the Bank contain provisions on the allowed difference between credit exposure and collateral value.

Collateral agreements may allow two forms of collateral: cash and securities.

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

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

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

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

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

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

The identification of transactions threatened with impairment consists in recognition of events that indicate a threat to payments under such transactions, in particular:

1) delays in making payments under such transactions,
2) no cover of a transaction from foreseeable cash flows from client's economic activities or accepted transaction collateral,
3) significant deterioration of a client's internal rating or missing information on current rating.

The following methods are applicable while determining adjustments of derivative transaction valuations:

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

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

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

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

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

In 2011, the only subsidiaries of the Group beside the Bank that use derivatives for market risk management (to hedge the risk resulting from their major activities) were subsidiaries of the BFL SA Group. The other subsidiaries of the Group may also enter into such transactions only to hedge their business risk (since February 2012 also KREDOBANK SA may use FX forward transactions to hedge the foreign exchange risk of specific currencies).

2.3. Interest rate risk

2.3.1. Introduction

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

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

2.3.2. Interest rate risk measurement and assessment

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

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

In order to determine VaR for market risk management purposes, the variance-covariance method is applied with the 99% confidence level. For interest rate risk management purposes, the following, among other things, are applied: the VaR value determined for individual financial instruments and for the Bank's portfolios, and by individual types of business activity of the Bank.

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

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

Stress tests for interest rate risk are used to assess potential losses resulting from the maintained structure of

the balance sheet and off-balance sheet items where market situation occurs that is not described in a standard manner using the statistical measures. The following scenarios are applied at the Bank:

1) hypothetical scenarios – within which the scale of fluctuations in interest rates is assumed arbitrarily, e.g. parallel movement of the interest rate curves in the following currencies: PLN, EUR, USD, CHF and GBP by ±50 BPS, by ±100 BPS and by ±200 BPS. Moreover, the scenario of ±200 BPS is defined for all other currencies in relation to which the interest rate risk is borne by the Bank.
2) historical scenarios – within which fluctuations in interest rates are assumed on the basis of fluctuations in interest rates in the past, including: the biggest historical change, deflection of the profitability curve with due account to portfolio positions, peak- and twist-type deflections of the profitability curve, the biggest historical non-parallel shift of interest rates for securities and for derivatives guaranteeing those securities.

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

2.3.3. Monitoring of the interest rate risk

In 2011, interest rate risk of the Bank Group was determined mainly by the risk of mismatch of dates of reassessment of assets and liabilities.

As at 31 December 2011 the mismatch of reassessment dates of the Bank Group in case of PLN interest rate and also of EUR and CHF interest rates comprised mainly the Bank's mismatch. The mismatch of interest rate reassessment dates for these currencies, that was generated by the other subsidiaries Group had no significant impact on the interest rate risk for the entire Group and consequently, it did not change its risk profile significantly. The mismatch of the Group's USD reassessment dates comprised mainly the Bank's exposures and the mismatch of the Group's subsidiaries. The mismatch of the Group's subsidiaries reduced the mismatch of the Group in USD in the range up to 1 month, from 1 to 3 months and from 1 to 2 years. As far as the other ranges are concerned, the mismatch of the Group's subsidiaries increased the mismatch of the Group.

The tables 2.16 – 2.19 present the reassessment gaps of the Group as at 31 December 2011 by currencies.

Table 2.16

PLN reassessment gap (in PLN million)

2 011	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	50 554	14 208	-20 597	-22 364	-4 513	1 132	80	18 499
Cumulative gap	50 554	64 762	44 165	21 801	17 288	18 420	18 499	0
Group subsidiaries								
Periodic gap	-253	-352	63	42	26	-231	0	-705
Cumulative gap	-253	-605	-542	-499	-473	-705	-705	0
TOTAL - Periodic gap	50 300	13 857	-20 533	-22 322	-4 487	901	80	17 795
TOTAL - Cumulative gap	50 300	64 157	43 624	21 302	16 814	17 715	17 795	0

Table 2.17

USD reassessment gap (in USD million)

2 011	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	559	28	-295	-357	-47	0	0	-112
Cumulative gap	559	587	292	-65	-112	-112	-112	0
Group subsidiaries								
Periodic gap	-16	-63	-17	-4	8	24	84	16
Cumulative gap	-16	-79	-96	-100	-92	-68	16	0
TOTAL - Periodic gap	543	-35	-311	-361	-39	24	84	-96
TOTAL - Cumulative gap	543	507	196	-165	-204	-180	-96	0

Table 2.18

EUR reassessment gap (in EUR million)

2 011	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	289	-93	-21	-14	-44	-353	-1	-236
Cumulative gap	289	196	175	161	117	-236	-236	0
Group subsidiaries								
Periodic gap	10	-94	-5	-2	3	15	9	-65
Cumulative gap	10	-84	-89	-91	-88	-74	-65	0
TOTAL - Periodic gap	299	-187	-26	-17	-41	-338	8	-301
TOTAL - Cumulative gap	299	112	87	70	29	-309	-301	0

Table 2.19

CHF reassessment gap (in CHF million)

2 011	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
PKO Bank Polski SA								
Periodic gap	-682	549	-15	-38	1	-29	7	-207
Cumulative gap	-682	-133	-149	-187	-185	-214	-207	0
Group subsidiaries								
Periodic gap	-2	-2	0	0	0	0	0	-4
Cumulative gap	-2	-4	-4	-4	-4	-4	-4	0
TOTAL - Periodic gap	-684	546	-15	-38	1	-29	7	-212
TOTAL - Cumulative gap	-684	-138	-153	-191	-190	-219	-212	0

The VaR and analysis of stress test scenarios of the Group's exposure to the interest rate risk as at 31 December 2011 and 31 December 2010 respectively are presented below:

Table 2.20

Sensitivity of financial assets Exposed to interest rate risk

	2011		2010	
	10-day VaR	Stress-test ±200 base points	10-day VaR	Stress-test ±200 base points
PKO Bank Polski SA	62,7	486,1	39,0	475,1
Group subsidiaries	-	99,7	-	94,7
Total	-	530,7	-	522,6

As at 31 December 2011, the 10-day VaR on the Bank's interest rate was PLN 63 million and accounted for approx. 0.36% of the Bank's own funds.

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

Table 2.21

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

	Bank		Group Subsidiaries		Total	
Currency	2011	2010	2011	2010	2011	2010
PLN	-386,6	255,4	-15,0	1,4	-401,5	256,8
EUR	-90,3	216,2	-12,1	17,4	-78,3	198,7
USD	-9,2	2,3	-72,7	75,9	-50,9	66,0
CHF	2,7	0,4	0,0	0,0	2,6	0,3
GBP	-1,2	0,8	0,0	0,0	-1,2	0,8

* Foreign currency values have been shown as PLN equivalents.

Given the nature of business activity of the subsidiaries of the Group generating the largest interest rate risk (the BFL SA Group and KREDOBANK SA) and the specific nature of the market on which those subsidiaries operate, the Group does not determine the consolidated VaR sensitivity measure in respect of the interest rate. The subsidiaries use their own risk measures to manage interest rate risk. The 10-day VaR measure for main currencies is used by

KREDOBANK SA. Its value as at 31 December 2011 was PLN 29.7 million, while as at 31 December 2010 - PLN 30.2 million.

2.3.4. Reporting of the interest rate risk

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

2.3.5. Management actions related to interest rate risk

The main tools used in interest rate risk management in the Group include:
1) interest rate risk management procedures,
2) limits and thresholds for interest rate risk,
3) defining the allowable transactions based on interest rates.

The Group established limits and thresholds for interest rate risk comprising price sensitivity, interest income sensitivity, the limits and thresholds for losses, limits on instruments sensitive to interest rate fluctuations.

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

2.4. Foreign exchange risk

2.4.1. Introduction

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

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

2.4.2. Foreign exchange risk measurement and assessment

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

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

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

2.4.3. Monitoring of the foreign exchang risk

In 2011, the FX risk of the Group was low as it is the Bank's policy to close currency positions in the main currencies, that is EUR, USD, CHF i GBP.. 10-day VaR for FX position of the Bank at the end of 2011 amounted to PLN 1.5 million, which accounted for approx. 0.01% of the Bank's own funds. The VaR and stress-test analysis in respect of the Bank's and the Group's financial assets (jointly for all currencies) exposed to FX risk as at 31 December 2011 and 31 December 2010 respectively was as follows:

Table 2.22

Sensitivity of financial assets exposed to FX risk

	2011		2010	
	10-day VaR	Stress-test ±20%*	10-day VaR	Stress-test ±20%*
PKO Bank Polski SA	1,5	13,6	3,2	-5,3
Group subsidiaries	0,0	-30,9	-	-2,8
Total	-	-17,2	-	-8,1

*The table presents the value of most infavourable stress test among all scenarios: PLN appreciation by 20% and PLN depreciation by 20%. The data as at the end of 2010 were checked for comparability.

As in the case of interest rate risk, given the nature of business activity of the subsidiaries of the Group generating the largest FX risk (the BFL SA Group and KREDOBANK SA) and the specific nature of the market on which those subsidiaries operate, the Bank does not determine the consolidated VaR sensitivity measure for FX risk. The subsidiaries use their own risk measures to manage FX risk. The 10-day VaR measure is used by KREDOBANK SA. As at 31 December 2011 its value was ca. PLN 0.47 million while as at 31 December 2010 - PLN 0.2 million.

2.4.4. Reporting of the foreign exchange risk

The Bank prepares daily, weekly, monthly and quarterly reports are also applicable to the group. The reports contain information on FX risk exposure and on the use of these risk limits. The recipients of such reports are mainly ALCO, RC, the Bank's Management Board and Supervisory Board.

2.4.5. Management actions related to foreign exchange risk

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

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

2.5. LIQUIDITY RISK

2.5.1. INTRODUCTION

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

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

2.5.2. LIQUIDITY RISK MEASUREMENT AND ASSESSMENT

The Group's liquidity policy is based on maintenance of liquid securities portfolio and growth of stable financing sources (in particular stable deposit base). Moreover, money market instruments, including operations of the open market of the National Bank of Poland are used for liquidity risk management.

The Group makes use the following liquidity risk measures:
1) the contractual liquidity gap method – listing of all balance sheet items by their maturity,
2) the real-terms liquidity gap method– listing of individual balance sheet categories by their real-terms maturity,
3) liquidity reserve – the difference between the most liquid assets and expected and potential liabilities that mature in a given period,
4) stability measures of deposit and loan portfolio,
5) stress tests (liquidity stress tests).

Stress tests for liquidity risk are used to assess the minimum number of business days over which the Bank could fully pay funds to non-financial subsidiaries and to verify if the Bank's funds would be enough to cover the liabilities should the shock scenario be fulfilled. The following two scenarios are applied at the Bank:
1) scenarios of mass withdrawal of deposits by non-financial clients,
2) scenarios of sensitivity of in- and outflows to changing market conditions.

2.5.3. MONITORING OF THE LIQUIDITY RISK

The real-terms liquidity gaps presented below include a list of matured assets, payable liabilities, and additionally selected balance sheet items for a realistic presentation of the liquidity status of the Bank and the subsidiaries of the Group. Put in real terms were in particular the following:
1) the core deposits (interbank market excluded) and their pay ability - clients' deposits (current accounts, savings accounts and fixed term deposits) have been classified to appropriate time frames with due account to their stability (maintenance of an appropriate balance or revolving after pay ability),
2) the core deposits on the current accounts of non-financial entities and their maturity - overdrafts have been classified to appropriate time frames with due account to their possibility of revolving,
3) liquid securities and their maturity – liquid securities have been classified into the time frame of up to 7 days according to the possible date of their liquidation (pledging, sale).

The table below presents data concerning periodic gap and cumulative periodic gap of the Bank and of the subsidiaries of the Group as at 31 December 2011 and 31 December 2010 respectively.

Table 2.23

REAL-TERMS LIQUIDITY GAP* - ASSETS AND LIABILITIES

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

2 010	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
PKO Bank Polski SA								
Periodic gap	3 221	14 310	-711	-66	3 965	5 019	-1 317	-24 421
Cumulative gap	3 221	17 531	16 819	16 754	20 719	25 738	24 421	0
Group subsidiaries								
Periodic gap	-13	-207	-239	-41	-165	141	303	220
Cumulative gap	-13	-221	-459	-500	-665	-523	-220	0
TOTAL - Periodic gap	3 207	14 103	-950	-107	3 801	5 160	-1 014	-24 200
TOTAL - Cumulative gap	3 207	17 310	16 360	16 254	20 054	25 215	24 200	0

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

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

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

Table 2.24

CONTRACTUAL OFF-BALANCE SHEET LIQUIDITY GAP FOR DERIVATIVES

The Bank Group

2011	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
TOTAL - Periodic gap	100	181	462	1 038	554	238	9	2 582
TOTAL - Cumulative gap	100	282	744	1 781	2 335	2 573	2 582	0

2 010	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
TOTAL - Periodic gap	123	183	471	527	515	101	-30	1 889
TOTAL - Cumulative gap	123	306	777	1 304	1 818	1 919	1 889	0

The table below shows the Bank's liquidity reserve as at 31 December 2011 and 31 December 2010.

Table 2.25

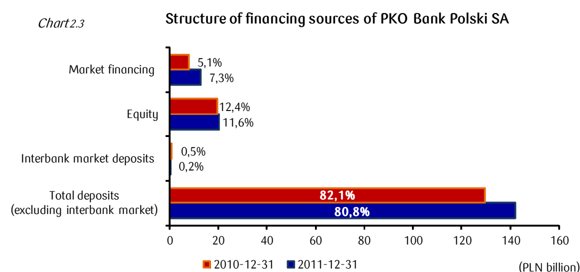
LIQUIDITY RESERVE
PKO Bank Polski SA

Sensitivity measure	31.12.2011	31.12.2010
Liquidity reserve for up to 1 month	17 723	10 151

As at 31 December 2010, core deposits amounted to approx. 94.8% of all deposits held by the Bank (the interbank market excluded), which was an decrease of approx. 0.4 percentage points compared to 31 December 2010.

The following chart presents the structure of the Bank's financing sources as of 31 December 2010 and 31 December 2011.

Chart 2.3



2.5.4. Liquidity risk reporting

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

2.5.5. Management actions related to liquidity risk

The main tools used in liquidity risk management by the Group are as follows:

1) liquidity risk management procedures including emergency plans,
2) limits and thresholds mitigating liquidity risk,
3) deposit, investment, derivative transactions, including structured FX transactions and transactions or purchase of securit,
4) transactions ensuring long-term financing of credit activities.

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

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

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

2.6. Price risks of equity securities and other price risks

2.6.1. Introduction

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

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

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

Taking account of other price risks, as of the end of 2011 the Bank was exposed to the price risk of participation units in collective investment institutions.

2.6.2. Measurement and assessment of price risk of equity securities and other price risks

The impact of the price risk of equity securities and other price risk on the Bank's financial conditions was defined as insignificant. Positions in equity securities and indexed instruments decreased and their significant increase is not expected.

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

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

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

Table 2.26

CAPITAL EXPOSURES - BANKING BOOK

	The Bank Group			
	2011		2010	
	Carrying amount	fair value*	Carrying amount	fair value*
Total	55 640	55 900	97 483	97 743
Shares in other entities	17 565	17 565	43 228	43 228
Equity securities	38 075	38 335	54 255	54 515
Shares in entities listed on regular market **	10 357	10 357	11 384	11 384
Shares in entities not listed on regular market ***	19 730	19 990	18 246	18 506
Participation units in collective investment undertakings	7 988	7 988	24 625	24 625

* Assessed fair value
** Fair value of listed securities equals their market value.
*** This line includes also shares not allowed for trading on the regular market of public companies.

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

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

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

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

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

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

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

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

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

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

As at 31 December 2011, the unrealised loss of the Group relating to reassessment of capital exposures amounted to PLN 30.6 million, and the realised profit from the disposal of capital exposures amounted to PLN 12 million. Additionally, on account of its capital exposure in the stocks held, the Group received a gross dividend in 2011 in the total amount of PLN 6.5 million.

2.6.4. Reporting price risk of equity securities and other price risks

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

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

The price risk of equity securities is managed through limits imposed on the activities of Dom Maklerski PKO Banku Polskiego divided into banking book and trading book and monitoring of their use.

2.7. Operational risk

2.7.1. Introduction

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

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

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

1) sets the objectives for operational risk management,
2) defines policies for operational risk,
3) adopts resolutions on operational risk tolerance and operational risk limits,
4) accepts the value of the management adjustment of the capital requirements for operational risk by AMA approach,
5) accepts reports relating to operational risk.

2.7.2. Operational risk measurement and assessment

2.7.2.1. Measurement and assessment of the operational risk

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

Operational risk measurement includes:
1) KRI calculation,
2) calculation of the threatened value for operational risk,
3) scenario analyses.

Operational risk assessment comprises operational risk arising in the existing products, processes and IT application of the Bank and it is conducted using the following:
1) collected data on operational risk events,
2) internal audit results,
3) results of internal functional control,
4) the key operational risk indicators (KRI).

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

According to the AMA approach, the capital requirement for operational risk corresponds to the VaR in respect to operational risk plus the result of complementary method and adjusted by the value of adjustments related to changes in quality of internal functional audit and management adjustment pertaining to the following formula:
$AMA = (LDA_{99,9\%}+CMR)*(1+IA)+MA$
where:
AMA –AMA result,
$LDA_{99,9\%}$ – value at risk,
CMR –complementary method result,
IA – adjustment related to changes in quality of internal functional audit,
MA – management adjustment

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

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

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

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

Risk measurement includes stress tests referring to potential consequences of extremely unfavourable, yet possible, scenarios. Its aim is to define the sensitivity of the Bank's results to the fulfilment of a test scenario and to determine if AMA's result covers the total amount of losses resulting from the accomplishment of such scenarios.
The results of stress tests do not challenge the sufficient conservatism of the results of AMA measurements.

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

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

2.7.2.2. The Bank's insurance policy

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

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

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

2.7.2.3. Impact of insurance

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

The main operational events that occur in the Bank are covered with respective insurance policies. The policies used

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

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

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

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

2.7.3. Monitoring of the operational risk

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

2.7.4. Operational risk reporting

Reporting operational risk-related information concerning the Bank and the subsidiaries of the Group is conducted on a quarterly basis. The recipients of such reports are the Operational Risk Committee, the Risk Committee, the Management and Supervisory Boards of the Bank. The reports contain information relating to the following:
1) the Bank's operational risk profile resulting from its process of identification and assessment of threats for products, processes and IT applications of the Bank,
2) results of operational risk assessment and monitoring,
3) operational events and their financial effects,
4) the most significant projects and undertakings as regards operational risk management,
5) recommended or proposed activities for the Operational Risk Committee or the Bank's Management Board,
6) information on the level of compliance with operational risk tolerance and limits.

Information on operational risk for the members of the Bank's Management Board and the Bank's units responsible for systematic operational risk management is prepared in monthly cycles. The scopes of information vary and are adjusted to the scope of responsibility of individual recipients of the information.

2.7.5. Management actions related to operational risk

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

Systemic operational risk management consists in developing internal regulations and other solutions relating to operational risk and concerning, among other things, the following:
1) human resources,
2) organisation of the Bank,
3) accounting,
4) principles of preparation of the Bank's internal provisions,
5) IT,
6) security,
7) internal processes,
8) client service processes,
9) creation and implementation of internal operational risk models and systems of identification, assessment, monitoring and limiting of operational risk,
10) outsourcing of the operations ordered by the Bank to external parties.

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

"Day-to-day" operational risk management consists in the following:
1) preventing the operational risk events arising while servicing products, during the course of realisation of internal processes or use of the systems,
2) taking action aimed at limiting the number and scale of threats (operational risk events),
3) liquidating the negative effects of operational risk events,
4) recording data on operational risk events,
5) complying with the operational risk limits.

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

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

Three subsidiaries, i.e. PKO Bank Polski, the BFL SA Group and KREDOBANK SA, have a decisive impact on the operational risk profile of the Group. Other subsidiaries of the Group, due to a considerably lower scale and specific type of their businesses, generate only limited operational risk.

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

4) strategic operational risk tolerance limits and loss limits,
5) contingency plans,
6) insurance,
7) outsourcing.

Selection of instruments used to mitigate operational risk is performed depending on the following, among other factors:
1) availability and adequacy of instruments mitigating the risk,
2) nature of the business or process, in which the operational risk has been identified,
3) risk materiality,
4) cost of use of an instrument.

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

If the operational risk level is too high, the Bank undertakes the following activities:
1) risk avoidance – withdrawing from too risky activities or deciding not to undertake it, if it is not possible to manage it,
2) limiting the volume of activities bearing too high risk, if it is possible to manage it and undertake activities to limit the risk level,
3) risk transfer – insurance against operational events, ensuring that the operational risk is maintained on the level that is not hazardous to the security of the Bank's operations.

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

2.8. COMPLIANCE RISK

2.8.1. INTRODUCTION

Compliance risk is the risk of incurring legal sanctions or occurrence of financial losses or a loss of reputation or credibility as a result of failure on the part of the Group, the Group's employees or entities operating on its behalf to observe legal provisions, internal regulations and the standards of procedure adopted by the Bank, the ethical standards included.
The purpose of compliance risk management is to consolidate, through elimination of compliance risk, the image of the Bank Group as a group of entities operating in compliance with the law and the generally recognised standards of procedure, trustworthy, honest and reliable; to prevent the Group's loss of reputation or credibility; and to prevent financial losses or legal sanctions that might result from the violation of the law and norms of conduct.

2.8.2. COMPLIANCE RISK MEASUREMENT AND ASSESSMENT

The Bank identifies and assesses compliance risk and this process includes in particular, in case of every process exposed to the compliance risk, determination of risks related to violation of laws and other standards of conduct, as well as the results of materialisation of such threats and best solutions that would limit the level of the risk borne.
The assessment includes also changes in the regulatory environment and results of activities undertaken by external regulators and internal audit.

2.8.3. COMPLIANCE RISK MONITORING

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

2.8.4. COMPLIANCE RISK REPORTING

Reporting compliance risk is conducted on a quarterly basis. The recipients of such reports are RC, the Management and Supervisory Boards of the Bank. The reports contain information relating to the following:
1) results of compliance risk identification and assessment,
2) cases of materialisation of compliance risk at the Bank and in the banking industry,
3) major changes in the regulatory environment,
4) works conducted at the Bank to adjust to new regulations and standards of conduct,
5) fulfilment of recommendations after audits conducted by external Regulator and essential correspondence of the Bank with such authorities.

2.8.5. MANAGEMENT ACTIONS RELATED TO COMPLIANCE RISK

Compliance risk management covers specifically the following issues:
1) prevention of the Group's involvement in illegal activities,
2) ensuring data protection,
3) propagation of the ethical standards and monitoring of their functioning,
4) management of conflicts of interests,
5) prevention of situations when the Bank's employees accept and offer benefits and incentive that would result in an establishment of non-formal obligations in relations with representatives of governmental authorities, clients or counterparties, cause conflicts of interests or have any other negative impact on the fulfilment of professional obligations by employees,
6) professional, reliable and clear formulation of the product offer and the advertising and marketing messages,
7) immediate, honest and professional consideration of the clients' complaints, applications and suggestions.

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

Respective organisational entities or appointed employees of such entities are responsible for establishment of systemic solutions within the scope of compliance of the

operations of individual Group's entities with applicable legislations and standards of conduct.

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

2.9. Business risk

2.9.1. Introduction

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

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

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

2.9.2. Strategic risk measurement and assessment

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

2.9.3. Monitoring of strategic risk

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

2.9.4. Strategic risk reporting

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

2.9.5. Management actions related to strategic risk

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

2.10. Reputation risk

2.10.1. Introduction

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

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

2.10.2. Reputation risk measurement and assessment

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

2.10.3. Monitoring of reputation risk

Monitoring of image-related events is performed on an ongoing basis and it includes:
1) monitoring the external and internal channels of the Group's communication with its environment in order to identify adverse effects of image-related events,
2) gathering and analyzing information on the occurrence or potential occurrence of an image-related event,
3) recording data on identified negative effects of image-related events.

2.10.4. Reputation risk reporting

Reputation risk reporting is performed in the Bank on an annual basis. Information on reputation risk is submitted to the Banking Risk Division units.

2.10.5. Management actions related to reputation risk

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

3. OWN FUNDS

For the purpose of capital adequacy, own funds are calculated according to the provisions of the Banking Law and Resolution no 325/2011[6] of the Polish Financial Supervision Authority dated 20 December 2011 concerning decreases of basic funds, (Official Journal of PFSA no 13 item 49 dated 30December 2011).

Included in the basic funds (Tier 1) are the following:
1) core funds comprising:
   a) share capital – in the amount defined in the Bank's Statutes and entry in the Register of Entrepreneurs, at nominal value,
   b) reserve capital – established in accordance with the Bank's Statutes from write-offs of net profits and premiums on the issue of shares, assigned to absorb balance sheet losses that may arise within the Bank's activities; decisions concerning utilisation of the reserve capital are taken by the General Shareholders' Meeting,
   c) other reserve capital – to be utilised for the purposes defined in the Statutes, created from write-offs of net profits in the amount defined by the General Shareholders' Meeting,
2) general banking risk fund – created in accordance with the Banking Law from the net profit,
3) retained earnings,
4) net financial result prior to approval and net result for the current reporting period – calculated based on applicable accounting standards, decreased by any expected charges and dividends, in amounts not exceeding amounts audited by a certified public accountant, pertaining to article 127 item 2 point 2) c) of the Banking Law.

In addition, the basic funds are reduced by the following items:
1) intangible assets valued at their carrying amount,
2) equity exposures[7] of the Bank to financial institutions, lending institutions, Polish and foreign banks and insurance subsidiaries, in the form of:
   a) shares or stocks held,
   b) amounts classified as subordinated liabilities,
   c) other equity exposure in items classified as own funds or capital of those entities, including additional contributions in favour of a limited liability subsidiary, in the amount of 50% of carrying amounts of such exposures,
3) unrealised losses on debt and equity instruments classified as available for sale,
4) negative amounts in respect of adjustments on revaluation of the assets held in the trading book.

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

In addition, supplementary funds are reduced by 50% of the value of the Bank's equity exposure[7] in financial or lending institutions, Polish and foreign banks and insurance subsidiaries. Where the value of those reductions decreases the amount of supplementary funds to below zero, the amount is deducted from the basic funds.

In addition, the following is included in the balance of consolidated own funds:
1) goodwill of the subsidiaries (acts to reduce own basic funds),
2) non-controlling interest (acts to increase own funds),
3) currency translation differences from foreign operations (negative differences decrease own funds, whereas positive differences increase own funds).

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

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

Table 3.1

	Group		Bank	
	2011	2 010	2 011	2 010
OWN FUNDS	18 343	17 619	17 348	16 563
Basic funds (Tier 1)	16 664	15 960	16 225	15 450
core funds	17 752	16 874	17 468	16 632
general risk funds	1 070	1 070	1 070	1 070
retained profit/loss	-23	112	0	0
profit/loss from the current period	0	0	0	0
intangible assets	-1 800	-1 802	-1 523	-1 528
capital exposures	-109	-118	-662	-658
unrealised losses on instruments available for sale	-130	-67	-127	-66
revaluations of assets in the portfolio	0	0	0	0
currency translation differences	-94	-111	0	0
minority interest	-1	2	0	0
Supplementary funds (Tier 2)	1 546	1 513	990	967
subordinated liabilities	1 601	1 601	1 601	1 601
unrealised profits on instruments available for sale	52	29	51	24
currency translation differences	2	1	0	0
capital exposures	-109	-118	-662	-658
Short-term equity (Tier 3)	133	146	133	146

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

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

In 2011, the amount of the Group's own funds grew ca. PLN 724 million, which was mainly due to the fact that the Bank's result for 2010 (minus expected charged in the amount of PLN 836 million) was recorded as funds and the increase of the Group's supplementary and reserves capitals by PLN 41 million. As compared to the end of 2010, the result from previous years decreased by PLN 135, while the value of unrealised losses on debt and capital instruments in AFS portfolio grew by the amount of ca. PLN 62 million with simultaneous decrease of the value of the other deductions by the amount of PLN 37 million.

According to resolution no 8/2011 of the Ordinary General Shareholders' Meeting of PKO Bank Polski SA dated 30 June 2011, the dividend for 2010 was agreed to be PLN 2,475 million that is PLN 1.98 gross per share.

As of 31 December 2011, the Bank has not decided about dividend for 2011. Pertaining to the Bank's new policy in dividend payment (announced in the Current Report no 22/2012) while making a recommendation on dividend payment, the Bank's Management Board will take account of the need to ensure the capital basis necessary to maintain the solvency ratio at the level of at least 12% and the Common Equity Tier 1 Ratio at the level of at least 9%.

Table 3.1 in line of subordinate liabilities presents 10-year subordinate bonds issued in 2007 in the total value of PLN 1,600.7 (redemption date on 30 October 2017 and option of early redemption by the Bank as from 30 October 2012). The bonds were included in the compensatory amounts after the Bank obtained the approval of the Polish Financial Supervision Authority.

4. CAPITAL REQUIREMENTS (PILLAR I)

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

Table 4.1

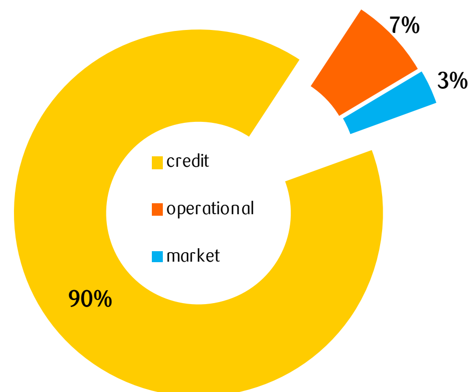
	Group		Bank	
	2011	2010	2011	2010
Total capital requirement	11 865	11 302	11 635	11 049
Credit risk	10 657	9 822	10 487	9 626
credit risk (banking book)	10 535	9 757	10 364	9 561
counterparty risk (trading book)	123	65	123	65
Market risk	355	422	391	466
foreign currency	0	0	0	0
commodities risk	0	0	0	0
equity securities risk	2	1	2	1
specific risk of debt instruments	262	341	295	380
general interest rate risk	91	80	94	85
Operational risk	852	1 058	758	958
Other types of risk*	0	0	0	0

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

As at 31 December 2010, the biggest part of the Group's total capital requirement was the requirement on account of credit risk (approx. 90%) – chart 4.1.

Chart 4.1

STRUCTURE OF CAPITAL REQUIREMENT
OF THE BANK GROUP
BY RISK TYPES



As at 31 December 2011:
1) the capital requirement for credit risk and counterparty credit risk was calculated under the standardised approach (pertaining to Appendices no. 4, 11, 16 and 17 to Resolution of PFSA No. 76/2010 as amended[8] (Official Journal of PFSA no 2 item 11 of 9 April 2010 as amended)),
2) the capital requirement for market risk was calculated under the basic methods (Appendices No. 6 to 10 to Resolution No. 76/2010 of PFSA as amended),
3) the capital requirement for operational risk was calculated for the Bank under the advanced approach (AMA) (for 2010 it was standardised approach (TSA)) and under basic indicator approach (BIA) for the

[8] Amendments to Resolution no 76/2010 of PFSA were introduced with the following PFSA's Resolutions: resolution no 369/2010 dated 12 Octover 2010, PFSA's resolution no 153/2011 dated 7 June 2011, PFSA's resolution 206/2011 dated 22 August 2011 and PFSA's Resolution no 324/2011 dated 20 December 2011.

subsidiaries of the Group (Appendix No. 14 to Resolution No. 76/2010 of PFSA as amended),

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

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

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

The increase in the credit portfolio (balance sheet and off-balance sheet exposures) of the Group contributed to the increased capital requirement for credit risk in 2011 by 8.5% to the amount of PLN 10,657 million. The decreased capital requirement for market risk by 15.8% to the amount of PLN 355 million results mainly a decrease of the value of liabilities due for guarantees of issues of corporate bonds with a simultaneous loss growth of the value of corporate bonds (total decrease of the requirement for bonds by ca. 29%).

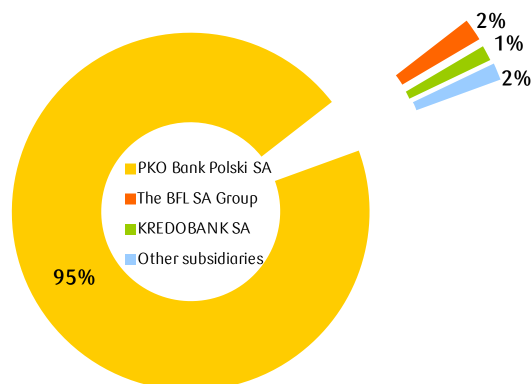
The capital requirements of the Bank and the Group for settlement and delivery risks, the risk of exceeding the exposure concentration limit and the capital concentration threshold were zero as at 31 December 2010 and 31 December 2011 due to the fact that such events did not occur.

The Bank's capital requirements for operational risk for 2010 was calculated under the standardized approach (TSA). On 21 June 2011 the Bank received a conditional approval from PFSA to implement the advanced approach (AMA) with a temporary (until PFSA's conditions are fulfilled) restriction of a decrease of the capital requirement that is not bigger than by the level of 75% of the capital requirement calculated by means of the standardized approach (TSA). Consequently, as of 31 December 2011 the capital requirement for operational risk for the Group decreased by ca. PLN 206 million as compared to the data for 2010, to the amount of PLN 852 million.

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

Chart 4.2

STRUCTURE OF CAPITAL REQUIREMENT OF BANK GROUP BY SUBSIDIARIES



A considerable proportion of the capital requirement of both the Group (Table 4.2) and the Bank (Table 4.3) results from exposure in the banking book especially within the requirement established for balance sheet exposures (over 87%).

Table 4.2

	The Bank Group		
	2011		
	Book		
	banking	trading	total
Capital requirement*	10 535	387	10 921
Balance sheet exposures	9 447	211	9 659
Off-balance sheet liabilities	1 011	53	1 064
Derivatives	76	123	199

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

Table 4.3

	PKO Bank Polski SA		
	2011		
	Book		
	banking	trading	total
Capital requirement*	10 364	419	10 783
Balance sheet exposures	9 226	224	9 450
Off-balance sheet liabilities	1 062	73	1 135
Derivatives	76	123	199

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

4.1. Credit Risk

The capital requirement for credit risk and the counterparty credit risk as at 31 December 2011 was calculated under the standardised approach in accordance with Appendices No. 4, 11, 16 and 17 to Resolution No. 76/2010 of PFSA as amended. The value of that capital requirement of the Group by exposure classes is shown in Table 4.4.

Table 4.4

STRUCTURE OF CAPITAL REQUIREMENT FOR CREDIT RISK

PKO Bank Polski SA Group

	2011
TOTAL	10 657
Corporate	4 604
Secured on real estate property	3 202
Retail	1 894
Central governments and central banks	20
Other exposures	352
Institutions (banks)	224
Regional governments and local authorities	84
Past dues	272
Administrative bodies and non-commercial undertakings	0
Other*	5

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

In 2011, the capital requirement of the Group for credit risk (the counterparty credit risk included) increased by PLN 836 million compared to 2010, which was mainly due to the Bank's increased crediting action.

The Group is obliged to maintain the highest capital requirement for the risk related to corporate exposures and exposures secured on real property, which results from the Bank's high exposure to such types of clients. The low capital requirement for exposures to central governments and central banks, despite the high value of such exposures, results from the low risk weights attached to such entities (a considerable proportion of such exposures is accounted for by securities of the State Treasury of Poland and the National Bank of Poland, for which the risk weight is 0%).

The value of exposures hedged with collateral types recognised under Basel II, which permit a reduction of the capital requirement, amounted to PLN 2,270 million as at 31 December 2011 (Tables 4.5 and 4.6).

Table 4.5

EXPOSURES COLLATERALISED WITH GUARANTEES

The PKO Bank Polski SA Group

	2011
TOTAL	1 346
Corporate	1 297
Secured on real estate property	0
Retail	0
Central governments and central banks	6
Other exposures	26
Institutions (banks)	0
Regional governments and local authorities	5
Past dues	12
Administrative bodies and non-commercial undertakings	0
Other*	0

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

As part of the credit risk mitigation techniques, the Bank, in accordance with Basel II, uses guarantees (89% of the guarantees accepted by the Bank are guarantees issued by the State Treasury of Poland) and financial collateral as funded credit protection (mainly registered pledges on securities, irrevocably blocked funds on a bank account or a deposit account at the Bank or payment of cash to the account of the Bank). The Bank applies the Financial Collateral Comprehensive Method, which makes use of collateral haircuts. Apart from financial collateral and guarantees, the Bank uses mortgages to classify its exposures as belonging to the class of exposures secured on real properties. The value of the portfolio of those exposures was PLN 57 billion as at 31 December 2010.

In 2011 and in the previous years, the Group did not conclude any securitisation transaction within the meaning of the Banking Law and Appendix no 18 to the Resolution of PSFA no 76/2010 (as amended).

In the 1st half of 2011 the Bank conducted a package sales of 51 thousand items of retail receivables classified as lost due from individual persons who do not run economic activity. The sales covered a package of debts of the total value of PLN 565 million.

In the 2nd half of 2011 further package sales were conducted, for which sales agreements were signed in 2011:

1) in the 3rd quarter: over 49 thousand items of retail receivables classified as lost due from individual persons who do not run economic activity. The sales covered a package of debts of the total value of PLN 418 million,
2) in the 4th quarter: over 43 thousand items of retail receivables classified as lost due from individual persons who do not run economic activity. The sales covered a package of debts of the total value of PLN 533 million,
3) in the 4th quarter: over 4 thousand items of receivables classified as lost due from corporate clients of the total value of PLN 520 million.

The total balance sheet value of provisions for potential claims related to sold receivables as at 31 December 2011 amounted to PLN 3,9 million (as at 31 December 2010 is was PLN 11.4 million).

Table 4.6

EXPOSURES COLLATERALISED WITH RECOGNIZED FINANCIAL COLLATERAL*

The Bank Group

	2011
TOTAL	924
Corporate	839
Secured on real estate property	0
Retail	68
Central governments and central banks	7
Other exposures	0
Institutions (banks)	0
Regional governments and local authorities	0
Past dues	10
Administrative bodies and non-commercial undertakings	0
Other **	0

* After volatility haircuts.

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

The tables below show the value of exposures (before and after the application of the credit risk mitigation techniques) by exposure classes and the counterparty credit quality steps as at 31 December 2011. Approximately 82% of the exposures lack the credit quality step. This results from the small number of entities operating on the Polish market that have been awarded the creditworthiness rating by recognised rating agencies. The exposures that involve the credit quality step are mainly: securities of and receivables to the State Treasury of Poland and the National Bank of Poland as well as transactions with other banks.

Table 4.7

VALUE OF EXPOSURES* BEFORE APPLICATION OF THE CREDIT RISK MITIGATION TECHNIQUES
The Bank Group
2011

	PKO BP SA, KREDOBANK SA and the BFL SA Group							Other Group subsidiaries	Adjustments and exclusions	Total
	Counterparty's credit quality step									
	1	2	3	4	5	6	none			
Corporate	0	0	45	495	0	0	62 271	536	-3 884	59 463
Secured on real estate property	0	0	0	0	0	0	55 986	0	-10	55 977
Retail	0	0	0	0	0	0	31 612	1	0	31 613
Central governments and central banks	0	27 371	0	0	251	0	584	119	0	28 325
Other exposures	0	0	39	0	0	0	10 461	1 245	-133	11 612
Institutions (banks)	1 310	4 463	972	237	363	0	1 083	4 759	-5 475	7 711
Regional governments and local authorities	0	0	405	0	0	0	4 585	0	0	4 990
Past dues	0	0	0	0	0	0	3 036	236	-7	3 264
Administrative bodies and non-commercial undertakings		0	0	0	0	0	0	0	0	0
Other **	0	0	0	0	0	0	306	8	-273	41
Total	1 310	31 834	1 461	732	614	0	169 923	6 903	-9 782	202 996

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

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

Table 4.8

VALUE OF EXPOSURES* AFTER APPLICATION OF THE CREDIT RISK MITIGATION TECHNIQUES
The PKO Bank Polski SA Group
2011

	PKO BP SA, KREDOBANK SA and the BFL SA Group							Other Group subsidiaries	Adjustments and exclusions	Total
	Counterparty's credit quality step									
	1	2	3	4	5	6	none			
Corporate	0	0	45	495	0	0	60 438	536	-3 884	57 630
Secured on real estate property	0	0	0	0	0	0	55 986	0	-10	55 977
Retail	0	0	0	0	0	0	31 567	1	0	31 568
Central governments and central banks	0	27 371	0	0	251	0	1 770	119	0	29 512
Other exposures	0	0	39	0	0	0	10 435	1 245	-133	11 586
Institutions (banks)	1 310	4 463	972	237	363	0	1 083	4 759	-5 475	7 711
Regional governments and local authorities	0	0	405	0	0	0	4 643	0	0	5 048
Past dues	0	0	0	0	0	0	3 019	231	-7	3 242
Administrative bodies and non-commercial undertakings		0	0	0	0	0	0	0	0	0
Other**	0	0	0	0	0	0	306	8	-273	41
Total	1 310	31 834	1 461	732	614	0	169 247	6 899	-9 782	202 315

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

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

In 2011, the transactions that had the greatest influence on the amount of the Group's capital requirement for derivatives were the IRS and CIRS transactions (Table 4.9).

Table 4.9

CAPITAL REQUIREMENT FOR DERIVATIVES *
2011
The Bank Group

	Book		
	banking	trading	Total
Derivatives	76	123	199
IRS	20	88	108
CIRS	43	12	55
SWAP	13	0	13
Forward	0	12	12
Options	0	8	8
FRA	0	1	2
SWAP	0	1	1
Revers Repo	0	0	0

* Credit risk and counterparty credit risk.

In 2011, within the calculation of capital requirement for derivatives, no netting of the balance sheet and off-balance sheet items was used.

Within the calculation of its capital requirements, the Bank utilizes the credit assessments assigned by the following external credit assessment institutions (rating agencies):
1) Moody's Investors Service,
2) Standard and Poor's Ratings Services,
3) Fitch Ratings.

The Bank implemented the process of carrying the issuer's and issue's rating to off-trading book items for the purposes of calculation of the capital requirements in accordance with the provisions of Annexes No. 4 and No. 15 to Resolution No. 76/2010 of PFSA of 10 Arch. 2010 as amended and Resolution No. 387/2008 of PFSA of 17 December 2008[9].

4.2. Market risk

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

The total capital requirement for market risk decreased in 2011 by ca. 16%. The largest share in the value of requirement for market risk in this period fell to the specific risk of debt instruments (approx. 74%), which results from the corporate and municipal debt securities held in the Bank's trading book and from underwriting by the Bank of the issue of those securities. Another type of capital requirement that is significant in terms of value is the capital requirement for the general interest rate risk (approx. 26%).

The change in the amount of the capital requirement for interest rate risk and FX risk in the consolidated statements for 2011 resulted from the scale of exclusions of the mutual transactions in the capital requirement calculations.

The capital requirement for all other types of market risk is approx. PLN 1.6 million. The capital requirement for FX risk is zero due to the fact that the total currency position does not exceed 2% of the Bank's own funds and the capital requirement for the commodities risk is insignificant and amounted to PLN 0.16 thousand as of the end of December 2011.

4.3. Operational risk

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

The Bank has an approval from THE PFSA to use the advanced approach (AMA) with a temporary (until PFSA's conditions are fulfilled) restriction of a decrease of the capital requirement that is not bigger than by the level of 75% of the capital requirement calculated by means of the standardized approach (TSA). In case of the Group's subsidiaries, the basic index approach) BIA.

For the external reporting purposes, the Bank calculates also the capital requirement for the Bank's operational risk by means of the TSA approach through a calculation of the gross result for business lines within the meaning of Appendix no 14 to the Resolution no 76/2010 of PFSA (as amended). The gross results of individual business lines are adjusted according to the costs of mutual financing of business lines. The capital requirement is calculated by means of TSA approach on the basis of weighted adjusted gross results of individual business lines in accordance with the provisions of the above mentioned resolution.

The value of the Group's capital requirement for operational risk was PLN 852 million (including PLN 758 million of the capital requirement for the Bank's operational risk).

As compared to 2010 this amount was lower by ca. PLN 206 million which resulted from a reduction of the capital requirements by 25% in consequence of the approval received by the Bank to apply advance methods and the impact of the annual revaluation of the capital requirement (as at 31 December 2011 the capital requirements was calculated on the basis of the data for 2008-2010, while as at 31 December 2010 - on the basis of the data for 2007-2009).

Table 4.10

CAPITAL REQUIREMENT FOR OPERATIONAL RISK
2011
The Bank Group

	Portfolio		
	Bank	Subsidiaries	Group
Total	758	94	852
Basic Index Approach - BIA	n.a.	94	94
Advanced approach - AMA*	758	n.a.	758

* capital requirement at the level of 75% of the capital requitement calculated pertaining to the standardized approach

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

5. INTERNAL CAPITAL (PILLAR II)

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

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

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

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

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

The total internal capital of the Group is the sum of internal capital required to cover all significant risk types that occur in the subsidiaries of the Group. The Bank has a conservative approach to risk aggregation and does not use the diversification effect.

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

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

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

In 2011, PD parameters based on the models worked out during the project works related to the implementation of the advance method of capital requirement calculation for credit risk were used in the process of internal capital assessment for credit risk.

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

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

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

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

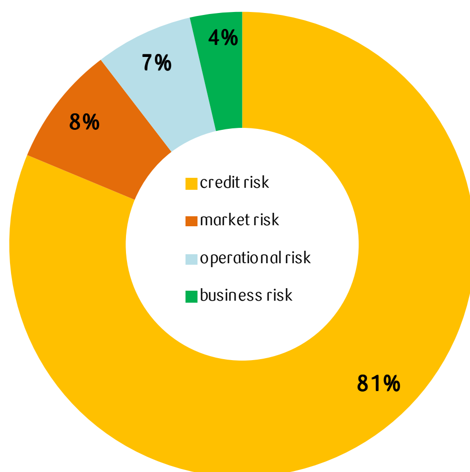
The internal capital for business risk is determined as the product of:
1) ratio of internal capital calculation for business risk
2) and result on banking activities.

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

The chart below presents the structure of internal capital by risk type, as assessed as at 31 December 2011 for the Group.

Chart 5.1

INTERNAL CAPITAL STRUCTURE
The Bank Group



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

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

6. CAPITAL ADEQUACY

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

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

The main measures of capital adequacy are as follows:
1) the capital adequacy ratio of at least 8% as required by the Banking Law,
2) the own funds to internal capital ratio of at least 1.0 pursuant to the Banking Law,
3) Common Equity Tier 1 Ratio –CET1 with the minimum level equal to 9%. Since there are no hybrid instruments in PKO Bank Polski SA, the CET1 ratio is equal to Tier 1 Ratio.

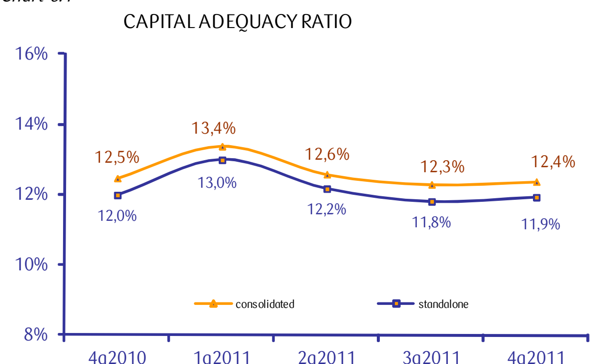
Due to the recommendation of the Polish Financial Supervisions Authority (letter no: DNB/I/7111/4/2/11 dated 29 December 2011) for the banks to monitor potential threats on regular basis and continue activities aimed at ensuring appropriate capital buffer, as well as to maintain and enhance their liquidity position through the maintenance of the capital adequacy ratio of at least 12% and Tier 1 Ratio at the level of at least 9%, PKO Bank Polski modified its dividend payment policy in order to fulfil these requirements, and this policy was published in the Current Report no 22/2012.

The Bank undertook to continue activities aimed at ensuring proper capital buffer, and to maintain and enhance its liquidity position and to maintain the capital adequacy ratio of at least 12% and Tier 1 Ratio at the level of at least 9%.

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

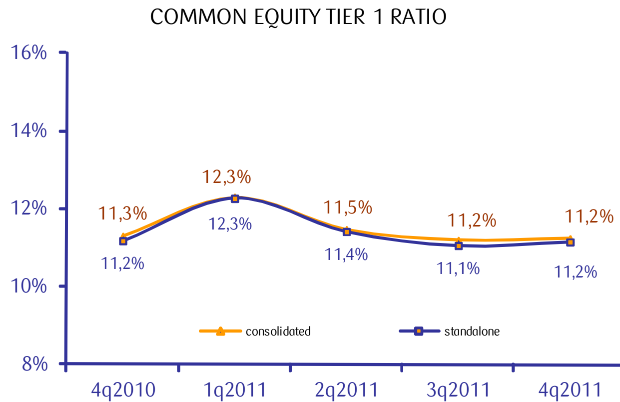
Chart 6.1

CAPITAL ADEQUACY RATIO



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

Chart 6.2



In 2011, the Bank's and the Group's capital adequacy ratio remained at a safe level above both the statutory and internal limits.

As at 31 December 2011, compared to the state as of 31 December 2010, the Group's capital adequacy ratio decreased by 0.10 percentage points, to the level of 12.37%, which resulted mainly from an increase of the capital requirements for the credit risk caused mainly by the dynamics of the credit portfolio of the Group, which was partially set off against a decrease of the capital requirement for operational risk because of AMA approached used for calculations in 2011.

The Bank monitors drafted changes in regulations (in particular requirements of so called Basel III and directives CRD 3 and 4) that in the future may have a significant impact on the operations of European banks. The Bank participates in preparation of opinions on such solutions.

In 2011, the Bank participated in stress tests performed by the European Banking Authority (EBA). They were aimed at presenting the general resistance of the banking sector and ability of banks to absorb potential shocks that have an impact on the growth of credit and market risks. On the EU level the tests were prepared and coordinated by the European Banking Authority (EBA) and the Office of the Polish Financial Supervision Authority (PFSA). The results of the tests confirm the strong capital position of PKO Bank Polski and the Bank's considerable resistance to macroeconomic shocks, fulfilment of negative market scenarios. The Bank records net profit in every scenario and the value of capital adequacy remains above internal and external limits. The Bank participated also in similar examination on the national level that was prepared by the Polish Financial Supervision Authority (PFSA).

7. GLOSSARY OF TERMS AND ABBREVIATIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

CFBS – the Commission for Banking Supervision

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

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

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

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

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

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

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

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

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

Cut-off point – the minimum number of points awarded as a result of client creditworthiness assessment made using the scoring system (for individual clients) or the client or joint rating class (for institutional clients), starting from which a loan transaction may be concluded with a specific client

Cumulated contractual liquidity gap – the sum of all partial contractual liquidity gaps from the first a'vista interval to the interval for which the cumulated contractual liquidity gap is calculated

Cumulated real-terms liquidity gap – the sum of all partial real-terms liquidity gaps from the first a'vista interval to the interval for which the cumulated real-terms liquidity gap is calculated

Expected Loss, EL – a statistically assessed value of the mean (expected) credit risk loss that the bank expects to incur on the portfolio within one year

Fair value – an amount for which a specific asset might be exchanged, and a liability discharged, within a market transaction between interested and informed unrelated parties

Framework agreement – an agreement between parties regulating the principles of the Bank's co-operation with counterparties on the financial market with respect to forward financial transactions

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

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

FX Swap – a foreign currency exchange swap

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

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

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

IAS – the International Accounting Standards

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

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

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

ISDA – the International Swap and Derivatives Association

ISMA – the International Securities Market Association

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

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

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

Key Risk Indicators, KRI – an amount related to the operational risk profile, describing a specific risk, action or process in terms of frequency, susceptibility or loss; KRI are used for prompt risk measurement and monitoring, and also for projections of future threats

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

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

LMA – the Loan Market Association

Loss Distribution Approach (LDA) – a VaR approach

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

NBP – the National Bank of Poland

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

Rating system – a system for assessing the bank's credit risk involved in the financing of institutional clients, incurred when awarding or changing the essential terms of a loan transaction and in the period of performance of such transaction

REPO – an operation within which funds are borrowed on securities

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

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

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

PBA – the Polish Bank Association

PCBA – the Polish Classification of Business activity

PFSA – the Polish Financial Supervision Authority

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

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

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

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

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

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

Probability of Default, PD – a statistical assessment of the probability of a borrower's insolvency on the annual scale (defines the portfolio-related credit risk to become materialised in the future)

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

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

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

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

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

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

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

Value at risk (VaR) – a potential loss resulting from changes in the present value of cash flows from financial instruments, or a potential loss on the maintained currency positions due to changes in the foreign exchange rates, on the assumption that a defined confidence level and holding period of the position are kept