



BANK HANDLOWY W WARSZAWIE S.A.
2017 ANNUAL REPORT

MARCH 2018

SELECTED FINANCIAL DATA	PLN'000		EUR'000**	
	2017	2016	2017	2016
Interest income	1,350,155	1,257,019	318,080	287,273
Fee and commission income	609,283	591,196	143,540	135,109
Profit before tax	700,340	763,820	164,992	174,559
Net profit	537,102	604,199	126,535	138,081
Total comprehensive income	742,580	552,947	174,943	126,368
Increase/decrease of net cash	(158,277)	(1,681,354)	(37,288)	(384,248)
Total assets	42,863,964	45,091,648	10,276,910	10,192,506
Amounts due to banks	1,568,261	2,303,627	376,001	520,711
Amounts due to customers	32,172,441	34,031,947	7,713,549	7,692,574
Shareholders' equity	6,874,618	6,723,926	1,648,234	1,519,875
Share capital	522,638	522,638	125,306	118,137
Number of shares (in pcs)	130,659,600	130,659,600	130,659,600	130,659,600
Book value per share (PLN/EUR)	52.61	51.46	12.61	11.63
Capital adequacy ratio (in %)	17.6	17.2	17.6	17.2
Earnings per share (PLN/EUR)	4.11	4.62	0.97	1.06
Diluted net earnings per share (PLN/EUR)	4.11	4.62	0.97	1.06
Declared or paid dividends per share (PLN/EUR)*	4.11	4.53	0.99	1.02

*The presented ratios are related to declared dividend from the appropriation of the 2017 profit and dividend paid in 2017 from the appropriation of the 2016 profit.

**The following foreign exchange rates were applied to convert PLN into EUR: for the statement of financial position - NBP mid exchange rate as at 31 December 2017 - PLN 4. 1709 (as at 31 December 2016: PLN 4.4240); for the income statement, statement of comprehensive income and cash flow statement - the arithmetic mean of NBP end-of-month exchange rates in 2017 – PLN 4. 2447 (in 2016: PLN 4.3757).



THE ANNUAL FINANCIAL STATEMENTS OF
BANK HANDLOWY W WARSZAWIE S.A.
FOR THE FINANCIAL YEAR ENDED
31 DECEMBER 2017

MARCH 2018

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Income statement

	For the period	2017	2016
PLN'000	Note		
Interest and similar income	4	1,350,155	1,257,019
Interest expense and similar charges	4	(271,234)	(257,149)
Net interest income	4	1,078,921	999,870
Fee and commission income	5	609,283	591,196
Fee and commission expense	5	(67,760)	(64,795)
Net fee and commission income	5	541,523	526,401
Dividend income	6	32,939	29,005
Net income on trading financial instruments and revaluation	7	343,910	345,671
Net gain on debt investment securities available-for-sale		35,772	44,746
Net gain on capital investment instruments available-for-sale		3,377	95,913
Net gain on hedge accounting	8	10,261	9,553
Other operating income	9	28,642	37,245
Other operating expenses	9	(31,389)	(28,628)
Net other operating income	9	(2,747)	8,617
General administrative expenses	10	(1,094,472)	(1,108,862)
Depreciation expense	11	(72,456)	(69,128)
Profit/loss on sale of other assets	12	437	104
Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted	13	(99,491)	(48,759)
Tax on some financial institutions		(77,634)	(69,311)
Profit before tax		700,340	763,820
Income tax expense	14	(163,238)	(159,621)
Net profit		537,102	604,199
Weighted average number of ordinary shares (in pcs)	15	130,659,600	130,659,600
Net earnings per share (PLN)	15	4.11	4.62
Diluted net earnings per share (PLN)	15	4.11	4.62

Statement of comprehensive income

	For the period	2017	2016
PLN'000	Note		
Net profit		537,102	604,199
Other comprehensive income which may be reclassified to the income statement:			
Net valuation of financial assets available-for-sale	16	205,685	(51,252)
Other comprehensive income which may not be reclassified to the income statement:			
Net actuarial profits (losses) on specific services program valuation	16	(207)	-
Other comprehensive income after tax		205,478	(51,252)
Total comprehensive income for the period		742,580	552,947

Explanatory notes on pages 10-84 are an integral part of the annual financial statements.

Statement of financial position

	As at	31.12.2017	31.12.2016
PLN'000	Note		
ASSETS			
Cash and balances with the Central Bank	17	462,126	665,755
Amounts due from banks	18	836,166	586,973
Financial assets held-for-trading	19	2,162,040	3,772,162
Hedging derivatives	20	-	12,244
Debt securities available-for-sale	21	17,439,439	19,072,371
Equity investments	22	132,539	125,107
Amounts due from customers	23	19,766,803	18,795,341
Tangible fixed assets	24	375,673	332,336
Intangible assets	25	1,351,583	1,349,810
Receivables due to current income tax		-	12,911
Deferred income tax asset	27	176,979	199,354
Other assets	28	158,688	165,356
Non-current assets held-for-sale		1,928	1,928
Total assets		42,863,964	45,091,648
LIABILITIES			
Amounts due to banks	29	1,568,261	2,303,627
Financial liabilities held-for-trading	19	1,351,031	1,305,614
Hedging derivatives	20	50,191	39,897
Amounts due to customers	30	32,172,441	34,031,947
Provisions	31	17,871	22,068
Current income tax liabilities		52,340	-
Other liabilities	32	777,211	664,569
Total liabilities		35,989,346	38,367,722
EQUITY			
Share capital	34	522,638	522,638
Supplementary capital	34	2,944,585	2,944,585
Revaluation reserve	34	(9,376)	(215,061)
Other reserves	34	2,879,669	2,867,565
Retained earnings		537,102	604,199
Total equity		6,874,618	6,723,926
Total liabilities and equity		42,863,964	45,091,648

Explanatory notes on pages 10-84 are an integral part of the annual financial statements.

Statement of changes in equity

<i>PLN'000</i>	Share capital	Supplementary capital	Revaluation reserve	Other reserves	Retained earnings	Total equity
As at 1 January, 2017	522,638	2,944,585	(215,061)	2,867,565	604,199	6,723,926
Total comprehensive income, including:	-	-	205,685	(207)	537,102	742,580
net profit	-	-	-	-	537,102	537,102
valuation of financial assets available-for-sale (net)	-	-	205,685	-	-	205,685
actuarial profits on specific services program valuation (net)	-	-	-	(207)	-	(207)
Dividends paid	-	-	-	-	(591,888)	(591,888)
Transfer to capital	-	-	-	12,311	(12,311)	-
As at 31 December 2017	522,638	2,944,585	(9,376)	2,879,669	537,102	6,874,618

Note: 16, 34

<i>PLN'000</i>	Share capital	Supplementary capital	Revaluation reserves	Other reserves	Retained earnings	Total equity
As at 1 January 2016	522,638	2,944,585	(163,809)	2,858,825	620,227	6,782,466
Total comprehensive income, including:	-	-	(51,252)	-	604,199	552,947
net profit	-	-	-	-	604,199	604,199
valuation of financial assets available-for-sale (net)	-	-	(51,252)	-	-	(51,252)
Dividends paid	-	-	-	-	(611,487)	(611,487)
Transfer to capital	-	-	-	8,740	(8,740)	-
As at 31 December 2016	522,638	2,944,585	(215,061)	2,867,565	604,199	6,723,926

Note: 16, 34

Explanatory notes on pages 10-84 are an integral part of the annual financial statements.

Cash flow statement

	For the period	2017	2016
<i>PLN'000</i>			
A. Cash flows from operating activities			
I. Net profit		537,102	604,199
II. Adjustments to reconcile net profit or loss to net cash provided by operating activities:		(1,014,051)	(2,816,746)
Current and deferred income tax recognized in income statement		163,238	159,621
Depreciation expense		72,456	69,128
Net impairment due to financial assets value loss		100,034	51,996
Net provisions (recoveries)		3,526	8,318
Net interest income		(1,078,921)	(999,870)
Dividend income from subsidiaries		(24,145)	(21,724)
Profit/loss on sale of investments		(501)	(74)
Net unrealized exchange differences		8,155	1,057
Other adjustments		4,242	(12,109)
Cash flows from operating income before changes in operating assets and liabilities		(751,916)	(743,657)
Change in operating assets (excl. cash and cash equivalents)		2,085,204	2,187,657
Change in amounts due from banks		(203,705)	(6,145)
Change in amounts due from customers		(1,064,950)	8,905
Change in debt securities available-for-sale		1,743,917	(932,036)
Change in equity investments		635	656
Change in financial assets held-for-trading		1,590,396	3,128,899
Change in hedging derivatives		12,244	(10,449)
Change in other assets		6,667	(2,173)
Change in operating liabilities (excl. cash and cash equivalents)		(2,347,339)	(4,260,746)
Change in amounts due to banks		(650,236)	(4,577,939)
Change in amounts due to customers		(1,857,478)	2,266,723
Change in liabilities held-for-trading		45,417	(1,941,909)
Change in amounts due to hedging derivatives		10,294	(72,486)
Change in other liabilities		104,664	64,865
Interest received		1,498,028	1,516,039
Interest paid		(273,294)	(260,162)
Income tax paid		(123,810)	(183,758)
III. Net cash flows from operating activities		623,975	(1,140,428)
B. Cash flows from investing activities			
Purchase of tangible fixed assets		(91,916)	(27,752)
Disposal of tangible fixed assets		9,396	1
Purchase of intangible assets		(38,786)	(15,441)
Disposal of non-current assets held-for-sale		-	73
Dividends received		24,145	21,724
Other investing inflows		50	129,684
Net cash flows from investing activities		(97,111)	108,289
C. Cash flows from financing activities			
Dividends paid		(591,888)	(611,487)
Inflows due to long-term loans from financial sector entities (Note 29)		31,292	21,873
Repayment of long-term loans from financial sector entities (Note 29)		(112,116)	(62,910)
Net cash flows from financing activities		(672,712)	(652,524)
D. Exchange rates differences resulting from cash and cash equivalents conversion		(12,429)	3,309
E. Net increase/ decrease in cash and cash equivalents		(158,277)	(1,681,354)
F. Cash at the beginning of the period		672,754	2,354,108
G. Cash at the end of the period (Note 43)		514,477	672,754

Explanatory notes on pages 10-84 are an integral part of the annual financial statements.

Explanatory notes to the financial statements

1. General information about the Bank

Bank Handlowy w Warszawie S.A. ("Bank") has its registered office in Warsaw at ul. Senatorska 16, 00-923 Warszawa. The Bank was founded on the basis of the Notarial Deed of 13 April 1870 and is registered in the Register of Entrepreneurs in the National Court Register kept by the District Court for the Capital City of Warsaw, XII Commercial Department in Warsaw, under KRS number 0000001538.

The Bank was given REGON statistical number: 000013037 and tax identification number NIP: 526-030-02-91.

The Bank was set up for an unspecified period of time.

The share capital of the Bank equals PLN 522,638,400 and is divided into 130,659,600 common bearer shares with a nominal value of PLN 4.00 per share. The shares are quoted on the Warsaw Stock Exchange.

The Bank is a member of Citigroup Inc. Citibank Overseas Investment Corporation with headquarters in New Castle, USA, a subsidiary of Citibank N.A. with headquarters in New York, USA, and is the ultimate parent entity for the Bank.

The Bank operates on the basis of applicable regulations and its Articles of Association.

The Bank is a universal commercial bank that offers a wide range of banking services for individuals and corporate clients on domestic and foreign markets.

2. Significant accounting policies

Declaration of conformity

The annual unconsolidated financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("IFRS EU") and in respect to matters that are not regulated by the above standards, in accordance with the requirements of the Accounting Act dated 29 September 1994 (Official Journal from 2017, item 2342) and respective operating regulations.

The annual unconsolidated financial statements of the Bank have been approved by the Management Board of the Bank for publication on 21 March 2018. The financial statements will be finally approved by the General Shareholders' Meeting of the Bank.

The annual consolidated financial statements were approved by the Management Board of the Bank for publication on 21 March 2018. The financial statements will be finally approved by the General Shareholders' Meeting of the Bank.

Basis of preparation

These annual financial statements of the Bank have been prepared for the period from 1 January 2017 to 31 December 2017 and for the statements of financial situation as at 31 December 2017. The comparable financial data are presented for the period from 1 January 2016 to 31 December 2016. and for the statements of financial situation as at 31 December 2016.

The financial statements are presented in PLN (presentation currency), rounded to the nearest thousand.

The financial statements have been prepared on the fair-value-basis for financial assets and financial liabilities measured at fair value including derivatives and available-for-sale financial assets with the exception of assets and liabilities whose fair value cannot be estimated in a reliable way. Other assets and liabilities are presented at amortized cost (loans and receivables, financial liabilities other than measured at fair value in the income statement) or at cost decreased by depreciation/ amortization and impairment losses.

The principal accounting policies, used when preparing these financial statements, were presented below. These policies were applied in the presented years continuously.

In order to prepare financial statements in accordance with IFRS EU, the management of the Bank has to make judgments, estimates and assumptions that have an impact on the amounts presented in the financial statements.

Estimates and associated assumptions are made on the basis of available historical data and many other factors that have been recognized as material in the presented period. These factors form the basis to make estimates of the balance-sheet value of assets and liabilities whose value cannot be estimated on the basis of other sources. Actual results could differ from those estimates.

Estimates and associated assumptions are reviewed on an ongoing basis. Revisions to the accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Standards and interpretations approved but not obligatory or awaiting the European Union's approval that can have an influence on financial statements of the Group:

- IFRS 9. Described in separate section,

- MSSF 15. Described in separate section,
- IFRS 16 „Leasing”, endorsed by the European Union for application starting from 1 January 2019 r., will replace IAS 17.

The new standard introduces amended comprehensive approach to lease contract identification and their recognition in financial statements of lessors and lessees. IFRS 16 introduces control model, which is a method of distinguishment of lease contracts from service agreements. The distinguishment focuses on assessment whether within the contract a specified asset controlled by Bank can be identified.

Standard introduces significant changes in lessee accounting - no longer will there be a separation of operating and finance lease. It is also necessary to recognize right of use asset and corresponding lease liability.

Bank started implementation work and believes that the application of the new standard will impact recognition, disclosures and measurement of assets used in operating lease contract together with corresponding liabilities.

Other standard amendments awaiting endorsement by the European Union:

- IFRIC 22 specifying rules for currency exchange rate setting for recognition of nonmonetary assets and liabilities in case of advance payments received or paid before recognition of relevant assets, expense or income,
- IFRIC 23 specifying measurement of uncertainties resulting from solutions applied for use of IAS 12 „Income taxes” when it is not clear if they are appropriate from perspective of tax authorities,
- amendment to IAS 40 specifying classification of investment property,
- standard amendments cycle 2014-2016 including: IFRS 1 in respect to exemptions for first time adoption of IFRS,
- amendment to IFRS 4 that allows specific option of reclassification of part of profit or loss to other comprehensive income for specific financial assets and temporary exemption from IFRS 9 for entities that mainly originate contracts under IFRS 4,
- IFRS 17 „Insurance” replacing IFRS 4 „Insurance contracts” and introducing comprehensive regulations for accounting of insurance contracts, in particular the measurement of relevant liabilities. Standard eliminates differences in accounting of insurance contracts depending on local jurisdictions, allowed by IFRS 4,
- amendments to IFRS 2 regarding classification and measurement of share based payment, in particular equity settled share based payment, ,
- standard amendments cycle 2015-2017 including: IFRS 3 and IFRS 11 in respect of measurement of interest in case of taking control over joint arrangements, IAS 12 in respect of recognition of tax on dividends in profit and loss, IAS 23 for borrowing costs treatment,
- amendments to IAS 28 regarding measurement of the long-term share in affiliate companies and joined ventures,

do not impact the financial statement.

IFRS 9 “Financial instruments”

Since 1 January 2018 Bank has been using IFRS 9 „Financial instruments” adopted for use by European Union on 22 November 2016 (European Union Regulation no. 2016/2067/EU).

Bank has conducted IFRS 9 implementation work from September 2015. In December 2016 the implementation process was structured and made formal by considering it Critical Project run by Steering Committee comprising: Vice-President of the Management Board supervising Finance and Vice-President of the Management Board supervising Risk.

According to recommendations of European Securities and Markets Authority and Financial Supervision Authority, the full implementation process was supervised by Audit Committee of Supervisory Board. The Committee has received regular project status information and important issues important for specific phase of implementation. In particular, Bank presented to Audit Committee basic amendments of accounting principles resulting from IFRS 9, interpretation and operational doubts emerging at different stages of the project and market practice (in this respect cooperation of the banking sector in IFRS 9 Working Group working within the Polish Banking Association).

Selected implementation areas in classification and measurement stream of IFRS 9 have been verified by independent professional external advisor to obtain assurance that Bank made proper conclusions and identified obligations.

Classification and measurement - principles

IFRS 9 introduces in this respect the following significant amendments::

- Standard introduces 3 financial instruments categories:
 - assets measured at amortized cost,
 - assets measured at fair value through other comprehensive income,
 - assets measured at fair value through profit and loss.
- Bank classifies financial assets to specific categories on initial recognition considering 2 criteria:
 - **business model** for management of assets, which determines, whether cash flows will result from collecting contractual cash flows, selling financial assets or both

- **features of contractual cash flows** dla for an asset. Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI test) are consideration for the time value of money, credit risk, other basic lending risks (for example liquidity risk), costs (for example administration) associated with holding the financial asset for a particular period of time and profit margin.

If SPPI test is passed, and business model reflects contractual cash flow collection, Bank classifies financial assets to assets measured at amortized cost.

If SPPI test is passed, and business model reflects contractual cash flow collection and sales, Bank classifies financial assets to assets measured at fair value through other comprehensive income.

If SPPI test is passed, but business model is different than the above mentioned, or if SPPI test is failed (irrespective of business model) Bank classifies financial assets to assets measured at fair value through profit and loss.

Business model

In respect to business model, based on current and planned management approach to financial asset portfolios in respect of method of cash flow collection from groups of assets, Bank assesses that business model criterion will cause changes in classification and measurement compared to IAS 39. Bank originates loans and other financing instruments so far classified as loan and receivables under IAS 39 in order to collect principal and interest. Loan sales are rare and concern deteriorated exposures.

Debt instruments in held for trading portfolio are managed under business model of frequent sales and purchases with expectations to take advantage of short-term market fluctuations and profit making patterns. As a result Bank has not changed approach to such instruments compared to IAS 39 regulations.

Debt instruments held for sale under IAS 39 are managed under business model of contractual cash flows and sales, so they are classified as assets measure at fair value through other comprehensive income and it means there has been no change in classification and measurement for IFRS 9 purposes.

Contractual cash flows features

Bank analyzed thoroughly contractual stipulations and practices in respect of consideration formulas in order to conclude whether contractual cash flows are solely payments of principal and interest.

In corporate loans and small and medium enterprise loans as well as trade loans Bank identified interest rate tenor and reset frequency mismatch. It is the following: WIBOR 3M and reset frequency 1M, WIBOR 6M and reset frequency 3M or 1M, EURIBOR 3M and reset frequency of 1M or 6M, LIBOR 3M and reset frequency 1M.

As a result of extension of SPPI analysis through use of benchmark test Bank concluded that the difference between undiscounted cash flows (forecast and actual) from contracts with the mismatch compared to benchmark contracts (the same features but without the mismatch, for example: WIBOR 1M and reset frequency 1M) is insignificant, so SPPI test is passed.

In other cases that might impact assessment of SPPI, so for other interest calculation formulas, including managed rates, fees, prepayment fees Bank has not identified solutions that would make SPPI test fail. Bank has not identified any features, options, covenants or contract modification rules that could question SPPI test.

Bank is in the possession of assets for which interest formula contains a multiplier. In particular it concerns credit cards portfolio. For credit cards interest rate is based on analysis of similar products and it reflects consideration for time value of money, credit risk related with unpaid principal within specified time period, and other basic lending risks, as well as profit margin. Rates used by Bank with multiplier higher than 1 results from current and past level of maximum acceptable interest set by law.

For disclosure of anticipated impact of IFRS 9 implementation, Bank classified such exposures as measured at amortized cost. In view of the lack of homogenous market practice and discussions in respect of classification and measurement of financial instruments with multiplier higher than 1 in interest rate formula, with regard to the letter from the President of the Financial Supervision Authority as of 12 December 2017 the above approach may be subject to change.

In respect to that situation Bank is in the process of additional analysis of contract documentation to conclude whether it is necessary to implement changes to contract stipulations that provoke interpretation doubts.

As a result of the above analyses Bank has not identified changes in the classification of financial assets resulting from contractual cash flows features.

- According to IFRS 9 minority equity shares shall be measured at fair value. IFRS 9 provides that further changes in fair value, after initial application, are recognized in profit and loss. However, it allows an irrevocable option to record such changes in OCI without recycling to profit and loss. If such option is elected, dividends are generally recorded in profit and loss. Bank decided to record changes in fair value in profit and loss.
- In hedge accounting Standard extends the scope of instruments than can be considered as hedged or hedging instruments. The condition of hedge accounting application is economic relation between hedging instrument and hedged item without obligation to measure hedge effectiveness retrospectively. IFRS 9 also allows use of hedge accounting covered by IAS 39 „Financial instruments: recognition and measurement” and Bank followed that approach.

- Calculation and disclosure of exposures and provisions in explanatory notes after adopting new requirements in respect of gross balance sheet exposure definition. According to statement of Transition Resource Group for Impairment of Financial Instruments, for the purpose of provision calculation for impaired loans, Bank applied the approach to include interest accruals after impairment identification in gross carrying amount of the exposure. In practice that results in direct increase of gross carrying value of impaired loans and corresponding increase in provisions.

Impairment

Expected credit loss impairments as per IFRS 9 are established with exposure classification into one of the 3 Stages:

- Stage 1: Credit exposures that have not had a significant increase in credit risk since initial recognition
 - For these assets, a 12-months ECLs are recognized (representing the portion of lifetime expected credit losses that result from default events that are possible within 12 months after the reporting date),
- Stage 2: Credit exposures that have experienced a significant increase in credit risk since initial recognition, but for which the exposure is not yet defaulted
 - For these assets, a lifetime ECLs are recognized,
- Stage 3: Credit exposures with credit loss that has already been suffered on the assets
 - For these assets, ECL is established as for impaired assets.

As a rule, all exposures extended to newly acquired clients (with the exception of POCI assets), are classified as exposures in Stage 1.

As part of customer risk analysis, identification of a significant increase in credit risk and assessment of premises and evidence of impairment are made, taking into account existing and future events, including macroeconomic factors presented in scenarios prepared cyclically by the Chief Economist.

The Bank regularly, at least one a year, carries out the analysis to verify how much provisions that were made reflect the actual losses incurred as a part of assessing the adequacy of the methodology used to determining impairment loss/provisions.

Institutional Clients Group

ICG Clients are assessed individual based on the consideration of presumption that there is a significant increase in credit risk and/or presumptions of credit loss in order to assign relevant internal classification / classify to relevant Stage as per IFRS 9. Assessment of the presumptions that there is a significant increase in credit risk and/or presumptions of credit loss are conducted on continuous basis as per early warning system process and internal classification. Internal classification process is a multifactor and comprehensive credit risk analysis and is a supporting element of portfolio monitoring and corrective action plan management.

The value of impairment allowances for credit exposures and provisions for balance sheet credit exposures is determined monthly for each customer in order to calculate, maintain and report information on impairment and IFRS 9 provisions for ICG clients exposure. The algorithms used depend on the assignment of the client to the Stage in accordance with IFRS 9 and the method of managing the given Client (Clients managed on the basis of classification vs. clients managed on a days past due basis). If the Bank has sufficient data to create homogeneous groups of exposure, it measures them in a group approach, in particular exposures managed on a past due basis are valued in accordance with the group approach.

As a rule, for Classifiably managed Clients, the Bank uses an individual approach to assess the level of impairment for exposures with identified impairment, including also exposures with an unusual risk profile.

Losses in respect of impairment / loan exposure reserve are recognized and calculated on the basis of the current value of projected cash flows expected in the loan period. Losses are calculated based on individual cash flow forecasts resulting from, among others, repayment by the borrower or collateral enforcement. The projected cash flows concern repayments of both capital and interest.

Global Consumer Banking

In the case of retail exposures, the level of write-downs is set at the level of individual loan exposures and then aggregated to the level of product portfolios. The level of the provision related to credit risk reflects the expected amount of credit losses over a time horizon depending on the exposure reporting Stage. In the range covered by the impairment model, there are

- Cash loans,
- Mortgage loans.
- Credit cards together with related products (EPP, LOP, ALOP) and
- renewable credit lines.

The rules for classifying exposures to the Stages are based on the credit risk management processes existing at the Bank, in particular, as a rule, on a cyclical risk analysis of the client. It includes quantitative criteria related to determining the probability of customer default (PD) within the credit products held and quality criteria. The PD value is set at the customer level, in a 12-month horizon, based on a set of statistical models. These are scoring models: demographic, behavioral and using data from the Credit Information Bureau (BIK). These models work on the basis of the so-called integration logic, whose task is to provide the best PD value forecast for a set of partial model values available for

a given client.

Assessment of the impact of IFRS 9 on the Bank

Below IFRS 9 impact on classification and valuation of financial assets was shown as per 1.01.2018 (data in thousands PLN):

The below amounts are estimates and general view nature in respect of discussions in place in time of the report publication regarding method of classification and measurement of assets including multiplier in interest rate formula, lack of homogenous market practice and standard implementation interpretation differences.

Item	Measurement category – IAS 39	Measurement category – IFRS 9	IFRS 9 Carrying amount – IAS 39	IFRS 9 implementation impact	Carrying amount – IFRS 9
Assets					
Amounts due from banks and customers	Amortised cost	Amortised cost	2,602,969	(71,714)	20,531,255
Financial assets available for sale – Equity investments	Purchase price less impairment	Fair value through OCI	132,539	16,064	148,603
Total assets			20,735,508	(55,650)	20,679,858

Item	Measurement category – IAS 39	Measurement category – IFRS 9	IFRS 9 Carrying amount – IAS 39	IFRS 9 implementation impact	Carrying amount – IFRS 9
Liabilities					
Provisions	Provisions for off-balance sheet	Provisions for off-balance sheet	12,789	22,875	35,664
Total liabilities			12,789	22,875	35,664

The structure of financial assets as of January 1, 2018, divided in a new way based on the rules of determining impairment provisions is as follows:

- Stage 1 – represents around 87% of total financial assets of the Group subject to write-offs for expected losses;
- Stage 2 – represents around 7% of total financial assets of the Group subject to write-offs for expected losses;
- Stage 3 – represents around 6% of total financial assets of the Group subject to write-offs for expected losses. The share of Stage 3 in the total structure was determined taking into account the new definition of the gross carrying amount of financial asset, ie including the total value of interest accrued in the gross value of assets in Stage 3, even after impairment.

The values presented in the table above do not include the deferred tax effect in the form of asset, which increased to PLN 16,934 thousand. The total value of the impact of IFRS 9 implementation on Bank's equity is negative and amounts to PLN 61,591 thousand.

The total estimated negative impact of the IFRS 9 standard calculated as of January 1 2018 on Tier 1 and TCR is negative and less than 21 basis points.

The Bank decided that for the needs of capital adequacy assessment, based on Article 1 paragraph 9 of the Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending the Regulation (EU) 575/2013, it will not adopt the transition period in respect of IFRS 9 impact and it will choose the one-off recognition of the impact of IFRS 9 implementation on own funds.

IFRS 15 „Revenue from contracts with customers”

On 29 October 2016 IFRS 15 “Revenue from contracts with customers” was endorsed for use in the European Union effective 1 January 2018, replacing IAS 18 “Revenue”.

The standard introduces the obligation to use the sequence indicated below in the process of recognizing revenue from contracts with customers, specifically, some commissions recognized by the Bank:

1. Identifying the contract with a customer- Bank shall account for a contract with a customer that is within the scope of IFRS 15 only when all of the following criteria are met:
 - a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
 - b) the Bank can identify each party's rights regarding the goods or services to be transferred;
 - c) the Bank can identify the payment terms for the goods or services to be transferred;

- d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
- e) it is probable that the Bank will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

2. Identifying performance obligations

The Bank shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- a) good or service (or a bundle of goods or services) that is distinct; or
- b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer

3. Determining the transaction price

The Bank shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both. When determining the transaction price, the Bank shall consider the effects of variable consideration, time value of money in case of the existence of a significant financing component in the contract, non-cash consideration, consideration payable to a customer as well as estimates.

4. Allocating the transaction price to performance obligations to identify amounts to be recognized as revenue

The Bank allocates the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the Bank expects to be entitled in exchange for transferring the promised goods or services to the customer.

The stand-alone selling price is the price at which Bank would sell a promised good or service separately to a customer.

If a stand-alone selling price is not directly observable, Bank shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price based on adjusted market assessment approach, expected cost plus margin approach and residual approach.

5. Revenue recognition

The Bank recognises revenue when (or as) it satisfies the performance obligation by transferring a promised good or service to a customer. Transfer of a promised good or service is when the customer obtains control of the good or service.

The basic criteria for transferring control of a good or service are:

- a) Bank's present right to payment for the asset or service
- b) The customer has legal title to the asset
- c) The Bank has transferred physical possession of the asset or performed the service
- d) The customer has the significant risks and rewards of ownership of the asset or service
- e) The customer has accepted the asset or the service

Revenue is recognised over time if one of the following criteria is met:

- a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the Bank performs;
- b) the Bank's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
- c) the Bank's performance does not create an asset with an alternative use to it and Bank has an enforceable right to payment for performance completed to date.

In other circumstances, revenue is recognized immediately.

The Bank shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

- a) the costs relate directly to a contract or to an anticipated contract that the Bank can specifically identify;
- b) the costs generate or enhance resources of the Bank that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and
- c) the Bank expects to recover the costs.

Costs recognized as an asset are recognized in the profit and loss according to the manner in which revenue is recognized as performance obligation is satisfied by the Bank.

Assessment of the impact of IFRS 15 on the Bank

In the process of implementation of the standard, the Bank did not identify differences in the approach to revenue recognition in relation to IAS 18 effective until the end of 2017. Most of the Bank's revenues are recognized using the effective interest rate method, in accordance with the provisions of IAS 39. In case of the Bank, IFRS 15 applies to part of commissions not related to financial instruments. The revenue recognition method for these commissions complies with the regulations of the new standard and in case of one-off services, revenue is recognized at the time the service is performed, and for services provided over time revenue is recognized using the straight-line method. The Bank did not identify significant costs necessary to obtain contracts that would have to be amortized over time.

Standards demanding applications for the first time in 2017

In 2017 the following standards became applicable, but their implementation has no significant impact on the financial statement:

- standard amendments cycle 2014-2016 regarding IFRS 12 in respect of clarification of information disclosure for shares in other subsidiaries,
- changes to IAS 12 concerning recognition of the unrealized debt instruments loss in deferred tax,
- changes to IAS 7 introducing the obligation to disclose reconciliation of changes in financial obligations included in transfers from financial operations.

Foreign currency

The statement of financial position and contingent liabilities received and granted items denominated in foreign currencies are converted to PLN equivalents using the average exchange rate of the currency determined by the Governor of the National Bank of Poland ("NBP") prevailing at the date of preparation of the statement of financial position.

Foreign currency transactions are converted at initial recognition to the functional currency (PLN) using the exchange rates prevailing at the date of transactions.

Foreign exchange profits and losses resulting from revaluation of the statement of financial position items denominated in foreign currencies and settlement of transactions in foreign currencies are included in net profit on foreign exchange, within the trade financial instruments and revaluation income.

The exchange rates of the major currencies applied in the preparation of these financial statements are:

PLN		31 December 2017	31 December 2016
1	USD	3.4813	4.1793
1	CHF	3.5672	4.1173
1	EUR	4.1709	4.4240

Financial assets and liabilities

Classification

The Bank classifies its financial instruments into the following categories:

- financial assets or financial liabilities at fair value through profit or loss;
- loans and receivables;
- financial assets available-for-sale;
- other financial liabilities.

In the reporting period, the Bank did not classify assets to investments held-to-maturity. The Bank classifies financial assets to particular categories on the date of their first recognition.

(a) Financial assets or financial liabilities at fair value through profit or loss

This category has two sub-categories: (i) financial assets and liabilities held-for-trading and (ii) financial assets designated at fair value through profit or loss at initial recognition.

Assets or liabilities are included in this category once they were purchased with the primary objective of selling or repurchasing to generate short-term profits, they are a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of generating short-term profits, or when they are classified to this category at the management's discretion provided that they meet the criteria from IAS 39. The derivative instruments, excluding hedging instruments, and selected debt securities are also categorized as held-for-trading.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on the active market. They arise when the Bank provides funds to the debtor for any purpose except for the generation of short-term profits from trading in such loans or receivables. This category comprises, in the first instance, amounts due in respect of loans, purchased receivables and debt securities that are not quoted on the active market and internal deposits. The purchased receivables contain short-term receivables from domestic and foreign turnover documented by invoices and bills of exchange.

(c) Financial assets available-for-sale

Financial assets available-for-sale are those non-derivative financial assets that (i) are classified by the Bank in this category at initial recognition or (ii) are not classified in any other asset category. Selected debt and equity securities are classified in this category.

(d) Other financial liabilities

Other financial liabilities are financial liabilities which are not classified as financial liabilities at fair value through profit or loss. Customers' deposits are primarily classified in this category and commercial commitments.

Cash

Cash is cash in hand and receivables on current balances in banks, described in detail in note 43 "Cash flow statement".

Recognition and derecognition

Transactions of purchase or sale of financial assets at fair value through profit or loss and available-for-sale are recognized in the Bank's statement of financial position and derecognized at transaction settlement date, i.e., the date on which the Bank will receive or transfer the ownership right to assets. The rights and liabilities from a concluded transaction are measured at fair value from the transaction conclusion day to the transaction settlement day.

Loans and receivables are recognized at the time of mobilization of funds for the borrower.

Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Bank has transferred substantially all risks and rewards of ownership.

Financial liabilities are derecognized when and only when they are extinguished, i.e., the obligation described in the agreement had been discharged, cancelled or expired.

Derivative financial instruments are recognized at fair value from the trade date and are derecognized from the balance on the settlement date.

Valuation

When financial assets or financial liabilities are recognized initially, they are measured at fair value plus, in the case of assets and liabilities not measured at fair value through profit or loss, significant transactional costs that are directly attributable to the acquisition or issue of the financial assets or financial liabilities.

After initial recognition the Bank measures financial assets including derivatives that are assets at fair value without deducting transactional costs which it may incur in connection with the sale or disposal of assets except for loans and receivables which are measured at amortized cost using the effective interest rate method, and investments in equity instruments for which no quotations on the active market are available and whose fair value cannot be reasonably determined.

After initial recognition financial liabilities are measured at amortized cost using the effective interest rate method except for financial liabilities that are measured at fair value through profit or loss. Financial liabilities that are measured at fair value through profit or loss, including derivatives that are liabilities, are measured at fair value.

Profits or losses resulting from the change of fair value of financial assets or financial liabilities, which are not the part of the hedging relationship, are recognized in the following way:

- in the case of financial assets or financial liabilities measured at fair value through profit or loss, they are shown in revenues or expenses;
- profits or losses resulting from valuation of financial assets classified as available-for-sale are recognized in other comprehensive income. Revaluation write-offs for impairment of financial assets available-for-sale and exchange rate differences on monetary assets and liabilities are recognized in the income statement. When financial assets are excluded from the statement of financial position, accumulated profits or losses which were previously included in equity are recognized through profit or loss.

Interest accrued using the effective interest rate method is recognized through profit or loss.

Dividends on available-for-sale equity investments are recognized in profit and loss when the entity's right to receive payment is established.

The fair value of shares in companies other than subsidiaries and associates listed on the active market is based on their current purchase price. If the market for specific financial assets is inactive (this also applies to unlisted securities), the Bank determines fair value using appropriate valuation techniques.

Derivative instruments

Fair value of derivatives financial instruments is determined by reference to their prices on the active market, including prices in recent market transactions, or using valuation techniques, including discounted cash flow models and option pricing models, as appropriate. Derivatives which were not designated as hedging instruments according to hedge accounting rules, are classified as assets or liabilities held-for-sale and measured at fair value.

Embedded derivatives are accounted for as separate derivatives if the risks and economic characteristics of the embedded derivative are not closely related to the risks and characteristics of the host contract and the host contract is not measured at fair value through profit or loss.

Hedge accounting

The Bank designates certain derivatives for hedging positions in hedge accounting. The Bank applies fair value hedge accounting provided that meeting the criteria from IAS 39 – “Financial Instruments: Recognition and Measurement”.

Fair value hedge is a hedge against the impact of changes in an asset, liability or unrecognized firm commitment, or a separated part of such an asset, liability or to which a particular risk may be attributable and which may affect profit or loss.

A fair value hedge is recognized in the following way: profits or losses resulting from valuation of fair value of hedging instrument (hedging derivatives) are recognized in the income statement. Changes in valuation to the fair value of financial instruments designated as hedging positions are recognized – in a part resulting from hedged risk- in the income statement. In case of other parts, the changes in carrying amount are booked in accordance with the general rules for a given class of financial instruments.

Offsetting financial instruments

Financial assets and financial liabilities are offset and presented in the statement of financial position on a net basis when there is a legally enforceable right to offset and their settlement is intended to take place on a net basis or to realize the asset and settle the liability simultaneously. Currently, the Bank does not offset its financial assets and liabilities on a net basis.

Cash pooling

The Bank offers its clients cash management services which consolidate balances within the structure of related accounts (“cash pooling”). Such transactions net the positive and negative balances of participants’ current accounts on a designated account of the entity which manages the settlements. The consolidation of balances is executed at the end of the working day and at the beginning of the next working day the transaction is reversed. Cash pooling transactions are presented on a net basis only if they meet the requirements of IAS 39 regarding derecognition of financial assets and liabilities from the statement of financial position. Accounts receivable presented on a gross basis are presented as Amounts due from customers and accounts payable as customers’ deposits.

Repurchase and resale agreements, repo/ reverse repo transactions

The Bank enters into purchase and sale transactions under agreements to resell and repurchase the same financial assets, so called sell-buy-back and buy-sell-back respectively, as well as repo and reverse repo transactions in securities. Securities sold under repurchase agreements continue to be shown as the Bank’s assets and the Bank discloses liabilities resulting from the repurchase clause. In the case of securities purchased under agreements to resell, securities are presented in the statement of financial position as loans and advances. Any differences between sale/purchase prices and repurchase/resale prices are recognized respectively as interest income and expense using the effective interest rate method. In the case of sale of the securities previously purchased in the reverse repo transaction, the Bank recognizes liabilities due to the short sale of securities. These liabilities are evaluated fair value.

Impairment of assets measured at amortized cost

On a commitment basis, the Bank classifies assets measured at amortized cost into the portfolio of assets that are individually significant and the portfolio of assets that are not individually significant (portfolio basis). On the balance sheet date, the Bank assesses if there is objective evidence of impairment of one financial asset or a group of financial assets. A financial asset or a group of financial assets were impaired and the impairment loss was incurred only when there is an objective evidence of impairment resulting from one or more events taking place after the initial recognition of an asset (the loss event) and the loss event (or events) influences the future expected cash flows resulting from a financial asset or a group of financial assets which may be reliably estimated.

Objective evidence of impairment of a financial asset or group of financial assets includes the following events known to the Bank:

- significant financial difficulty of the issuer or obligor;
- breach of contract, such as default or delinquency in interest or principal payments;
- granting the borrower a concession that the lender would not otherwise consider due to economic or legal reasons relating to the borrower's financial difficulty;
- high probability of the borrower's bankruptcy or other financial reorganization;
- the disappearance of an active market for this financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - adverse changes in the payments status of borrowers in the group; or
 - national or local economic conditions that are correlated with defaults on the assets in the group.

The losses expected as a result of future events regardless of their probability are not recognized.

Non-recoverable loans (i.e., loans for which the Bank does not expect any future cash flows and that may be treated as tax deductible costs under separate tax regulations or that were unconditionally written off under an agreement with the customer) are, on the basis of Bank's decision, written down against impairment allowances. If a written-down amount is subsequently recovered, the amount of income is presented in "Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted".

Forbearance

In case the Bank grants a concession to the debtor, if it does not change significantly the terms and expected cash flows of the financial asset, the expected cash flows from the financial asset subject to the concession are included in the measurement of the asset using the prior effective interest rate for the instrument.

If the concession granted significantly changes the important terms or expected cash flows, the financial asset is derecognized and the new one is recognized at fair value on the day of the initial recognition.

Impairment allowances for incurred but not recognized credit losses

The Bank creates impairment allowances for incurred but not recognized credit losses ("IBNR"). The IBNR impairment allowances process covers all receivables for which no evidence of impairment was found or for which such evidence was found but the individual assessment of possible impairment did not confirm the need to write them down. The IBNR impairment allowances reflect the level of a credit loss incurred but not reported, which will be identified at the level of exposure in the period of loss recognition adopted by the Bank. The IBNR impairment allowances are calculated using statistical parameters for the Banks of assets combined in portfolios having similar credit risk characteristics. In the financial statements, the Bank corrects credit exposure with the value of the IBNR impairment allowances.

Impairment allowances for individually significant assets

The level of the impairment write-off for receivables that are deemed as individually significant and for which evidence of impairment was detected is calculated as the difference between the carrying value of an asset and the present value of the future cash flows from expected repayments by the borrower, from cash settlement of collateral or the sale of receivables. The future cash flows are discounted to the present value with the effective interest rate for a given instrument.

If the present value of the estimated cash flows increases after an event occurring after impairment was identified, the write-off that was previously made will be reversed as appropriate through profit or loss.

Impairment allowances for individually not significant assets

The level of the impairment allowances for receivables that are deemed as individually not significant, for which evidence of impairment was detected, is calculated on the basis of a portfolio assessment which is based on the history of losses incurred on assets with similar risk characteristics.

Impairment write-off for amounts due from banks and customers, allowances for impairment of securities and other assets adjust the value of particular asset categories. Provisions for contingent commitments are shown in the liabilities section "Provisions."

Impairment of financial assets available-for-sale

For financial assets classified as available-for-sale, for which there is objective evidence of impairment, the cumulative loss recognized in equity which is the amount of the difference between the purchase price adjusted for subsequent payment and amortization and fair value, taking into account the previous impairment losses, should be transferred to the income statement. Impairment losses on equity investments classified as available-for-sale are not reversed through profit or loss. Loss on impairment of debt instruments classified as available-for-sale are reversed through profit or loss, if in subsequent periods the fair value of a debt instrument increases and the increase can be objectively related to an

event occurring after the loss.

Impairment of financial assets measured at cost

The group of financial assets measured at cost in the financial statements of the Bank consists of shares in entities other than dependent entities classified as available-for-sale for which the fair value cannot be reasonably measured (for example the assets are not quoted on an active market) and equity investments in dependent entities measured at purchase price in accordance with IAS 27 (Separate Financial Statements). In the case of objective evidence of impairment of equity investments, the amount of impairment is measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted at the current market rate for similar financial assets. Losses related to impairment of shares in entities other than dependent entities classified as available-for-sale where the fair value cannot be reliably measured are not reversed through profit or loss. When there are impairment losses of equity investments in dependent entities measured at cost in accordance with IAS 27, IAS 36 "Impairment of Assets" is applied.

Impairment of assets other than financial assets

The carrying amounts of the Bank's assets, excluding deferred tax assets, are reviewed at each balance sheet date to determine whether there is any evidence of impairment. If so, the asset's recoverable amount is estimated.

Revaluation impairment allowances are recognized if the book value of an asset or of cash-generating unit exceeds the recoverable amount. Revaluation impairment allowances are recognized in profit or loss.

In the case of a cash-generating unit, revaluation impairment allowances first reduce the goodwill allocated to such the cash-generating units (group of units) and then proportionally reduce the carrying value of other assets in the unit (group of units).

Calculation of recoverable amount

The recoverable amount in the case of assets other than financial assets is higher fair value less selling costs and value in use. For value in use calculation, the estimation of future cash flows is discounted to their present value using the discount rate before taxation, which represents present market expectations regarding money value and specific risk regarding an asset. For assets that are not generating independent cash flows, the recoverable amount is estimated for cash-generating unit, the asset owner.

Reversal of revaluation write-offs

Revaluation write-offs for impairment, excluding goodwill, are reversed if the estimations for the recoverable amount have changed.

The revaluation write-off for impairment for other assets can be reversed only to the level by which the book value of the asset do not exceed the depreciation decreased book value that would be estimated if the impairment write-off was not recognized.

Equity investments – shares in subsidiaries

Subsidiaries – definition

Subsidiaries are all entities controlled by the Bank. The Bank controls an entity when the Group has power over an entity, is exposed to or has rights to variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity.

Subsidiaries - recognition and measurement

Investments in subsidiaries in the Bank's separate financial statements are recognized using the cost method in accordance with IAS 27. The cost method is a method of accounting for an investment whereby the investment is recognized at cost.

Equity investments – shares in other entities

Shares in entities other than dependent entities are classified as financial assets available-for-sale.

Goodwill

In the financial statements of the Bank, goodwill represents the difference between the cost of the acquisition and the fair value of the Bank's interest in identifiable assets, liabilities and contingent liabilities acquired at the business combination date. Goodwill is included in intangible assets. Goodwill is stated at cost minus any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortized, but is tested annually for impairment independently of objective evidence of impairment. The revaluation write-off for impairment for goodwill can no be reversed.

Goodwill resulting from takeovers that occurred before 31 March 2004, i.e., the effective date of IFRS 3 ("Business Combinations"), was calculated in accordance with the previous accounting policies, as the difference between the cost of acquisition of an entity and the net asset value of the acquired entity at the acquisition date.

Property and equipment and intangible assets (excluding goodwill)

Property and equipment and intangible assets are stated at historical cost minus accumulated depreciation or amortization and impairment losses. The historical cost of an item of property and equipment and intangibles includes any directly attributable costs of purchasing and bringing the asset into use.

Subsequent expenditure relating to an item of property and equipment or intangibles is added to the carrying amount of the asset or recognized as a separate asset (where appropriate) only when it is probable that future economic benefits will flow to the Bank and the cost of the asset can be measured reliably. Any other expenditure, e.g., repairs and maintenance is recognized as an expense when incurred.

Depreciation and amortization are calculated using the straight-line method over the expected useful life of an asset on the basis of rates that are approved in the depreciation and amortization plan for 2017.

Illustrative annual depreciation and amortization rates applied by the Bank are presented in the table below:

Buildings and structures	1.5%-4.5%
Motor vehicles	14.0%-20.0%
Computers	34.0%
Office equipment	20.0%
Other tangible fixed assets	7.0%-20.0%
Computer software and licenses (except the main operating systems, which are depreciated at the rate of 10% and 20%)	34.0%
Other intangible fixed assets	20.0%
Leasehold improvements - compliant with lease agreement period	

At each balance sheet date, the residual values of non-current assets and their useful lives are reviewed and the depreciation and amortization schedule is adjusted where appropriate.

Assets with original cost less than PLN 3,500 are fully depreciated on a one-off basis when brought into use. The total cost of other tangible fixed assets depreciated on a one-off basis is not material to the financial statements.

Assets in the course of construction are stated at the total of costs directly attributable to construction, assembly or improvement in progress less impairment write-offs.

Property and equipment includes rights to perpetual usufruct of land.

Items of property and equipment and intangibles are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount of an item of property and equipment or intangible asset is written down to its recoverable amount if the carrying amount exceeds the recoverable amount. The recoverable amount of an item of property and equipment is the higher of its fair value minus costs of sale and value in use.

Employee benefits

Short-term employee benefits

The Bank's short-term employee benefits include wages, bonuses, holiday pay and social security contributions.

Depending on their individual compensation category, employees may receive an award from the incentive fund, a bonus under the bonus scheme applicable in a given area or a discretionary annual bonus under the internal employee compensation regulations. Bonuses and awards are granted after completion of the period for which the employee's performance is evaluated.

Short-term employee benefits are recognized as an expense in the period when they were incurred.

Share-based payments

Within the equity compensation plans the selected employees get under stock award programs based on shares of Citigroup common stock in the form of deferred stock (CAP) and under stock award programs based on phantom shares of Bank Handlowy w Warszawie S.A. In 2017 there were no employees awarded as part of the CAP program.

In accordance with IFRS 2 "Share-based payment", all the programs functioning in the Bank are deemed to be cash-settled programs. A provision is created for future payments and is shown in the "statement of financial position" and "General administrative expenses" in the income statement. The costs of the program are determined on the basis of the Bank's shares price or Citigroup shares price. According to IFRS, the fair value is measured at grant date and, subsequently, at each reporting date until the final settlement. Total expenses recorded in a given period are based on the fair value deferred shares at the reporting date times the part of the rights that were deemed acquired in that period.

Long-term employee benefits

Under its compensation scheme, the Group guarantees its employees retirement and pension, allowances, constituting defined benefit plans. Their amount depends on years worked in the Bank, falling directly before gaining rights to payment. For the future payments of retirement and pension allowances there is a reserve made, shown in "Liabilities" in "Other liabilities" and in "Activities costs and general and administrative expenses" of profit and loss account in part resulting from costs of current employment and time. Part of the provision resulting from a change of actuarial assumptions (economics and demographic) taken to valuation is shown in other total income.

A component of variable remuneration granted to the Management Board and people, whose professional operating has a significant impact on the Bank's risk profile, is also the deferred cash prize described in detail in Note 46 "Employee benefits".

Defined contribution plans

The Bank enables its employees to join a pension plan, which is described in detail in Note 46. The Bank pays contributions for employees who participate in the plan into a separate fund and has no subsequent obligation to pay further contributions; hence, this is a defined contribution plan in accordance with IAS 19 ("Employee Benefits"). Contributions are recognized as an expense in the related period.

Provisions

A provision is recognized in the statement of financial position when the Bank has a present legal or constructive obligation as a result of a past event, and also if it is probable that the discharge of this obligation will result in an outflow of economic benefits, and the provision amount can be reliably estimated.

Restructuring provision

A restructuring provision is recorded when the following conditions have been met: (i) the Bank has a detailed and formalized restructuring plan; (ii) the restructuring has already begun or has been publicly announced; (iii) the provision amount can be reliably estimated. The restructuring provision does not include future operating expenses.

Equity

Equity is stated at nominal value, with the exception of the equity from revaluation reserve of available-for-sale financial assets that is stated after the effect of deferred income tax.

Dividends are recognized as liabilities on the date at which the General Meeting of the Bank has approved the appropriation of earnings.

Accruals and prepayments

The Bank records accruals and prepayments of expenses primarily in relation to the Bank's overhead expenses in reporting periods to which they relate.

Calculating net income

Net income is calculated in compliance with the accrual accounting and the matching concept. Net income reflects all income and relevant expenses set off against income within a particular reporting period, irrespective of the day on which these are received or paid.

Interest income and interest expenses

For all financial instruments, interest income and interest expense is recognized through the profit or loss account using the effective interest rate method.

The effective interest rate method calculates the amortized cost of a financial asset or a financial liability and allocates interest income or interest expense to appropriate periods. The effective interest rate is a rate that discounts the estimated future inflows or payments in the expected period until the maturity of the financial instrument to the carrying value of a financial asset or a financial liability. When calculating the effective interest rate, the Bank takes into account all the terms and conditions of a financial instrument agreement (e.g., prepayments, call options, etc.), but excludes potential future losses in connection with non-recoverable loans. The calculation covers all the commissions payable to and receivable from the parties to the agreement, integral components of the effective interest rate, transactional costs and any other premiums and discounts. As a result, commissions that are an integral part of the effective interest rate less direct costs of obtaining the financial instrument are recognized as components of interest income.

In the case of financial assets or groups of similar financial assets for which impairment losses were recognized, interest income is measured using the interest rate that was used to discount the future cash flows to estimate such impairment losses.

Interest income/expenses from derivatives designated as derivatives in hedge accounting are presented in the net interest income.

Penalty interests resulting from income tax exposure is included in "Other operational income" or "Other operational expenses" in the income statement.

Fee and commission income and expenses

Commission and fee income is generated when the Bank renders financial services to its customers. The Bank classifies its commission into the following categories:

- commissions that are an integral part of the effective interest rate;
- commissions for services rendered;
- commissions for executing significant transactions.

Commissions that are an integral part of the effective interest rate are recognized in the income statement adjusted by the calculation of the effective interest rate and are shown in interest income.

Commissions for services rendered and for executing significant transactions are recognized in the income statement, in proportion to the completion of the services rendered, or as a single amount after completing the rendering of a service, respectively and are shown in commission income.

In the case of loans and borrowings with undetermined installment payment dates, e.g., overdrafts or credit cards, commissions and fees are recognized using the straight-line method until the expiry date of a credit limit. Such commissions and fees are recognized as commission income.

Income and expense from distribution of insurance products

The Bank renders insurance products intermediary services. Income for the distribution of insurance products not directly relating to occurrence of financial assets is recognized in the income statement when the service has been provided or renewal of the insurance policy has taken place, except for the part of remuneration for services provided after the sale, which is amortized over the life of the facility using the straight-line method.

In the case of products directly attributable to financial assets, where income is received up front for a period longer than one month, to establish the way of showing income on distributing this insurance, a model of relative fair value is used. On the basis of proportions of fair value of insurance product's distribution service and fair value of a loan against the sum of these values allocation of total income is established. Income from the sale of an insurance product is divided into the following components:

- income on account of services provided as an insurance agent, and
- income recognized in the Income Statement as an effective interest rate component, adjusted by the estimated amounts of potential future returns in case of early termination of insurance products based on the share of the fair value of each of these parts in the total of their fair values.

Above described income is shown with estimation of future returns on customers renouncing their insurance in given conditions.

Part of income corresponding to services rendered by the Bank after the sale of an insurance product is bifurcated from income on account of services provided as an insurance agent and the portion is recognized over the life of the facility. The remainder is recognized up-front.

Costs directly attributable to the acquisition of a cash loan are amortized over the life of the product as an effective interest rate component and are part of the interest income.

If the Bank incurs costs directly associated with the sale of an insurance product, such costs are accounted for in accordance with the principle of matching revenues and expenses. Costs not directly associated with the sale of insurance products are recognized when incurred.

Hedge accounting income

The valuation of hedged and hedging transactions in fair value hedge accounting is presented in this position.

Other operating income and expenses

Other operating income and expenses comprise income and expenses that are not directly related to banking activities. They include the proceeds from and costs of selling or disposing of tangible fixed assets and assets held for disposal, income from processing data for related companies, compensation, penalties and fines.

Income tax

Income tax consists of current tax and deferred tax. Income tax is recognized in the income statement, except for taxes related to amounts that are allocated to the other comprehensive income.

A deferred tax provision and asset are calculated using the carrying value method by computing temporary differences between the carrying value of assets and liabilities in the statement of financial position and the tax base of assets and liabilities. In the statement of financial position the Bank discloses deferred tax asset net of deferred tax provisions after compensation, when there is a legal title to set such a compensation and when provision and asset refer to the same taxpayer.

Deferred tax assets are recognized only to the extent that it is probable that a tax benefit will be realized in the future.

Non-current assets held-for-sale

Assets or groups of assets together with liabilities directly associated with those assets are classified as non-current assets held-for-sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the assets or group of assets must be available for immediate sale in their present condition and the sale must be highly probable, which means that there is a commitment to a plan to sell the assets and an active program to locate a buyer and complete the plan must have been initiated. Furthermore, the assets or group of assets must be actively marketed for sale at a price that is reasonable in relation to its present fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification of the assets or group of assets.

Non-current assets held-for-sale are measured at the lower of their carrying amount and fair value less costs to sell and are not subject to depreciation.

No depreciation or amortization applies to such assets.

Accounting estimates and judgments

Determination of the carrying values of selected assets and liabilities as well as revenue and expense requires estimating the effect of uncertain future events on these items at the balance sheet date. The estimates and assumptions are subject to continuous evaluation and are based on historical experience and other factors, including expectations of future events which seem justified in a given situation. The most crucial estimates applied in the preparation of the financial statements are presented below.

Fair value of derivatives

The fair value of financial instruments not quoted on active markets is determined using valuation techniques. If valuation techniques are used to determine the fair values, these methods are periodically assessed and verified. All the models are tested and approved before application. As far as possible, only observable data are used in the models, although in some areas, the entity's management must use estimates. Changes in the assumptions relating to the estimated factors may affect the fair value of financial instruments disclosed.

The Bank applies the following methods of measurement of particular types of derivative instruments:

- FX forwards – discounted cash flows model;
- options – option market-based valuation model;
- interest rate transactions – discounted cash flows model;
- futures – current quotations.

The Bank uses a Credit Default Swap quotation for valuation of counterparty credit risk.

The Bank differentiates the valuation of counterparty risk due to the availability of quotations of credit derivatives (CDS):

- Counterparty Credit Risk of companies for which there is an active CDS market: It is considered that the CDS quotes reflect the market value of the credit risk;
- Counterparty Credit Risk of companies for which there is no active CDS market: On the basis of credit rating (external or internal, when an external rating is not available) and industry, the CDS index (for a given industry) is assigned to the company. It is considered that the industry index CDS quotes reflect the market value of the credit risk.

In the case of valuation of own credit counterparty risk (DVA), the Bank is using a method defined for clients for which there is no active CDS market.

Main factors determining the change of counterparty credit risk estimations are: (i) change of fair value of derivative instruments correlated with a change of, inter alia, fx rates and interests rates, (ii) change of CDS quotes (iii) changes of credit risk ratings.

Impairment of loans

At each balance sheet date, the Bank assesses whether there is an objective evidence of impairment of loan exposures. If so, the Bank records an impairment loss equal to the difference between the carrying value and the estimated present value of the future cash flows from a given loan exposure. The Bank applies collective analysis of financial assets in respect of which evidence of impairment has not been identified individually, or in spite of finding the evidence of

impairment, the individual assessment of the given asset has not indicated the necessity of recording an impairment loss. For the purpose of collective evaluation of impairment, the credit exposures are grouped in order to ensure the uniformity of credit risk attached to the given portfolio. For the purpose of calculation of the amount to be provisioned against balance sheet exposures analyzed collectively the Bank has applied, among others, the probability of default (PD) and loss resulting from default (LGD).

The Bank uses estimates to determine whether there is objective evidence of impairment, calculate the present value of future cash flows and estimate impairment loss group method. Estimates may include observable data indicating an adverse change in macroeconomic conditions or standing of borrower's qualified to a particular portfolio. If necessary, historical loss experience may be adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based.

The methodology and assumptions used to determine the impairment level of loans are regularly reviewed and updated, as required. Further, data are backtested (based on historical data) to compare the actual amounts with estimated credit impairment, what may have an influence on the methodology applied by the Bank.

Impairment of goodwill

The Bank carries out obligatory annual impairment tests of goodwill in accordance with the model based on guidance from IAS 36. The basis of valuation of the recoverable amount of cash-generating units, to which the goodwill is assigned, is their value in use which is estimated by the Bank's management based on the financial plan reflecting the adopted assumptions on the future economic conditions and the expected Bank's performance, the discount rate used in cash flow forecasts and the growth rate used to extrapolate cash flow forecasts beyond the period covered by the financial plan.

Employee benefits

Provisions for future payments in respect of employee benefits such as jubilee awards and retirement and pension allowances are subject to periodic actuarial estimation by an independent actuary. The amount of provisions corresponds with the current value of future longterm liabilities of the Group to its employees according to employment and salaries on reporting day and is based on a number of assumptions in the field of staff statistics. Provisions are calculated on the basis of a number of assumptions on financial discount and probability of the given person reaching the retirement age as the Group's employee, including staff turnover, risk of death and risk of total work incapacity.

3. Segment reporting

Information on segment reporting is presented in Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2017, which have been approved by the Management Board of the Bank for publication on the same date as Annual Unconsolidated Financial Statements of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2017, i.e. 21 March 2018.

4. Net interest income

<i>PLN'000</i>	2017	2016
Interest and similar income due to:		
Balances with Central Bank	16,885	17,918
Amounts due from banks	22,085	19,924
Amounts from customers, including:	914,514	835,765
financial sector entities	48,840	30,025
non-financial sector entities, including:	865,674	805,740
credit cards	282,408	274,090
Debt securities available-for-sale	322,023	311,412
Debt securities held-for-trading	26,417	48,151
Liabilities with negative interest rate	7,161	3,676
Hedging derivatives	41,070	20,173
	1,350,155	1,257,019
Interest expense and similar charges due to:		
Amounts due to Central Bank	-	(82)
Amounts due to banks	(37,943)	(41,546)
Amounts due to financial sector entities	(55,023)	(56,617)
Amounts due to non-financial sector entities	(111,707)	(111,209)
Loans and advances received	(500)	(865)
Assets with negative interest rate	(1,240)	(945)
Derivatives in hedge accounting	(64,821)	(45,885)

PLN'000	2017	2016
	(271,234)	(257,149)
Net interest income	1,078,921	999,870

Net interest income for 2017 includes interest accrued on impaired loans of PLN 10,654 thousand (for 2016: PLN 13,408 thousand).

5. Net fee and commission income

PLN'000	2017	2016
Fee and commission income:		
Insurance and investment products (agency)	72,654	79,564
Payment and credit cards	158,443	158,912
Payment services	105,913	105,469
Custody services	122,805	108,376
Charges from cash loans	437	1,351
Cash management services on customers' accounts	25,099	25,437
Granted guarantee liabilities	19,289	18,435
Granted financial liabilities	6,406	5,882
Other, including:	98,237	87,770
installment products in credit card	26,142	22,003
	609,283	591,196
Fee and commission expense:		
Payment and credit cards	(28,571)	(27,623)
Fees paid to the National Depository for Securities (KDPW)	(19,782)	(17,481)
Brokers fees	(4,412)	(4,246)
Other	(14,995)	(15,445)
	(67,760)	(64,795)
Net fee and commission income	541,523	526,401

The net fee and commission income for 2017 comprises commission income (other than income covered by the calculation of the effective interest rate process) related to financial assets and liabilities not measured at fair value through profit or loss in the amount of PLN 164,040 thousand (for 2016: PLN 165,169 thousand) and commission expenses in the amount of PLN 28,571 thousand (for 2016: PLN 27,623 thousand).

6. Dividend income

Dividend income amounted to PLN 32,939 thousand in 2017 (2016: PLN 29,005 thousand) include dividends received and due from the Bank's subsidiaries - PLN 24,145 thousand (in 2016: PLN 21,724 thousand). The remaining amount of dividends was received from entities with no control equity interest of the Bank.

7. Net income on trading financial instruments and revaluation

PLN'000	2017	2016
Net income on financial instruments measured at fair value through profit of loss from:		
Debt instruments	15,248	(53,747)
Derivative instruments, including:	14,293	39,898
Interest rate derivatives	14,161	39,854
	29,541	(13,849)
Net profit on foreign exchange		
Net profit on foreign currency derivatives	(215,674)	468,071
Revaluation	530,043	(108,551)
	314,369	359,520
Net income on trading financial instruments and revaluation	343,910	345,671

The net income on trading financial instruments and revaluation for 2017 contains movement in (net) adjustment of the valuation of derivatives from adjustment of the valuation of derivatives reflecting the counterparty credit risk and own credit risk in the amount of PLN 396 thousand (in 2016: PLN 18,894 thousand).

Net income from debt instruments includes the net results on trading in government securities, corporate debt securities and money market instruments held-for-trading.

Income from derivative instruments includes net income due to transactions in interest rate swaps, options, futures and other derivatives.

Net profit on foreign exchange includes profit and losses on valuation of assets and liabilities denominated in foreign currency and foreign currency derivatives such as forward, CIRS and option contracts and also contains a margin realized on spot and forward currency transactions.

8. Hedge accounting income

PLN'000	2017	2016
Fair value hedge accounting		
Net gain on hedged transaction valuation	29,469	(37,135)
Net gain on hedging transaction valuation	(19,208)	46,688
Hedge accounting income	10,261	9,553

Detailed information on hedge accounting applied in the Bank is presented in the further part of these Financial Statements in note 37.

9. Net other operating income

PLN'000	2017	2016
Other operating income		
Services provided for related parties	11,060	11,818
Rental of office space	9,812	10,325
Reversal of provision on litigations	-	3,391
Other	7,770	11,711
	28,642	37,245
Other operating expenses		
Amicable procedure and debt collection expenses	(10,532)	(11,416)
Fixed assets held-for-sale maintenance cost	(100)	(118)
Creation of provisions for litigations (net)	(4,503)	-
Other	(16,254)	(17,094)
	(31,389)	(28,628)
Net other operating income	(2,747)	8,617

10. General administrative expenses

PLN'000	2017	2016
Staff expenses		
Remuneration costs, including:	(377,497)	(385,912)
Provisions for retirement allowances	(33,015)	(28,369)
Bonuses and rewards, including:	(78,321)	(87,173)
Payments related to own equity instruments	(7,364)	(9,100)
Rewards for long time employment	(37)	(35)
Social insurance costs	(60,545)	(64,809)
	(516,363)	(537,894)
Administrative expenses		
Telecommunication fees and hardware purchases	(182,848)	(183,938)
Costs of external services, including advisory, audit, consulting services	(52,745)	(54,872)
Building maintenance and rent costs	(69,248)	(84,290)
Advertising and marketing costs	(42,643)	(27,489)

PLN'000	2017	2016
Cash management service, KIR service and other transactional costs	(39,076)	(39,247)
Costs of external services related to the distribution of banking products	(33,486)	(18,183)
Postal services, office supplies and printmaking costs	(9,292)	(10,973)
Training and education costs	(1,728)	(2,588)
Banking and capital supervision costs	(3,110)	(1,145)
Bank Guarantee Funds costs	(71,226)	(75,070)
Other expenses	(72,707)	(73,173)
	(578,109)	(570,968)
General administrative expenses, total	(1,094,472)	(1,108,862)

Staff expenses include the following employee benefits for current and former members of the Management Board.

PLN'000	2017	2016
Short-term employee benefits	12,553	12,885
Long-term employee benefits	1,841	3,706
Capital assets	4,712	3,727
	19,106	20,318

11. Depreciation expense

PLN'000	2017	2016
Depreciation of property and equipment	(29,508)	(3,871)
Amortization of intangible assets	(42,948)	(37,257)
Depreciation expense, total	(72,456)	(69,128)

12. Sale of other assets

PLN'000	2017	2016
Profits on:		
Sale of property	437	31
Sale of fixed assets held-for-sale	-	73
	437	104
Result from the disposal of other assets	437	104

13. Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted

PLN'000	2017			
	Institutional customers	Retail customers	Banks	Total
Impairment allowances for financial assets:				
Amounts due from banks and customers	(90,419)	(121,011)	(1,471)	(212,901)
Amounts due from matured transactions in derivative instruments	(155)	-	-	(155)
	(90,574)	(121,011)	(1,471)	(213,056)
Reversals of impairment allowances for financial assets:				
Equity investments	3,872	-	-	3,872
Amounts due from banks and customers	45,749	53,885	512	100,146
Amounts due from matured transactions in derivative instruments	1,545	-	-	1,545
Recovery on the sale of debt, previously written-off	-	8,219	-	8,219
Other	(2,309)	7,667	-	5,358

PLN'000	2017			
	Institutional customers	Retail customers	Banks	Total
	48,857	69,771	512	119,140
Net impairment due to financial assets value losses	(41,717)	(51,240)	(959)	(93,916)
Establish of provisions for granted financial and guarantee commitments	(17,773)	-	-	(17,773)
Release of provisions for granted financial and guarantee commitments	12,040	158	-	12,198
Net impairment due to provisions for granted financial and guarantee commitments	(5,733)	158	-	(5,575)
Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted	(47,450)	(51,082)	(959)	(99,491)

PLN'000	2016			
	Institutional customers	Retail customers	Banks	Total
Impairment write-offs of financial assets:				
Equity investments	(225)	-	-	(225)
Amounts due from banks and customers	(50,673)	(138,634)	(3,426)	(192,733)
Amounts due from matured transactions in derivative instruments	(73)	-	-	(73)
	(50,971)	(138,634)	(3,426)	(193,031)
Reversals of impairment write-offs of financial assets:				
Amounts due from banks and customers	52,788	50,742	4,592	108,122
Amounts due from matured transactions in derivative instruments	7,693	-	-	7,693
Recovery on the sale of debt, previously written-off	9,438	10,067	-	19,505
Other	(2,296)	8,012	-	5,716
	67,623	68,821	4,592	141,036
Net impairment due to financial assets value losses	16,652	(69,813)	1,166	(51,995)
Establishment of provisions for granted financial and guarantee commitments	(17,913)	-	-	(17,913)
Release of provisions for granted financial and guarantee commitments	21,097	52	-	21,149
Net impairment due to provisions for granted financial and guarantee commitments	3,184	52	-	3,236
Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted	19,836	(69,761)	1,166	(48,759)

14. Income tax expense

Recognized in the income statement

PLN'000	2017	2016
Current tax		
Current year	(188,264)	(165,991)
Adjustments for prior years	(797)	(18,903)
	(189,061)	(184,894)
Deferred tax		
Origination and reversal of temporary differences	25,823	25,273
	25,823	25,273
Total income tax expense in income statement	(163,238)	(159,621)

Reconciliation of effective tax rate

<i>PLN'000</i>	2017	2016
Profit before tax	700,340	763,820
Income tax at the domestic corporate tax rate of 19%	(133,065)	(145,126)
Impairment write-offs not constituting deductible expenses	(4,693)	(5,298)
Deductible income not recognized in the income statement	(1,128)	(496)
Non taxable income	6,219	5,496
Other permanent differences, including other non-deductible expenses	(30,571)	(14,197)
Total tax expenses	(163,238)	(159,621)
Effective tax rate	23.31%	20.90%

Deferred tax recognized directly in equity

Deferred tax recognized directly in equity as at 31 December 2017 is related to debt and equity instruments available-for-sale and valuation of defined benefit plan and amounted to PLN 3,367 thousand (31 December 2016: PLN 51,565 thousand).

15. Earnings per share

As at 31 December 2017, earnings per share amounted to PLN 4.11 (31 December 2016: PLN 4.62).

The calculation of earnings per share as at 31 December 2017 was based on profit attributable to shareholders of PLN 537,102 thousand (31 December 2016: PLN 604,199 thousand) and the weighted average number of ordinary shares outstanding during the year ended 31 December 2017 of 130,659,600 (31 December 2016: 130,659,600).

The Bank does not have any ordinary shares that may have a dilution impact.

16. Changes in other comprehensive income

Deferred income tax and reclassification included in other comprehensive income concern the valuation of financial assets available-for-sale (AFS) recognized in the revaluation reserve and valuation of specific services program recognized in the other reserves.

<i>PLN'000</i>	Gross amount	Deferred income tax	Net amount
As at 1 January 2017	(271,396)	51,565	(219,831)
AFS valuation change	289,704	(55,044)	234,660
Valuation of sold AFS moved to income statement	(35,772)	6,797	(28,975)
Net actuarial losses on a defined benefit plan	(256)	49	(207)
As at 31 December 2017	(17,720)	3,367	(14,353)

<i>PLN'000</i>	Gross amount	Deferred income tax	Net amount
As at 1 January 2016	(208,122)	39,543	(168,579)
AFS valuation change	(108,020)	20,524	(87,496)
Valuation of sold AFS moved to income statement	44,746	(8,502)	36,244
As at 31 December 2016	(271,396)	51,565	(219,831)

17. Cash and balances with the Central Bank

<i>PLN'000</i>	31.12.2017	31.12.2016
Cash in hand	431,574	380,757
Current balances with Central Bank	29,031	3,587
Deposits	1,521	281,411
Cash and balances with the Central Bank, total	462,126	665,755

On the current account in the National Bank of Poland (NBP), the Bank maintains an obligatory reserve which may be

used only under the condition that the sum of the average monthly balance on the current account in NBP is not lower than the declared balance.

Declared balance of obligatory reserve amounted as at 31 December 2017 to PLN 1,270,278 thousand (31 December 2016: PLN 1,149,911 thousand).

18. Amounts due from banks

<i>PLN'000</i>	31.12.2017	31.12.2016
Current accounts	54,182	8,785
Loans and advances	1,092	913
Liabilities due to purchased securities with a repurchase agreement	276,477	418,283
Deposits pledged as collateral of derivative instruments and stock market transactions	505,526	159,169
Total gross amount	837,277	587,150
Impairment write-offs	(1,111)	(177)
Total net amounts due from banks	836,166	586,973

The movement in amounts due from banks is as follows:

<i>PLN'000</i>	2017	2016
As at 1 January	(177)	(1,750)
Increases (due to):		
Write-offs creation	(1,471)	(3,426)
Decreases (due to):		
Write-offs release	512	4,592
Other	25	407
As at 31 December	(1,111)	(177)

As at 31 December 2017 and 31 December 2016, recognized impairment on amounts due from banks concerned incurred but not reported (IBNR) write-offs.

19. Financial assets and liabilities held-for-trading

Financial assets held-for-trading

<i>PLN'000</i>	31.12.2017	31.12.2016
Debt securities held-for-trading		
Bonds and notes issued by:		
Banks*	1	482
Other financial entities	48,412	58,299
Central governments	1,095,495	2,546,247
	1,143,908	2,605,028
Including:		
Listed on active market	1,143,908	2,605,028
Derivative financial instruments	1,018,132	1,167,134
Financial assets held-for-trading, total	2,162,040	3,772,162

*As at 31 December 2017, the part of securities (bonds) issued by banks in the amount of PLN 1 thousand are covered by Government guarantees (31 December 2016: PLN 482 thousand).

Financial liabilities held-for-trading

<i>PLN'000</i>	31.12.2017	31.12.2016
Short positions in financial assets	-	208,106
Derivative financial instruments	1,351,031	1,097,508
Financial liabilities held-for-trading, total	1,351,031	1,305,614

As at 31 December 2017 and 31 December 2016, the Bank did not hold any financial assets and liabilities designated at fair value through profit or loss at initial recognition.

Derivative financial instruments as at 31 December 2017

PLN'000	Nominal amount with remaining life of				Total	Fair value	
	less than 3 months	between 3 months and 1 year	between 1 year and 5 years	more than 5 years		Assets	Liabilities
Interest rate instruments	24,295,666	17,869,973	85,623,135	24,725,360	152,514,134	789,232	927,088
FRA	20,000,000	2,100,000	-	-	22,100,000	625	953
Interest rate swaps (IRS)	3,396,815	12,408,395	75,015,277	17,054,089	107,874,576	335,185	468,544
Currency-interest rate swaps (CIRS)	871,017	3,361,578	8,867,208	7,622,195	20,721,998	450,492	454,484
Interest rate options	-	-	1,740,650	49,076	1,789,726	2,742	3,042
Futures*	27,834	-	-	-	27,834	188	65
Currency instruments	17,515,391	5,186,042	3,886,044	126,517	26,713,994	215,185	410,018
FX forward	2,158,225	1,443,017	225,134	126,517	3,952,893	96,626	27,094
FX swap	13,876,902	1,554,055	3,127,637	-	18,558,594	92,936	357,344
Foreign exchange options	1,480,264	2,188,970	533,273	-	4,202,507	25,623	25,580
Securities transactions	460,071	-	-	-	460,071	2,120	2,310
Securities purchased / sold pending delivery	460,071	-	-	-	460,071	2,120	2,310
Commodity transactions	53,345	124,505	28,219	-	206,069	11,595	11,615
Swaps	49,261	107,896	28,219	-	185,376	10,802	10,819
Options	4,084	16,609	-	-	20,693	793	796
Total derivative instruments	42,324,473	23,180,520	89,537,398	24,851,877	179,894,268	1,018,132	1,351,031

*Exchange-traded products

Derivative financial instruments as at 31 December 2016

PLN'000	Nominal amount with remaining life of				Total	Fair value	
	less than 3 months	between 3 months and 1 year	between 1 year and 5 years	more than 5 years		Assets	Liabilities
Interest rate instruments	19,554,407	23,382,572	57,901,103	24,179,834	125,017,916	873,191	913,240
FRA	15,100,000	12,295,600	750,000	-	28,145,600	1,352	1,458
Interest rate swaps (IRS)	2,590,538	7,406,664	46,239,791	14,195,451	70,432,444	475,564	531,287
Currency-interest rate swaps (CIRS)	1,695,111	3,680,308	8,821,662	9,984,383	24,181,464	386,873	370,946
Interest rate options	80,890	-	2,089,650	-	2,170,540	9,402	9,350
Futures*	87,868	-	-	-	87,868	-	199
Currency instruments	13,847,064	5,701,087	2,130,378	37,014	21,715,543	254,131	143,840
FX forward	2,222,894	1,710,653	337,921	37,014	4,308,482	82,173	42,147
FX swap	9,689,383	784,910	1,562,143	-	12,036,436	117,387	46,958
Foreign exchange options	1,934,787	3,205,524	230,314	-	5,370,625	54,571	54,735
Securities transactions	758,620	-	-	-	758,620	2,812	3,331
Securities purchased / sold pending delivery	758,620	-	-	-	758,620	2,812	3,331
Commodity transactions	149,986	358,250	41,072	-	549,308	37,000	37,097
Swap	70,024	306,423	41,072	-	417,519	23,775	23,824
Options	79,962	51,827	-	-	131,789	13,225	13,273
Total derivative instruments	34,310,077	29,441,909	60,072,553	24,216,848	148,041,387	1,167,134	1,097,508

*Exchange-traded products

20. Hedging derivatives

Assets - Positive valuation

PLN'000	31.12.2017	31.12.2016
Balance sheet valuation of instruments hedging the fair value of securities		
IRS transactions	-	12,244

Liabilities – Negative valuation

PLN'000	31.12.2017	31.12.2016
Balance sheet valuation of instruments hedging the fair value of securities		
IRS transactions	50,191	39,897

Hedging derivatives as at 31 December 2017

PLN'000	Nominal amount with remaining life of				Total
	less than 3 months	between 3 months and 1 year	between 1 year and 5 years	more than 5 years	
Interest rate instruments					
Interest rate swaps (IRS)	-	-	2,290,000	30,000	2,320,000

Hedging derivatives as at 31 December 2016

PLN'000	Nominal amount with remaining life of				Total
	less than 3 months	between 3 months and 1 year	between 1 year and 5 years	more than 5 years	
Interest rate instruments					
Interest rate swaps (IRS)	-	-	3,266,396	1,338,000	4,604,396

21. Debt securities available-for-sale

PLN'000	31.12.2017	31.12.2016
Bonds and notes issued by:		
Central bank	1,399,713	2,239,715
Other banks, including:*	32,576	66,384
bonds subject to fair value hedge accounting	32,576	-
Other financial entities	82,192	-
Central governments, including:	15,924,958	16,766,272
bonds subject to fair value hedge accounting	2,492,215	4,794,696
Debt securities available-for-sale, total	17,439,439	19,072,371
Including:		
Listed on active market instruments	16,039,726	16,832,656
Unlisted on active market instruments	1,399,713	2,239,715

The movement in debt securities available-for-sale is as follows:

PLN'000	2017	2016
As at 1 January	19,072,371	18,351,259
Increases (due to):		
Purchases	47,305,910	41,491,375
Revaluation	257,684	-
Foreign exchange differences	-	260,691
Depreciation of discount, premium and interest	411,359	164,552
Decreases (due to):		
Sale	(49,060,934)	(40,907,900)

PLN'000	2017	2016
Revaluation	-	(50,431)
Foreign exchange differences	(352,893)	
Depreciation of premium	(194,058)	(237,175)
As at 31 December	17,439,439	19,072,371

*As at 31 December 2017, some of the securities (bonds) issued by other banks in the amount of PLN 32,576 thousand are covered by Government guarantees (31 December 2016: PLN 66,384 thousand).

22. Equity investments

PLN'000	31.12.2017	31.12.2016
Shares in subsidiaries	116,054	116,103
Shares available-for-sale	30,421	29,389
Impairment	(13,936)	(20,385)
Equity investments, total	132,539	125,107
Including:		
Listed on active market instruments	987	839
Unlisted on active market instruments	131,552	124,268

The movement in equity investments is as follows:

PLN'000	Subsidiaries	Other entities	Total
As at 1 January 2017	102,545	22,562	125,107
Increases (due to):			
Revaluation	3,873	4,245	8,118
Decreases (due to):			
Sale*	-	(636)	(636)
Settlement due to payments	(50)	-	(50)
As at 31 December 2017	106,368	26,171	132,539

PLN'000	Subsidiaries	Other entities	Total
As at 1 January 2016	232,454	67,492	299,946
Decreases (due to):			
Sale**	-	(656)	(656)
Revaluation	(1,482)	(44,274)	(45,756)
Reducing the share capital	(128,370)	-	(128,370)
Settlement due to payments	(57)	-	(57)
As at 31 December 2016	102,545	22,562	125,107

*In the 2017 the following events took place:

- there was a sale of shares in Odlewnie Polskie S.A.. The balance value of sold shares amounted to PLN 636 thousand and the profit on sales to PLN 3,377 thousand.

**In the 2016 the following events took place:

- there was a sale of shares in Odlewnie Polskie S.A.. The balance value of sold shares amounted to PLN 656 thousand and the profit on sales to PLN 2,938 thousand.

Financial information on subsidiaries, 31.12.2017

PLN'000									
Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]*	Book value of shares	Assets	Liabilities	Equity	Revenues Profit/loss
HANDLOWY – LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	97.47	15,720	23,134	704	22,430	865 (678)
DOM MAKLERSKI BANKU HANDLOWEGO S.A.	Warsaw	Brokerage	Subsidiary	100.00	70,950	433,070	320,816	112,254	73,538 14,669
PPH SPOMASZ Sp. z o.o. w likwidacji	Warsaw	-	Subsidiary	100.00	13,502			Entity under liquidation	

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Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]*	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit/loss
HANDLOWY INVESTMENTS S.A.	Luxembourg	Investment activity	Subsidiary	100.00	5,282	18,298	430	17,869	432	61
HANDLOWY – INWESTYCJE Sp. z o.o. 1/	Warsaw	Investment activity	Subsidiary	100.00	914	11,118	41	11,077	446	242
106,368										

*direct share

The explanation of indirect relationships:

1/ Indirect relationship via Handlowy-Inwestycje Sp. z o.o. PLN'000

Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]*	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit
HANDLOWY - LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	2.53	414	23,134	704	22,430	865	(678)

The above presented financial data of the entities available at the time of preparation of the financial statements originate from the non-audited financial statements of the entities. Financial data of Handlowy Investments S.A. originate from the financial statements prepared as at 28 February 2018, which is the entity's balance sheet date.

Financial information on subsidiaries, 31.12.2016

PLN'000

Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]*	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit/Loss
HANDLOWY – LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	97.47	15,720	44,921	9,022	35,899	7,772	7,691
DOM MAKLERSKI BANKU HANDLOWEGO S.A.	Warsaw	Brokerage	Subsidiary	100.00	70,950	406,650	297,426	109,224	66,034	12,694
PPH SPOMASZ Sp. z o.o. w likwidacji	Warsaw	-	Subsidiary	100.00	9,442	Entity under liquidation				
HANDLOWY INVESTMENTS S.A.	Luxembourg	Investment activity	Subsidiary	100.00	5,469	19,303	447	18,856	421	(55)
HANDLOWY – INWESTYCJE Sp. z o.o. 1/	Warsaw	Investment activity	Subsidiary	100.00	964	10,913	29	10,885	212	50
102,545										

*direct share

The explanation of indirect relationships:

1/ Indirect relationship via Handlowy-Inwestycje Sp. z o.o. PLN'000

Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit
HANDLOWY - LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	2.53	414	44,921	9,022	35,899	7,772	7,691

The above presented financial data of the entities available at the time of preparation of the financial statements originate from the non-audited financial statements of the entities, except for PPH Spomasz Sp. z o.o. Financial data of Handlowy Investments S.A. originate from the financial statements prepared as at 28 February 2017, which is the entity's balance sheet date.

23. Amounts due from customers

PLN'000	31.12.2017	31.12.2016
Amounts due from financial sector entities		
Loans and advances	444,777	293,117
Debt securities unlisted	1,200,636	1,199,671
Guarantee funds and deposits pledged as collateral	286,432	160,349
Total gross amount	1,931,845	1,653,137
Impairment write-offs	(17,473)	(17,810)
Total net amount	1,914,372	1,635,327

PLN'000	31.12.2017	31.12.2016
Amounts due from non-financial sector entities		
Loans and advances	16,722,365	16,051,239
Unlisted debt securities	496,125	514,401
Purchased receivables	1,193,041	1,116,054
Effectuated guarantees	1,038	1,056
Other receivables	7,998	18,671
Total gross amount	18,420,567	17,701,421
Impairment write-offs	(568,136)	(541,407)
Total net amount	17,852,431	17,160,014
Total net amounts due from customers	19,766,803	18,795,341

*As of 31 December 2017 "Other receivables" contains dues from financial leasing of PLN 1,808 thousand (31 December 2016: PLN 0.0 thousand).

In amounts due from customers presented on the line Unlisted debt securities are securities assets covered by the Bank. Deciding to invest in securities based on economic calculation, measuring return on investment against the potential risks. The Bank that owns the portfolio (the Initiator) founds a special purpose company (SPV) in order to issue debt securities in each securitization transaction. The issued debt securities are solely repaid from the cash flows generated by securitized receivables portfolio which the SPV bought from the Initiator. Until now the Bank acted as investor and acquired the senior tranche in the amount of PLN 1,199,611 thousand. Securities purchased by the Bank are not traded on the market. The Bank intends to maintain investments until the maturity date. The main risk of securitisation transactions is credit risk. Bank's maximum exposure to loss from involvement in these entities is equal to their carrying gross value, as at 31 December 2017 in the of amount PLN 1,200,636 thousand (31 December 2016: PLN 1,199,671 thousand). The carrying value of assets relating in Bank participation in unconsolidated structured entities as at 31 December 2017 in the amount of PLN 1,200,576 thousand (31 December 2016: PLN 1,199,611 thousand).

The closing balance of impairment recognized on loans and advances to customers consisted of:

PLN'000	31.12.2017	31.12.2016
Portfolio impairment loss	(244,633)	(227,432)
Individual impairment loss	(261,608)	(252,096)
Incurred but not reported losses (IBNR)	(79,368)	(79,689)
Impairment loss, total	(585,609)	(559,217)

The movement in impairment loss on amounts due from customers is as follows:

PLN'000	2017			2016		
	Institutional customers	Retail customers	Total	Institutional customers	Retail customers	Total
As at 1 January	(274,435)	(284,782)	(559,217)	(313,480)	(263,916)	(577,396)
Increases (due to):						
Creation of write-offs	(90,419)	(121,011)	(211,430)	(50,673)	(138,634)	(189,307)
Other	-	-	-	(12,830)	607	(12,223)
Decreases (due to):						
Restating receivables into write-offs	24,358	13,470	37,828	22,033	24,272	46,305
Reversal of write-offs on receivables on made derivatives transactions	1,390	-	1,390	7,620	-	7,620
Write-offs release	45,749	53,885	99,634	52,788	50,742	103,530
Sale of receivables	-	42,458	42,458	20,107	42,147	62,254
Other	3,287	441	3,728	-	-	-
As at 31 December	(290,070)	(295,539)	(585,609)	(274,435)	(284,782)	(559,217)

Dues from financial leasing

In the fourth quarter 2016, a decision was made on the purchase by the Bank of the remaining working lease portfolio from Handlowy Leasing Sp. z o.o. The transaction was executed at the end of the first quarter 2017.

Leasing products continue to be offered by the Bank and are made available as part of the "open architecture", i.e. the Bank's partnership with organizations from outside its Group.

The asset position "Amounts due from customers" contains the following positions referring to receivables from the non-financial sector based on financial leasing:

<i>PLN'000</i>	31.12.2017
Receivables (gross) based on financial leasing	1,808
Impairment of finance lease receivables	(2)
Unrealized financial income	-
Receivables (net) based on financial leasing total	1,806

Gross finance lease receivables as follows (by time to maturity):

<i>PLN'000</i>	31.12.2017
Less than 1 year	1,808
	1,808

Net finance lease receivables as follows (by time to maturity):

<i>PLN'000</i>	31.12.2017
Less than 1 year	1,808
Impairment of finance lease receivables	(2)
	1,806

Income based on financial leasing deals is shown in the Interest and similar income position.

24. Tangible fixed assets

Movements of tangible fixed assets in 2017

<i>PLN'000</i>	Land and buildings	Vehicles	Other	Under construction	Total
Gross amount					
As at 1 January 2017	583,295	121	276,693	19,465	879,574
Increases:					
Purchases	53	10,524	4,435	76,904	91,916
Other increases	-	-	466	-	466
Decreases:					
Disposals	(20,895)	-	(13,446)	-	(34,341)
Liquidation	(623)	-	(17,702)	-	(18,325)
Other decreases	(22)	-	(4)	-	(26)
Transfers	10,327	-	5,508	(25,729)	(9,894)
As at 31 December 2017	572,135	10,645	255,950	70,640	909,370
Depreciation					
As at 1 January 2017	298,363	121	248,754	-	547,238
Increases:					
Amortization change for the period	16,545	513	12,450	-	29,508
Other increases	-	-	462	-	462
Decreases:					
Disposals	(12,153)	-	(13,293)	-	(25,446)
Liquidation	(623)	-	(17,439)	-	(18,062)
Other decreases	-	-	(3)	-	(3)
As at 31 December 2017	302,132	634	230,931	-	533,697
Carrying amount					
As at 1 January 2017	284,932	-	27,939	19,465	332,336
As at 31 December 2017	270,003	10,011	25,019	70,640	375,673

Movements of tangible fixed assets in 2016

<i>PLN'000</i>	Land and buildings	Vehicles	Other	Under construction	Total
Gross amount					
As at 1 January 2016	604,216	121	290,664	9,457	904,458
Increases:					
Purchases	137	-	3,388	24,227	27,752
Other increases	45	-	227	-	272
Decreases:					
Liquidation	(25,560)	-	(22,002)	-	(47,562)
Other decreases	(20)	-	(742)	-	(762)
Transfers	4,477	-	5,158	(14,219)	(4,584)
As at 31 December 2016	583,295	121	276,693	19,465	879,574
Depreciation					
As at 1 January 2016	305,481	119	255,917	-	561,517
Increases:					
Amortization charge for the period	17,037	2	14,832	-	31,871
Other increases	8	-	231	-	239
Decreases:					
Liquidation	(24,163)	-	(21,479)	-	(45,642)
Other decreases	-	-	(747)	-	(747)
	298,363	121	248,754	-	547,238
As at 31 December 2016					
Carrying amount					
As at 1 January 2016	298,735	2	34,747	9,457	342,941
As at 31 December 2016	284,932	-	27,939	19,465	332,336

25. Intangible assets**Movements of intangible assets in 2017**

<i>PLN'000</i>	Goodwill	Patents, licenses etc.	Software	Other intangible assets	Prepayments	Total
Gross amount						
As at 1 January 2017	1,245,976	735	409,904	18,242	12,690	1,687,547
Increases:						
Purchases	-	-	217	-	38,569	38,786
Decreases:						
Liquidation	-	-	(7,434)	-	-	(7,434)
Transfers	-	-	37,368	-	(31,433)	5,935
As at 31 December 2017	1,245,976	735	440,055	18,242	19,826	1,724,834
Depreciation						
As at 1 January 2017	-	735	318,760	18,242	-	337,737
Increases:						
Amortization charge for the period	-	-	42,948	-	-	42,948
Decreases:						
Liquidation	-	-	(7,434)	-	-	(7,434)
As at 31 December 2017	-	735	354,274	18,242	-	373,251
Carrying amount						
As at 1 January 2017	1,245,976	-	91,144	-	12,690	1,349,810
As at 31 December 2017	1,245,976	-	85,781	-	19,826	1,351,583

Movements of intangible assets in 2016

PLN'000	Goodwill	Patents, licenses etc.	Software	Other intangible assets	Prepayments	Total
Gross amount						
As at 1 January 2016	1,245,976	735	400,064	18,242	10,332	1,675,349
Increases:						
Purchases	-	-	812	-	14,629	15,441
Decreases:						
Liquidation	-	-	(4,610)	-	-	(4,610)
Transfers	-	-	13,638	-	(12,271)	1,367
As at 31 December 2016	1,245,976	735	409,904	18,242	12,690	1,687,547
Depreciation						
As at 1 January 2016	-	735	285,980	18,242	-	304,957
Increases:						
Amortization charge for the period	-	-	37,257	-	-	37,257
Decreases:						
Liquidation	-	-	(4,477)	-	-	(4,477)
As at 31 December 2016	-	735	318,760	18,242	-	337,737
Carrying amount						
As at 1 January 2016	1,245,976	-	114,084	-	10,332	1,370,392
As at 31 December 2016	1,245,976	-	91,144	-	12,690	1,349,810

As at 31 December 2017, goodwill includes the amount of PLN 1,243,645 thousand arising from the merger of Bank Handlowy w Warszawie S.A. and Citibank (Poland) S.A. as at 28 February 2001 and the amount of PLN 2,331 thousand as a result of the purchase of an organized part of the enterprise of ABN AMRO Bank (Poland) S.A. as at 1 March 2005.

26. Impairment test for goodwill

For the purpose of carrying out impairment tests, goodwill has been allocated to two cash generating-units: the Institutional Bank and Consumer Bank. Assignment was made on the basis of discounted cash flows models on the basis of the strategy before the merge. After fusion reallocation of goodwill was conducted on the basis of the assets' relative values transferred to another center comparing to the assets held in the center given. For both sectors the value in use exceeds the carrying value, therefore no goodwill impairment was recognized.

The allocation of goodwill to cash-generating units is presented in the table below.

Book value of goodwill allocated to unit

PLN'000	31.12.2017
Institutional Bank	851,944
Consumer Bank	394,032
	1,245,976

The basis of valuation of the recoverable amount for a unit is the value in use, assessed on the basis financial plan. The plan is based on rational assumptions about future facts that reflect management assessment of future economic conditions and expected results of the Bank. The plan is periodically updated and approved by the Bank's Supervisory Board. The board accepted a 3 year time period for the process of financial planning.

The discount rate is assessed on the basis of the capital assets pricing model (CAPM) using a beta coefficient for the banking sector, a risk premium and Treasury bond yield curves. In 2017, the discount rate amounted to 9.00% (9.20% at the end of 2016).

Extrapolation of cash flows, which exceed the period covered by the financial plan, has been based on growth rates reflecting the long-term NBP inflation target that amounted to 2.5 pp as at 31 December 2017.

The Bank's Management Board believes that reasonable and probable changes in the key assumptions adopted in the valuation of the recoverable amounts for cash-generating units would not cause their book value to exceed their recoverable amount.

27. Deferred income tax asset

PLN'000	31.12.2017	31.12.2016
Deferred income tax asset	370,308	405,472
Deferred income tax liability	193,329	206,118
Deferred income tax net asset	176,979	199,354

Deferred income tax asset and provision are presented in the statement of financial position after compensation.

Positive and negative taxable and deductible temporary differences are presented below:

Deferred income tax asset is attributable to the following:

PLN'000	31.12.2017	31.12.2016
Interest accrued and other expense	9,483	10,763
Revaluation impairment write-offs	48,321	39,680
Unrealized premium from securities	58,436	46,370
Negative valuation of derivative financial instruments	164,972	158,447
Negative valuation of securities held-for-trading	688	2,938
Income collected in advance	29,480	26,455
Valuation of shares	779	2,039
Commissions	6,137	8,181
Debt and equity securities available-for-sale	2,199	50,446
Staff expenses and other cost due to pay	45,136	57,155
Other	4,677	2,998
Deferred income tax asset	370,308	405,472

Deferred income tax liability is attributable to the following:

PLN'000	31.12.2017	31.12.2016
Interest accrued (income)	37,733	39,035
Positive valuation of derivative financial instruments	115,419	127,598
Unrealized securities discount	7,097	7,372
Income to receive	3,243	4,842
Positive valuation of securities held-for-trading	568	(69)
Debt and equity securities available-for-sale	10,833	9,313
Investment relief	11,401	12,334
Other	7,035	5,693
Deferred income tax liability	193,329	206,118
Net asset for deferred income tax	176,979	199,354

Movement in temporary differences during the year 2017

The movement in temporary differences relating to deferred income tax asset:

PLN'000	As at 1 January 2017	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2017
Interest accrued and other expense	10,763	(1,280)	-	9,483
Revaluation impairment write-offs	39,680	8,641	-	48,321
Unrealized premium from securities	46,370	12,066	-	58,436
Negative valuation of derivative financial instruments	158,447	6,525	-	164,972
Negative valuation of securities held-for-trading	2,938	(2,250)	-	688
Income collected in advance	26,455	3,025	-	29,480
Valuation of shares	2,039	(1,260)	-	779
Commissions	8,181	(2,044)	-	6,137
Debt and equity securities available-for-sale	50,446	-	(48,247)	2,199

<i>PLN'000</i>	As at 1 January 2017	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2017
Staff expenses and other costs due to pay	57,155	(12,068)	49	45,136
Other	2,998	1,679	-	4,677
	405,472	13,034	(48,198)	370,308

The movement in temporary differences relating to deferred income tax provision:

<i>PLN'000</i>	As at 1 January 2017	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2017
Interest accrued (income)	39,035	(1,302)	-	37,733
Positive valuation of derivative financial instruments	127,598	(12,179)	-	115,419
Unrealized securities discount	7,372	(275)	-	7,097
Income to receive	4,842	(1,599)	-	3,243
Positive valuation of securities held-for-trading	(69)	637	-	568
Debt and equity securities available-for-sale	9,313	1,520	-	10,833
Investment relief	12,334	(933)	-	11,401
Other	5,693	1,342	-	7,035
	206,118	(12,789)	-	193,329
Change in net assets for deferred income tax	199,354	25,823	(48,198)	176,979

Movement in temporary differences during the year 2016

The movement in temporary differences relating to deferred tax assets:

<i>PLN'000</i>	As at 1 January 2016	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2016
Interest accrued and other expense	14,489	(3,726)	-	10,763
Revaluation impairment write-offs	36,950	2,730	-	39,680
Unrealized premium from securities	8,273	38,097	-	46,370
Negative valuation of derivative financial instruments	374,063	(215,616)	-	158,447
Negative valuation of securities held-for-trading	2,892	46	-	2,938
Income collected in advance	19,122	7,333	-	26,455
Valuation of shares	2,545	(506)	-	2,039
Commissions	8,526	(345)	-	8,181
Debt and equity securities available-for-sale	38,424	-	12,022	50,446
Staff expenses and other costs due to pay	56,318	837	-	57,155
Other	4,756	(1,758)	-	2,998
	566,358	(172,908)	12,022	405,472

The movement in temporary differences relating to deferred tax liability:

<i>PLN'000</i>	As at 1 January 2016	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2016
Interest accrued (income)	21,375	17,660	-	39,035
Positive valuation of derivative financial instruments	318,957	(191,359)	-	127,598
Unrealized securities discount	1,105	6,267	-	7,372
Income to receive	4,131	711	-	4,842
Positive valuation of securities held-for-trading	1,950	(2,019)	-	(69)
Debt and equity securities available-for-sale	18,602	(9,289)	-	9,313
Investment relief	13,236	(902)	-	12,334
Other	24,943	(19,250)	-	5,693
	404,299	(198,181)	-	206,118
Change in net asset for deferred income tax	162,059	25,273	12,022	199,354

28. Other assets

<i>PLN'000</i>	31.12.2017	31.12.2016
Interbank settlements	3,495	3,556
Income to receive	53,256	67,456
Staff loans out of the Social Fund	16,912	17,574
Sundry debtors	77,703	72,597
Prepayments	7,322	4,173
Other assets, total	158,688	165,356
Including financial assets*	98,110	93,727

* Financial assets include all the positions "Other assets", except the positions "Income to receive" and "Prepayments".

29. Amounts due to banks

<i>PLN'000</i>	31.12.2017	31.12.2016
Current accounts	1,108,686	1,466,806
Term deposits*	248,261	173,310
Loans and advances received	36,467	121,026
Liabilities due to sold securities under repurchase agreements	9,085	212,372
Other liabilities*, including:	165,762	330,113
margin deposits	163,769	330,099
Amounts due to banks, total	1,568,261	2,303,627

* In 2017, margins' presentation of was changed by transferring them from the term Deposits to Other Liabilities, comparative data were changed accordingly.

Movements in loans received:

<i>w tys. zł</i>	2017	2016
As at the beginning of the period	121,026	156,867
Increase (due to):		
drawing of loans	31,292	21,873
interest on loans	500	865
FX differences	-	4,331
Decrease (due to):		
repayment of loans	(111,713)	(62,001)
interest repayment	(403)	(909)
FX differences	(4,235)	-
As at the end of the period	36,467	121,026

30. Amounts due to customers

<i>PLN'000</i>	31.12.2017	31.12.2016
Deposits from financial sector entities		
Current accounts	571,248	695,551
Term deposits*	4,406,480	4,189,434
	4,977,728	4,884,985
Deposits from non-financial sector entities		
Current accounts, including:	22,027,628	22,202,431
institutional customers	10,758,084	10,883,841
individual customers	8,442,804	8,192,551
public sector units	2,826,740	3,126,039
Term deposits*, including:	4,975,540	6,815,479
institutional customers	3,073,215	5,040,424

PLN'000	31.12.2017	31.12.2016
individual customers	1,805,359	1,664,395
public sector units	96,966	110,660
	27,003,168	29,017,910
Total deposits	31,980,896	33,902,895
Other liabilities		
Other liabilities*, including:	191,545	129,052
liabilities due to deposits	112,611	80,622
margin deposits	40,671	11,548
Total other liabilities	191,545	129,052
Total amounts due to customers	32,172,441	34,031,947

* In 2017, margins' presentation of was changed by transferring them from the term Deposits to Other Liabilities, comparative data were changed accordingly.

31. Provisions

PLN'000	31.12.2017	31.12.2016
Litigation	3,154	3,823
Granted financial and guarantee commitments	12,789	7,215
Workforce restructuring	-	3,383
Restructuring of the branch network	1,928	7,647
Provisions, total	17,871	22,068

The movement in provisions is as follows:

PLN'000	2017	2016
As at 1 January	22,068	22,814
Provisions for:		
Litigation	3,823	10,522
Granted financial and guarantee commitments	7,215	10,451
Workforce restructuring	3,383	-
Restructuring of the branches network	7,647	1,841
Increases:		
Charges to provisions in the period:	23,347	35,406
litigation	5,574	1,571
granted financial and guarantee commitments	17,773	17,913
workforce restructuring	-	3,948
restructuring of the branch network	-	11,974
Decreases:		
Release of provisions in the period:	(13,612)	(27,088)
litigation	(1,071)	(4,962)
granted financial and guarantee commitments	(12,198)	(21,149)
restructuring of the branch network	(343)	(977)
Provisions used in the period, including:	(13,864)	(9,064)
litigation	(5,104)	(3,308)
workforce restructuring	(3,383)	(565)
restructuring of the branch network	(5,377)	(5,191)
Other, including	(68)	-
litigation	(68)	-
As at 31 December	17,871	22,068

32. Other liabilities

<i>PLN'000</i>	31.12.2017	31.12.2016
Staff benefits	37,590	43,812
Interbank settlements	293,405	145,536
System settlements	4,728	718
Settlements with Tax Office and National Insurance (ZUS)	20,020	24,637
Sundry creditors	172,067	143,652
Accruals, including:	231,089	282,629
Provision for employee payments	81,652	89,439
Provision for employee retirement payments	49,832	40,290
IT services and bank operations support	29,449	62,098
Consultancy services and business support	9,273	24,091
Other	60,883	66,711
Deferred income	18,312	23,585
Other liabilities, total	777,211	664,569
Including financial liabilities*	738,879	616,347

* Financial liabilities include all the positions "Other liabilities", except the positions "Settlements with Tax Office and National Insurance (ZUS)" and "Deferred income".

33. Financial assets and liabilities by contractual maturity

As at 31 December 2017

<i>PLN'000</i>	Note	Total	Up to 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	More than 5 years
Amounts due from banks (gross)	18	837,277	568,693	1,044	-	267,540	-
Financial assets held-for-trading							
Debt securities held-for-trading	19	1,143,908	3,037	-	30,104	624,158	486,609
Financial assets available-for-sale							
Debt securities available-for-sale	21	17,439,439	1,399,713	-	-	11,589,050	4,450,676
Amounts due from customers (gross)				-			
Amounts due from financial sector entities	23	1,931,845	431,845	-	-	1,500,000	-
Amounts due from non-financial sector entities	23	18,420,567	6,535,495	1,586,969	1,402,874	6,833,854	2,061,375
Amounts due to banks	29	1,568,261	1,512,791	6,624	42,594	6,252	-
Amounts due to customers							
Amounts due to financial sector entities	30	5,015,317	4,835,998	174,350	4,957	12	-
Amounts due to non-financial sector entities	30	27,157,124	26,016,689	750,293	358,935	31,207	-

As at 31 December 2016

<i>PLN'000</i>	Note	Total	Up to 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	More than 5 years
Amounts due from banks (gross)	18	587,150	381,285	205,865	-	-	-
Financial assets held-for-trading							
Debt securities held-for-trading	19	2,605,028	313,250	-	246,232	1,492,755	552,791
Financial assets available-for-sale							
Debt securities available-for-sale	21	19,072,371	2,239,715	-	-	15,163,320	1,669,336
Amounts due from customers (gross)							
Amounts due from financial sector entities	23	1,653,137	198,137	70,000	185,000	1,200,000	-
Amounts due from non-financial sector entities	23	17,701,421	6,798,322	1,227,233	2,057,996	5,556,584	2,061,286
Amounts due to banks	29	2,303,627	2,140,199	20,897	27,628	114,903	-
Amounts due to customers							
Amounts due to financial sector entities	30	4,895,202	4,849,610	41,959	3,633	-	-
Amounts due to non-financial sector entities	30	29,136,745	28,151,169	706,906	261,019	17,651	-

34. Capital and reserves

Share capital

Series/ issue	Type of shares	Type of preference	Type of limitation	Number of shares	Par value of series / issue [PLN'000]	Method of issue payment	Date of registration	Eligibility for dividends (from date)
A	bearer	none	-	65,000,000	260,000	paid in	27.03.97	01.01.97
B	bearer	none	-	1,120,000	4,480	paid in	27.10.98	01.01.97
B	bearer	none	-	1,557,500	6,230	paid in	25.06.99	01.01.97
B	bearer	none	-	2,240,000	8,960	paid in	16.11.99	01.01.97
B	bearer	none	-	17,648,500	70,594	paid in	24.05.02	01.01.97
B	bearer	none	-	5,434,000	21,736	paid in	16.06.03	01.01.97
C	bearer	none	-	37,659,600	150,638	transfer of Citibank Poland assets to the Bank	28.02.01	01.01.00
				130,659,600	522,638			

The par value of 1 share amounts to PLN 4.00

As at 31 December 2017, the Bank's share capital amounted to PLN 522,638,400 divided into 130,659,600 common bearer shares with a nominal value of PLN 4 each, which has not changed since 31 December 2016.

The Bank has not issued preferred shares.

Both in 2017 and 2016 there was no increase in the share capital by shares issuance.

Principal shareholders

The following table presents the shareholders who, as at 31 December 2017 and 31 December 2016, held at least 5% of the total number of votes at the General Meeting or at least 5% of the Bank's share capital:

	Value of shares (PLN'000)	Number of shares	% shares	Number of votes at GM	% votes at GM
Citibank Overseas Investment Corporation, USA	391,979	97,994,700	75.0	97,994,700	75.0
Other shareholders	130,659	32,664,900	25.0	32,664,900	25.0
	522,638	130,659,600	100.0	130,659,600	100.0

During 2017 and during the period from the publication of the previous interim quarterly report for Q3 2017 until the day of the publication of this annual unconsolidated financial statements for 2016, the structure of major shareholdings of the Bank has not changed.

Supplementary capital

As at 31 December 2017, supplementary capital was PLN 2,944,585 thousand (31 December 2016: PLN 2,944,585 thousand). Supplementary capital is designated for offsetting the Bank's financial losses or for other purposes including payment of dividends to the shareholders. The General Shareholders' Meeting decides upon the utilization of supplementary capital, but a portion of its balance amounting to one third of total share capital may be used exclusively for offsetting losses shown in the financial statements.

The supplementary capital includes the amount of PLN 2,485,534 thousand constituting the excess of the fair value of the issued shares over their nominal value in connection with the business combination of the Bank and Citibank (Poland) S.A., which took place on 28 February 2001.

Revaluation reserve

PLN'000	31.12.2017	31.12.2016
Revaluation of financial assets available-for-sale	(9,376)	(215,061)

The revaluation reserve is not distributed. As at the day of derecognition of all or part of the financial assets available-for-sale from the statement of financial position, accumulated profits or losses that were previously presented in the other comprehensive and accumulated income in the revaluation reserve are reclassified to the income statement.

Other reserves

PLN'000	31.12.2017	31.12.2016
Reserve capital	2,344,446	2,343,335
General risk reserve	540,200	529,000
Net actuarial losses on specific services program valuation	(4,977)	(4,770)
Other reserves, total	2,879,669	2,867,565

On 22 June 2017 the Ordinary General Meeting of Shareholders of Bank Handlowy w Warszawie S.A. adopted a resolution on distribution of the net profit for 2016, deciding to appropriate the amount of PLN 11,200 thousand for the general risk reserve and PLN 1,111 thousand for reserve capital.

Reserve capital

Reserve capital is created from the annual distribution of profits or from other sources, independently of the supplementary capital.

Reserve capital is designated for offsetting the Bank's financial position losses or for other purposes, including payment of dividends to the shareholders. The General Shareholders' Meeting makes decisions on utilization of reserve capital.

General risk reserve

The general risk reserve is recorded out of net profit against unidentified risk arising from banking activities. The General Shareholders' Meeting makes decisions on utilization of the general risk reserve subject to applicable regulations.

Dividends

Dividends paid for 2016

At the meeting on June 22, 2017, the Ordinary General Meeting of Shareholders of the Bank Handlowy w Warszawie S.A. (hereinafter WZ) adopted a resolution on distribution of the net profit for 2016. The WZ resolved to appropriate the amount of PLN 591,887,988.00 to the dividend payment, which means that the dividend per one ordinary share is PLN 4.53. The number of shares covered by the dividend is 130,659,600.

Simultaneously, the WZ resolved to set the day of the right to the dividend for July 3, 2017 (day of dividend) and the day of the dividend payment for July 20, 2017 (day of the dividend payment).

Declared dividends

On 14 March 2018, the Bank's Management Board adopted a resolution on the proposed distribution of profit for 2017. The Bank's Management Board has proposed to allocate the amount of PLN 537,010,956.00 for the dividend payment. The dividend has a cash character. This means that the dividend per share amounts to PLN 4.11. The number of shares covered by dividends is 130,659,600. The dividend record date was designated as 18 June 2018 and the dividend payment date was designated as 25 June 2018. This proposal of the Bank's Management Board will be submitted to the Supervisory Board for an opinion and then to the General Shareholders' Meeting for approval.

35. Repurchase and reverse repurchase agreements

Repurchase agreements

The Bank raises liquid assets by selling financial instruments under agreements to repay the funds by repurchasing the instruments at future dates at the same price plus interest at a predetermined rate.

Repurchase agreements are commonly used as a tool for short-term financing of interest-bearing assets, depending on the prevailing interest rates.

As at 31 December 2017, assets sold under repurchase agreements were as follows:

PLN'000	Fair value of underlying assets	Carrying amount of corresponding liabilities*	Repurchase dates	Repurchase price
Debt securities held for trading	9,079	9,085	Up to 1 week	9,086

* including interest

As at 31 December 2016, assets sold under repurchase agreements were as follows:

PLN'000	Fair value of underlying assets	Carrying amount of corresponding liabilities*	Repurchase dates	Repurchase price
Debt securities held for trading	212,143	212,372	Up to 1 week	212,397

* including interest

In repo transactions, all gains and losses on the assets held are on the Bank's side.

As at 31 December 2017 and 31 December 2016, assets sold through repo cannot be further traded.

In 2017, the total interest expense on repurchase agreements was PLN 12,981 thousand (in 2016: PLN 6,495 thousand).

Reverse repurchase agreements

The Bank also purchases financial instruments under agreements to resell them at future dates (reverse repurchase agreements). The seller commits to repurchase the same or similar instruments at an agreed future date. Reverse repurchase agreements are entered into as a facility to provide funding to customers.

As at 31 December 2017, assets purchased subject to agreements to resell were as follows:

PLN'000	Carrying amount of receivable*	Fair value of assets held as collateral	Resale date	Resale price
Amounts due from banks	9,085	8,974	Up to 1 week	9,086
	266,522	342,810	Up to 3 months	342,188

*including interest

As at 31 December 2016, assets purchased subject to agreements to resell were as follows:

PLN'000	Carrying amount of receivable*	Fair value of assets held as collateral	Resale date	Resale price
Amounts due from banks	212,361	207,952	Up to 1 week	212,377
	205,922	181,933	Up to 2 years	178,886

*including interest

As at 31 December 2017 and 31 December 2016, the Bank held the option to pledge or sell the assets acquired through reverse repo.

In 2017, the total interest income on reverse repurchase agreements was PLN 12,488 thousand (in 2016: PLN 10,522 thousand).

As at 31 December 2017 the liabilities due to short sale of securities purchased in reverse repo transactions amounted to PLN 0.0 thousand (as at 31 December 2016: PLN 208,106 thousand).

36. Offsetting of financial assets and financial liabilities

According to information in Note 2, the Bank does not offset financial assets and liabilities. Therefore, in line with requirements of IFRS 7, disclosures provided below relate only to financial assets and liabilities resulting from derivative contracts, settled by a central counterparty (CCP) - KDPW_CCP S.A. or concluded under master agreements such as ISDA, the Master Agreement recommended by the Polish Banks' Union, and other master agreements, under which, in certain breaches of the contracts' provisions, the contract may be terminated and settled in the net amount of receivables and liabilities, where such offsetting has been recognized as legal effective.

The table below presents the fair values of derivatives (from the trading portfolio and designated as hedging instruments) as well as executable collateral for timed transactions and derivative framework deals enabling lawful compensation in described situations.

PLN'000	31.12.2017		31.12.2016	
	Financial assets	Financial liabilities	Financial assets	Financial liabilities
Fair value of derivatives	1,064,803	1,365,131	1,239,184	1,173,839
Value of collateral received/placed	(166,550)	(528,493)	(286,475)	(208,094)
Assets and liabilities subject to offsetting under the master agreement	898,253	836,638	952,709	965,745
Maximum amount of potential offset	(778,682)	(778,682)	(680,079)	(680,079)
Assets and liabilities subject to offsetting under the master agreement considering the maximum amount of potential offset	119,571	57,956	272,630	285,666

37. Hedge accounting

The Bank hedges against the risk of change in the fair value of fixed interest rate debt securities available for sale. The hedged risk results from changes in interest rates.

IRS is the hedging instrument swapping the fixed interest rate for a variable interest rate.

The gain or loss on the hedged item attributable to the hedged risk is recognized in the result on hedge accounting in the income statement. The remainder of the change in the fair value valuation of debt securities available for sale is recognized in other comprehensive income. Interest income on debt securities is recognized in net interest income.

Changes in the fair value of derivative instruments designated and qualifying as fair value hedges are recognized in the result on hedge accounting in the income statement. Interest income and interest expenses related to the interest measurement component of derivatives concluded as hedging instruments under fair value hedge are presented in the interest result in the position interest income/expense on derivatives in hedge accounting.

Fair value of instruments within fair value hedge accounting of securities

PLN'000	31.12.2017		31.12.2016	
	Nominal value	Fair value	Nominal value	Fair value
Hedged instruments				
Debt securities available-for-sale				
Treasury bonds	2,290,000	2,492,215	4,604,396	4,794,696
Bonds issued by banks	30,000	32,76	-	-
Hedging instruments				
Derivative instruments				
Interest rate swaps – negative valuation	-	-	2,431,660	12,244
Interest rate swaps – negative valuation	2,320,000	50,191	2,172,736	39,897

38. Fair value information

Fair value of financial assets and liabilities

Fair value is a price that would be received for selling an asset or would be paid for transferring the liability in a transaction carried out in the conditions between the market participants, at the measurement date.

The summary below provides statement of financial position (by category) and fair value information for each category of financial assets and liabilities.

As at 31 December 2017

PLN'000	Note	Held-for-trading	Loans, advances and other receivables	Available-for-sale	Other financial assets / liabilities	Total carrying value	Fair value
Financial assets							
Cash and balances with Central Bank	17	-	462,126	-	-	462,126	462,126
Amounts due from banks	18	-	836,166	-	-	836,166	836,166
Financial assets held-for-trading	19	2,162,040	-	-	-	2,162,040	2,162,040
Debt securities available-for-sale	21	-	-	17,439,439	-	17,439,439	17,439,439
Equity investment	22	-	-	26,171	106,368	132,539	201,002
Amounts due from customers	23	-	19,766,803	-	-	19,766,803	19,727,148
		2,162,040	21,065,095	17,465,610	106,368	40,799,113	40,827,921
Financial liabilities							
Amounts due to banks	29	-	-	-	1,568,261	1,568,261	1,568,359
Financial liabilities held-for-trading	19	1,351,031	-	-	-	1,351,031	1,351,031
Hedging derivatives	20	50,191	-	-	-	50,191	50,191
Amounts due to customers	30	-	-	-	32,172,441	32,172,441	32,171,614
		1,401,222	-	-	33,740,702	35,141,924	35,141,195

As at 31 December 2016

PLN'000	Note	Held-for-trading	Loans, advances and other receivables	Available-for-sale	Other financial assets / liabilities	Total carrying value	Fair value
Financial assets							
Cash and balances with Central Bank	17	-	665,755	-	-	665,755	665,755
Amounts due from banks	18	-	586,973	-	-	586,973	586,957
Financial assets held-for-trading	19	3,772,162	-	-	-	3,772,162	3,772,162
Hedging derivatives		12,244	-	-	-	12,244	12,244
Debt securities available-for-sale	21	-	-	19,072,371	-	19,072,371	19,072,371
Equity investments	22	-	-	22,562	102,545	125,107	193,334
Amounts due from customers	23	-	18,795,341	-	-	18,795,341	18,813,995
		3,784,406	20,048,069	19,094,933	102,545	43,029,953	43,116,818
Financial liabilities							
Amounts due to banks	29	-	-	-	2,303,627	2,303,627	2,303,661
Financial liabilities held-for-trading	19	1,305,614	-	-	-	1,305,614	1,305,614
Hedging derivatives		39,897	-	-	-	39,897	39,897
Amounts due to customers	30	-	-	-	34,031,947	34,031,947	34,031,387
		1,345,511	-	-	36,335,574	37,681,085	37,680,559

Depending on the method of determining fair value, individual financial assets or liabilities are classified into the following categories:

- Level I: financial assets / liabilities valued directly on the basis of prices from an active market where the regular quotations and turnover are available.
The active market includes stock and brokerage quotes and quotes in systems as pricing services, such as Reuters and Bloomberg, which represent the actual market transactions concluded on market conditions. Level I mainly include securities held-for-trading or available-for-sale.
- Level II: financial assets / liabilities valued on the basis of models based on input data from the active market and presented in Reuters and Bloomberg systems, depending on financial instruments, the following specific valuation techniques are used:
 - listed market prices for a given instrument or listed market prices for an alternative instrument;
 - fair value of interest rate swaps and forward foreign exchange contracts is calculated as the current value of future cash flows based on the market yield curves and current NBP fixing exchange rate in case of foreign currency instruments;
 - other techniques, such as yield curves based on alternative prices for a given financial instrument.
- Level III: financial assets/liabilities valued on the basis of valuation techniques using relevant parameters not market-based.

In 2017, the Bank did not make any changes in the classification of financial instruments (presented by the fair value method in the statement of financial position) to categories of fair value assignment (Level I, Level II, Level III).

The tables below present carrying amounts of financial instruments presented in the statement of financial position measured at fair value, arranged according to the above categories:

As at 31 December 2017

PLN'000	Note	Level I	Level II	Level III	Total
Financial assets					
Financial assets held-for-trading	19	1,144,095	1,017,945	-	2,162,040
derivatives		188	1,017,944	-	1,018,132
debt securities		1,143,907	1	-	1,143,908
Debt securities available-for-sale	21	16,007,151	1,432,288	-	17,439,439
Equity investments available-for-sale	22	987	-	23,062	24,049
Financial liabilities					
Financial liabilities held-for-trading	19	65	1,350,966	-	1,351,031
short sale of securities		-	-	-	-

PLN'000	Note	Level I	Level II	Level III	Total
derivatives		65	1,350,966	-	1,351,031
Hedging derivatives	20	-	50,191	-	50,191

As at 31 December 2016

PLN'000	Note	Level I	Level II	Level III	Total
Financial assets					
Financial assets held-for-trading	19	2,604,546	1,167,616	-	3,772,162
derivatives		-	1,167,134	-	1,167,134
debt securities		2,604,546	482	-	2,605,028
Hedging derivatives	20	-	12,244	-	12,244
Debt securities available-for-sale	21	16,766,272	2,306,099	-	19,072,371
Equity investments available-for-sale	22	838	-	18,965	19,803
Financial liabilities					
Financial liabilities held-for-trading	19	208,305	1,097,309	-	1,305,614
short sale of securities		208,106	-	-	208,106
derivatives		199	1,097,309	-	1,097,508
Hedging derivatives	20	-	39,897	-	39,897

As of 31st of December 2017 the amount of financial assets classified to the Level III includes the share of PLN 23,062 thousand in Visa Inc. (31 December 2016: PLN 18,965 thousands).

The fair value valuation method takes into account the value of shares of Visa Inc. as well as corrections resulting from legal cases (actual and potential) a party of which could be Visa or the Bank.

Changes of financial assets and liabilities priced up to the fair value determined using non-market parameters of importance are presented the table below:

PLN'000	1.01.-31.12.2017		1.01.-31.12.2016	
	Financial assets available-for-sale		Financial assets available-for-sale	
	Equity investments		Equity investments	
As at January	18,965		63,323	
Derecognition valuation of shares	-		(63,323)	
Recognition of valuation of shares	-		17,355	
Valuation of shares	4,097		1,610	
As at December	23,062		18,965	

In a final allocation of settlement transaction overtaking Visa Europe Limited by Visa Inc. In 2016 Bank recognize results on share sale and minority interest (AFS) in amount of PLN 92,975 which comprises of cash received, deferred payment paid after 3 years from transaction date and valuation of preference shares Visa Inc.

In 2017 and 2016 the Bank did not make any transfers between levels of financial instruments' fair value according to method of establishing fair value.

Fair value measurement

In the case of short-term financial assets and liabilities, it is assumed that their carrying amount is practically equal to their fair value. In the case of other instruments, the following methods and assumptions have been adopted.

Equity investments

In the case of financial assets which are interests in subsidiaries, the fair value was presented as the percentage of net assets of an entity that is attributable to the Bank's interests in a given entity. The Bank's Management Board believes that this is the best available approximation of fair value of such instruments.

For non-controlling interests, fair value is the purchase price adjusted for impairment losses for both unlisted and listed investments due to the contractual time limit of the possibility of their disposal.

According to the Bank's strategy, presented equity investments will be gradually reduced except for selected strategic investments in "infrastructure companies" that provide services to the financial sector. Particular entities will be sold at the most suitable time under market conditions.

In 2017, among all equity investments, where fair value could not be established, the Bank sold the shares in Odlewnie Polskie S.A. The carrying/book value of sold shares in Odlewnie Polskie S.A. amounted to PLN 636 thousands and the profit of sales to PLN 3,377 thousands.

In 2016, among all equity investments, where fair value could not be established, the Bank sold the shares in Odlewnie

Polskie S.A. The carrying/book value of sold shares in Odlewnie Polskie S.A. amounted to PLN 656 thousands and the profit of sales to PLN 2,938 thousands.

Amounts due from customers and banks

The carrying amount of loans is presented at amortized cost less impairment. The fair value of loans and advances is calculated as the discounted value of expected future principal payments and takes into account fluctuations in market interest rates as well as changes in margins during the financial period. Changes in margins on loans are based on concluded transactions. It is assumed that loans and advances will be paid on the contractual date. Retail cash loans based on a rate managed by the Bank are an exception as their carrying amount is considered the fair value. In the case of loans for which repayment dates are not fixed (e.g., overdrafts), the fair value is the repayment that would be required if the amount were due on the balance sheet date.

For overnight placements, the fair value is equal to their carrying amount. For fixed interest rate placements, the fair value is assessed on the basis of discounted cash flows using current money market interest rates for receivables with similar credit risk, time to maturity, and currency.

The methods of valuation mentioned above are classified to the third of the level fair value financial hierarchy: assets valued on the basis of valuation techniques using relevant parameters not market-based.

Amounts due to banks and customers

In the case of on-demand deposits, as well as deposits without a pre-determined maturity date, the fair value is the amount that would be paid out if demanded on the balance date. The fair value of fixed maturity deposits is estimated on the basis of cash flows discounted with current interest rates taking into account its current margins in a similar way as adopted for the valuation of loans.

As described above, the models used to determine the fair value of assets and liabilities to banks and customers, recognized in the consolidated statement of financial position at amortized cost, the use of valuation techniques based on non-market parameters. Therefore, the Bank classifies the valuation of financial instruments for the purpose of disclosure to the third level fair value hierarchy. For all other financial instruments not at fair value, the Bank believes that the fair value is generally approximates the carrying value.

39. Contingent liabilities and litigation proceedings

Information on pending proceedings

In 2017, there was no single proceeding regarding the Bank's receivables or liabilities, the value of which would be equal to at least 10% of equity, pending in court, before a public administration authority or an arbitration authority.

The total value of all pending legal proceedings regarding receivables with the participation of the Bank did not exceed 10% of the Bank's equity in 2017.

Total value of liabilities of the Bank and its subsidiaries on all pending legal proceedings did not exceed 10% of the Bank's equity in 2017.

In accordance with applicable regulations, the Bank recognizes impairment losses for receivables subject to legal proceedings.

In the case of legal proceedings involving the risk of cash outflow as a result of meeting the Bank's commitments, the appropriate provisions are created.

As at 31 December 2017, the Bank was among others a party to 17 court proceedings associated directly with derivative transactions that have not been legally terminated: in 11 proceedings the Bank acted as a defendant and in 6 as a plaintiff. Additionally, during this time, the Bank was involved in two closing proceedings that were legally terminated, both resolved in the Bank's favor (one in which the Bank was a plaintiff and one as a defendant). The claims and allegations in the individual cases against the Bank are based on various legal bases. The subject of the dispute refers mainly to the validity of the derivative transactions and clients' liabilities demanded by the Bank with respect to those derivative transactions, as well as potential claims regarding potential invalidation of such demands by court decisions. Clients try to prevent the Bank from seeking claims resulting from derivative transactions; they dispute their liabilities towards the Bank, question the validity of the agreements and, in some cases, demand payment from the Bank. In 2017 two cases ended legally binding and in favour of the Bank, regarding term financial transactions, where the Bank was defendant or plaintiff.

The Bank was a party to proceedings initiated by the President of the Office of Competition and Consumer Protection (UOKiK) against the Visa and Europay payment system operators and banks - issuers of Visa cards and Europay/Eurocard/Mastercard cards. The Bank was one of the addressees of the President of UOKiK's decision in the case. The proceedings have concerned alleged practices limiting competition on the payment cards market in Poland consisting in the fixing of interchange fees for transactions made with Visa and Europay/Eurocard/Mastercard cards, as well as limiting access to the market for operators who do not belong to the unions of card issuers, against whom the proceedings were initiated. The President of UOKiK's decision was the subject of legal analyses in appeal proceedings. On April 22, 2010, the Appeal Court overturned the verdict of the Court of Competition and Consumer Protection (SOKiK) and referred the case back to the court of first instance. On 21 November 2013 SOKiK gave a judgment, under which a penalty imposed on the Bank was modified and set in the amount of PLN 1,775,720. On October 6, 2015 the

Appeal Court modified the verdict of the Competition and Consumer Protection Court and denied all appeals from the decision of the President of the Competition and Consumer Protection Office, including the changes of amounts of the fines that were imposed upon banks. As a result, the fine in the amount of 10,228,470 PLN that was originally imposed upon the Bank has been reinstated. The verdict is binding and enforceable. Due to the Banks' submitted extraordinary appeal on the 25 October 2017 the Supreme Court has overturned the Appeal Court's verdict and the case has been returned to the Appeal Court for a second review. The first hearing is set for the 17 April 2018.

In 2017 the Bank has made significant settlement due to court case. As the result of dispute's final settlement, the Bank has made a sentenced payment to plaintiff in the amount of PLN 5,155 thousand.

Commitments due to granted and received financial and guarantees liabilities

The amount of financial and guarantees commitments granted and received, by product category, is as follows:

PLN'000	31.12.2017	31.12.2016
Financial and guarantees liabilities granted		
Letters of credit	167,983	145,852
Guarantees granted	2,312,023	2,131,868
Credit lines granted	14,373,084	13,382,369
Underwriting other issuers' securities issues	-	1,246,100
	16,853,090	16,906,189

PLN'000	31.12.2017	31.12.2016
Letters of credit by category		
Import letters of credit issued	148,607	144,829
Export letters of credit confirmed	19,376	1,023
	167,983	145,852

The Bank makes provisions for granted financial and guarantees commitments. As at 31 December 2017, the provisions created financial and guarantees commitments amounted to PLN 12,789 thousand (31 December 2016: PLN 7,215 thousand).

Guarantees issued include credit principal repayment guarantees, other repayment guarantees, advance repayment guarantees, performance guarantees, tender guarantees, and bill of exchange guarantees.

PLN'000	31.12.2017	31.12.2016
Financial and guarantees liabilities received		
Finance	-	-
Guarantees	18,142,380	18,125,921
	18,142,380	18,125,921

40. Assets pledged as collateral

Assets are pledged as collateral of the following liabilities:

PLN'000	31.12.2017	31.12.2016
Collateral liabilities		
Amounts due to banks		
securities sale and repurchase agreements	9,085	212,372
liabilities on credit received	36,970	114,903
	46,055	327,275

Details of the carrying amounts of assets pledged as collateral are as follows:

PLN'000	31.12.2017	31.12.2016
Assets pledged		
Debt securities held-for-trading	9,079	212,143
Debt securities available-for-sale	334,396	336,624
Amounts due from banks		
Settlements related to operations in derivative instruments and stock market transactions	505,526	159,169

PLN'000	31.12.2017	31.12.2016
Amounts due from customers		
Stock market trading guarantee funds and settlements	286,432	160,349
	1,135,433	868,285

As at 31 December 2017, the debt securities available-for-sale presented in the table constituted a reserve against the funds guaranteed to the Bank Guarantee Fund in the amount of PLN 183,843 thousand (31 December 2016: PLN 183,022 thousand), the collateral against loan received in the amount of PLN 150,553 thousand (31 December 2016: PLN 153,602 thousand).

Debt securities held-for-trading as at 31 December 2017 constitute collateral of the Bank's obligations under securities sold with a repurchase agreement.

For more details on assets covering the Bank's obligations under repo transactions, see Note 35.

Other assets disclosed above secure settlement of derivatives transactions and stock market transactions. The terms and conditions of the transactions executed to date are standard and typical for such dealings.

41. Custodian activities

The Bank offers both custodian services connected with securities accounts for foreign institutional investors and custodian services for Polish financial institutions, including pension, investment and equity insurance funds. As at 31 December 2017, the Bank maintained over 9.2 thousand securities accounts (31 December 2016: approx. 9.2 thousand accounts).

42. Operating leases

Leases where the Bank is the lessee

Non-cancellable operating lease rentals are payable as follows (by time to maturity):

PLN'000	31.12.2017	31.12.2016
Less than 1 year	4,399	7,047
Between 1 and 5 years	28,734	57,859
More than 5 years	18,974	19,096
	52,107	84,002
Total annual rentals for contracts for an unspecified period of time	341	683

The Bank uses office space and cars under operating lease contracts.

Most of the office space lease contracts are signed for 5 years with the option of extension for another three years; however, some contracts have been signed for a period up to 1 year and some for more than 10 years. Lease payments are subject to annual indexation. The total amount of lease payments in 2017 amounted to PLN 21,548 thousand (in 2016: PLN 29,646 thousand).

The car leases are signed for 3 years. Lease payments are based on a fixed interest rate throughout the lease period. In 2017, total amount of leasing fees amounted to PLN 4,951 thousand (in 2016: PLN 6,812 thousand).

These payments are presented in the income statement in "General administrative expenses."

Leases where the Bank is the lessor

Non-cancellable operating lease rentals are payable as follows (by time to maturity):

PLN'000	31.12.2017	31.12.2016
Less than 1 year	28	296
Between 1 and 5 years	2,958	5,403
More than 5 years	3,363	6,163
	6,349	11,862
Total annual rentals for contracts for an unspecified period of time	6,974	7,826

The Bank leases some office space under lease contracts which fulfill the economic criteria of operating leases.

Most of the office space lease contracts are signed for an unspecified period of time. Other contracts are signed for a period of between 2 and 10 years. Lease payments are subject to annual indexation. The income related to these contracts amounted in 2017 to PLN 9,919 thousand (in 2016: PLN 9,935 thousand).

These payments are presented in the income statement in "Other operating income."

43. Cash flow statement

Cash

PLN'000	31.12.2017	31.12.2016
Cash related items:		
Cash in hand	431,574	380,757
Nostro current account in Central Bank	29,031	283,587
Current accounts in other banks (nostro, overdrafts on loro accounts)	53,872	8,410
	514,477	672,754

44. Transactions with the key management personnel

PLN'000	31.12.2017		31.12.2016	
	Members of the Management Board	Members of the Supervisory Board	Members of the Management Board	Members of the Supervisory Board
Loans granted	174	48	719	-
Deposits				
Current accounts	9,246	3,508	10,078	4,216
Term deposits	7,935	450	5,227	1,000
	17,181	3,958	15,305	5,216

As at 31 December 2017 and 31 December 2016, no loans or guarantees were granted to members of the Management Board or the Supervisory Board.

All transactions of the Bank with members of the Management Board and the Supervisory Board are at arm's length.

Within the scope of the work relationship, among contracts of employment between the Bank and Members of the Management Board, only in the case of one Member of the Management Board the contract includes a provision on financial compensation in the case of its termination upon notice.

A separate non-competition agreement conducted with the Bank applies to each member of the Bank's Management Board. According to its provisions, in case of termination of employment in the Bank, within a period of 12 months (in the case of one member of the Management Board – of 6 months) from the date of employment termination, the member of the Management Board is obligated to refrain from competitive activities against the Bank. Due to limitations mentioned above, the Bank will be obliged to pay compensation to the member of the Management Board.

45. Related parties

The Bank is a member of Citigroup Inc. Citibank Overseas Investment Corporation, a subsidiary of Citibank N.A., which is the ultimate parent entity for the Bank.

In the normal course of business activities, the Bank enters into transactions with related parties, in particular with entities of Citigroup Inc. and subsidiaries (see Note 22).

The transactions with related parties, resulting from the current Group's activities, mainly include loans, deposits, guarantees and derivatives transactions.

Apart from the transactions described in this section, in the presented period neither the Bank nor the Bank's subsidiaries conducted any transactions with related entities, which would be individually or jointly significant. No transaction with related entities was concluded on terms other than market terms.

Transactions with subsidiaries

The receivables and liabilities towards subsidiaries are as follows:

<i>PLN'000</i>	31.12.2017	31.12.2016
Receivables		
Overdraft facilities	21	5
	21	5
Receivables		
Opening balance	5	5
Closing balance	21	5
Deposits		
Current accounts	80,094	55,279
Term deposits	141,895	201,314
	221,989	256,593
Deposits		
Opening balance	256,593	286,895
Closing balance	221,989	256,593
Contingent liabilities granted		
Credit lines granted	80,550	50,968
<i>PLN'000</i>	31.12.2017	31.12.2016
Interest and commission income	11,607	9,979
Interest and commission expenses	2,846	2,918
Other operating income	2,593	1,913

As at 31 December 2017 and 31 December 2016, no receivables or contingent liabilities granted to subsidiaries were subject to impairment write-offs.

In the first half of 2016 there was a reduction of the share capital in the Bank's subsidiaries. The share capital of the Handlowy Leasing Sp. z o.o. was reduced by PLN 106,991 thousand and the share capital of the Handlowy Investments S.A. was reduced by PLN 24,090 thousand.

Transactions with other related entities

The receivables and liabilities towards Citigroup Inc. entities are as follows:

<i>PLN'000</i>	31.12.2017	31.12.2016
Receivables, including:	347,515	89,369
Placements	-	-
Liabilities, including:	1,032,018	1,184,307
Deposits*	220,304	204,911
Balance-sheet valuation of derivative transactions:		
Assets held-for-trading	446,178	823,853
Assets of derivative hedging instruments	-	11,912
Liabilities held-for-trading	716,669	669,388
Liabilities due to hedging derivatives	17,507	26,482
Contingent liabilities granted	373,018	264,347
Contingent liabilities received	71,587	68,290
Contingent transactions in derivative instruments (nominal value), including:	40,741,781	77,856,118
Interest rate instruments	25,946,494	68,946,263
FRA	-	14,745,600
Interest rate swaps (IRS)	9,456,993	33,717,144
Currency – interest rate swaps (CIRS)	15,566,804	19,310,382
Interest rate options	894,863	1,085,269
Futures contracts	27,834	87,868
Currency instruments	14,591,578	8,439,712

PLN'000	31.12.2017	31.12.2016
FX forward/spot	745,294	1,215,512
FX swap	11,687,926	4,549,027
Foreign exchange options	2,158,358	2,675,173
Securities transactions	100,674	195,488
Securities purchased pending delivery	79,250	102,785
Securities sold pending delivery	21,424	92,703
Commodity transactions	103,035	274,655
Swaps	92,688	208,760
Options	10,347	65,895

*including deposits from parent company in the amount of PLN 7 thousand (31 December 2016: PLN 2 thousand)

PLN'000	31.12.2017	31.12.2016
Interest and commission income*	39,598	36,807
Interest and commission expense*	42,914	64,824
General administrative expenses	182,785	174,247
Other operating income	8,467	9,905

* including interest and commission income in amount of PLN 1,431 thousand (2016: PLN 1,477 thousand) and interest and commission expense in amount of PLN 5 thousand (2016 : PLN 0 thousand) refer to the parent company

The Bank incurs costs and receives income on derivative transactions with Citigroup Inc. entities to hedge the Bank's position in market risk. These derivative transactions are opposite (back-to-back) to derivative transactions with other Bank clients or close the proprietary position of the Bank. The net carrying amount of financial derivative transactions with related entities as at 31 December 2017 amounted to PLN (287,998) thousand (as at 31 December 2016: PLN 139,895 thousand). The Bank runs a compression of derivative transaction portfolios' periodically. It is one of the risk-mitigation technique recommended by "Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories" and the implementing regulations (EMIR Regulation). In accordance with the EMIR Regulations this in particular applies to the portfolios exceeding 500 derivative transactions.

Furthermore, the Bank incurs costs and receives income from agreements concluded between Citigroup Inc. entities and the Bank for the mutual provision of services.

The costs arising and accrued (including VAT, reflected in the Bank's costs) under concluded agreements in 2017 and 2016 mainly related to the cost of services provided to the Bank for the maintenance of the banking IT systems and advisory support and are included in general administrative expenses; income was mainly related to the provision of data processing services by the Bank to such entities and is presented in other operating income.

In 2017 capitalization of investment regarding functionality modification of Bank's IT systems took place. Total payments for Citigroup entities amounted to PLN 79,805 thousand (in 2016: PLN 11,229 thousand).

46. Employee benefits

Employee benefits are divided into the following categories:

- short-term benefits, which include salaries, social insurance contributions, paid leave and benefits in kind (such as medical care, company apartments, company cars and other free or subsidized benefits). The costs of short-term benefits are expensed in the income statement in the period to which they relate. At the end of a given reporting period, if there is a balance payable which equals the expected undiscounted value of short-term benefits for that period, the Bank will record it as an accrued expense;
- benefits after termination of employment – including retirement allowances (see Note 2) and pension plans presented below offered by the Bank to its staff.

A provision is created for future retirement allowances that is shown in the statement of financial position in "Other liabilities." An independent actuary periodically verifies the provision in accordance with IFRS EU.

The Bank's pension plan is a defined contribution program in accordance with IAS 19. The Bank pays contributions for its staff to a separate organization and, after they are paid, has no other payment liabilities. Premiums are shown as employee benefit expenses in the period they concern.

Description of the Employee Pension Plan

The Bank conducts for its employees the Employee Pension Plan ("PPE", "Plan"), registered by the Supervisory Authority under number RPPE 178/02. Collective agreement is based on records on paying the employees' contributions to the investment fund by the employer. The Plan is conducted and managed by Esaliens TFI S.A. (previously Legg Mason TFI S.A.).

The basic contribution paid by the employer is defined as a percentage of salary of the Plan member. The basic contribution rate amounts to 7%. The additional contribution – voluntary, is paid by an employee – the Plan participant. The minimum amount of the monthly additional contribution is PLN 10,00 and the maximum amount of the additional contribution is limited to the amount resulting from Announcement of Minister of Labour and Social Policy regarding value of corresponding sum of additional contributions made by participant Plan in concerned year, based on articles 25 item 4a Act of 20 April 2004 regarding employee pension plan (Journal of Law of 2016, item 1449). The basic contribution is the Plan participant's income, from which he is obligated to pay the personal income tax (articles 12 and 13 of the Act on the income tax from individuals of 26 July 1991, Official Journal from 2016, item 2032 with amendments).

Payments from the Plan are paid after the participant's or entitled person's motion and under conditions specified in program.

The Plan participant may quit the Plan. The employer stops charging and paying basic and additional contributions for the Plan participant, and the funds, which were so far collected on the Plan participant's registers, are left there till the time of payment, transfer payment, transfer or refund.

- other long-term employee benefits – jubilee and other long service awards and deferred cash award. From 1 of January 2015, employees with long-term work-experience (10, 20, 30 years etc.) are entitled to rewards in kind;
- employee equity benefits – in the form of phantom shares of Bank Handlowy w Warszawie S.A. and also in the form of common stock, under stock award programs based on shares of Citigroup common stock in the form of deferred stock. Valuation and presentation principles of these programs are described in Note 2 in "Share-based payments". In 2017 there were no employees rewarded as part of the stock award programs based on Citigroup shares. Detailed information concerning the employee equity benefits are presented in the further part of this Note.

Provisions/accruals for the above employee benefits are as follows:

PLN'000	31.12.2017	31.12.2016
Provision for remuneration	53,233	59,103
Provision for unused leave	13,535	13,864
Provision for employees' retirement and pension allowances	49,832	40,290
Provisions for employees' jubilee payments	14,885	16,472
Provision for employees' equity compensation	-	3,383
	131,485	133,112

The provision for retirement and pension benefits is created individually on the basis of an actuarial valuation performed periodically by an external independent actuary. The valuation of the employee benefit provisions is performed using actuarial techniques and assumptions. The calculation of the provision includes all retirement and pension benefits expected to be paid in the future. The Bank performed a reassessment of its estimates as at 31 December 2017, on the basis of calculation conducted by an independent external actuary. The provisions calculated equate to discounted future payments, taking into account staff turnover, and relate to the period ending on the balance sheet date. The discount rate was set at 3.25%. A significant factor was the change in retirement age, this resulted in a recalculation of rezerw and recognized the cost of future employment at 6.7 mln PLN.

Change in provisions/accruals for employees' retirement and pension allowances and jubilee payments

PLN'000	2017	2016
	Provision for retirement and pension allowances	Provision for retirement and pension allowances
As at 1 January	40,290	36,672
Increases (due to):	11,379	5,944
Actuarial profit/loss of revaluation	256	-
Including those resulting from:		
Change of economic assumptions	1,885	-
Change of demographic assumptions	216	-
Adjustments of actuarial assumptions ex post	(1,845)	-
Salary expenses	3,006	-
Interest expenses	1,410	-
Cost of past employment	6,707	-
Establishment of provisions	-	5,944
Decreases (due to):	(1,837)	(2,326)

PLN'000	2017	2016
	Provision for retirement and pension allowances	Provision for retirement and pension allowances
Provisions utilisation	(1,837)	(2,326)
As at 31 December	49,832	40,290

Analysis of sensitivity for significant actuarial assumptions

w tys. zł	2017
	Provision for retirement and pension allowances
Central value	49,832
Decrease of growth salary to 1 p.p.	44,150
Increase of growth salary to 1 p.p.	56,524
Decrease of rotation by 10%	56,524
Increase of rotation by 10%	47,693
Decrease of discount rate by 0.5 p.p., including:	51,388
Falling to benefits paid within 1 year	5,034
Increase of discount rate by 0.5 p.p., including:	48,343
Falling to benefits paid within 1 year	5,034

More information about specific services program and their estimation is in note 2.

In 2017, the Bank's expenses in respect of premiums for the employee pension plan amounted to PLN 23,485 thousand (in 2016: PLN 24,003 thousand).

Employment at the Bank:

FTEs	2017	2016
Average employment during the year	3,511	3,730
Employment at the end of the year	3,438	3,587

Description and principles of employee stock benefit schemes

Under the employee stock benefit program, the phantom shares of Bank Handlowy w Warszawie S.A. and awards in the form of Citigroup stock (the so-called Capital Accumulation Program, or CAP) are offered to selected employees.

Within the framework of the CAP, eligible employees receive so-called "deferred shares" of Citigroup. "Deferred shares" within the framework of the CAP are granted at the NYSE average closing price as at the 5 days prior to the grant date. "Deferred shares" give the right to equivalents of dividends, but without voting rights, and must not be sold prior to their conversion into stocks. "Deferred shares" are converted into stocks after the end of a period that is determined in the Program Rules. As a general rule, the employee has a right to options revoked at the moment of employment termination in the Citigroup, provided the termination of said contract „Capital Accumulation Program – Prospectus” for granted options. Deferred shares granted in previous years will be transferred partially in 25% every year for the next four years, starting from the first anniversary of the option to acquire.

In 2017 no employees were rewarded as part of this program.

The employee share program is subject to internal controls in the Compensation and Benefits Unit.

In 2012 Bank introduced "Variable Remuneration Components Policy For Managerial Staff At Bank Handlowy w Warszawie S.A.", according to requirements described in the Resolution 258/2011 of Komisja Nadzoru Finansowego (Polish Financial Supervisory Authority) dated 4-th of October 2011. As of 22 december 2017 this Policy has been replaced by the remuneration Policy of individuals, whose operations have a significant impact on the risk profile of Banku Handlowego w Warszawie S.A., in accordance with the Resolution of the Minister of Development and Finances from 6 march 2017 referring to the system of managing risk and internal control, remuneration policy as well as a detail method of assessing the Banks internal capital.

According to the above mentioned policy's the Management Board of the Bank and other managerial staff having a significant influence on the Bank's risk profile receive variable remuneration in relation to individual performance and the Bank's financial results.

A portion of the Variable Remuneration awarded conditionally in 2017 for persons covered by the Policy will be paid in

tranches during in the next 3,5 years. The Policy implemented as of 22 december 2017, introducing changes among other to the fields of postponements and retention had an effect on the varying remuneration granted conditionally in 2018.

Variable Remuneration – Phantom shares

Transaction as per IFRS	Transactions share-based payments settled in cash in accordance with IFRS 2
Phantom Shares grant date	20 of January 2015 18 of January 2016 16 of January 2017
Number of Phantom Shares granted	The number of shares was set on grant date
Date of maturity	At least 6, 18, 30 and 42 months after grant date
Vesting date	At least 6, 12, 24 and 36 months after grant date
Terms and conditions for acquiring rights to the award	Satisfying the conditions on the Bank's results, individual performance of the employee and employment in the Group in 2015-2018 in relation to the award from 2015 and in 2016-2019 and in relation to 2016 reward and in 2017-2020 in respect of reward from 2017.
Program settlement	At the settlement date the participants will get an amount of cash being the product held by a participant phantom shares and the arithmetic mean of the lowest and highest prices of shares of the Bank notified on WSE at the maturity date. Acquisition of rights to every tranche will be confirmed by a decision of the Supervisory Board of the Bank in relation to the Management Board and by a decision of the Management Board in relation to other employees covered by the Policy. According to a decision of the above mentioned Bank Management the amount of payment may be partially or fully reduced according to conditions given in the Policy. These terms and conditions relate to Bank's results, individual performance and employment status and will relate to the vesting period of each tranche.

Another component of the Variable Remuneration granted according to the Policy is Deferred Cash Award.

Variable Remuneration – Deferred Cash Award

Transaction as per IFRS	Other long-term employee benefits in accordance with IAS 19
Grant date of the Deferred Cash Award	20 of January 2015 18 of January 2016 16 of January 2017
Granted amount	The amount was settled on the Deferred Cash Award grant date
Date of maturity	At least 18, 30 and 42 months after grant date
Vesting date	At least 12, 24 and 36 months after grant date
Terms and conditions for acquiring rights to the award	Satisfying the conditions on Bank results, individual performance of the employee and employment in the Group in 2015-2018 in relation to the award from 2015 and in 2016-2019 in relation to the award from 2016 reward and in 2017-2020 in relation to the award from 2017.
Program settlement	At the settlement date the participants will get an amount of Deferred Cash tranche with interest counted for the deferral period till the payment date. The interest rate was approved by the Resolution of the Supervisory Board in January 2014, 2015, 2016 and 2017. Acquisition of rights to every tranche will be confirmed by a decision of the Supervisory Board of the Bank in relation to the Management Board and by a decision of the Management Board in relation to other employees covered by the Policy. According to a decision of the above mentioned Bank's Management the amount of payment may be partially or fully reduced according to conditions given in the Policy. These terms and conditions relate to Bank's results, individual performance and employment status and will relate to the vesting period of each tranche.

As of 22 december 2017 the Bank implemented the employee remuneration Policy of Bank Handlowy w Warszawie S.A., replacing the prior policy for the remuneration of key persons in the Bank Handlowy w Warszawie S.A.. The newly implemented Remuneration Policy describes accepted rules of awarding remuneration in the Bank for all employees, underlining Key Persons, whose operations have a significant impact on the Banks risk profile, employees involved in the sale of products and services as well as those officiating control functions. The for mentioned Remuneration Policy implements the provisions related to formulation of the remuneration principles in banks in accordance with legal regulations, Principles of of Institutional Governance Rules for Supervised Institution adopted by the Polish Financial

Supervision Auditory and Best Practices of WSE Listed Companies 2016, recommendations of the Polish Financial Supervision Auditory regarding the correct remuneration, mentioned in art. 74 statute 3 and art. 75 statute 2 directive 2013/36/UE and reveals information in accordance with art. 450 ordinance nr 575/2013, guidelines of the European Authority for Bank Supervision referring to politics and practices in the field of remuneration regarding sales and distribution of retail goods and banking services, guidelines of the European Authority for Market and Security Supervision referring to politics and practices regarding remuneration (MiFID).

Assumptions of valuation of the employee equity benefit schemes

The fair value of particular awards and the assumptions used in their measurement, is shown below:

CAP Program	Grant date	Exercise price / stock price at grant date [USD]	Number of eligible employees	Number of options / shares
1	18.02.2014	49.66	6	1,189
2	16.02.2015	50.07	1	224

Phantom Shares Program	Grant Date	Exercise price / stock price at grant date [PLN]	Number of eligible employees	Number of options / shares
1	20.01.2015	103.98	30	19,215
2	18.01.2016	72.21	45	39,243
3	16.01.2017	77.31	44	49,255

	CAP Program	Phantom Shares Program
Period to acquire the title (in years)	25% after each of the following years	40% after 0.5 of a year and 20% after each of the following years or 60% after 0.5 of a year and 13.33% after each of the following years
Expected average life cycle of the instrument	At the time of rights acquisition	At the time of rights acquisition
Probability of premature termination of employment (annual staff turnover for awarded employees)	0.00%	4.17%
Fair value of one instrument* (in USD)	75.49 (USD)	77.92 (PLN)

*Varies depending on the date of exercise

The number and weighted average price of shares (CAP Program) are presented below:

	31.12.2017		31.12.2016	
	Number	Weighted average share price [USD]	Number	Weighted average share price [USD]
At the beginning of the period	4,251	48.09	24,107	39.33
Executed/redeemed/expired in the period	2,838	-	19,856	-
At the end of the period	1,413	49.73	4,251	48.09

The number and weighted average price of Phantom Shares are presented below:

	31.12.2017		31.12.2016	
	Number	Weighted average share price [PLN]	Number	Weighted average share price [PLN]
At the beginning of the period	118,489	88.03	131,687	102.19
Allocated in the period	114,484	77.31	131,042	72.21
Executed in the period	123,807	68.37	144,240	69.05
Redeemed/expired in the period	1,453	-	-	-
At the end of the period	107,713	80.21	118,489	88.03

On 31 December 2017, the book value of liabilities from the phantom share and CAP programs amounted to PLN 24,558 thousand (31 December 2016: PLN 28,402 thousand). The costs recognized in this respect in 2017 amounted to PLN 7,364 thousand (in 2016: 8,319 thousand, including SOP costs).

47. Risk management

RISK MANAGEMENT ORGANIZATION STRUCTURE AND PROCESS

The Bank's activities involve analysis, assessment, approval and management of a broad range of risks associated with its business, arising from the applied business strategy. Such a risk management process is performed at different units and levels of the organization and covers among others: credit risk (including counterparty credit risk, residual risk of accepted collateral and concentration risk), liquidity risk, market risk, and operational risk.

The concept of risk management, taking into account the shared responsibility, is organized at three independent levels (three levels of risk reduction, interchangeably "three lines of defense"):

- Level 1 i.e.: Organizational units responsible for business activities resulting in risk taking and for risk management in the Bank's operational activity, as well as risk identification and reporting to second line of defense,
- Level 2 i.e.: risk management in organizational units, independently from the risk management by the first Level, and compliance; organizational unit or employees responsible for establishing standards for the risk management in the scope of risk identification, measurement or estimation, mitigation, control, monitoring and reporting and for overseeing the control mechanisms applied by other organizational units to mitigate the risk – organizational units in Risk Management Sector, Compliance Department, Financial Division Legal Division; Human Resources Division,
- Level 3 i.e.: Internal Audit that provide an independent assessment of risk management processes and internal control system.

In the risk management area, the Supervisory Board of Bank resolves upon:

- approving a strategy of the Bank's activity and the rules of prudent and stable risk management, including operational risk strategy;
- approving a general level of the Bank's risk appetite within the document summarizing the process of assessing and internal capital allocation in subsequent years (ICAAP),
- approving the fundamental organizational structure of the Bank, determined by the Bank's Management Board and matched to the size and the profile of incurred risks.

In addition, the Supervisory Board supervises the compliance of the Bank's policy related to risk-taking with the Bank's strategy and financial plan and performs the duties resulted from mentioned above strategies, regulations or other documents approved by the Supervisory Board.

The Management Board of the Bank by way of a resolution:

- approves the organizational structure of the Bank with well-defined, transparent and consistent roles and responsibilities, adequate for the size and risk profile ensuring that the functions of risk measurement, monitoring and control are independent from risk taking activities;
- defines the Bank's Risk's Profile, by establishing significant risk types, simultaneously ensuring introducing processes of managing them and/or allocation of internal capital;
- establishes the principles of prudent and stable risk management which constitute, together with the ICAAP Document, the risk management strategy, including operational risk strategy;
- approves the acceptable risk level in the Bank ("Overall risk appetite"), within the document summarizing the process of assessing and internal capital allocation in subsequent years (ICAAP).

The Management Board of Bank has nominated an independent Chief Risk Officer (CRO) reporting directly to the President of the Management Board and responsible for the management and control of credit risk, market risk, and operational risk, including:

- introducing a risk management system in the Bank as well as risk identification, measurement, control and reporting methods;
- developing the risk management policy and developing risk assessment and control systems;
- making credit decisions in compliance with the principles resulting from the credit procedures as well as documents determining the Bank's credit policy;
- ensuring the proper safety level of the credit portfolio;
- managing the problem loans portfolio (including collections and debt restructurings).

and is responsible for compile, implementation and update regulations, strategy and procedure in term of risk management, internal control and valuation of internal capital, review of valuation process and maintaining of internal capital and regulation of remuneration components.

Processes of managing of credit, market, operational risks are implemented in Bank based upon written policies and principles of identification, valuation, monitoring and risk control accepted by the Management Board or appropriately nominated Committees.

In the risk management area there are following Committees:

- Assets and Liabilities Management Committee,

- Risk and Capital Management Committee, including Operational Risk, Control and Compliance Commissions (BRCC)
- Risk Committee of Retail (Consumer) Banking Sector.

The Chief Risk Officer presents the organizational structure of the Risk Management Sector to the Management Board of the Bank, taking into account the specificity of credit, market, liquidity and operational risk management in the respective customer segments. For this purpose, organizational units have been set up within the Risk Management Sector that are responsible for:

- managing credit risk of the Corporate Bank;
- managing credit risk of the Commercial Bank;
- managing credit risk of the Consumer Bank;
- managing impaired receivables;
- managing market risk, including interest rate risk in banking book;
- managing liquidity risk;
- managing operational risk;
- managing the equity process and model risk;
- model validation;
- supporting risk management in the above areas including in control functions;
- the process of comprehensive and continuous assessment of credit risk (Fundamental Credit Risk Assessment).

Risk and Business managers are responsible for developing and implementing risk management policies and practices in their respective business units, overseeing risks in the business units, and responding to the needs and issues of the business units.

Risk management in the Bank is supported by a range of IT systems in the following areas:

- obligor and exposure credit risk assessment;
- credit, market and operational risk measurement, reporting and monitoring;
- monitoring and reporting of collateral;
- calculation and reporting of impairment-write-offs.

Due to the execution of the Polish Financial Supervision Authority (KNF) C Recommendation, binding from the 1st of January 2017, the Bank implemented adjustments in the risk management processes. In order to streamline the efficiency of the concentration risk management the following actions had been undertaken: estimation of concentration risk appetite and implementation of its identification, assessment, monitoring and reporting principles. The rules mentioned above not only had been applied in credit risk management, but also in operational, market and liquidity risk. Furthermore, the accountability of the Bank's Management Board and the Supervisory Board related to concentration management was enhanced.

Significant Risks

The Bank manages all significant risks arising from the implementation of its business strategy. In the process of significant risks identification in 2017, the Management Board considered the following type of risk as significant:

- Credit risk and counterparty risk,
- Liquidity risk
- Market risk in the trading book,
- Interest rate risk in the banking book,
- Operational risk,
- Compliance risk,
- Model risk,
- Outsourcing risk,
- Information security risk (including cyber risk).

The Bank monitors all the above types of risk. Due to portfolio characteristics in this chapter are presented principles related to management of credit risk (including counterparty risk and concentration), operational risk, liquidity risk, market risk in the trading book and interest rate risk in banking book.

Credit risk including also counterparty credit risk results from credit exposure or other exposure related to concluding and clearing below listed transactions, and is defined as the potential for financial loss resulting from the failure of a borrower or counterparty to honor its financial or contractual obligations. Credit risk arises in many of the Bank's business activities, hereinafter "products," including:

- Loans and advances;
- FX and derivatives transactions;

- Securities transactions;
- Financing and handling settlements, including trade (domestic and foreign);
- Transactions in which the Bank acts as an intermediary on behalf of its clients or other third parties.

The framework described in the "Credit Risk" section of this document covers different types of exposure, as defined in relevant Credit Policies of the Bank.

Additionally, within the risk management system, the Bank also applies credit risk mitigation rules (including by accepting collateral, thus mitigating the inherent **residual risk**) and manages **concentration risk**, taking into account material concentration risk factors.

Liquidity risk is the risk that the Bank may be unable to meet a financial commitment to a customer, creditor, or investor when due. Liquidity risk is measured in accordance with the applicable law, in particular with the Banking Act, under standards set by the regulator (regulatory liquidity measures) and with internal measures which support liquidity risk management.

Market risk is the risk to profits due to changes in interest rates, foreign exchange rates, commodity prices, and their volatilities. Market risk arises in non-trading portfolios, as well as in trading portfolios. Market risk is measured in accordance with established standards to ensure consistency across businesses and the ability to aggregate risk.

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people, or technical systems, or from external events. It includes reputation and franchise risks associated with operational risk events and business practices or market conduct. It also includes legal risk and compliance risk. Operational Risk does not cover strategic risks or the risk of loss resulting solely from authorized judgments made with respect to taking credit, market, liquidity or insurance risk. As part of operational risk, the following difficult to measure risks, which were identified as significant, are identified: compliance risk, model risk and outsourcing risk and information security risk (including cyber risk).

CREDIT RISK

The main objective in the field of credit risk management is to support the long-term plan for the stable development of the credit portfolio while maintaining its proper quality. Credit risk is minimized through the Bank's regulations and implemented controls.

Principles of the Credit Risk Management Policy

The Risk Management unit is responsible for establishing the principles of the Credit Policy for the Corporate Bank, the Credit Policy for the Commercial Bank and credit policies for the Consumer Bank as well as approving other policies and procedures, monitoring credit risk management performance, providing ongoing assessment of the credit risk of the portfolio and approving individually significant credit risk limits. The rules for approving risk are matched with the strategy of the Bank, general acceptable risk level, credit portfolio performance and internal control results.

According to Bank activity, credit portfolio is divided by management process into two categories:

- credit exposures of clients managed on the classifiable basis (individual assessment)
- credit exposures of clients managed on delinquency basis (portfolio assessment).

Eligibility for either portfolio is managed based on classification (individual assessment) or delinquency (portfolio assessment) depends on the amount of aggregate exposure to the customer or group. In specific circumstances, each exposure might be managed on classifiable basis.

For corporate and commercial clients as well as investment banking activities across the organization, the credit process is based on a range of fundamental policies, including:

- Joint business and independent risk management responsibility for the quality of the credit portfolio and process as well as for credit loss;
- Adherence to portfolio guidelines to ensure diversification and maintain risk/capital alignment;
- Credit authorities system assuming that credit authority can be given to authorized, trained and experienced staff based upon their professional experience and tested qualifications concerning the risk assessment and making credit decisions;
- A minimum of two authorized credit approvers with delegated credit authority required for all significant exposures;
- Dependence of approval level from the risk taken – exposures with a higher risk (including size and risk assessment) require approval at a higher decision-making level;
- Diverse risk rating standards, adequate to every obligor and exposure, including remedial actions;
- Risk rating of every obligor and exposure in a consistent rating process using risk rating models and scorecards (scoring);
- Periodic monitoring of customers' business results and identification of negative changes in their standing which require immediate reclassification of exposure or remedial actions;

- Exceptions to Credit Policies are approved at higher levels within the organization to ensure control over risk policy implementation by higher level managers in accordance with internal Bank's normative acts and generally applicable laws and regulations issued by the appropriate regulators.

In the Consumer Bank (GCB), the Management Board of the Bank has approved credit policies for each credit product offered.

Credit risk in this area is managed by means of:

- detailed credit policies which define the credit scoring rules;
- a system for allocation of credit authority and independent supervision of the quality of credit analyst performance;
- a system of monitoring the quality of IT tools supporting credit scoring;
- a system of risk measurement and control for credit portfolios including: a detailed management information system covering the quality of the credit portfolio and debt collection, identification of impaired exposures, monitoring of delinquencies, monitoring of benchmarks, etc., internal limits of credit portfolio parameters approved by the Management Board;
- debt collection policy rules approved by the Management Board as well as a fraud prevention policy and a credit and debit card transaction authorization policy;
- credit portfolio quality reports to the GCB Risk Committee, the Risk and Capital Management Committee and the Supervisory Board's Risk and Capital Committee;
- stress testing rules;
- monitoring of the performance of scoring models and measurement and identification of impaired exposures;
- checking the behavior of Bank customers in the Credit Information Bureau (BIK);
- collateral valuation policy for mortgage-secured credits offered by GCB.

Each portfolio has stress testing performed at least on an annual basis.

Credit risk assessment and rating

The Bank maintains consistent risk ratings methodology across the corporate and commercial credit portfolio, which facilitates comparison of credit exposure across all lines of business, geographic regions and products.

Obligor Risk Rating and Obligor Limit Rating are elements of the assessment of credit risk associated with granted products. Obligor Risk Ratings reflect an estimated probability of default for an obligor within 1 year and are derived primarily through the use of statistical models, external rating agencies, or scoring models.

Obligor Limit Rating (OLR) as a measure of medium to long-term risk of the obligor is subject to assessment in terms of qualitative factors including: cyclical, of sector, management quality, client's business strategy, influence of vulnerability to regulatory environment on client, transparency and quality of control processes.

Facility Risk Ratings are assigned using the obligor risk rating and facility-level characteristics such as collateral, thus decreasing the potential loss on a facility in case of default. As a result, Facility Risk Rating reflects a potential expected loss given-default.

Credit Risk is measured at a number of levels, including:

- At a facility level, which may include one or more contracts, disposals or transactions;
- At an obligor level, if there are multiple facilities approved for an obligor where the risk associated with an obligor default can be assessed jointly;
- At a group level, considering the group structure of connected clients;
- At a portfolio level where Portfolio Risk Rating is calculated as the average rating of individual facility exposure ratings weighted with the size of exposure.

In case of the amount of exposure, the measurement methods vary from the most simple, such as the value of the asset, to complex, such as estimating potential replacement cost on a derivative contract. The processes required for these measurements also vary considerably, from a simple feed of balances to a complex, multiple simulation engine.

For retail credit exposures, the Bank uses scoring models developed on the basis of the history of behavior of the Bank's customers. Such models analyze the behavior of customers in the Credit Information Bureau as well as customer demographics. The quality of performance of scoring models is reviewed on an ongoing basis and monitored annually. As a result, modifications are made in the model or the credit policy.

Credit risk of the retail credit portfolio is measured based on dedicated scoring models and reporting techniques including an analysis of ratios for new customers and existing portfolios with and without impairment.

The effectiveness of scoring models used in risk assessment processes is regularly monitored with population stability reports, KS (Kolmogorov-Smirnov) test reports and portfolio quality reports (delinquency and loss ratios). Each scoring model is validated annually.

Credit risk monitoring

Risk management units, supported by business units responsible for the cooperation with customers, are responsible for monitoring the probability of obligor default.

Credit risk exposure is monitored and managed at two levels: (a) customer level, and (b) portfolio level.

Exposure monitoring and management at a customer level includes periodic control reports, an early warning system and periodic reviews of the customer's standing.

Monitoring of portfolio performance and identification of portfolio trends include regular management reports and control reports which also support active response to negative signals or trends.

In addition to various management information reports analysis, risk managers and business representatives take part in regular round tables regarding the portfolio in order to review business pipelines and discuss the credit issues.

In GCB, monitoring covers scoring models, impairment measurements, delinquencies, the effectiveness of debt collection, internal limits, customer behavior checks with BIK, benchmarks, etc.

Risk mitigation

Credit risk mitigation within the set risk appetite is an ongoing and key element of the Bank's risk management processes. It is achieved as described below:

- Customers selection and credit confirmation:
 - Target market and customer selection criteria are determined;
 - Maximum credit exposure against the obligor is determined through obligor limits related to customer risk ratings and/or through risk acceptance criteria;
 - Limits are established and monitored in order to mitigate exposure concentration risk;
 - Robust credit due diligence standards are established and maintained;
 - Credit process standards are established in order to ensure a consistent approach to each segment;
 - Credit documentation standards are applied;
- Collateral is used in order to minimize the risk and to manage residual risk:
 - Establishing acceptable collaterals and their classification in view of regain possibility in case of execution;
 - Setting collaterals in right law's form (documentation standards);
 - Expected collateral structure or credit value in relation to collateral value is determined;
 - The value of collateral on property and equipment is determined by dedicated specialty functions within the Bank using external valuation where required;
- Monitoring and early warning system:
 - Credit exposures periodic monitoring and an early warning system are used;
 - Regular inspection of portfolio ensuring identification of adverse tendencies and concentration;
 - Active portfolio management includes implementation of necessary modifications to the credit strategy based on portfolio reviews or stress testing.

Policy of collateral acceptance

Apart from general rules of credit risk mitigation, the Bank has defined specific Corporate and Consumer rules of accepting, assessing, establishing and monitoring various types of collateral, including guarantees and similar forms of support as well as pledge on fixed assets (jointly: "collateral"). These rules serve to minimize the residual risk associated with collateral.

As an additional element limiting this risk, in financing of companies and individuals who pursue business activity, revenues from the customer's ongoing business are the key element of creditworthiness assessment of potential borrowers and the primary source of repayment of debt to the Bank.

In order to diversify risks associated with collateral, the Bank accepts various types of collateral:

- In the Consumer Bank, the most common type of collateral is residential real estate;
- In the Corporate and Commercial Bank, the following types of collateral are mainly accepted:
 - Guarantees;
 - Cash;
 - Securities;
 - Receivables;
 - Inventory;
 - Real estate;
 - Equipment and machines (including vehicles).

Detailed procedures outlining the types of collateral acceptable to the Bank and the rules of their establishment and valuation as well as the creation of a special risk unit responsible for the collateral management process allow for the development of appropriate standards for this process, including:

- criteria for acceptance and valuation of collateral;
- documentation standards;
- rules and frequency of value of collateral monitoring and updating (including inspections).

In addition, Corporate Banking credit regulations set such parameters as:

- the structure of collateral required for different types of credit receivables;
- the relationship of loan value to collateral value for each type of collateral;
- the desirable structure of the different types of collateral in the credit portfolio.

The Bank periodically checks whether the current structure of the collateral portfolio in Corporate Banking is compatible with the objectives and whether the value of the collateral is sufficient.

Within the Corporate Bank, the expected ratio of loan value to collateral value is determined in each case in a credit decision. This ratio is also subject to periodic inspection / monitoring.

The principal type of collateral in GCB is an entry in the land and mortgage register for mortgage-secured loans. The Bank also uses bridge insurance to mitigate the risk of the borrower's default between the time of disbursement of a loan and the time of making an entry in the land and mortgage register.

The value of collateral is measured at each time on the basis of an expert valuation of real estate commissioned by the Bank. Expert valuations are reviewed by an independent valuation division according to valuation guidelines for real estate used as collateral of real estate loans for individuals who are GCB customers. The quality of the division's performance is monitored.

As at 31 December 2017, the financial effect of receivables recovered from collateral for receivables from customers with recognized impairment based on individual measurement in the Bank amounted to PLN 138,734 thousand (31 December 2016: PLN 46,874 thousand). This is how much higher the required impairment write-offs of the portfolio would be if the estimation of the write-offs did not include cash flows from such collateral.

Concentration in credit risk

In order to prevent adverse events resulting from excessive concentration, the Bank reduces the concentration risk by setting limits arising from law and concentration standards adopted internally, in order to ensure adequate diversification of risk in the portfolio. The Bank establishes General and specific limits to mitigate the risk of credit concentration, adequate to the approved risk appetite in the Bank as well as business strategy.

In its credit risk management, the Bank takes into account in particular the risk arising from:

- exposure to single entities (including taking into account the effect of exposure to a single clearing house - CCP on the level of concentration risk exposure, particularly in the event of potential inability to meet the obligations of the clearing house), or related entities capitally or economically (counterparty concentration risk),
- exposure to the same industry, economic sector, similar type of activity or trading similar goods (industry concentration risk)
- exposure to the same geographical region, as well as individual countries (risk of geographical concentration)
- exposure to the entities belonging to the Capital Group of the Bank,
- exposure to counterparties in derivative transactions,
- used credit risk mitigation techniques (exposures secured by the same type of collateral), including due to large indirect credit exposures such as a single issuer (collateral concentration risk),
- specific of Bank products/portfolio and exposure tenor,
- individual products, markets or currencies.

General concentration limits are approved on the Management Board level and monitored according to relevant Policy rules, primarily by the Risk and Capital Management Committee. Credit Risk and Business managers define (where appropriate) detailed internal concentration limits, control and reporting frequency and rules of approval for excesses and corrective action plans. Exceeding of established limits is reported, depending on the specific requirements of the Policy, to the approval of appropriate persons, the Risk and Capital Management Committee and the Bank Management Board together with corrective action plans.

In hedge concentration, in accordance with S Recommendation, are settled and controlled appropriate limits of commitments hedged with a mortgage.

Obligor exposure concentration risk

The Bank limits the concentration of its exposure to a single customer or a group of customers with common ownership and/or organization. As at 31 December 2017, the Bank's exposure in bank portfolio transactions with groups of customers whose aggregate exposure exceeded 10% of the Bank's equity (as defined below in this report) amounted to PLN 7,286,844 thousand, i.e., 148 % of equity (31 December 2016: PLN 7,221,065 thousand, i.e., 153%). In 2017 and 2016 the Bank complied with the provisions on limits of concentration of exposure.

Concentration of exposure to the top 10 non-banking borrowers of the Bank:

PLN'000	31.12.2017			31.12.2016		
	Balance sheet exposure*	Granted financial and guarantee liabilities	Total exposure	Balance sheet exposure*	Granted financial and guarantee liabilities	Total exposure
CLIENT 1	1,000,000	-	1,000,000	1,000,000	-	1,000,000
GROUP 2	828,101	115,658	943,759	431,855	156,716	588,571
GROUP 3	261,317	574,317	835,634	115,751	763,725	879,476
CLIENT 4	191,400	558,600	750,000	316,900	433,100	750,000
CLIENT 5	251,522	475,980	727,502	564,798	500,185	1,064,983
GROUP 6	557,053	83,530	640,583	216,836	85,968	302,804
GROUP 7	18	618,348	618,366	14	641,332	641,346
GROUP 8	396,000	205,185	601,185	396,000	205,445	601,445
CLIENT 9	600,000	-	600,000	600,000	-	600,000
GROUP 10	74,439	495,376	569,815	187,415	323,310	510,725
GROUP 11	-	-	-	531,149	53,370	584,519
Total	4,159,850	3,126,994	7,286,844	4,360,718	3,163,151	7,523,869

*Excluding investment in shares and other securities

The limits of the Bank's maximal exposure are determined in the Banking Law Bill from 29 August 1997 and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Regulation No 575/2013). When keeping conditions determined in Regulation 575/2013 it is allowed for the Bank to maintain an overdraft of liabilities level over limits determined in paragraph 71 of the Banking Law Bill only in the case of liabilities resulting from operations rated in trade portfolio. Own funds for determining limits of exposure purposes were determined according to Regulation No 575/2013.

As at 31 December 2017, the Bank had an exposure to one entity exceeding the statutory exposure concentration limits. The excess exposure resulted from trade portfolio transactions. As a consequence, an additional capital requirement for excess exposure was factored into the calculation of the Bank's total capital requirement as at 31 December 2017.

Concentration of exposure in individual industries*

Given that there is a large diversity of customers representing individual industries, the table below shows aggregate data for the Bank's gross exposure to the industrial sectors.

Sector of the economy according to the Polish Classification of Economic Activity (PKD)*	31.12.2017		31.12.2016	
	PLN'000	%	PLN'000	%
Wholesale trade, excluding trade in vehicles	4,458,076	18.2%	4,122,906	17.3%
Financial intermediation, excluding insurance and pension funds	3,039,423	12.4%	2,493,023	10.4%
Manufacture and supply of electricity, gas, steam, hot water and air conditioning	2,645,822	10.8%	2,526,268	10.6%
Production of food and beverages	1,071,761	4.4%	1,169,614	4.9%
Production and processing of coke and petroleum products	884,023	3.6%	936,473	3.9%
Retail trade, excluding retail trade in vehicles	825,311	3.4%	1,313,366	5.5%
Wholesale and retail trade, excluding of retail trade in motor vehicles, repair of motor vehicles	739,417	3.0%	582,693	2.4%
Metal ore mining	727,502	3.0%	1,064,982	4.5%
Production of metal goods, excluding machines and equipment	657,375	2.7%	615,380	2.6%
Production of motor vehicles, trailers and semi-trailers, excluding motorcycles	633,978	2.6%	512,187	2.1%
10 business sectors	15,682,688	64.1%	15,336,892	64.3%
Other sectors	8,789,811	35.9%	8,531,484	35.7%
Total	24,472,499	100.0%	23,868,376	100.0%

*Gross balance-sheet and off-balance-sheet exposure to institutional customers (including banks), based on NACE Revision 2.

Gross amounts due from customers and banks by type of business:

<i>PLN'000</i>	31.12.2017	31.12.2016
Gross amounts due from economic entities and banks		
Financial	2,809,513	2,209,402
Production	4,041,837	4,391,227
Services	4,528,131	4,402,099
Other	2,718,123	2,242,082
	14,097,604	13,244,810
Gross amounts due from individual customers	7,092,085	6,696,898
	(see Note 18, 23)	
	21,189,689	19,941,708

Management of impaired exposures

Credit exposures, with identified impairment or if there is a risk of impairment, are managed by specialized unit within Risk Management Sector. Depending on their economic or legal situation, Bank takes restructuring or collection actions, according to law.

Bank considers balance sheet credit exposure as impaired and related loss as recognized upon meeting the following two conditions:

- objective proofs (prerequisites) of impairment, arising out of one or more events, that occurred after initial balance sheet credit exposure recognition in financial books, have been identified and
- event (or events) causing the loss impacts future cash flow, associated with balance sheet credit exposure or out of group of balance sheet credit exposures, which can be reliably assessed.

The Bank identifies following events or evidences, which might result in impairment: credit exposure impairment:

- Significant financial difficulty of the obligor;
- Breach of contract, such as default or delinquency in interest or principal payments;
- Granting the borrower a concession, which the lender would not otherwise consider, due to economic or legal reasons relating to the borrower's financial difficulty;
- High probability of customer bankruptcy or information on opened bankruptcy proceedings;
- National or local economic conditions that may be correlated with default of exposure;
- Payment overdue for more than 60 days;
- Significant deterioration of the customer's rating;
- Bank's petition for an enforcement procedure to be opened against the customer;
- Downgrade of the counterparty's rating by a recognized external credit rating institution accepted by the Bank and other events that may have a negative impact on future cash flows resulting from the balance sheet credit exposure.

For customers in the delinquency managed portfolio, loans are considered impaired as soon as a specified benchmark of days past due is met.

Credit Risk Management employees regularly evaluate the adequacy of the established write-offs for impaired loans.

Customers in the classifiable portfolio (individual assessment)

Impairment is determined by estimating the exposure loss, case by case, and the following factors are considered:

- Aggregate exposure to the customer;
- The viability of the customer's business model and the capacity to successfully work out their financial difficulties;
- Covering debt obligations from generated cash flows;
- The amount and timing of expected payments;
- The probability of meeting granted contingent commitments;
- The realizable value of collateral and the probability of successful repossession (considering all legal risks and hedge maintenance costs until disposal);
- The expected receipts due to enforcement, bankruptcy and liquidation;
- Estimation of possible expenses concerned in recovering outstanding amounts;
- Where appropriate, the market price of debt.

Level of impairment write-offs on classifiable exposures that are above materiality thresholds is reviewed monthly. The review covers collateral held and an assessment of actual and anticipated payments value.

Customers in the delinquency managed portfolio (portfolio assessment)

For exposures that are not considered individually significant, impairment is calculated on a portfolio basis, essentially when a specified benchmark of days past due is met. A formulaic approach is used which allocates progressively higher percentage loss rates the longer a customer's loan is overdue.

The main criterion of impairment for GCB customers is a delay in payment of the principal amount and interest, a minimum payable balance, a commission, or an exceeded balance limit. For the purposes of impairment, it is assumed that the criterion is met when a payment is overdue for at least 90 days at the impairment assessment date.

Additional criteria of impairment include:

- death, permanent disability or serious illness;
- fraud;
- information about initiated bankruptcy proceedings of the customer or bankruptcy declared by the customer;
- impairment or risk of impairment of collateral;
- detention or imprisonment of the customer;
- partial cancellation of the principal amount;
- termination of contract;
- petition of the Bank for an enforcement procedure to be opened against the customer.

The table below presents the maximum exposure of the Bank to credit risk:

<i>PLN'000</i>	<i>Note</i>	31.12.2017	31.12.2016
Receivables due from Central Bank*	17	29,031	283,595
Gross receivables due from banks	18	837,277	587,150
Gross receivables due from institutional customers**		13,260,327	12,657,660
Gross receivables due from individual customers***		7,092,085	6,696,898
Debt securities held-for-trading	19	1,143,908	2,605,028
Derivative instruments	19	1,018,132	1,167,134
Hedging derivatives	20	-	12,244
Debt securities available-for-sale	21	17,439,439	19,072,371
Other financial assets	28	98,110	93,727
Contingent liabilities granted	39	16,853,090	16,906,189
		57,771,399	60,081,996

* In 2016, deposits in the amount of PLN 280,008 thousand were additionally included in the value of receivables due from the Central Bank.

** At the end of 2017, the value of collateral reducing the maximum exposure to credit risk of gross receivables due from institutional customers amounted to PLN 2,279,820 thousand compared to PLN 2,670,621 thousand in 2016.

*** At the end of 2017, the value of collateral reducing the maximum exposure to credit risk of gross receivables due from individual customers amounted to PLN 1,481,839 thousand compared to PLN 1,321,925 thousand in 2016.

The table below presents the Bank's portfolio grouped by receivables from customers with established impairment and receivables without impairment. The tables also present the details of impairment write-offs.

According to credit management process, Bank identifies classifiable portfolio (individual assessment) and based on portfolio classification (portfolio assessment).

Exposures without impairment are classified based on the internal risk ratings from 1 to 7, where risk category 1 is the best rating.

Exposures, classified based, with identified impairment have assigned internal risk ratings from 8 to 10.

The internal risk ratings are received in the complex credit assessment's process, which consists of rating models and methodologies, additional corrections resulting among others from the acquired support and the security, and all the defined processes used in order to get risk ratings.

The risk rating defines the probability of breach of contract by the debtor within the 1 year period. Ratings from 1 to 4-inclusive are treated as the equivalent of ratings at investments levels of external credit rating agencies, which implies that they indicate a low or medium level of credit risk. Ratings below 4- indicate increased credit risk, wherein the rating 7 means high credit risk and low ability to service debt obligations, even in favorable macroeconomic conditions.

Commitment due to customers in terms of credit risk:

PLN'000	31.12.2017			31.12.2016		
	Amounts due from institutional customers	Amounts due from individual customers	Amounts due from banks	Amounts due from institutional customers	Amounts due from individual customers	Amounts due from banks
Impaired receivables						
Individual receivables						
Gross amount	376,854	10,897	-	297,092	11,873	-
Impairment write-off	254,975	6,633	-	245,864	6,232	-
Net amount	121,879	4,264	-	51,228	5,641	-
Portfolio receivables						
Gross amount	23,258	309,418	-	14,339	305,513	-
Impairment write-off	17,632	227,001	-	9,191	218,241	-
Net amount	5,626	82,417	-	5,148	87,272	-
Not impaired receivables						
by risk rating						
Risk rating 1-4-	9,634,012	-	805,754	9,084,789	-	580,537
Risk rating+ 5-6-	3,070,022	-	31,523	3,065,281	-	6,613
Risk rating+7and greater	156,181	-	-	196,159	-	-
by delinquency						
no delinquency	-	6,436,616	-	-	6,098,826	-
1-30 days	-	283,109	-	-	233,240	-
31-90 days	-	52,045	-	-	47,446	-
Gross amount	12,860,215	6,771,770	837,277	12,346,229	6,379,512	587,150
Impairment	17,463	61,905	1,111	19,380	60,309	177
Net amount	12,842,752	6,709,865	836,166	12,326,849	6,319,203	586,973
Total net amount	12,970,257	6,796,546	836,166	12,383,225	6,412,116	586,973

PLN'000	31.12.2017			31.12.2016		
	Amounts due from institutional customers	Amounts due from individual customers	Amounts due from banks	Amounts due from institutional customers	Amounts due from individual customers	Amounts due from banks
Impairment write-offs for impaired receivables						
Impairment write-offs for individual receivables	254,975	6,633	-	245,864	6,232	-
Impairment write-offs for portfolio receivables	17,632	227,001	-	9,191	218,241	-
IBNR provisions						
by risk rating						
Risk rating 1-4-	3,380	-	950	3,320	-	88
Risk rating+5-6-	8,566	-	161	8,983	-	89
Risk rating +7 and greater	5,517	-	-	7,077	-	-
by delinquency						
no delinquency	-	20,935	-	-	21,992	-
1-30 days	-	16,066	-	-	15,227	-
31-90 days	-	24,904	-	-	23,090	-
	17,463	61,905	1,111	19,380	60,309	177
Total impairment write-offs	290,070	295,539	1,111	274,435	284,782	177

Receivables due from individual customers not impaired and without delay in payment in terms of overdue history:

PLN'000	31.12.2017	31.12.2016
Receivables due from individual customers not impaired and without delay in payment, including:	6,436,616	6,098,826
receivables at least once have exceeded 30 days of delay in payment (but have not exceeded 90 days)	370,836	365,690
receivables at least once have exceeded 90 days of delay in payment	5,823	5,498

Receivables not impaired by delinquency:

PLN'000	31.12.2017			31.12.2016		
	Amounts due from institutional customers	Amounts due from individual customers	Amounts due from banks	Amounts due from institutional customers	Amounts due from individual customers	Amounts due from banks
Receivables with incurred but not recognized (IBNR) losses						
Regular receivables	12,818,752	6,436,616	837,277	12,332,619	6,098,826	587,150
Overdue receivables, including:	41,463	335,154	-	13,610	280,686	-
1-30 days	37,240	283,109	-	6,281	233,240	-
Gross amount	12,860,215	6,771,770	837,277	12,346,229	6,379,512	587,150

Structure of derivatives in terms of credit risk

PLN'000	31.12.2017			31.12.2016		
	Transactions with institutional customers	Transactions with retail customers	Transactions with banks	Transactions with institutional customers	Transactions with retail customers	Transactions with banks
Derivatives by risk rating						
Risk rating 1-4-	234,724	4,632	753,408	96,107	6,141	1,053,076
Risk rating+5-6-	25,090	-	2	14,650	-	8,242
Risk rating +7 and greater	276	-	-	1,162	-	-
Total	260,090	4,632	753,410	111,919	6,141	1,061,318

The classification of exposures in the portfolio of debt securities held for trading and portfolio of debt securities available for sale by ratings agency Fitch is presented below:

PLN'000	31.12.2017		31.12.2016	
	Debt securities held-for-trading	Debt securities available-for-sale	Debt securities held-for-trading	Debt securities available-for-sale
Issuer rating by Fitch agency				
A (including from A to AAA)	1,143,908	17,439,439	2,605,028	19,072,371
Total	1,143,908	17,439,439	2,605,028	19,072,371

Other financial assets in the amount of PLN 98,110 thousand at the end of 2017 (PLN 93,727 thousand at the end of 2016) include receivables with delinquency over 90 days in the amount of PLN 2,520 thousand (PLN 1,709 thousand at the end of 2016).

Structure of granted contingent liabilities in terms of credit risk:

PLN'000	31.12.2017		31.12.2016	
	Liabilities due to institutional customers	Liabilities due to banks	Liabilities due to institutional customers	Liabilities due to banks
Granted contingent liabilities by risk rating				
Risk rating 1-4-	7,261,959	383,555	7,740,598	276,957
Risk rating+5-6-	2,696,078	6,326	2,828,993	9,024
Risk rating +7and greater	58,102	-	33,266	-
Total	10,016,139	389,881	10,602,857	285,981

The granted contingent liabilities due to individual customers in terms of overdue history:

PLN'000	31.12.2017	31.12.2016
Granted contingent liabilities due to individual customers, including:	6,447,070	6,017,351
contingent liabilities at least once have exceeded 30 days of delay in payment (but have not exceeded 90 days)	322,651	319,995
contingent liabilities at least once have exceeded 90 days of delay in payment	1,526	1,584

The Banks's ratio of impairment write-offs to receivables is presented in the table below:

PLN'000	31.12.2017	31.12.2016
Gross amount		
Receivables with recognized impairment, including:	720,427	628,817
Individual receivables	387,751	308,965
Portfolio receivables	332,676	319,852
Receivables without recognized impairment	20,469,262	19,312,891
Total gross amount	21,189,689	19,941,708
Impairment write-offs		
Receivables with recognized impairment, including:	506,241	479,528
Individual receivables	261,608	252,096
Portfolio receivables	244,633	227,432
Receivables without recognized impairment	80,479	79,866
Impairment write-offs in total	586,720	559,394
Net amount		
Receivables with recognized impairment, including:	214,186	149,289
Individual receivables	126,143	56,869
Portfolio receivables	88,043	92,420
Receivables without recognized impairment	20,388,783	19,233,025
Total net amount	20,602,969	19,382,314
Ratio of impairment write-offs to receivables with recognized impairment	70.3%	76.3%

“Forbearance” practices

Forborne exposures are identified in the Bank within credit risk management. Bank takes into account "forborne" exposures according to the reporting requirements under the EBA Technical Standards EBA/ITS/2013/03.

The Bank considers as "forborne" exposures, where the Bank grants debtor experiencing financial difficulties preferential financing conditions (i.e. on non-market conditions), which would not have been considered in a different situation. Preferential financing conditions are considered situations in which for example the yield of the modified facility is lower than the contractual yield prior to the restructuring and/or the yield on the modified loan is below a market yield for the relevant tenor and credit risk.

The extent to which the financing conditions are changed is determined individually for each debtor in question. In particular, these activities include:

- receipt of assets;
- granting a new or restructured facility in partial or full satisfaction of a facility;
- modification of the terms of the existing facility, including rescheduling of future payments (e.g. extension of financing tenor), change of interest rate or methods of repayment, reduction of amount to be repaid (principal or accrued interest).

The process of assigning "forborne" status for exposures is closely related to the credit risk management process, including the impairment recognition process for exposures.

In terms of institutional clients, the Bank recognizes "forborne" status for exposures with identified impairment, which entails the need to write off some of the receivables.

In terms of individual clients, the "forborne" status may refer to both the exposures: from the impaired portfolio as well as from the portfolio without any impairment. As "forborne" without impairment are recognized by the Bank exposures, where restructuring activities were applied, but change of financing conditions has not implied any deterioration of future payment streams. In such cases the change into "forborne" status is not an evidence of exposure's impairment.

The Bank assumes that exposures will remain in "forborne" status until they are entirely paid off.

Exposures with modified conditions according to forbearance rules (forborne exposures) are subject to regulatory and

internal reporting.

PLN'000	As of	
	31.12.2017	31.12.2016
Receivables without recognized impairment, including	19,631,985	18,725,741
non-financial sector entities	17,717,273	17,089,740
Institutional customers	10,945,503	10,710,228
Individual customers	6,771,770	6,379,512
Receivables with recognized impairment, including:	720,427	628,817
non-financial sector entities	703,293	611,681
Institutional customers, including:	382,978	294,295
„forborne”	77,706	78,766
Individual customers, including:	320,315	317,386
„forborne”	19,556	24,273
Total gross amount, including:	20,352,412	19,354,558
non-financial sector entities	18,420,567	17,701,421
Institutional customers, including:	11,328,482	11,004,523
„forborne”	77,706	78,766
Individual customers, including:	7,092,085	6,696,898
„forborne”	19,556	24,273
Impairment write-off	(585,609)	(559,217)
On „forborne” receivables	(58,855)	(56,959)
Total net amounts due from customers, including:	19,766,803	18,795,341
„forborne” receivables	38,407	46,080

“Forborne” exposures by period of overdue

PLN'000	As of	
	31.12.2017	31.12.2016
Not past due	31,964	49,435
Past due, including:	65,298	53,604
Past due less than 30 days	1,980	2,125
Past due 31 - 90 days	11,151	6,576
Past due over 90 days	52,167	44,903
Total gross amount	97,262	103,039

LIQUIDITY RISK

The processes and organization of liquidity risk management

Liquidity risk is defined as the risk that the Bank may not be able to meet its financial commitments to customers or counterparties when due.

The objective of liquidity risk management is to ensure that the Bank can meet all commitments to customers when due and to secure the liquidity necessary to clear all money market transactions when due.

Liquidity risk management is based on:

- Applicable law, in particular on the Banking Law;
- Requirements of Polish regulatory institutions and especially resolutions of the Polish Financial Supervision Authority;
- Rules of prudent and stable risk management of the Bank as well as general risk levels approved by the Supervisory Board of the Bank;

taking into account best market practice.

The ultimate responsibility for ensuring that the Bank operates under approved liquidity risk limits lies within the Management Board of the Bank, and ongoing market risk management is performed by the:

- Member of the Management Board of the Bank – Head of the Risk Management Sector;
- Assets and Liabilities Management Committee (ALCO);
- Head of the Market Risk unit.

Liquidity management

The objective of liquidity risk management is to ensure that the Bank has adequate access to liquidity in order to meet its financial obligations when due, including under extreme but probable stress conditions.

The Bank analyses and manages liquidity risk in several time horizons while distinguishing current, short-, mid- and long-term liquidity, to which appropriate risk measurement methods and limits apply. The adopted measures and limits aim to limit excessive concentration in terms of the balance sheet structure and sources of financing.

Long-term liquidity management is the responsibility of ALCO and as such it is reflected in the Bank's strategy. It is based on the monitoring of balance sheet structural ratios and on long-term regulatory liquidity measures and includes the analysis of liquidity gaps, the ability to acquire in the future sufficient funding sources as well as funding costs in the light of the overall business profitability.

Mid-term liquidity management, in the one-year time horizon, is the responsibility of ALCO and is based on the established on annual bases Funding and Liquidity Plan which defines the size of internal limits taking into account the business plans for changes in assets and liabilities that are being prepared by business units of the Bank as part of financial plans for the next budget year.

Short-term liquidity management, in the three-month time horizon, is the responsibility of the Financial Markets Sub-Sector and is performed based on short-term regulatory liquidity measures as well as internal limits. In addition, the Bank analyses liquidity under stress scenarios, assuming the lack of liquidity gaps in all tenors up to three months as a necessary condition.

Current liquidity management is the responsibility of the Financial Markets Sub-Sector and comprises the management of the balances on the Bank's nostro accounts and especially the mandatory reserve account with NBP while applying available money market products and central bank facilities.

In 2017 the Bank has not implemented any significant changes in liquidity risk management processes, procedures, systems and policies.

Funding and Liquidity Plan

The Head of the Bank's Financial Markets Sub-Sector is responsible for preparing an annual Funding and Liquidity Plan ("Plan") for the Bank and obtaining the ALCO's approval for the Plan. The Plan addresses all funding or liquidity issues resulting from business plans, especially in the customer deposits and loans area, as defined in annual budgets of particular business entities, as well as any material changes in regulatory requirements and market dynamics.

Liquidity risk management tools

The Bank measures and manages liquidity risk by applying both external regulatory measures and additional internal liquidity measures.

The supervisory liquidity measures

The supervisory liquidity measures M1-M4 i LCR were as follows:

	31.12.2017	31.12.2016	Change
M1 - Short-term liquidity gap (PLN)	8,380,500	8,332,306	48,194
M2 - Short-term liquidity ratio	1.37	1.36	0.01
M3 - Coverage of illiquid assets with regulatory capital	9.78	10.33	(0.55)
M4 - Coverage of illiquid assets and assets of limited liquidity with regulatory capital and stable external funds	1.54	1.54	-
LCR	145%	154%	(9%)

Internal liquidity risk management tools

In addition to the regulatory liquidity measures, the Bank applies a range of liquidity risk management tools including:

- Gap analysis –MAR/S2;
- Stress scenarios;
- Liquidity ratios;
- Market Triggers;
- Significant Funding Sources;
- Contingency Funding Plan.

Stress scenarios

Stress tests are intended to quantify the potential impact of an event on the Bank's balance sheet and cumulative gap over a twelve-month period, and to ascertain what incremental funding may be required under any of the defined scenarios. The scenarios are proposed by the Bank's Financial Markets Sub-Sector and Market Risk and approved by ALCO.

The Bank conducts the stress tests monthly. The scenarios assume material changes in the underlying funding parameters, i.e.:

- Concentration event;
- Highly Stressed Market Disruption ("S2");
- Local market event.

Contingency Funding Plan

Financial Markets Sub-Sector is responsible for the preparation and annual update of the Contingency Funding Plan, which defines the Bank's action plan in case of a contingency, specifically in cases assumed in liquidity stress scenarios and described in the annual Funding and Liquidity Plan. The Contingency Funding Plan is approved by ALCO.

The Contingency Funding Plan defines:

- Circumstances / symptoms of contingency events;
- Responsibilities for executing the action plan;
- Sources of liquidity, and in particular the principles of maintenance of a liquid assets portfolio to be used in the case of a liquidity contingency;
- Rules for assets disposal and balance sheet restructuring;
- Procedures for restoring customer confidence.

The levels of the cumulative liquidity gap in stress conditions and the level of liquid assets as at 31 December 2017 and 31 December 2016.

The cumulative liquidity gap as at 31 December 2017 in real terms:

PLN'000	Up to 1 month	More than 1 to 3 months	More than 3 months to 1 year	More than 1 year to 2 years	More than 2 years
Assets	16,313,128	339,462	430,219	267,538	25,513,617
Liabilities and equity	6,975,759	4,079,318	41,636	1,636	31,765,615
Balance sheet gap in the period	9,337,369	(3,739,856)	388,583	265,902	(6,251,998)
Contingent derivatives transactions – inflows	12,590,330	4,304,593	6,233,163	4,916,257	15,623,622
Contingent derivatives transactions – outflows	12,595,726	4,368,335	6,280,196	5,114,065	15,629,018
Off-balance-sheet gap in the period	(5,396)	(63,742)	(47,033)	(197,808)	(5,396)
Potential use of the granted credit lines	693,057	658,001	191,750	-	(1,542,773)
Cumulative gap	8,638,916	4,177,317	4,327,117	4,395,211	(319,410)

The cumulative liquidity gap as at 31 December 2016 in real terms:

PLN'000	Up to 1 month	More than 1 to 3 months	More than 3 months to 1 year	More than 1 year to 2 years	More than 2 years
Assets	19,691,190	563,913	417,261	-	24,532,683
Liabilities and equity	7,899,170	4,190,501	57,424	46,014	33,011,938
Balance sheet gap in the period	11,792,020	(3,626,588)	359,837	(46,014)	(8,479,255)
Contingent derivatives transactions – inflows	10,159,711	3,370,020	6,341,294	4,169,771	17,095,176
Contingent derivative transactions – outflows	10,123,268	3,346,658	6,365,283	4,227,780	17,276,599
Off-balance-sheet gap in the period	36,443	23,362	(23,989)	(58,009)	(181,423)
Potential use of the granted credit lines	696,104	1,351,335	-	-	(2,047,439)
Cumulative gap	11,132,359	6,177,798	6,513,646	6,409,623	(203,616)

Liquid assets and the cumulative liquidity gap up to 1 year:

PLN'000	31.12.2017	31.12.2016	Change
Liquid assets, including:	18,805,370	22,190,847	(3,385,477)
nostro account in NBP and stable part of cash	222,023	513,448	(291,425)
debt securities held-for-trading	1,143,908	2,605,028	(1,461,120)
debt securities available-for-sale	17,439,439	19,072,371	(1,632,932)
Cumulative liquidity gap up to 1 year	4,327,117	6,513,646	(2,186,529)
Coverage of the gap with liquid assets	Positive gap	Positive gap	-

Financial liabilities of the Bank, by contractual maturity, are presented below. Presented amounts do not include the impact of the effective rate on interest liabilities.

As at 31 December 2017

PLN'000	Note	Total	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	More than 5 years
Amounts due to banks	29	1,568,261	1,512,791	6,624	42,594	6,252	-
Financial liabilities held-for-trading							
Short positions in financial assets	19	-	-	-	-	-	-
Amounts due to customers, including:	30	32,172,442	30,852,688	924,643	363,892	31,219	-
Deposits from financial sector entities	30	4,977,728	4,798,459	174,300	4,957	12	-
Deposits from non-financial sector entities	30	27,003,168	25,950,649	696,794	325,734	29,991	-
Other liabilities	30	191,546	103,580	53,549	33,201	1,216	-
Financial liabilities held-for-trading							
Derivative financial instruments (settled on a net basis)	19	749,655	11,601	32,601	62,037	406,488	236,928
Hedging derivatives	20	50,191	-	-	-	49,392	799
Unused credit lines liabilities	39	14,373,083	11,461,259	2,174	176,805	2,231,647	501,198
Guarantee lines	39	2,312,023	2,312,023	-	-	-	-
		51,225,655	46,150,362	966,042	645,328	2,724,998	738,925
Derivatives settled on a gross basis							
Inflows		42,812,185	12,660,817	4,245,328	6,358,651	12,219,978	7,327,411
Outflows		43,030,215	12,663,748	4,310,234	6,370,062	12,391,474	7,294,697
		(218,030)	(2,931)	(64,906)	(11,411)	(171,496)	32,714

As at 31 December 2016

PLN'000	Note	Total	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	More than 5 years
Amounts due to banks	29	2,303,628	2,140,200	20,897	27,628	114,903	-
Financial liabilities held-for-trading							
Short positions in financial assets	19	208,106	208,106	-	-	-	-
Amounts due to customers*, including:	30	34,031,948	33,000,780	748,865	264,652	17,651	-
Deposits from financial sector entities	30	4,884,985	4,839,443	41,909	3,633	-	-
Deposits from non-financial sector entities	30	29,017,911	28,086,055	689,494	226,188	16,174	-
Other liabilities	30	129,052	75,282	17,462	34,831	1,477	-
Financial liabilities held-for-trading							
Derivative financial instruments (settled on a net basis)	19	750,866	27,175	38,182	121,727	365,330	198,452
Hedging derivatives		39,897	-	-	-	18,549	21,348
Unused credit lines liabilities	39	13,382,368	11,384,078	49,282	312,309	1,128,776	507,923
Guarantee lines	39	2,131,868	2,131,868	-	-	-	-
		52,848,681	48,892,207	857,226	726,316	1,645,209	727,723
Derivatives settled on a gross basis							
Inflows		40,526,382	10,536,899	3,070,489	6,175,871	10,721,726	10,021,397
Outflows		40,462,467	10,486,275	3,055,881	6,153,208	10,693,570	10,073,533
		63,915	50,624	14,608	22,663	28,156	(52,136)

* In 2017, margins' presentation of was changed by transferring them from the term Deposits to Other Liabilities, comparative data were changed accordingly.

MARKET RISK

The processes and organization of market risk management

Market risk is the risk of negative impact on the Bank's earnings and equity resulting from changes in market interest rates, foreign exchange rates, equity and commodity prices, as well as all volatilities of these rates and prices.

The objective of market risk management is to ensure that the extent of risk accepted within the Bank corresponds to the level acceptable to the shareholders and banking supervision authorities and to ensure that all exposures to market risk are properly reflected in the calculated risk measures, communicated to relevant persons and bodies responsible for the management of the Bank. The adopted market risk measures and limits aim to prevent excessive concentration of exposure to a single risk factor or a group of related risk factors, as well as to determine the overall maximum level of risk taken in the trading or banking book.

Market risk management in the Bank is based on:

- Requirements of Polish regulatory institutions and especially resolutions of the Polish Financial Supervision Authority;
- Rules of prudent and stable risk management of the Bank as well as general risk levels approved by the Supervisory Board of the Bank;

taking into account best market practice.

The ultimate responsibility for ensuring that the Bank operates under approved market risk exposure limits lies within the Management Board of the Bank, and ongoing market risk management is performed by the:

- Member of the Management Board of the Bank – Head of the Risk Management Sector;
- Assets and Liabilities Management Committee (ALCO);
- Head of the Market Risk unit;
- Heads of risk-taking business units;
- Persons delegated to risk management in Bank entities.

Market risk management

Scope of risk

Market risk management applies to all portfolios generating income exposed to the negative impact of market factors including interest rates, foreign exchange rates, equity prices, commodity prices and the parameters of their volatility. Two types of portfolios have been defined for the purpose of market risk management: trading portfolios and bank portfolios.

The trading portfolios include transactions in financial instruments (balance-sheet and off-balance-sheet instruments) expected to generate income owing to a change in market parameters over a short period. The trading portfolios include balance-sheet items such as debt securities held-for-trading, i.e., debt securities acquired to be further traded and meeting pre-defined liquidity criteria, as well as all derivative instrument positions broken down into portfolios acquired purely for trading and transactions executed in order to provide an economic hedge of bank portfolio positions. The trading portfolios are valued directly at market prices or using market pricing-based valuation models. The trading portfolio operations are performed by the Bank's Financial Markets Sub-Sector in respect of interest rate risk portfolios and FX risk portfolios. The trading portfolio also includes options, mainly foreign exchange options and interest rate options and optional structures being a reflection of economic nature and risk resulting from products offered to customers of the Bank. In this area, the Bank concludes transactions in a way which ensures concurrent (at each time and immediate) conclusion of an opposite transaction with the same parameters and, in consequence, the option portfolio does not generate open exposition of market risk. The only item related to the conclusion of option transactions which is reflected in market risk measurement, and in particular in foreign exchange risk, is the premium paid/received in a foreign currency.

The bank portfolios include all other balance-sheet and off-balance-sheet positions not assigned to any of the trading portfolios. The transactions are executed to realize a profit over the entire contracted transaction period. The Bank's Financial Markets Sub-Sector takes over the interest rate risk positions held in the bank portfolios of all other organizational units of the Bank. The mechanism of transferring the interest rate risk positions is based on the transfer price system.

Measurement of the pricing risk of the bank portfolios

The Bank typically uses the following methods for measuring the risk of the bank portfolios:

- Interest rate gap analysis;
- Value-at-Close and Total Return methods;
- Interest Rate Exposure (IRE); and
- Stress testing.

Interest rate gap analysis uses the schedule of maturities or revaluations of balance-sheet positions and of derivative

instruments used in hedge accounting or qualified as economic hedge for the purpose of establishing the differences between positions whose maturity or interest rate revaluation fall within a given time range.

The general rule in the interest rate gap analysis is that of classifying transactions to respective bank portfolio position revaluation bands by the contracted or assumed transaction interest rate revaluation dates.

It is assumed that:

- transactions with a fixed interest rate (such as term deposits, interbank deposits, portfolio of debt securities available-for-sale with a fixed interest rate, granted loans both repaid in full at maturity and repaid in installments) are classified into appropriate revaluation bands in accordance with their maturity dates;
- transactions with a floating interest rate, updated at a regular frequency (primarily, loans granted with interest set based on a specific base/market rate such as, e.g., WIBOR 1M) are classified into appropriate revaluation bands in accordance with the nearest interest rate revaluation date;
- transactions with an administrated floating interest rate (i.e., any changes in the interest rate and its revaluation date are reserved to sole decision of the Bank) or undefined maturity or interest rate revaluation date are classified into appropriate revaluation bands in accordance with historically observed or expert assessed shifts in the moment and scale of change in the interest rate of given positions in relation to change in the market interest rates (model of minimizing product margin variability). This group of transactions / balance-sheet positions includes among others: current accounts, card loans, overdraft facilities. Additionally, early loan repayments are taken into account based on analysis of actual repayments made by customers before the due date and product interest rate revaluation profiles are set on that basis. This pertains particularly to installment loans;
- transactions insensitive to changes of interest rates, including cash, fixed assets, equity, other assets/liabilities, are classified into the longest revaluation band;
- transactions executed directly by the Financial Markets Sub-Sector for the purpose of management of interest rate risk and liquidity risk (Financial Markets Sub-Sector own portfolio) are always classified into appropriate revaluation bands in accordance with the contracted dates.

The Value-at-Close method is an estimation of the economic or "fair" value of positions, equivalent to the market valuation of the trading portfolio. Total return on a portfolio is the sum total of the changes in the value of closing the interest rate gap, accrued interest and gains/losses on sale of assets or cancelling of obligations.

The Interest Rate Exposure (IRE) method is used to estimate the potential impact of a specific parallel shift in the interest rate curves on interest income from the bank portfolio before tax which can be earned in a specific period of time. This is a prospective indicator, equivalent to Factor Sensitivity of trading portfolios. An assumption is made that under standard conditions interest rate shifts are identical for every currency and stand at 100 basis points upwards. IRE measures are calculated separately for positions in each currency in the time horizon of 10 years; however, for the purpose of current monitoring and limiting of interest rate risk positions in bank portfolios, the Bank normally applies IRE measures with one-year and five-year time horizons.

The table below presents the IRE measures for the Bank as at 31 December 2017 and 31 December 2016. The list has been broken down into the main currencies, i.e., PLN, USD and EUR, which jointly account for over 90% of the Bank's balance-sheet.

PLN'000	31.12.2017		31.12.2016	
	IRE 12M	IRE 5L	IRE 12M	IRE 5L
PLN	29,217	163,736	35,688	178,434
USD	18,002	32,083	17,212	36,974
EUR	(409)	(6,467)	(3,351)	(20,705)

Stress tests measure the potential impact of material changes in the level or directionality of interest rate curves on open interest positions in the bank portfolio.

The Bank runs stress tests of predefined interest rate movement scenarios, which represent combinations of market factor movements defined as large moves and stress moves occurring both in Poland and abroad. Values of the assumed market factor movements are revised at least once a year and adjusted as appropriate to changes in the market conditions of the Bank's operation.

Activities relating to securities available-for-sale are the responsibility of the Assets and Liabilities Management Department within the Professional Markets Division. Three basic goals of activities in the portfolio of securities available-for-sale have been defined as follows:

- management of the Bank's liquidity;
- hedging against the risk transferred to the Financial Markets Sub-Sector from other organizational units of the Bank;
- opening of own interest rate risk positions on the Bank's books by the Financial Markets Sub-Sector.

In order to avoid excessive fluctuations in the Bank's capital funds, caused by the revaluation of assets held-for-sale, the maximum limits of DV01 (Dollar Value of 1 basis point), which determines the potential change in the value of risk positions on a given interest rate curve at a specific nodal point (which brings together all the cash flows in a given time horizon), caused by a shift in the market interest rate by 1 basis point upwards are established for this kind of portfolio. The limits also concern the open positions in derivatives (i.e. interest rate swap transactions), carried out to hedge the fair value of the portfolio.

Hedge accounting program

In addition to the general rules limiting market risk, in particular, interest rate risk, the Bank has defined rules for the application of fair value hedge accounting. The main risk, which is hedged under hedge accounting is the risk of changes in interest rates resulting from holding portfolio of securities available for sale (AFS) with fixed interest rates. At the end of each month, when the hedging relation happened, the Bank shall evaluate the effectiveness of the hedging instrument used, by analyzing the changes in the fair value of the hedged and hedging instrument in respect of the risk being hedged.

The hedged item was part of a portfolio of securities available for sale at a fixed interest rate, denominated in PLN and EUR. In all cases, the hedging instrument was the interest rate swap (IRS), which converts the fixed interest rate on a variable. Gains and losses arising from revaluation at fair value of the hedging instrument and changes in the fair value of the hedged items are reflected - in part resulting from the hedged risk - in profit and loss item "Net income from hedge accounting."

The table below presents the risk measured with DV01 for the portfolio of securities available-for-sale, including the economic collateral, broken down by currency:

PLN'000	31.12.2017			31.12.2016			Total in the period 1.01.2017 – 31.12.2017		
	Total	Securities	IRS	Total	Securities	IRS	Average	Maximum	Minimum
PLN	(1,813)	(2,560)	747	(1,491)	(2,637)	1,146	(1,337)	(487)	(2,215)
USD	(18)	(18)	-	(49)	(358)	309	(125)	(18)	(255)
EUR	(451)	(451)	-	(430)	(430)	-	(539)	(423)	(593)

The Bank's activities involving investments in debt securities available-for-sale were also one of the main factors influencing changes in the level of the risk of mismatch in revaluation periods as expressed by the IRE measure.

Measurement of the market risk of the trading portfolios

The following methods are applicable in measurement of the risk of the trading portfolios:

- Factor Sensitivity;
- Value at Risk (VaR); and
- Stress testing.

Factor Sensitivity measures the change in the value of positions in an underlying instrument in the case of a specific change in a market risk factor (e.g., change of the interest rate by 1 basis point at a given point on the interest rate curve, change of the currency exchange rate or share price by 1%).

In the case of interest rates, the applicable sensitivity measure is DV01.

In the case of exchange rate (FX) risk, the Factor Sensitivity value is equal to the value of the FX position in a given currency.

In the case of positions held in equities, the Factor Sensitivity value is equal to the net value of the positions held in the respective instruments (shares, indices, participation units).

Value at Risk (VaR) is the integrated measure of the market risk of trading portfolios which combines the impact of positions in respective risk factors and accounts for the effect of correlation between the fluctuations of different factors. VaR is applied for the purpose of measuring the potential decrease in the value of a position or portfolio under normal market conditions, at a specific confidence level and within a specific time period. In the case of positions opened in the Bank's trading portfolio, VaR is calculated at a 99% confidence level and a one-day holding period.

DV01 as well as VaR for the trading portfolio are calculated net of the economic hedge of the portfolio of securities available-for-sale, i.e., net of derivative instruments intended to hedge the fair value of the portfolio. The exposures to the risk of such transactions are mitigated through the application of relevant risk measurement methods and by the bank portfolio risk limits.

Each day, the Bank runs stress tests on the assumption that the risk factors change by more than expected in the Value at Risk scenario and ignoring the historical correlations of these factors.

The Bank keeps records of exposures of the bank portfolios to market risk in over twenty currencies both for currency positions and exposures to interest rates risk. These exposures are significant only for a few currencies. For a large group of currencies, the exposures are the consequence of a gap between transactions executed on the customer's orders and closing transactions with other wholesale market counterparties. Significant exposures to market risk are opened for PLN, currencies of well-developed markets (predominantly USD and EUR with a lesser focus on GBP, CHF and JPY) and Central European currencies.

The values of significant exposures to the interest rate risk of the trading portfolios in terms of DV01 in 2016 are presented in the table below:

PLN'000	31.12.2017	31.12.2016	In the period 01.01.2017 – 31.12.2017		
			Average	Maximum	Minimum
PLN	313	267	320	839	(242)
EUR	73	(123)	3	98	(127)
USD	9	9	(5)	42	(139)

Average exposures to the interest rate risk in the local currency in 2017 was higher comparing to the level from the previous year and amounted to PLN 337 thousand. Average exposure to the interest rate risk in EUR was lower than in 2016 (DV01 amounted to PLN 36 thousand, compared to PLN 126 thousand in the previous year). Average exposure in USD was lower than in 2016 (DV01 amounted to PLN 22 thousand, compared to PLN 32 thousand in 2016). The maximum exposure in PLN of the biggest exposures accepted by the Treasury Division was PLN 839 thousand compared to PLN 870 thousand in 2016 and the position in EUR amounted to PLN 127 thousand compared to PLN 395 thousand in the previous year.

The Financial Markets Sub-Sector, which trades in financial instruments within the Bank, continued the strategy of very active management of exposures to FX risk and interest rate risk by adjusting the volume and direction of such exposures depending on changing market conditions, which is reflected in the range of volatility of these exposures (the minimum and the maximum values in the table above).

The table below presents the levels of risk measured by VaR (net of economic hedges of the portfolio of securities available-for-sale) broken down by FX risk and interest rate risk position in 2016:

PLN'000	31.12.2017	31.12.2016	In the period 1.01.2017 – 31.12.2017		
			Average	Maximum	Minimum
FX risk	289	287	786	4,940	68
Interest rate risk	3,499	6,280	4,086	8,746	851
Spread risk	6,202	5,046	4,613	7,188	2,252
Overall risk	7,347	8,333	8,079	15,198	2,898

The overall average level of the market risk of the trading portfolios was 12% higher in 2017 than the average level in 2016, representing an increase by over PLN 869 thousand, mainly as a result of higher exposures to credit spread changes. The maximum price risk level was PLN 15,198 thousand, compared to PLN 18,737 thousand in 2016.

Equity instruments risk

In its trading activity, the Bank is not exposed to the price risk of equity instruments. The Bank's equity investment portfolio is not a trading portfolio.

The Bank's FX exposure

The table below presents the Bank's FX exposure by main currencies:

31.12.2017

PLN'000	Balance-sheet transactions		Contingent derivatives transactions*		Net position
	Assets	Liabilities	Assets	Liabilities	
EUR	3,739,727	4,465,703	15,467,548	14,648,480	93,092
USD	1,103,587	3,751,783	11,883,166	9,222,515	12455
GBP	14,450	396,013	412,574	31195	(184)
CHF	339,293	223,461	1,685,061	1,791,647	9,246
Other currencies	38,542	211,370	1,872,809	1,680,813	19168
	5,235,599	9,048,330	31,321,158	27,374,650	133,777

* at present value which is the sum of discounted future cash flows

31.12.2016

PLN'000	Balance-sheet transactions		Contingent derivatives transactions*		Net position
	Assets	Liabilities	Assets	Liabilities	
EUR	3,157,017	4,538,578	17,289,321	15,769,761	137,999
USD	2,924,823	2,887,135	7,839,769	7,904,888	(27,431)
GBP	12,322	353,656	380,457	38651	472
CHF	302,186	147,687	1,422,369	1,579,560	(2,692)
Other currencies	1,821	266,477	1,833,809	1,569,944	(791)
	6,398,169	8,193,533	28,765,725	26,862,804	107,557

* at present value which is the sum of discounted future cash flows

OPERATIONAL RISK

Strategic goals and assumptions of the operational risk management system

The strategic objective of operational risk management is to ensure a consistent and effective approach to identification, assessment, mitigation, control, monitoring and reporting of these risks, as well as the effective reduction of the level of exposure to operational risk, and consequently reduction of the amount of operational risk events and their severity (low level of tolerance policy for operating losses).

Operational risk management is also aimed at the full integration of this risk management processes into business decision-making processes (i.e. business strategy will be supported by an operational risk assessment, and the business will be assessed on the basis of pre-determined indicators of control and operational risk).

While organizing the operational risk management process, the Bank takes into account business strategy, the Bank's risk profile, macroeconomic environment, available resources of capital and liquidity and regulatory requirements that constitute a framework for the preparation of operational risk control and management system in the Bank.

The Management Board is responsible for the development, implementation and operation of proper operational risk management system through the introduction of appropriate internal regulations, ensures consistency between operational risk management system and Bank's Strategy, as well as its proper functioning within the organization through an analysis of information that allow to assess whether the system is adequate for operational risk profile. If needed, the operational risk management system is enhanced through implementation of crucial improvements.

The operational risk management system in the Bank is built in a way that ensures proper risk management at every stage, i.e.: identification, evaluation, mitigation, control, monitoring and reporting.

The implementation of the strategy by the Management Board shall be assessed by the Supervisory Board, assisted by the Audit Committee and Risk and Capital Management Committee based on synthetic reports submitted by the Management Board at least twice a year, determining the scale and types of operational risk that the Bank is exposed to, risk concentration areas, methods of operational risk management, probability of its occurrence, assessment of potential negative impact of operational risk management methods, as well as results of operational risk profile and operational risk appetite monitoring.

Operational risk definition

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

Operational risk includes technological and technical risk, also outsourcing, malpractice/embezzlement, money laundering, information security, data security, external events (continuity of business), tax and accounting risk. Moreover, operational risk embraces product, legal, model, staffing, concentration, reputational risk, related to operational risk incidents, business and market practice. Operational risk management processes cover also operational risk incorporated into other risk categories and/or managed within separated processes (e.g. credit risk, market risk, counterparty, liquidity, compliance), thus supports management of other risks, identified in Bank's activity.

Operational risk does not cover strategic risk or the risk of loss resulting solely from authorized judgments made with respect to taking credit, market, liquidity or insurance risk.

As part of operational risk, the following difficult to measure risks, which were identified as significant, are identified: compliance risk, model risk, outsourcing risk and information security risk (including cyber risk).

Rules of operational risk identification

Each Bank's Business Unit identifies all significant operational risks related to its processes. This includes identification by the Bank's Management of risks associated with all material processes, products, human factors, systems and compliance with applicable laws, regulatory administrative actions, the Bank's internal regulations and the Bank's strategy, also taking into consideration risk associated with Bank's dependence on other entities in the group.

Bank's organizational units and the Independent Control and Operational Risk Department use in the operational risk identification processes, regular analysis of information generated using the tools of operational risk management (e.g. risk appetite, target risk profile, KRI, data loss and operational risk incidents, issues and corrective actions, self-assessment process, heatmap, key projects, risk areas concentration and areas of increasing risk exposure level of risk, scenario analysis, stress testing, changes in processes and products, operational risk attestations, information from internal and external reviews and audits, information reported to the Commissions and Committees).

Operational Risk Profile

Operational Risk Profile – scale and structure of exposure to operational risk, defining the level of exposure to operational risk, expressed in selected by the Bank structural measures (e.g. types of operational risk events, types of business lines, significant processes) and scale measures (e.g. assessed potential loss). The Bank defines its operational risk profile based on operational loss data and based on information gathered through utilized operational risk management tools.

The target operational risk profile, facilitating identification of concentration risk, was established with consideration of the scale and structure of operational risk, accepted appetite/tolerance for operational risk, analysis of historical data and utilizing tools applied for operational risk management. Established indicators are monitored for particular operational risk categories and the main areas of the Bank's activity.

Measurement and assessment

In the process of risk estimation Bank applies differentiated methods of risk measurement and assessment. Risk assessment is the determination of the probability of occurrence and scale of potential future operational losses. Bank applies quantitative and qualitative methods for the purpose of risk assessment (e.g. appetite for risk, capital requirements, the target risk profile, KRI, data loss and operational risk events, issues and corrective actions, the process of self-assessment, risk map, key projects, concentration risk areas and increasing the risk level, scenario analysis, stress tests, changes in processes and products, operational risk attestations, information from internal and external reviews and audits, information reported to the Commissions and Committees). Risk assessment analyses involve internal and external threats. Proper operational risk assessment enables adequate determination of risk profile and adequate risk management.

Assessed capital requirement for operational risk covers all risk categories included by the Bank in operational risk definition.

Risk tolerance framework, risk control and mitigation

The Bank sets tolerance levels for each operational risk category and business areas within a determined risk appetite. Excess of the established level of tolerance thresholds for particular operational risk category requires undertaking of corrective actions in line with the decision of the Risk and Capital Management Committee.

Risk and Capital Management Committee and/or Management Board can decide on the following treatment of the identified risks by:

- accepting (conscious avoidance of activities, aiming at mitigation of probability and results of an event, including ensuring of funds for covering of potential losses);
- mitigation (mainly by adequate definition of processes, products, systems, procedures and implementation of control mechanisms);
- transfer (movement of part or whole risk related to a particular threat to the external party, in particular by outsourcing of activity to an external services provider or by insurance);
- avoidance of activities, leading to risk exposure.

In key aspects, processes of risk identification, self-assessment, measurement, monitoring and reporting are unified and generally accepted in all organizational Bank's units. Risk mitigation processes are determined for each entity, and may be different for individual units.

Control is a process designed to mitigate cause(s), reduce the probability of an event occurring and/or minimize the severity of an effect. Risk mitigation measures include also risk transfer mechanisms (outsourcing, insurance). Risk mitigation measures include internal controls as well as risk transfer mechanisms, i.e. transfer of part or whole risk related to a given threat to an external entity, in particular by outsourcing or insurance. The Bank regularly assesses and monitors the proper functioning of risk transfer mechanisms.

Monitoring and reporting

The Risk and Capital Management Committee, supported by Commissions, is accountable for ongoing monitoring of operational risk. Quality and effectiveness of operational risk management processes (including the self-assessment process) in the respective organizational units of the Capital Group are subject to inspections and assessment carried out by the internal audit.

Within the consolidated oversight operational risk data of Bank and subsidiaries is presented to Commissions and Committees, supporting the Management and Supervisory Board in the operational risk management process.

The Supervisory Board supervises and assesses the adequacy and effectiveness of operational risk management. The

Supervisory Board is supported by Committees of Supervisory Board - Audit Committee, Risk and Capital Committee and Remuneration Committee.

Based on synthetic reports, presented periodically by the Management Board at least twice a year, prepared based on data resulting from operational risk monitoring, covering scale and types of operational risk the Bank is exposed to, risk concentration areas, the probability of its occurrence, the dimension of its possible negative impact, operational risk management principles and the operational risk profile, the Supervisory Board, supported by the Audit Committee and Risk and Capital Committee, monitors the effectiveness of internal control and risk management (in particular in relation to principles of operational risk management) and the Supervisory Board shall review the implementation by the Management of the strategy of operational risk management.

Assumptions of internal control of operational risk

Within the Management Board, one of its members – Risk Management Sector Head - supervises Independent Control and Operational Risk Department.

The Management Board is supported the by Risk and Capital Management Committee and subordinated Commissions.

Each Business Unit must establish an appropriate system of controls that are commensurate with the level of operational risk and other risks being managed, including proper documentation of the control procedures and appropriate staff training. Each Business Unit must evaluate the risks that are unacceptable or outside of the Business Unit's risk appetite/tolerance and determine the appropriate actions for their mitigation or transfer.

Settings of control standards, as well as monitoring of operational risk for key risk categories are supported by specialized Bank's organizational units.

Additionally, periodic assessment of adequacy and effectiveness of controls (Manager's Control Assessment), covers monitoring and testing of the adequacy and effectiveness of the Key Controls, at a frequency commensurate with the underlying risk and frequency of the control, and independent review by internal audit. In the case of identification of deficiency or an area of unacceptable risk, the management of the Business Unit is responsible for formulating a corrective action plan to resolve these deficiencies. Completion of corrective actions falls under independent monitoring and control.

The Audit Department (IA-Internal Audit) is responsible for independent assessment of the effectiveness of operational risk management processes and assessment of adequacy and effectiveness of operational risk management system, as well as for its regular reviews.

Results of internal and external audits are considered in the management information system, the process of decision making with regard to risk management and management of the Bank.

In December 2017 the Bank has enhanced its internal control system, among other changes, by implementation of vertical testing, conducted by second line of defense over control mechanisms executed by first line of defense.

EQUITY MANAGEMENT

According to the Banking Act, banks in Poland are obliged to maintain equity at a level adequate for their specific business risks.

The Bank's equity amounted to PLN 6,874,618 thousand as at 31 December 2017 (as at 31 December 2016: PLN 6,723,926 thousand). Regulatory capital, which include,d increases and decreases required by the Polish Financial Supervision Authority (KNF), amounted to PLN 4915,602 thousand (as at 31 December 2016: PLN 4,727,393 thousand) Such a capital level is considered sufficient for conducting business activity. The capital level is regularly monitored by using the capital adequacy ratio.

In 2008, the Bank launched the process of estimating internal capital. The Bank identified significant risks and assessed the capital required for coverage of these risks.

The Bank determines a policy of future dividend payment to the shareholders as part of the capital management process. The dividend policy depends on a number of factors including the Bank's profits, the Bank's expectations concerning future financial results, the level of capital requirements, as well as tax, regulatory and legal issues.

Financial data necessary to calculate the Bank's capital adequacy ratio is presented in the table below:

Capital adequacy ratio*

PLN'000	31.12.2017	31.12.2016
I Common Equity Tier 1 Capital	4,916,526	4,727,393
II Total capital requirements, including:	2,237,431	2,204,888
credit risk capital requirements	1,759,541	1,698,683
counterparty risk capital requirements	57,098	65,487
Credit valuation correction capital requirements	49,033	63,927
excess concentration and large exposures risks capital requirements	5,353	3,176

Capital adequacy ratio*

<i>PLN'000</i>	31.12.2017	31.12.2016
total market risk capital requirements	81,813	74,245
operational risk capital requirements	284,593	299,370
Common Equity Tier 1 Capital ratio	17.6%	17.2%

**Capital Adequacy Ratio was calculated according to the rules stated in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.*

In 2017, as well as in 2016, the Bank complied with all the regulatory prudential standards on capital adequacy.

48. Subsequent events

After 31 December 2017 there were no major events undisclosed in these financial statements, that could have a significant influence on the net result of the Bank.

Signatures of Management Board Members

21.03.2018	Sławomir S. Sikora	President of the Management Board	
..... Date	..... Name	..... Position/function	..... Signature
21.03.2018	Maciej Kropidłowski	Vice-President of the Management Board	
..... Date	..... Name	..... Position/function	..... Signature
21.03.2018	David Mouillé	Vice-President of the Management Board	
..... Date	..... Name	..... Position/function	..... Signature
21.03.2018	Barbara Sobala	Vice-President of the Management Board	
..... Date	..... Name	..... Position/function	..... Signature
21.03.2018	Katarzyna Majewska	Member of the Management Board	
..... Date	..... Name	..... Position/function	..... Signature
21.03.2018	Czesław Piasek	Member of the Management Board	
..... Date	..... Name	..... Position/function	..... Signature
21.03.2018	Natalia Bożek	Vice-President of the Management Board	
..... Date	..... Name	..... Position/function	..... Signature