Bank Pekao

Unconsolidated Financial Statements of Bank Pekao S.A. for the year ended on 31 December 2018

Warsaw, February 2019

This document is a free translation of the Polish original. Terminology current in Anglo-Saxon countries has been used where practicable for the purposes of this translation in order to aid understanding. The binding Polish original should be referred to in matters of interpretation.

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Unconsolidated income statement

(in PLN thousand)

	NOTE	2018	2017
Interest income	8	5 941 176	5 511 253
Financial assets measured at amortised cost		5 066 072	X
Financial assets measured at fair value through other comprehensive income		699 844	X
Financial assets measured at fair value through profit or loss		175 260	X
Interest expense	8	(1 072 163)	(1 024 509)
Net interest income		4 869 013	4 486 744
Fee and commission income	9	2 392 585	2 403 995
Fee and commission expense	9	(369 326)	(325 898)
Net fee and commission income		2 023 259	2 078 097
Dividend income	10	255 364	188 070
Result on financial assets and liabilities measured at fair value through profit or loss	11	66 710	31 822
Result on fair value hedge accounting	28	723	4 616
Result on derecognition of financial assets and liabilities not measured at fair value through profit or loss	12	140 652	X
Gains (losses) on disposal of financial assets and liabilities	13	X	186 757
OPERATING INCOME		**7 355 721**	**6 976 106**
Net impairment losses on financial assets and off-balance sheet commitments	14	(500 447)	(515 905)
NET RESULT ON FINANCIAL ACTIVITY		**6 855 274**	**6 460 201**
Administrative expenses	15	(3 607 875)	(3 488 435)
Personnel expenses		(1 781 967)	(1 739 984)
Other administrative expenses		(1 825 908)	(1 748 451)
Depreciation and amortization	16	(338 179)	(329 140)
Net result on other provisions		(14 663)	(28 526)
Net other operating income and expenses	17	41 207	113 593
OPERATING COSTS		**(3 919 510)**	**(3 732 508)**
Gains (losses) on subsidiaries and associates	18	(11 069)	-
Gains (losses) on disposal of property, plant and equipment, and intangible assets	19	96 056	92
PROFIT BEFORE INCOME TAX		**3 020 751**	**2 727 785**
Income tax expense	20	(710 151)	(639 656)
NET PROFIT		**2 310 600**	**2 088 129**
Earnings per share (in PLN per share)	21		
basic for the period		8.80	7.96
diluted for the period		8.80	7.96

Notes to the financial statements presented on pages 11 – 178 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of comprehensive income

(in PLN thousand)

	NOTE	2018	2017
Net profit		**2 310 600**	**2 088 129**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss:			
Change in fair value of financial assets measured at fair value through other comprehensive income:		12 472	X
Profit or loss on fair value measurement		141 158	X
Profit or loss reclassified to income statement after derecognition		(128 686)	X
Change in fair value of available-for-sale financial assets		X	229 601
Change in fair value of cash flow hedges	28	44 959	(33 143)
Tax on items that are or may be reclassified subsequently to profit or loss	20	(10 912)	(37 327)
Items that will never be reclassified to profit or loss:			
Effects of the revaluation or sale of investments in equity instruments designated at fair value through other comprehensive		(29 551)	X
Remeasurements of the defined benefit liabilities		404	8 589
Tax on items that will never be reclassified to profit or loss	20	5 550	(1 632)
Other comprehensive income (net of tax)		**22 922**	**166 088**
Total comprehensive income		**2 333 522**	**2 254 217**

Notes to the financial statements presented on pages 11 – 178 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of financial position

(in PLN thousand)

	NOTE	31.12.2018	31.12.2017
ASSETS			
Cash and due from Central Bank	23	12 972 575	5 186 259
Loans and advances to banks	24	2 508 553	2 692 930
Financial assets held for trading	25	890 339	1 734 768
Derivative financial instruments (held for trading)	26	1 455 976	1 351 344
Loans and advances to customers	27	122 349 115	128 873 178
1. Measured at amortised cost		120 349 597	X
2. Measured at fair value through profit or loss		302 630	X
3. Measured at fair value through other comprehensive income		1 696 888	X
Hedging instruments	28	313 565	259 396
Investment (placement) securities	29	38 333 179	36 625 996
1. Measured at fair value through profit or loss		65 408	X
2. Designated at fair value through profit or loss		-	-
3. Measured at fair value through other comprehensive income (debt securities)		26 904 574	X
4. Designated at fair value through other comprehensive income (equity instruments)		232 830	X
5. Measured at amortised cost		11 130 367	X
6. Available for sale		-	33 259 172
7. Held to maturity		-	3 366 824
Assets held for sale	30	11 550	51 450
Investments in subsidiaries		1 682 756	1 693 825
Investments in associates		-	-
Intangible assets	33	633 165	629 321
Property, plant and equipment	34	1 384 203	1 401 291
Investment properties		11 168	12 462
Income tax assets		840 988	717 726
1. Current tax assets		-	9 497
2. Deferred tax assets		840 988	708 229
Other assets		960 044	847 062
TOTAL ASSETS		**184 347 176**	**182 077 008**
EQUITY AND LIABILITIES			
Liabilities			
Amounts due to Central Bank	23	5 067	6 079
Amounts due to other banks	38	2 921 955	3 438 801
Financial liabilities held for trading	25	102 429	469 448
Derivative financial instruments (held for trading)	26	1 919 394	2 036 928
Amounts due to customers	39	150 132 028	146 898 298
Hedging instruments	28	905 056	862 331
Debt securities issued	40	1 732 596	1 470 000
Subordinated liabilities	41	2 012 485	1 257 188
Income tax liabilities		187 938	188 505
1. Current tax liabilities		187 938	188 505
2. Deferred tax liabilities		-	-
Provisions	42	654 960	593 635
Other liabilities		1 951 270	2 597 261
TOTAL LIABILITIES		**162 525 178**	**159 818 474**
Equity			
Share capital		262 470	262 470
Other capital and reserves		20 185 676	19 907 935
Retained earnings and net profit for the period		1 373 852	2 088 129
TOTAL EQUITY		**21 821 998**	22 258 534
TOTAL LIABILITIES AND EQUITY		**184 347 176**	**182 077 008**

Notes to the financial statements presented on pages 11 – 178 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of changes in equity

(in PLN thousand)

For the period from 1 January 2018 to 31 December 2018

	SHARE CAPITAL	OTHER CAPITAL AND RESERVES						RETAINED EARNINGS AND NET PROFIT FOR THE PERIOD	TOTAL EQUITY
		TOTAL OTHER CAPITAL AND RESERVES	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	OTHER		
Equity as at 1.01.2018	**262 470**	**19 907 935**	**9 137 221**	**1 982 459**	**8 612 550**	**(57 422)**	**233 127**	**2 088 129**	**22 258 534**
Initial application of IFRS 9	-	240 203	-	-	-	240 203	-	(936 748)	(696 545)
Equity as at 1.01.2018 - restated	**262 470**	**20 148 138**	**9 137 221**	**1 982 459**	**8 612 550**	**182 781**	**233 127**	**1 151 381**	**21 561 989**
Management options	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options exercised (share issue)	-	-	-	-	-	-	-	-	-
Revaluation of management options	-	-	-	-	-	-	-	-	-
Comprehensive income	**-**	**22 922**	**-**	**-**	**692**	**22 230**	**-**	**2 310 600**	**2 333 522**
Remeasurements of the defined benefit liabilities (net of tax)	-	327	-	-	-	327	-	-	327
Revaluation of debt financial instruments measured at fair value through other comprehensive income (net of tax)	-	10 102	-	-	-	10 102	-	-	10 102
Revaluation or sale of investments in equity instruments designated at fair value through other comprehensive income (net of tax)	-	(23 924)	-	-	692	(24 616)	-	-	(23 924)
Revaluation of hedging financial instruments (net of tax)	-	36 417	-	-	-	36 417	-	-	36 417
Net profit for the period	-	-	-	-	-	-	-	2 310 600	2 310 600
Appropriation of retained earnings	**-**	**14 616**	**-**	**-**	**14 616**	**-**	**-**	**(2 088 129)**	**(2 073 513)**
Dividend paid	-	-	-	-	-	-	-	(2 073 513)	(2 073 513)
Profit appropriation	-	14 616	-	-	14 616	-	-	(14 616)	-
Equity as at 31.12.2018	**262 470**	**20 185 676**	**9 137 221**	**1 982 459**	**8 627 858**	**205 011**	**233 127**	**1 373 852**	**21 821 998**

Notes to the financial statements presented on pages 11 – 178 constitute an integral part of the unconsolidated financial statements.

Unconsolidated statement of changes in equity

(in PLN thousand)

For the period from 1 January 2017 to 31 December 2017

	SHARE CAPITAL	OTHER CAPITAL AND RESERVES						RETAINED EARNINGS AND NET PROFIT FOR THE PERIOD	TOTAL EQUITY
		TOTAL OTHER CAPITAL AND RESERVES	SHARE PREMIUM	GENERAL BANKING RISK FUND	OTHER RESERVE CAPITAL	REVALUATION RESERVES	OTHER		
Equity as at 1.01.2017	**262 470**	**19 741 712**	**9 137 221**	**1 982 324**	**8 612 550**	**(223 510)**	**233 127**	**2 278 375**	**22 282 557**
Management options	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options exercised (share issue)	-	-	-	-	-	-	-	-	-
Revaluation of management share options	-	-	-	-	-	-	-	-	-
Comprehensive income	**-**	**166 088**	**-**	**-**	**-**	**166 088**	**-**	**2 088 129**	**2 254 217**
Remeasurements of the defined benefit liabilities	-	6 957	-	-	-	6 957	-	-	6 957
Revaluation of available-for-sale investments (net of tax)	-	185 977	-	-	-	185 977	-	-	185 977
Revaluation of hedging financial instruments (net of tax)	-	(26 846)	-	-	-	(26 846)	-	-	(26 846)
Net profit for the period	-	-	-	-	-	-	-	2 088 129	2 088 129
Appropriation of retained earnings	**-**	**135**	**-**	**135**	**-**	**-**	**-**	**(2 278 375)**	**(2 278 240)**
Dividend paid	-	-	-	-	-	-	-	(2 278 240)	(2 278 240)
Profit appropriation	-	135	-	135	-	-	-	(135)	-
Equity as at 31.12.2017	**262 470**	**19 907 935**	**9 137 221**	**1 982 459**	**8 612 550**	**(57 422)**	**233 127**	**2 088 129**	**22 258 534**

Notes to the financial statements presented on pages 11 – 178 constitute an integral part of the unconsolidated financ

Unconsolidated cash flow statement

(in PLN thousand)

	NOTE	2018	20178
Cash flow from operating activities – indirect method			
Net profit for the period		**2 310 600**	**2 088 129**
Adjustments for:		**(5 277 256)**	**(1 443 511)**
Depreciation and amortization	16	338 179	329 140
(Gains) losses on investing activities		(236 749)	(40 756)
Impairment on Investments in subsidiaries		-	4 600
Net interest income	8	(4 869 013)	(4 486 744)
Dividend income	10	(255 364)	(188 070)
Interest received		6 280 309	5 470 654
Interest paid		(1 056 723)	(1 035 829)
Income tax		710 151	639 656
Income tax paid		(701 827)	(336 586)
Change in loans and advances to banks		332 137	(22 423)
Change in financial assets held for trading		836 445	(1 013 029)
Change in derivative financial instruments (assets)		(104 632)	604 155
Change in loans and advances to customers		(7 484 633)	(9 765 225)
Change in investment (placement) securities		(646 228)	(198 390)
Change in other assets		(103 307)	(354 287)
Change in amounts due to banks		(325 747)	210 848
Change in financial liabilities held for trading		(367 019)	(203 717)
Change in derivative financial instruments (liabilities)		(117 534)	87 593
Change in amounts due to customers		3 231 864	8 857 960
Change in debt securities issued		(9 632)	(8 462)
Change in subordinated liabilities		5 297	7 188
Change in provisions		970	33 152
Change in other liabilities		(734 200)	(34 939)
Net cash flows from operating activities		**(2 966 656)**	**644 618**
Cash flow from investing activities			
Investing activity inflows		**146 545 988**	**63 947 355**
Sale of investment securities		145 276 591	63 083 547
Sale of intangible assets and property, plant and equipment	33, 34	73 552	152
Dividend received	10	255 364	188 070
Other investing inflows		940 481	675 586
Investing activity outflows		**(134 377 693)**	**(66 043 715)**
Acquisition of shares in subsidiary		-	(607 825)
Acquisition of investment securities		(134 058 724)	(65 083 389)
Acquisition of intangible assets and property, plant and equipment	33, 34	(318 969)	(352 501)
Net cash flows from investing activities		**12 168 295**	**(2 096 360)**

Notes to the financial statements presented on pages 11 – 178 constitute an integral part of the unconsolidated financial statements.

Unconsolidated cash flow statement

(in PLN thousand)

	NOTE	2018	2017
Cash flows from financing activities			
Financing activity inflows		**2 672 934**	**2 628 944**
Due to loans and advances received from banks	50	9 250	-
Issue of debt securities	50	1 913 684	1 378 944
Issue of subordinated liabilities	50	750 000	1 250 000
Financing activity outflows		**(3 935 510)**	**(2 633 506)**
Repayment of loans and advances received from banks	50	(216 237)	(139 462)
Redemption of debt securities	50	(1 645 760)	(215 804)
Dividends and other payments to shareholders		(2 073 513)	(2 278 240)
Net cash flows from financing activities		**(1 262 576)**	**(4 562)**
Total net cash flows		**7 939 063**	**(1 456 304)**
including: effect of exchange rate fluctuations on cash and cash equivalents held		92 587	(154 966)
Net change in cash and cash equivalents		**7 939 063**	**(1 456 304)**
Cash and cash equivalents at the beginning of the period	50	**7 293 707**	**8 750 011**
Cash and cash equivalents at the end of the period	50	**15 232 770**	**7 293 707**

Notes to the financial statements presented on pages 11 – 17 constitute an integral part of the unconsolidated financial statements.

Notes to the financial statements

(in PLN thousand)

The accompanying notes to the financial statements constitute an integral part of the unconsolidated financial statements.

1. General information

Bank Polska Kasa Opieki Spółka Akcyjna (hereafter 'Bank Pekao S.A.' or 'the Bank'), with its headhalfs in Warsaw 00-950, Grzybowska Street 53/57, was incorporated on 29 October 1929 in the Commercial Register of the District Court in Warsaw and has been continuously operating since its incorporation.

Bank Pekao S.A. is registered in the National Court Registry – Enterprise Registry of the Warsaw District Court XII Commercial Division of the National Court Registry in Warsaw under the reference number KRS 0000014843.

The Bank's shares are quoted on the Warsaw Stock Exchange (WSE). The Bank's securities, traded on regulated markets, are classified in the banking sector.

Bank Pekao S.A. is a universal commercial bank, offering a broad range of banking services on domestic and foreign financial markets, provided to retail and corporate clients, in compliance with the scope of services, set forth in the Bank's Articles of Association. The Bank runs both PLN and forex operations, and it actively participates in both domestic and foreign financial markets. Moreover, acting through its subsidiaries, the Group provides stockbroking, leasing, factoring operations and offering other financial services.

According to IFRS 10 'unconsolidated financial statements', the parent entity of Bank Pekao S.A. is Powszechny Zakład Ubezpieczeń S.A. (hereinafter 'PZU S.A.') with its registered office in Warsaw at Al. Jana Pawła II 24.

The share ownership structure of the Bank is presented in the Note 5.1 of the Report on the activities of Bank Pekao S.A. for the year of 2018.

2. Business combinations

In 2018 there were no business combinations.

3. Statement of compliance

The annual unconsolidated financial statements ('financial statements') of Bank Pekao S.A. have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union, 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 2018, item 395 with further amendments) and respective operating regulations, and in accordance with the requirements for issuers of securities admitted or sought to be admitted to trading on an official stock exchange listing market.

These unconsolidated financial statements were approved for publication by the Bank's Management Board on 25 February 2019.

4. Significant accounting policies

4.1 Basis of preparation of Unconsolidated Financial Statements

General information

The Unconsolidated Financial Statements of the Bank Pekao S.A. which have been prepared for the period from 1 January to 31 December 2018 based on the following valuation methods:

- at fair value for: derivatives, financial assets and liabilities held for trading, financial assets designated as measured at fair value through profit and loss at initial recognition, equity instruments, financial assets classified to business model whose objective is achieved by both collecting contractual cash flows and selling financial assets that do meet SPPI criteria and financial assets that do not meet SPPI criteria,
- at amortized cost for financial assets, classified to business model whose objective is to hold financial assets in order to collect contractual cash and meeting SPPI criteria at the same time, for other financial liabilities,
- at historical cost for non-financial assets and liabilities,
- non-current assets (or disposal Banks) classified as held for sale are measured at the lower of the carrying amount or the fair value less costs to sell.

Comparative data in these Unconsolidated Financial Statements of the Bank have been prepared based on the following valuation methods:

- at fair value for: derivatives, financial assets and liabilities held for trading, financial assets recognized initially at fair value through profit or loss and available-for-sale financial assets, except for those for which the fair value cannot be reliably measured,
- at amortized cost for other financial assets, including loans and advances and other financial liabilities,
- at historical cost for non-financial assets and liabilities or financial assets available for sale whose fair value cannot be reliably measured,
- non-current assets (or disposal Banks) classified as held for sale are measured at the lower of the carrying amount or the fair value less costs to sell.

The unconsolidated financial statements include the requirements of all the International Financial Reporting Standards and International Accounting Standards approved by the European Union and related interpretations. Changes in published standards and interpretations, which became effective on or after 1 January 2018, had no material impact on the Group's financial statements with the exception of IFRS 9 'Financial Instruments' (Note 4.9).

The Bank has adopted IFRS 9 'Financial Instruments' with a date of transition of 1 January 2018. The adoption of IFRS 9 has resulted in changes in the accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets.

The Bank has taken advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally have been recognized Retained earnings' and 'Revaluation reserves' as at 1 January 2018.

The Bank decided to take advantage of the choice which gives IFRS 9 and continues to apply the hedge accounting requirements of IAS 39. This decision will apply to all hedging relationships, for which the Bank applies and will apply hedge accounting in the future.

The financial statements does not take into consideration interpretations and amendments to Standards, pending approval by the European Union or approved by the European Union but came into force or shall come into force after the balance sheet date (Note 4.10 and Note 4.11).

In the Bank's opinion, amendments to Standards and interpretations will not have a significant influence on the consolidated financial statements of the Group, with the exception of IFRS 16 'Leases'.

IFRS 16 ‘Leases’

The Bank has adopted International Financial Reporting Standard 16 ‘Leases’ (hereinafter “IFRS 16”) with a date of transition of 1 January 2019.

The application of IFRS 16 resulted in changes to the Bank's accounting policy regarding the recognition, measurement and presentation of lease agreements. The Bank decided to recognize right-of-use assets in the statement of financial position ‘Property, plant and equipment’ and lease liabilities - in the statement of financial position ‘Amounts due to customers’.

The Bank recognizes the lease contract as a component of the right-to-use assets and the corresponding lease liability on the date when the subject of the lease is available for use. Each lease payment is allocated between the liability and accrued interest on the liability. Interest expense is recognized in the income statement over the lease term to obtain a constant periodic interest rate on the remaining balance of the lease liability. The right-of-use asset is depreciated on a straight-line basis over the shorter of two periods: the useful life of the asset or the lease term.

On the date when the lease commences, the Bank, as the lessee, measures the lease liability in the present value of lease payments outstanding as at that date. The leasing liability includes the current value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable,
- variable lease payments that depend on an index or a rate,
- amounts expected to be payable by the lessee under residual value guarantees,
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option, and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

The lease payments are discounted using the interest rate implicit in the lease, if the rate can be readily determined, or the Bank’s incremental borrowing rate.

The right-to-use assets are measured at cost, including:

- the amount of the initial measurement of the lease liability,
- any lease payments made at or before the commencement date, less any lease incentives received,
- any initial direct costs incurred by the lessee, and
- an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located, whether the lessee incurs the obligation for those costs.

Short-term lease payments and payments for leases of low-value assets are recognized as an expense in the income statement on a straight-line basis. Short-term lease contracts are lease contracts that have a lease term of 12 months or less. Low-value assets include mainly lease of space (land) for ATMs.

In accordance with the transitional provisions included in IFRS 16, the Bank decided to apply IFRS 16 retrospectively with the recognition of the potential cumulative effect of the first application in the item ‘Retained earnings’ as at 1 January 2019.

As at the date of first application of IFRS 16, the Bank recognized new right-of-use assets of the Bank's Head Office, the Bank's branches buildings, perpetual usufruct rights and IT infrastructure. For these lease contracts, previously classified as operating leases in accordance with IAS 17, the Bank recognized leases as leasing liabilities measured at the present value of remaining lease payments discounted using the Bank’s incremental borrowing rates and recognized the right-to-use assets in the amount equal to leasing liabilities, adjusted by the amount of any prepayments or accrued lease payments relating to these leases, recognized in the statement of financial position prior to the date of first application.

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Notes to the financial statements (cont.)

(in PLN thousand)

The impact of first application of IFRS 16 as at 1 January 2019 is presented the table below.

	IMPACT OF FIRST APPLICATION OF IFRS 16 AS AT 01.01.2019
Property, plant and equipment	572 267
Other assets	(35 807)
Amounts due to customers	536 460

The first application of IFRS 16 had no impact on the item “Retained earnings”.

The incremental borrowing rates calculated by the Bank and applied to the leasing liabilities on 1 January 2019 were in the range (depending on the duration of the contract):

- for contracts in PLN: from 2.03% to 4.20%,
- for contracts in EUR: from 0.16% to 2.39%,
- for contracts in USD: from 3.31% to 4.11%,
- for contracts in GBP: from 1.41% to 2.78%.

The reconciliation of operating lease liabilities disclosed in accordance with IAS 17 Leases and the lease liabilities recognized on the date of the first application of IFRS 16 is presented in the table below.

	RECONCILIATION OF LEASING LIABILITIES
Operating lease liabilities disclosed as at 31 December 2018	**357 255**
Discount effect using the above disclosed incremental borrowing rates on the date of first application	(20 081)
Financial lease liabilities recognized as at 31 December 2018	38 014
Recognition of new assets in the form of perpetual usufruct rights and IT infrastructure	209 241
(Less): short-term leases recognized on a straight-line basis as expense	(9 684)
(Less): low-value leases recognized on a straight-line basis as expense	(271)
Leasing liabilities recognized as at 1 January 2019	**574 474**

Applying IFRS 16 for the first time, the Bank applied the following practical expedients permitted by the new standard:

- application of a single discount rate to a portfolio of leases with reasonably similar characteristics,
- exclusion the initial direct costs from the measurement of the right-of-use assets,
- a lessee may use hindsight in determining the lease term, if the contract contains options to extend or terminate the lease.

The following is a summary of the significant accounting policies applicable from 1 January 2018, as well as the accounting policies used to compile the comparative data.

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Notes to the financial statements (cont.)

(in PLN thousand)

4.2 Accounting estimates

Preparation of financial statements in accordance with IFRS requires the Bank to make certain estimates and to adopt certain assumptions, which affect the amounts of assets and liabilities presented in the financial statements.

Estimates and assumptions are reviewed on an ongoing basis and rely on historic data and other factors including expectation of the future events which seems justified in given circumstances. Although the estimates are based on the best knowledge of current conditions and activities which the Bank will undertake, the actual results may differ from such estimates.

Estimates and underlying assumptions are subject to regular review. Revisions to accounting estimates are recognized prospectively starting from the period in which the estimates are revised.

Information on the applied estimates and the underlying uncertainity related to significant risk of the material adjustments in the financial statements are presented below.

Impairment of loans and advances to customers, expected credit losses

At each balance sheet date the Bank assesses whether there is any objective evidence ('trigger') that credit exposures are impaired. Impairment losses are incurred if, and only if at least one impairment trigger, which has a negative impact on the estimated future cash flows of the credit exposure, is identified.

In the process of impairment assessment the Bank considers all credit exposures, irrespective of the level of risk of particular credit exposures or a group of credit exposures.

The Bank splits the credit exposures into individually significant exposures and individually insignificant exposures. The individually significant exposures are in particular all credit exposures of the borrower, for whom total Bank's exposure exceeds the threshold value as at balance sheet date and the restructuring credit exposures of debtors being the entrepreneurs within the meaning of the Article 43 of the Civil Code. The individually insignificant exposures are all credit exposures, which are not classified as individually significant exposures.

For all loans exposures, which are impaired, the Bank measures the amount of impairment allowance as the difference between the credit exposure's carrying amount and the present value of estimated future cash flows, discounted at the credit exposure's original effective interest rate.

For all individually significant exposures, which are impaired as at balance sheet date, the Bank measures the impairment allowance (impairment loss) as part of individual assessment. The individual assessment is carrying out by the Bank's employees and consists of individual verification of the impairment occurrence and projection of future cash flows from foreclosure less costs for obtaining and selling the collateral or other resources.

The Bank compares the estimated future cash flows applied for measurement of individual impairment allowances with the actual cash flows on a regular basis.

For all individually insignificant exposures, for which impairment triggers have been identified and for all credit exposures, for which no impairment triggers have been identified, the Bank measures the allowance according to IFRS 9 based on the expected credit losses and taking into account forecasts and expected future economic conditions in the context of credit risk exposure assessment in the period of 12 months or in the lifetime horizon (hereinafter referred to as 'ECL').

More information about the applied assumptions and the underlying uncertainty related to the estimates in respect to expected credit losses, as well as the sensitivity analysis concerning impairment of loans and advances estimates were presented in Note 5.2 'Credit risk'.

Notes to the financial statements (cont.)

(in PLN thousand)

Impairment of non-current assets

At each balance sheet date the Bank reviews its assets for indications of impairment. Where such indications exist, the Bank makes a formal estimation of the recoverable value. If the carrying amount of a given asset is in excess of its recoverable value, impairment is defined and a write-down is recorded to adjust the carrying amount to the level of its recoverable value. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value-in-use.

Estimation of the value-in-use of an assets (or cash generating unit) requires assumptions to be made regarding, among other, future cash flows which the Bank may obtain from the given asset (or cash generating unit), any changes in amount or timing of occurrence of these cash flows and other factors such as the lack of liquidity. The adoption of different measurement assumptions may affect the carrying amount of some of the Bank's non-current assets.

Measurement of derivatives, unquoted debt securities measured at fair value through other comprehensive income and loans and advances to customers measured at fair value through other comprehensive income and measured at fair value through profit or loss

The fair value of non-option derivatives, debt securities measured at fair value through other comprehensive income and loans and advances to customers measured at fair value through other comprehensive income and measured at fair value through profit or loss that do not have a quoted market price on an active market is measured using valuation models based on discounted cash flows. Options are valued using option valuation models. Variables used for valuation purposes include, where possible, the data from observable markets. However, the Bank also adopts assumptions concerning counterparty's credit risks which affect the valuation of instruments. The adoption of other measurement assumptions may affect the valuation of these financial instruments. The assumptions used for fair value measurement are described in detail in Note 5.7 'Fair value of financial assets and liabilities'.

Provisions for defined benefit plans

The principal actuarial assumptions applied to estimation of provisions for defined benefit plans, as well as the sensitivity analysis were presented in Note 44.

Goodwill

The Bank performs an impairment test of goodwill on a yearly basis or more often if impairment triggers occur. The assessment of goodwill impairment requires an estimate of value in use of all cash-generating units to which the goodwill relates. The principal assumptions applied to an impairment test of goodwill were presented in Note 33.

4.3 Foreign currencies

- Transactions and balances
  Foreign currency transactions are calculated into the functional currency using the spot exchange rate from the date of the transaction. Gains and losses from foreign currency translation differences resulting from settlements of such transactions and from the statement of financial position valuation of monetary assets and liabilities expressed in foreign currencies are recognized in the income statement.
- Foreign currency translation differences arising from non-monetary items, such as equity instruments classified as financial assets measured at fair value through the profit or loss are recognized together with the changes in the fair value of that item in the income statement.
- Foreign currency translation differences arising from non-monetary items such as equity instruments classified as financial assets measured at fair value through other comprehensive income are recognized in the revaluation reserves.

The foreign exchange rate differences from the valuation of foreign entities are accounted for as a separate component of equity.

Goodwill arising on acquisition of the entity operating abroad as well as any adjustments of the balance sheet value of assets and liabilities to fair value arising on the acquisition of the entity are treated as assets and liabilities of a foreign entity i.e. they are expressed in the functional currency of the overseas entity and translated at the closing exchange rate as described above.

Notes to the financial statements (cont.)

(in PLN thousand)

4.4 Income statement

Interest income and expense – principles applied since 1 January 2018

The Bank recognizes in the income statement all interest income and expense related to financial instruments measured at amortized cost using the effective interest rate method, financial assets measured at fair value through other comprehensive income and financial assets and liabilities measured through profit or loss.

The effective interest rate is the discount rate of estimated future cash inflows and payments made during the expected period until the expiry date of the financial instruments, and in justified cases in a shorter time, to the gross carrying amount of such financial asset or to the amortised cost of financial liability. The calculation of the effective interest rate includes all commissions paid and received by parties to the agreement, transaction costs and all other premiums and discounts, comprising an integral part of the effective interest rate.

Interest income includes interest and commission fees received or due from loans, interbank deposits and securities measured at amortised cost recognized in the calculation of effective interest rate of loans and financial assets measured at fair value through other comprehensive income or through profit or loss and hedging derivatives.

Gross carrying amount of the financial asset is the basis for interest income calculation except for credit-impaired financial assets and purchased or originated credit-impaired financial assets (POCI assets). At the recognition of impairment of financial assets measured at amortized cost or financial assets measured at fair value through other comprehensive income, the interest income is still recognized in profit or loss but is calculated by applying the effective interest rate to the gross carrying amount less the impairment charges.

Interest expense related to liabilities associated with client accounts and debt securities issued are recognized in the profit or loss using the effective interest rate.

Interest income and expense – principles applied until 31 December 2017

The Bank recognizes in the income statement all interest income and expense related to financial instruments valued at amortized cost using the effective interest rate method, financial assets available for sale and financial assets at fair value through profit or loss.

The effective interest rate is the discount rate of estimated future cash inflows and payments made during the expected period until the expiry of the financial instruments, and in justified cases in a shorter time, to the net carrying amount of such financial assets or liabilities.

The calculation of the effective interest rate includes all commissions paid and received by parties to the agreement, transaction costs and all other premiums and discounts, comprising an integral part of the effective interest rate.

Interest income includes interest and commission fees received or due from credits, interbank deposits and held to maturity securities, recognized in the calculation of effective interest rate, as well as from securities available for sale and measured at fair value through the income statement and hedging derivatives.

At the recognition of impairment of financial instruments measured at amortized cost and of available for sale financial assets, the interest income is accrued based on the carrying amount of the receivable (this is the new, lower value reduced by the impairment charge) using the interest rate used when discounting the future cash flows for impairment calculation.

Interest expense of the reporting period related to interest liabilities associated with client accounts and liabilities from the issue of treasury stock are recognized in the income statement using the effective interest rate.

Notes to the financial statements (cont.)

(in PLN thousand)

Fee and commission income and expense

Fee and commission income is generated from financial services provided by the Bank. Fee and commission income and expense is recognized in the profit or loss using the following methods:

- fees and commissions directly attributable to financial asset or liability origination (both income and expense) are recognized in the income statement using the effective interest rate method and are described above,
- fees and commissions relating to the loans and advances without a defined repayment schedule and without a defined interest rate schedule e.g. overdraft facilities and credit cards are amortized over the life of the product using the straight line method,
- other fees and commissions arising from the Bank's financial services offering (customer account transaction charges, credit card servicing transactions, bonuses from card providers in order to cover the marketing card cost, brokerage activity and canvassing) as well as the trade margins on foreign exchange transactions with the Bank's clients are recognized in the income statement up-front when the corresponding service is provided.

Income and expense from bancassurance

The Bank splits the remuneration for sale of insurance products linked to loans into separate components, i.e. dividing the remuneration into proportion of fair value of financial instrument and fair value of intermediary service to the sum of those values. The fair values of particular components of the remuneration are determined based on market data to a highest degree.

The particular components of the Bank's remuneration for sale of insurance products linked to loans are recognized in the income statement according to the following principles:

- remuneration from financial instrument – as part of effective interest rate calculation, included in interest income,
- remuneration for intermediary service – upfront at the time when the insurance product in sold, included in fee and commission income.

Additionally the Bank estimates the part of the remuneration which will be refunded in the future (eg. due to early termination of insurance contract, early repayment of loan). The estimate of the provision for future refunds is based on the analysis of historical data and expectations in respect to refunds trend in the future.

Result on financial assets and liabilities measured at fair value through profit or loss – principles applied since 1 January 2018

Result on financial assets measured at fair value through profit or loss includes:

- Foreign exchange result
  The foreign exchange gains (losses) are calculated taking into account the positive and negative foreign currency translation differences, whether realized or unrealized from the daily valuation of assets and liabilities denominated in foreign currencies. The revaluation is perform using the average exchange announced by the NBP on the balance sheet date.

  The foreign exchange result includes swap points from derivative transactions, entered into by the Bank for the purpose of managing the Bank's liquidity in foreign currencies.
  Income from foreign exchange positions includes also foreign currency translation differences from valuation of investments in foreign operations arising on disposal thereof. Until the disposal, foreign currency translation differences from valuation of assets in foreign operations are recognized in 'Other capital and reserves'.
- Result on derivatives, loans and advances to customers and securities measured at fair value through profit or loss.
  The income referred to above includes gains and losses realized on a sale or a change in the fair value of the assets mentioned above.
  The accrued interest and unwinding of a discount or a premium on loans and advances to customers and debt securities measured at fair value through profit or loss is presented in the net interest income.

Result on financial assets and liabilities held for trading – principles applied until 31 December 2017

Result on financial assets and liabilities held for trading include:

- Foreign exchange result
  The foreign exchange gains (losses) are calculated taking into account the positive and negative foreign currency translation differences, whether realized or unrealized from the daily valuation of assets and liabilities denominated in foreign currencies. The revaluation is perform using the average exchange announced by the NBP on the balance sheet date.
  The foreign exchange result includes swap points from derivative transactions, entered into by the Bank for the purpose of managing the Bank's liquidity in foreign currencies.
  Income from foreign exchange positions includes also foreign currency translation differences from valuation of investments in foreign operations arising on disposal thereof. Until the disposal, foreign currency translation differences from valuation of assets in foreign operations are recognized in 'Other capital and reserves'.
- Income from derivatives and securities held for trading
  The income referred to above includes gains and losses realized on a sale or a change in the fair value of assets and liabilities held for trading.
  The accrued interest and unwinding of a discount or a premium on securities held for trading is presented in the net interest income.

Gains (losses) on financial assets/liabilities designated at fair value through profit or loss

This includes gains and losses realized on a sale or a change in the fair value of assets and liabilities, designated at fair value through profit or loss.

The accrued interest and unwinding of a discount or a premium on financial assets/ liabilities designated at fair value through profit or loss are recognized in the interest result.

Other operating income/expense

Other operating income includes mainly amounts received for compensation, revenues from operating leases, recovery of debt collection costs, excess payments, miscellaneous income and releases of provision for legal cases. Other operating expenses include mainly the costs of client claims, compensation paid, sundry expenses and costs of provision for litigations.

4.5 Valuation of financial assets and liabilities, derivative financial instruments

Financial assets – principles applied since 1 January 2018

Financial assets are classified into the following categories:

- financial assets measured at amortised cost,
- financial assets measured at fair value through other comprehensive income,
- financial assets measured at fair value through profit or loss.

The above mentioned classification is based on the entity's business model for managing the financial assets and the characteristics regarding the contractual cash flows (i.e. whether the contractual payments are solely payments of principal and interest on the principal amount outstanding 'SPPI').

The financial assets could be classified depending on the Bank's business model to the following categories:

- a business model whose objective is to hold financial assets in order to collect contractual cash flows,
- a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets,
- a business model whose object is to held financial assets for trading and other business models.

Notes to the financial statements (cont.)

(in PLN thousand)

The business model assessment

The assessment of the business model is made at the initial recognition of the asset (with the exception of the first adoption of IFRS 9 – when implementing the Standard, the Bank classifies the particular Banks of the asset in accordance with the business model applied at the date of the implementation of the IFRS 9 i.e. 1 January 2018, not at the initial recognition of the financial asset.

The business model criteria refers to the way the Bank's managing financial assets in order to generate cash flows.

The Bank evaluates the purpose of the business model, to which the particular financial assets are classified on the level of particular portfolios of the assets – performing the analysis on those portfolio level is a reliable reflection of the Bank's business activities regarding these models and also reflects to information analysis of those activities provided to the Bank's management.

The assessment of the business model is based on the analysis of the following information regarding the portfolio of the financial assets:

- applied policies and business aims for the particular portfolio and its practical implementation. In particular, the management's strategy regarding the acquisition of revenues from contractual interest payments, maintaining a specific interest rate profile of the portfolio, managing the liquidity gap and obtaining cash flows as a result of the sale of financial assets is assessed,
- the manner in which the profitability of the portfolio is assessed and reported to the Bank's Management Board,
- types of risk that affect the profitability and effectiveness of a given business model (and financial assets held under this business model) and the manner of managing the identified types of risk,
- the way in which the managers of business operations are remunerated under a given business model - eg whether the remuneration depends on changes in the fair value of financial assets or the value of contractual cash flows obtained,
- frequency, value and moment of sale of financial assets made in prior reporting periods, the reasons for these sales and expectations regarding future sales activity. However, information on sales activity is analyzed taking into account the overall assessment of the Bank's implementation of the adopted method of managing financial assets and generating cash flows.

Financial assets held for trading or managed based on their fair value are measured at fair value through profit or loss, as they are not part of the business model, the purpose of which is to benefit from contractual cash flows from held financial assets or the purpose of which is to benefit from acquiring contractual cash flows and from the sale of financial assets.

Before making a decision regarding allocating a portfolio of financial assets to a business model which purpose is to obtain contractual cash flows, the Bank reviews and evaluates significant and objective quantitative data influencing the allocation of asset portfolios to the relevant business model, in particular:

- the value of sales of financial assets made within the particular portfolios,
- the frequency of sales of financial assets as part of particular portfolios,
- expectation analysis regarding the value of planned sales of financial assets and their frequency of the particular portfolios, this analysis is carried out on the basis of probable scenarios of the Bank's business activities in the future.

The portfolios of financial assets from which sales are made that do not result from an increase in credit risk meet the assumptions of the business model, which purpose is to obtain contractual cash flows, provided that these sales:

- are at low volume (even with a relatively high frequency of sales) or
- are made rarely - as a result of one-off events, which the probability to occur again in the future, according to the Bank's professional judgment is rare (even with a relatively high volume) or
- they occur close to the maturity date of the financial assets being sold, and the revenue obtained from such sales is similar to those which could be obtained from remaining contractual cash flows as if the financial asset was held in the Bank's portfolio to the original maturity date.

Notes to the financial statements (cont.)

(in PLN thousand)

The following sales are excluded from the analysis of sales value:

- the sales resulting from an increase in the credit risk of financial assets, regardless of their frequency and volume,
- the sales resulting from one-off events, which the probability to occur again in the future, according to the Bank's professional judgment is rare,
- the sales made close to maturity.

A held to obtain contractual cash flows or sale business model includes a portfolio of financial assets whose purpose is, in particular, managing current liquidity levels, maintaining the assumed profitability profile and / or adjust the duration of the asset and financial liabilities, and a level of sales are higher than for those financial assets classified in a model which purpose is to obtain contractual cash flows.

The business model comprising financial assets held for sale and other includes assets that do not meet the criteria to be classified into the business model, which purpose is to obtain contractual cash flows the business model which purpose is to obtain contractual cash flows or sales and also acquiring cash flows from interest and capital is not the main business target.

Assessment, whether the contractual payments are solely payments of principal and interest on the principal amount outstanding (SPPI criteria)

For the purposes of assessing cash flow characteristics, 'principal' is defined as the fair value of a financial asset at the time of initial recognition. 'Interest' is defined as the time value of money and the credit risk related to the unpaid part of principal and also other risks and costs associated with a standard loan agreement (e.g. liquidity risk or administrative costs) and margin.

When assessing whether the contractual cash flows constitute solely payments of principal and interest, the Bank analyzes contractual cash flows. This analysis includes an assessment whether the contractual terms include any provisions that the contractual payments could be changed or the amount of the contractual payments could be changed in a way that from an economic point of view they will not only represent repayments of principal and interest on the outstanding principal. When making this assessment, the Bank takes into account the occurrence of, among others:

- conditional events that may change the amount or timing of the payment,
- financial leverage (for example, interest terms include a multiplier greater than 1),
- terms regarding the extension of the contract or prepayment option,
- terms that the Bank's cash flow claim is limited to a specified assets (eg non-recourse assets),
- terms that modify the time value of money – e.g. mismatch of the frequency of the revaluation of the reference interest rate to its tenor.

The SPPI test is conducted for each financial asset classified into the business model, which purpose is to obtain contractual cash flows or a business model which purpose is to obtain contractual cash flows or sale, as at the initial recognition date or as at the latest significant annex changing the terms of contractual cash flows.

Notes to the financial statements (cont.)

(in PLN thousand)

The Bank performs an SPPI test at the level of homogeneous Banks of standard products or at the level of a single contract for non-standard products or at the level of ISIN code for debt securities.

In situation when the time value of money is modified for a particular financial asset, the Bank is required to make an additional assessment (i.e. Benchmark Test) to determine whether the contractual cash flows are still solely payments of principal and interest on the principal amount outstanding by determining how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not be modified (the benchmark cash flows). Benchmark Testing is not permitted for situation that some terms modify contractual cash flows, such as the built-in leverage element.

Financial assets measured at amortized cost

Financial assets are measured at amortized cost if at the same time they meet the following two criteria:

- the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI criteria are met).

Financial assets measured at amortized cost include amounts due from the Central Bank, amounts due from other banks, loans and advances to customers, investment debt securities, receivables reverse-repo and buy-sell-back transactions, meeting the criteria described in the previous paragraph.

Upon initial recognition, these assets are measured at fair value increased by transaction costs that are directly attributable to the acquisition or issue of a financial asset.

After initial recognition, these assets are measured at amortized cost using the effective interest rate. The calculation of the effective interest rate includes all commissions paid and received by the parties, transaction costs and other bonuses and discounts constituting an intergrated part of the effective interest rate.

Interest accrued using the effective interest rate is recognized in net interest income.

Since the impairment recognition, the interest recognized in the income statement is calculated based on the net carrying amount, whereas the interest recognized in the statement of financial position is accrued on the gross carrying amount. The impairment allowances are estimated for the part of accrued interest exposure, which the Bank consider as difficult to recover.

Allowances for expected credit losses reduce the gross carrying amount of assets, on the other hand they are recognized in the income statement under 'Net impairment losses on financial assets and off-balance sheet commitments.

Financial assets measured at fair value through other comprehensive income

Financial assets (excluding equity instruments) are measured at fair value through other comprehensive income when they simultaneously meet the following two conditions and have not been designated for measurement at fair value through profit or loss:

- the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI criteria are met).

Financial assets measured at fair value through other comprehensive income include investment debt securities as well as loans and advances to customers that meet the criteria described in the previous paragraph.

Interest accrued using the effective interest rate is recognized in net interest income.

The effects of changes in fair value are recognized in other comprehensive income until the asset is excluded from the statement of financial position, when accumulated profit or loss is recognized in the income statement under 'Result on derecognition of financial assets and liabilities not measured at fair value through profit or loss'.

Notes to the financial statements (cont.)

(in PLN thousand)

An allowance for expected credit losses from financial assets that are measured at fair value through other comprehensive income is recognized in other comprehensive income and does not reduce the carrying amount of the financial asset in the statement of financial position. On the other hand, an expected credit risk allowance is recognized in the income statement under 'Net impairment losses on financial assets and off-balance sheet commitments'.

Purchased or originated credit-impaired financial assets (POCI)

The Bank distinguishes the category of purchased or originated credit-impaired assets. POCI are assets that are credit-impaired on initial recognition. Financial assets that were classified as POCI at initial recognition should be treated as POCI in all subsequent periods until they are derecognition.

POCI assets may arise through:

- by purchasing a contract that meets the definition of POCI (e.g. as a result of a merger with another entity or purchase of a portfolio of assets),
- by concluding a contract that is POCI at the time of original granting (e.g. granting a loan to a customer in a bad financial condition),
- by modifying the contract (e.g. under restructuring) qualifying this contract to be derecognised, resulting in a recognitionof a new contract meeting the definition of POCI.

Conditions for qualifying a contract to be derecognised are described below.

At initial recognition, POCI assets are recognized in the balance sheet at their fair value, in particular they do not have recognized impairment allowance.

POCI assets do not constitute a separate accounting category of financial assets. They are classified into accounting categories in accordance with the general principles for classification of financial assets. The categories in which POCI assets may exist are a category of financial assets measured at amortized cost and financial assets measured at fair value through other comprehensive income.

Investments in equity instruments

For investments in equity instruments not held for trading, the Bank may irrevocably choose to present changes in their fair value in other comprehensive income. The Bank makes a decision in this respect based on an individual analysis of each investment. In sucha a case the amounts presented in other comprehensive income are not subsequently transferred to profit or loss. In case of sale of an equity investment elected to be measured at fair value through other comprehensive income, a result on sale is transferred to the item 'Other reserve capital'.

Equity investments not designated for measurement at fair value through other comprehensive income at the initial recognition are measured at fair value through profit or loss. Changes in the fair value of such investments, as well as the result on sales, are recognized in the income statement under 'Result on financial assets and liabilities measured at fair value through profit or loss'.

Dividends from equity instruments, both measured at fair value through profit or loss and designated for valuation through other comprehensive income, are recognized in the income statement when the Bank's right to receive payment is established.

Financial assets at fair value through profit or loss

In this category, the Bank qualifies derivatives (non-hedging instruments), debt and equity securities, loans and receivables that were acquired or included in this category with the intention of selling in the short term. In addition, this category includes financial assets not held for trading that are compulsorily measured at fair value through profit or loss for which the SPPI test has not been passed.

Moreover, at initial recognition, the Bank may irrevocably designate selected financial assets that meet the amortized cost measurement criteria or at fair value through other comprehensive income for measurement at fair value through profit or loss if it eliminates or significantly reduces the accounting mismatch that would otherwise arise from measuring assets at different methods.

Standardized purchase and sale transactions of financial assets the Bank, are recognized and derecognized by the Bank on the settlement date of such transaction, i.e. as at the date of receipt or delivery of such assets.

Changes in the fair value of assets, which occur during the period from transaction date to transaction settlement date, shall be recognized similarly as in the case of the asset held.

Credits and loans are recognized on the date of cash disbursement to the debtor.

Derivative instruments are recognized or derecognized on transaction dates.

Reclassification of financial assets - principles applied from 1 January 2018

Financial assets are not reclassified in the reporting periods following the initial recognition, except for the reporting period following the change of the business model for managing financial assets by the Bank.

The reclassification of financial assets is applied prospectively from the reclassification date - without restatement of previously recognized gains or losses (including impairment gains or losses) or interest.

The following are not changes in business model:

- a change in intention related to particular financial assets (even in circumstances of significant changes in market conditions),
- the temporary disappearance of a particular market for financial assets,
- a transfer of financial assets between parts of the entity with different business models.

Modifications of financial assets - principles applied from 1 January 2018

If the terms of the financial asset agreement change, the Bank assesses whether the cash flows generated by the modified asset differ significantly from those generated by the asset before modifying the terms of its agreement. If a significant difference is identified, the original financial asset is derecognised, and the modified financial asset is recognized in the books at its fair value.

If the cash flows generated by the modified asset measured at amortized cost are not materially different from the original cash flows, the modification does not result in derecognition of the financial asset. In this case, the Bank recalculates the gross carrying amount of the financial asset. Quantitative information about financial assets that were subject to modification that didn't result in derecognition was presented in Note 5.2 “Credit risk”.

The assessment whether a given modification of financial assets is significant or insignificant modification depends on the fulfillment of qualitative and quantitative criteria.

The Bank has adopted the following quality criteria to determine significant modifications:

- currency conversion, unless it results from existing contractual provisions or requirements of applicable legal regulations,
- change (replacement) of the debtor, excluding the addition / departure of the joint debtor or taking over the loan in inheritance,
- consolidation of several exposures into one under an annex or settlement / restructuring agreement,
- change in the terms of the contract resulting in a change in the result of the SPPI test.

The occurrence of at least one of these criteria results in a significant modification.

The Bank has adopted the following quantitative criteria to determine significant modifications:

- extension of the loan term by at least one year and at least a doubling of the residual maturity to the original maturity (meeting both conditions jointly) for Stage 1 and Stage 2, or
- increasing the current loan amount / limit by at least 10% for Stage 1 and Stage 2 or increasing the current loan amount / limit for a contract in Stage 3.

If the terms of a financial asset agreement are modified, and the modification does not result in derecognition of the asset from the balance sheet, the determination, whether the credit risk of a given asset significantly increases, is made by comparing:

- lifetime PD on the reporting date, based on modified conditions, with
- lifetime PD estimated on the basis of data valid at the date of initial recognition and initial contractual terms.

In the case of modification of financial assets, the Bank analyzes whether the modification has improved or restored the Bank's ability to collect interest and principal. As part of this process, the Group assesses the borrower's ability to pay in relation to modified terms of agreement..

Impairment of financial assets - principles applied from 1 January 2018

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

1) significant financial difficulty of the issuer or the borrower,
2) a breach of contract, such as a default or past due event,
3) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider,
4) it is becoming probable that the borrower will enter bankruptcy or other financial reorganization,
5) the disappearance of an active market for that financial asset because of financial difficulties, or
6) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

The Bank recognises a loss allowance for expected credit losses on a financial asset that is measured at amortised cost or at fair value through other comprehensive income, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract.

A loss allowance for financial assets that are measured at fair value through other comprehensive income is recognised in other comprehensive income and is not reducing the carrying amount of the financial asset in the statement of financial position.

If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, the Bank measures the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses.

At each reporting date, the Bank measures the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses if the credit risk on that financial instrument has increased significantly since initial recognition.

The Bank recognises in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this chapter.

For loan commitments and financial guarantee contracts, the date that the Bank becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.

Since initial recognition of POCI assets, the Bank recognises the cumulative changes in lifetime expected credit losses as a loss allowance for purchased or originated credit-impaired financial assets. At each reporting date, the Bank recognises in profit or loss the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition.

The Bank measures the loss allowance at an amount equal to lifetime expected credit losses for:

1) trade receivables or contract assets that result from transactions that are within the scope of IFRS 15,
2) lease receivables that result from transactions that are within the scope of IAS 17.

Expected credit losses are not recognized for impairment of equity instruments.

The methodology for calculating expected credit losses is described in detail in 'The description of the model for impairment allowance' in Note 5.2.

Financial assets – principles applied until 31 December 2017

Financial assets are classified into the following categories:

- Financial assets measured at fair value through profit or loss
  This category comprises two sub-categories: financial assets held for trading and financial assets designated at initial recognition as financial assets measured at fair value through profit or loss.

  Financial assets held for trading include: debt and equity securities, loans and receivables purchased or classified into this category for the purpose of disposal thereof on a short-term basis. The classification also includes derivative instruments (not used as hedging instruments).

  Financial assets classified at the moment of original recognition as financial assets measured at fair value through profit or loss include debt securities acquired by the Bank for the purpose of elimination or considerable reduction of inconsistencies in the valuation between these securities and the derivatives, which are economically hedging the interest rate risk of such securities. Otherwise, such securities would have been classified into the available for sale portfolio, with the effect of valuation recognized in revaluation reserves, and valuation of derivatives economically hedging such securities reported in the income statement.

- Held to maturity
  These are non-derivative financial assets with fixed or determinable payments and fixed maturity, for which the entity has an intent and ability to hold to maturity, other than:
  a) those that the entity upon initial recognition designates as at fair value through profit or loss,
  b) those that the entity designates as available for sale, and
  c) those that meet the definition of loans and receivables.

  Financial assets classified into this category are measured at amortized cost using the effective interest rate method. The recognition of amortized cost with the use of effective interest rate is recognized in interest income.

- Loans and receivables
  Loans and receivables are non-derivative financial assets, with fixed or determinable payments, not quoted on active markets, other than:
  a) those that the entity intends to sell immediately or in the near term which are classified as held for trading and those that the entity designates as at fair value through profit or loss upon initial recognition,
  b) those that the Bank upon initial recognition designates as available for sale, or
  c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available for sale.

  This category also contains debt securities, purchased from the issuer, for which there is no active market, as well as credits, loans, receivables from reverse repo transactions and other receivables acquired and granted. Loans and receivables are measured at amortized cost using the effective interest rate method and with consideration of impairment.

Notes to the financial statements (cont.)

(in PLN thousand)

- Available for sale

  This includes financial assets with an undefined holding period. The portfolio includes: debt and equity securities, as well as loans and receivables not classified into other categories. Interest on assets available for sale is calculated using the effective interest rate method, and recognized in the income statement.

  Available for sale financial assets are measured at fair value, whereas gains and losses resulting from changes in fair value against amortized cost are recognized in the revaluation reserves. Amounts in the revaluation reserves are recognized in the income statement either on the sale of an asset, or its impairment. In case of impairment of an asset, previous increases from revaluation to fair value will decrease the 'Revaluation reserves'. Should the amount of previously recognized increases be insufficient to cover the impairment, the difference will be recorded in the income statement as 'Net impairment losses on financial assets and off-balance sheet commitments'.

Dividends from equity instruments are recognized in the profit or loss at the moment the rights to receive such payments are established.

Standardized purchase and sale transactions of financial assets designated at fair value through profit or loss, designated as held for trading (except for derivatives), held to maturity, and available for sale, are recognized and derecognized by the Bank on the settlement date of such transaction, i.e. as at the date of receipt or delivery of such assets.

Changes in the fair value of assets, which occur during the period from transaction date to transaction settlement date, shall be recognized similarly as in the case of the asset held.

Credits and loans are recognized on the date of cash disbursement to the debtor.

Derivative instruments are recognized or derecognized on transaction dates.

Reclassification of financial assets – principles applied until 31 December 2017

The Bank may reclassify the financial assets classified as available for sale, which meet the definition of loans and receivables, from the category of available for sale financial assets to the category of loans and receivables, if the Bank has the intent and the ability to hold such financial assets in foreseeable future or until their maturity.

If the financial asset with a given maturity is reclassified, prior gains and losses associated with such asset, recognized in other comprehensive income, are amortized in the profit or loss throughout the remaining period until maturity, using the effective interest rate method. Any differences between such new amortized cost and embedded amount is amortized throughout the period remaining until the maturity of such asset using the effective interest rate method, similar to premium or discount amortization.

The Bank allows the reclassification of financial assets classified as financial assets measured at fair value through profit or loss, if extraordinary circumstances occur, i.e. events that are unusual and highly unlikely to recur in the near term.

Such financial assets are reclassified at fair value as at reclassification date. The gains or losses recognized in the profit or loss before such reclassification cannot be reversed. The fair value of financial assets, as at reclassification date, is recognized as its new cost or its new amortized cost.

Impairment of financial assets – principles applied until 31 December 2017

Assets measured at amortized cost – loans and advances

At each balance sheet date the Bank assesses whether there is any objective evidence ('triggers') that loans and advances or financial assets held-to-maturity measured at amortized cost ('loan exposures') are impaired. In the process of impairment assessment the Bank considers all loan exposures, irrespective of the level of risk of particular loan exposures or a Bank of loan exposures.

The Bank splits the loan exposures into individually significant exposures and individually insignificant exposures.
In respect to exposures assessed individually the Bank applies the following list of impairment triggers:

- overdue in repayment of principal, interest or credit fees more than 90 days and more than 2 working days in case of exposure towards banks including credit transactions and reverse repo/sell-buy-backs,
- significant financial difficulties of borrower (including loss of job or other events that could impact on ability to repayment in case of individuals). Significant financial difficulties of economic entity mean financial standing that could threaten timely repayment of liabilities towards the Bank, especially when incurred losses have consumed equity in 50%, excluding projects where losses have been assumed or where external financial support exists (in form of injections to the equity, granting a loan, warranty/guarantee by related company or other third party, conversion of loan into equity, issuance of shares/bonds),
- restructuring, if it is related with granting an advantage, due to economic or legal reasons resulted from financial difficulties of the borrower, that in other circumstances the Bank would not give. The advantage leads to reduction of the Bank's loan exposure, and may include: reduction of the interest rate, temporary interest accruing holidays, cancelling a part or total of the exposures, in this interest or principal,
- lowering by the well-known and accepted rating agency a borrower's rating or country's rating – country of domicile or rating of debt securities issued by the borrower by at least 4 notches including modifiers within one year. Decrease in credit rating alone is not an evidence of impairment trigger but could be confirmation of impairment if it is analyzed together with other available information,
- significant worsening of rating or scoring analysis results. It means the decrease in rating by 4 notches in the scale and at the same time move to non-performing category based only on rating criterion, excluding situations of rating deterioration resulted from seasonality of activity and excluding impact of classification in RMT ('Risk Management Tool') on rating. Decrease in rating alone is not an evidence of impairment trigger but could be confirmation of impairment if it is analyzed together with other available information,
- the Bank has started an execution process or has been informed about execution towards borrower,
- the debt/loan is questioned by the borrower including commencement of legal proceedings,
- the debt/loan has been due as the credit agreement has been terminated,
- the motion for borrower's bankruptcy has been filled in the court or legal proceedings has been instituted,
- disappearance of active market for given credit exposure resulted from financial difficulties of debtor. This impairment trigger could refer to financial instruments listed on stock exchanges, when due to significant deterioration in financial standing of issuer (eventually bankruptcy), the liquidity of assets trading is so low that reliable price fixing is not possible,
- receivership has been established or debtor has stopped/suspended its activity,
- unknown place of stay and not disclosed assets of the borrower.

In respect to exposures assessed collectively the Bank applies the following list of impairment triggers:

- overdue in repayment of principal, interest or credit fees greater or equal to 90 days,
- significant financial difficulties of debtor, including loss of job or other events that could impact on ability to repayment,
- unknown place of stay and not disclosed assets of the retail debtor or sole trader.

The Bank classifies the exposure as past due in case the borrower has failed to make payment on the principal and/or interest in the contractual maturity date. The Bank presents the whole amount of exposure as past due, regardless of whether the delay of payment affects the whole exposure, or only part of it (installment).

The number of days past due for receivables paid by installments is assumed as the period from the date of maturity of the earliest installment, when the repayment is delayed.

In case of identification of impairment triggers for at least one of loan exposures of the borrower, all loan exposures of such borrower are assessed for impairment.

Notes to the financial statements (cont.)

(in PLN thousand)

For all loans exposures, which are impaired, the Bank measures the amount of impairment allowance as the difference between the loan exposure's carrying amount and the present value of estimated future cash flows, discounted at the loan exposure's original effective interest rate. The carrying amount of the loan exposure is reduced through use of an allowance account. The amount of the impairment loss is recognized in profit or loss. If, in a subsequent period, the amount of impairment loss decreases, then the previously recognized impairment loss is reversed by adjusting an allowance account. The amount of the reversal is recognized in profit or loss.

For all individually significant exposures, which are impaired as at balance sheet date, the Bank measures the impairment allowance (impairment loss) as part of individual assessment. The individual assessment is carrying out by the Bank's employees and consists of individual verification of the impairment occurrence and projection of future cash flows from foreclosure less costs for obtaining and selling the collateral or other resources. The Bank compares the estimated future cash flows applied for measurement of individual impairment allowances with the actual cash flows on a regular basis.

For all individually insignificant exposures, which are impaired as at balance sheet date, the Bank measures the impairment allowance (impairment loss) as part of collective assessment. Each exposure assessed collectively is Banked based on similar credit risk characteristics on the basis of the borrower's type, the product's type, past-due status or other relevant factors impacting on the debtor's ability to pay all amounts due according to the contractual terms. The future cash flows are estimated on the basis of historical data of cash flows and historical loss experience for exposures with credit risk characteristics similar to those in the Bank (for example, the value of the real estate taken as the collateral for the mortgage).

Historical data, when necessary, are adjusted on the basis of current data to remove the effects of conditions in the historical period that do not exist currently. The recovery rates ('RR') and the methodology and assumptions used for estimating future cash flows for particular Banks of loan exposures are reviewed regularly.

For all loan exposures, for which no impairment triggers have been identified, the Bank measures the allowance for losses incurred, but not reported ('IBNR'). As part of IBNR assessment the Bank estimates the loss resulting from events not reported as at balance sheet date and for which no impairment triggers have been identified, but the events occurred prior to balance sheet date and the loss was incurred. While estimating the IBNR, it is assumed that there is a several-months period from the date of emergence of objective impairment trigger to the date of its reporting, i.e. loss identification period ('LIP'). The value of LIP parameter is estimated on the basis of statistical analysis using the historical data. The Bank applies different loss identification periods for different Banks of loan exposures, taking into account the client's segment, the product's type and the collateral. The update of LIP parameter is carrying out at least once a year.

The IBNR is measured based on the likelihood that the debtor will be unable to meet its obligations during loss identification period ('PD_LIP') multiplied by impairment loss estimated analogously like collective allowance for value of exposure at default ('EAD'). The value of EAD parameter is estimated on the basis of historical data.

The Bank estimates the value of PD_LIP parameter using the PD measured by Basel models with relevant transformation taking into account the shortening of loss identification period for applied length of LIP and Point-in-Time adjustment. Within the transformation the Bank calibrates the values of PD parameter to the most up to date realized PD_LIP values once a month. The values of PD_LIP as estimated reflect the current economic conditions the best. The model applied to measurement of PD_LIP is of 'Point-In-Time' type.

The values of LIP, PD_LIP, EAD and RR applied for IBNR measurement as well as the methodology and assumptions used for estimating such parameters for particular Banks of loan exposures are reviewed regularly.

Financial assets available for sale

When a decline in the fair value of an available for sale financial asset has been recognized directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that has been recognized directly in equity is removed from equity and recognized in the income statement. The amount of the cumulative loss transferred to the income statement is the difference between the acquisition cost (net of any principal repayment and amortization) and the current fair value. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in the income statement.

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Off-balance sheet commitments

The provisions for off-balance sheet commitments is measured as the difference between the expected value of balance sheet exposure arising from granted off-balance sheet commitment and the present value of estimated future cash flows from that balance sheet exposure at the date of impairment identification. The expected value of balance sheet exposure arising from granted off-balance sheet commitment is measured using the credit conversion factor ('CCF'), estimated on the basis of historical data.

The values of CCF applied for measurement of provisions for off-balance sheet commitments as well as the methodology and assumptions used for estimating such parameters for particular Banks of loan exposures are reviewed regularly.

The Bank estimates the future cash flows as part of individual assessment or collective assessment depending on classification of particular off-balance sheet commitments as individually significant exposures or individually insignificant exposures.

Derivative financial instruments and hedge accounting

The Bank acquires the derivative financial instruments: currency transactions (spot, forward, currency swap and currency options, CIRS), exchange rate transactions (FRA, IRS, CAP), derivative transactions based on security prices, indices of stocks and commodities. Derivative financial instruments are initially recorded at fair value as at the transaction date and subsequently re-measured at fair value at each balance sheet date. The fair value is established on the basis of market quotations for an instrument traded in an active market, as well as on the basis of valuation techniques, including models using discounted cash flows and options valuation models, depending on which valuation method is appropriate.

Positive valuation of derivative financial instruments is presented in the statement of financial position in the line 'Derivative financial instruments (held for trading)' or 'Hedging instruments' on an asset side, whereas the negative valuation - 'Derivative financial instruments (held for trading)' or 'Hedging instruments' on a liabilities side. For financial instruments with an embedded derivative component, if the whole or part of the cash flows related to such a financial instrument changes in a way similar to what would be the case with the embedded derivative instrument on its own, then the embedded derivative instrument is reported separately from the basic contract.

This occurs under the following conditions:

- the financial instrument is not included in assets held for trading or in assets designated at fair value through the profit or loss the revaluation results of which are reflected in the financial income or expense of the reporting period,
- the nature of the embedded instrument and the related risks are not closely tied to the nature of the basic contract and to the risks resulting from it,
- a separate instrument characteristics of which correspond to the features of the embedded derivative instrument would meet the definition of the derivative instrument,
- it is possible to reliably establish the fair value of the embedded derivative instrument.

In case of contracts that are not financial instruments with a component of an instrument meeting the above conditions the built-in derivative instrument is classified in accordance with assets or liabilities of derivatives financial instruments with respect to the income statement in accordance with derivative financial instruments valuation principles.

The method of recognition of the changes in the fair value of an instrument depends on whether a derivative instrument is classified as held for trading or is designated as a hedging item under hedge accounting.

The changes in fair value of the derivative financial instruments held for trading are recognized in the income statement.

The Bank designates some of its derivative instruments as hedging items in applying hedge accounting. The Bank decided to take advantage of the choice which gives IFRS 9 and continues to apply the hedge accounting requirements of IAS 39. This decision will apply to all hedging relationships, for which the Bank applies and will apply hedge accounting in the future. The Bank implemented fair value hedge accounting as well as cash flow hedge accounting.

Fair value hedge accounting principles

Changes in the measurement to fair value of financial instruments indicated as hedged positions are recognized - in the part ensuing from hedged risk - in the income statement. In the remaining part, changes in the carrying amount are recognized in accordance with the principles applicable for the given class of financial instruments.

Changes in the fair market valuation of derivative financial instruments, indicated as hedging positions in fair value hedge accounting, are recognized in the profit or loss in the same caption, in which the gains/losses from change in the value of hedged positions are recognized.

Interest income on derivative instruments hedging interest positions hedged is presented as interest margin.

The Bank ceases to apply hedge accounting, when the hedging instrument expires, is sold, dissolved or released (the replacement of one hedging instrument with another or extension of validity of given hedging instrument is not considered an expiration or release, providing such replacement or extension of validity is a part of a documented hedging strategy adopted by given unit), or does not meet the criteria of hedge accounting or the Bank ceases the hedging relation.

An adjustment for the hedged risk on hedged interest position is amortized in the income statement at the point of ceasing to apply hedge accounting.

Cash flow hedge accounting principles

Changes in the fair value of the derivative financial instruments indicated as cash flow hedging instruments are recognized:

- directly in the caption 'Revaluation reserves' in the part constituting the effective hedge,
- in the income statement in the line 'Result on financial assets and liabilities held for trading' in the part representing ineffective hedge.

The amounts accumulated in the 'Revaluation reserves' are transferred to the income statement in the period, in which the hedge is reflected in the income statement and are presented in the same lines as individual components of the hedged position measurement, i.e. the interest income from hedging derivatives in cash flow hedge accounting is recognized in the interest result, whereas gains/losses from foreign exchange revaluation are presented in the foreign exchange gains (losses).

The Bank ceases to apply hedge accounting when the hedging instrument expires or is sold, or if the Bank revokes the designation. In such cases, the accumulated gains or losses related to such hedging item, initially recognized in 'Revaluation reserves', if the hedge was effective, are still presented in equity until the planned transaction was closed and recognized in the income statement.

If the planned transaction is no longer probable, the cumulative gains or losses recognized in 'Revaluation reserves' are transferred to the income statement for the given period.

Financial liabilities

The Bank classifies financial liabilities other than financial guarantee contracts and loan commitments, as measured at amortized cost or at fair value through profit or loss.

Financial liabilities valued at amortized cost include liabilities to banks and customers, loans taken by the Bank, issued own debt securities and subordinated liabilities.

De-recognition of financial instruments from the statement of financial position

Financial assets are derecognized when the contractual rights to the cash flows from the financial assets expire or when the Bank transfers the contractual rights to receive the cash flows in a transaction in which substantially all risk and rewards of ownership of the financial asset are transferred.

The Bank derecognizes a credit or a loan receivable, or its part, when it is sold. Additionally, the Bank writes-off a receivable against the corresponding impairment provision (completely or partially) when the debt redemption process is completed and when no further cash flows from the given receivable are expected. Such cases are documented in compliance with the current tax regulations.

The value of contractual cash flows required under contracts of financial assets, which were written-off in 2018 and are still subject to enforcement proceedings as at 31 December 2018, is PLN 3 437 332 thousand.

Accumulated profits and losses that have been recognized in other comprehensive income from equity instruments designated to be measured at fair value through other comprehensive income are not recognized in the profit and loss account when these financial instruments are removed from the balance sheet.

The Bank derecognizes a financial liability, or its part, when the liability expires. The liability expires when the obligation stated in the agreement is settled, redeemed or the period for its collection expires.

Repo and reverse-repo agreements

Repo and reverse-repo transactions, as well as sell-buy back and buy-sell back transactions are classified as sales or purchase transactions of securities with the obligation of repurchase or resale at an agreed date and price.

Sales transactions of securities with the repurchase obligation granted (repo and sell-buy back) are recognized as at transaction date in amounts due to other banks or amounts due to customers from deposits depending upon the counterparty to the transaction. Securities purchased in reverse-repo and buy-sell back transactions are recognized as loans and receivables from banks or as loans and receivables from customers, depending upon the counterparty to the transaction.

The difference between the sale and repurchase price is recognized as interest income or expense, and amortized over the contractual life of the contract using the effective interest rate method.

4.6 Valuation of other items in the Bank's unconsolidated statement of financial position

Intangible assets

Goodwill

Goodwill is defined as a surplus of the purchasing price over the fair value of the assets, liabilities and contingent liabilities of the acquired subsidiary, associate or a unit under joint control. Goodwill at initial recognition is carried at purchase price reduced by any accumulated impairment losses. Impairment is determined by estimating the recoverable value of the cash generating unit, to which given goodwill pertains.

If the recoverable value of the cash generating unit is lower than the carrying amount an impairment charge is made. Impairment identified in the course of such tests is not subject to subsequent adjustments.

Goodwill on acquisition of subsidiaries is presented in intangible assets and goodwill on acquisition of associates is presented under the caption 'Investments in associates'.

Other intangible assets

Intangible assets are assets controlled by the Bank which do not have a physical form which are identifiable and represent future economic benefits for the Bank directly attributable to such assets.
These assets include:

- computer software licenses,
- copyrights,
- costs of completed development works.

Intangible assets are initially carried at purchase price. Subsequently intangible assets are stated at cost less accumulated amortization and accumulated impairment losses.

Intangible assets with a definite useful life are amortized over their estimated useful life. Intangible assets with indefinite useful life are not amortized.

All intangible assets are reviewed on a periodical basis to verify if any significant impairment triggers occurred, which would require performing a test for impairment and a potential impairment charge.

As far as intangible assets with indefinite useful life and those still not put into service are concerned, impairment test is performed on a yearly basis and additionally when impairment triggers are identified.

(in PLN thousand)

Property, plant and equipment

Property, plant and equipment are defined as controlled non-current assets and assets under construction. Non-current assets include certain tangible assets with an expected useful life longer than one year, which are maintained for the purpose of own use or to be leased to other entities.

Property, plant and equipment are recognized at historical cost less accumulated depreciation and accumulated impairment write downs. Historical cost consists of purchase price or development cost and costs directly related to the purchase of a given asset.

Each component of property, plant and equipment, the purchase price or production cost of which is significant compared to the purchase price or production cost of the entire item is a subject to separate depreciation. The Bank separates the initial value of property, plant and equipment into its significant parts.
Subsequent expenditures relating to property plant and equipment are capitalized only when it is probable that such expenditures will result in future economic benefits to the Bank, and the cost of such expenses can be reliably measured.

Service and maintenance costs of property, plant and equipment are expensed in the reporting period in which they have been incurred.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense.

Depreciation and amortization

Depreciation expense for property, plant and equipment and investment properties and the amortization expense for intangible assets are calculated using straight line method over the expected useful life of an asset. Depreciated value is defined as the purchase price or cost to develop a given asset, less residual value of the asset. Depreciation rates and residual values of assets, determined for balance-sheet purposes, are subject to regular reviews, with results of such reviews recognized in the same period.

The statement of financial position depreciation and amortization rates applied to property, plant and equipment, investment properties and intangible assets are as follows:

a) depreciation rates applied for non-current assets

Buildings and structures and cooperative ownership rights to residential premises and cooperative ownership rights to commercial premises	1.5% – 10.0%
Technical equipment and machines	4.5% – 30.0%
Vehicles	7% – 20.0%

b) amortization rates for intangible assets

Software licenses, copyrights	12.5% – 50.0%
Costs of completed development projects	33.3%
Other intangibles	20% - 33.3%

c) depreciation rates for investment properties

Buildings and structures	1.5% – 10.0%

Land, non-current assets under construction and intangible assets under development are not subject to depreciation and amortization.

Depreciation and impairment deductions are charged to the income statement in the item ‘Depreciation and amortization’.

Notes to the financial statements (cont.)

(in PLN thousand)

Investment properties

Investment properties assets are recognized initially at purchase cost, taking the transaction costs into consideration. Upon initial recognition, investment property assets are measured using the purchasing price model.

Investment property assets are derecognized from the statement of financial position when disposed of, or when such investment property is permanently decommissioned and no future benefits are expected from its sale. Any gains or losses resulting from de-recognition of an investment property are recognized in the income statement in the period when such de-recognition occurred.

Non-current assets held for sale and discontinued operations

Non-current assets held for sale include assets, the carrying amount of which is to be recovered by way of resale and not from their continued use. The only assets classified as held for sale are those available for immediate sale in their present condition, and the sale of which is highly probable, i.e. when the decision has been made to sell a given asset, an active program to identify a buyer has been launched and the divestment plan is completed. Moreover, such assets are offered for sale at a price which approximates its present fair value, and it is expected that the sale will be recognized as completed within one year from the date of such asset is reclassified into this category.

Non-current assets held for sale are recognized at the carrying amount or at fair value reduced by the cost of such assets, whichever is lower. Assets classified in this category are not subject to depreciation.

A discontinued operation is a component of the Bank’s business which constitutes a separate line of business or a geographical area of operations, which was sold, made available for sale or to be disposed, or is a subsidiary acquired exclusively with a view to re-sale. Classification as a discontinued operation occurs on disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as held for sale, the comparative figures in the income statement are represented as if the operation had been discontinued from the beginning of the comparative period.

Leases

The Bank is a party to leasing contracts on the basis of which it grants a right to use a non-current asset or an intangible asset for an agreed period of time in return for payment.

The Bank is also a party to leasing contracts under which it receives a right to use a non-asset or an intangible asset for an agreed period of time from another party in return for a payment.

Operating leases

In the case of leasing contracts entered into by the Bank acting as lessor, the leased asset is presented in the Bank’s statement of financial position, since there is no transfer to the lessee of essentially all risks and benefits resulting from the asset.

In the case of lease agreements, entered into by the Bank as lessee, the leased asset is not recognized in the Bank’s statement of financial position.

The entire amount of charges from operating leases is recognized in the profit or loss on a straight line basis, throughout the leasing period.

Finance leases

In the lease agreements, where essentially all risks and benefits relating to the ownership of an asset are transferred, the leased asset is no longer recognized in the statement of financial position of the Bank. However, receivables are recognized in the amount equal to the present value of the minimum lease payments. Lease payments are split into the financial income and the reduction of receivables balance in order to maintain a fixed interest rate on the outstanding liability. Finance lease costs are recognized directly in the income statement in the position ‘Interest expense’.

Non-current assets subject to finance lease agreements are depreciated in the same way as other non-current assets. However, if it is uncertain whether the ownership of the asset subject of the contract will be transferred then the asset is depreciated over the shorter of the expected useful life or the initial period of lease.

Notes to the financial statements (cont.)

(in PLN thousand)

Provisions

The provisions are recognized when the Bank has a present obligation (legal or constructive) resulting from the past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

If the effect of the time value of money is material, the amount of a provision is established by discounting forecasted future cash flows to the present value, using the discount rate reflecting current market estimates of the time value of money and the possible risk associated with the obligation.

The provisions include the provisions relating to long-term employee benefits, in this those measured by an actuary and provisions for restructuring costs. The provision for restructuring costs is recognized when the general recognition criteria for provisions and detailed criteria for recognition of provisions for restructuring cost under IAS 37 'Provisions, contingent liabilities and contingent assets' are met. The amount of employment restructuring provision is calculated by the Bank on the basis of the best available estimates of direct outlays resulting from restructuring activities, which are not connected with the Bank's current activities.

The provisions are charged to the income statement, except for actuarial gains and losses from the measurement of the defined benefit plans obligations, which are recognized in other comprehensive income.

Deferred income and accrued expenses (liabilities)

This caption includes primarily commission income settled using the straight line method and other income charged in advance, that will be recognized in the income statement in the future periods.

Accrued expenses include accrued costs resulting from services provided for the Bank by counterparties which will be settled in future periods, accrued payroll and other employee benefits (including annual and Christmas bonuses, other bonuses and awards and accrued holiday pay).

Deferred income and accrued expenses are presented in the statement of financial position under the caption 'Other liabilities'.

Government grants

The Bank recognizes government grants when there is reasonable assurance that it will comply with any conditions attached to the grant and the grant will be received. Government grants are recognized in profit or loss in the periods in which the related expenses are recognized which the grants are intended to compensate. For the settlement of the grant, the Bank uses the income method. Government grants related to assets are presented in the statement of financial position of the Bank as a reduction in the carrying value of the asset.

Equity of the Bank

Equity is comprised of the capital and funds created by the companies of the Bank in accordance with the binding legal regulations and the appropriate laws and Articles of Association. Equity also includes retained earnings. Subsidiaries' equity line items, other that share capital, are added to the relevant equity line items of the parent company, in the proportion of the Bank's interest.

The equity of the Bank includes only those parts of the subsidiaries' equity which were created after the date of purchase of shares or stocks by the parent entity.

Notes to the financial statements (cont.)

(in PLN thousand)

The Bank equity consists of the following:

a) share capital - applies only to the capital of the Bank as the parent entity and is presented at nominal value specified in the Articles of Association and in the entry in the Enterprises Registry,
b) ‘issue premium’ - surplus generated during share issues over the nominal value of such issues, remaining after the issue costs are covered. Moreover, this item also includes a change in the value of minority shares, ensuing from an increase of the share of the Parent entity in Bank’s share capital,
c) the general banking risk fund is established at Bank Pekao S.A. in keeping with the Banking Act dated 29 August 1997 from profit after tax,
d) other reserve capital utilized for the purposes defined in the Statute is created from appropriations of profits,
e) revaluation reserve includes the impact of revaluation of debt financial instruments measured at fair value through other comprehensive income, revaluation or sale of investments in equity instruments designated at fair value through other comprehensive income, revaluation of derivative instruments hedging cash flows, remeasurements of the defined benefit liabilities and the value of deferred tax for items classified as temporary differences, recognized as valuation allowance. In the statement of financial position, the valuation allowance is presented as net value,
f) other capital:
   - other supplementary capital, established in keeping with provisions under the Articles of Association of the Bank from profit appropriations,
   - bonds convertible to shares - includes the fair value of financial instruments issued as part of transactions settled in equity instruments,
   - brokerage activity fund for stock broking operations, carried out by Bank Pekao S.A.,
   - retained earnings from prior periods includes undistributed profit and uncovered losses generated/incurred in prior periods by the Bank Pekao S.A.,
   - net profit/loss which constitutes profit/loss presented in the income statement for the relevant period. Net profit is after accounting for income tax.

Bank’s Pekao S.A. phantom shares-settled share-based payment transaction

The cost of transactions settled with employees in phantom shares is measured by reference to the fair value of the liability as of the balance sheet date.

The fair value of the liability is estimated based upon the Bank’s shares price on the (WSE) as of the balance sheet date and expected number of phantom shares to which full rights will be acquired.

The cost of phantom share-based payments is recognized in personnel expenses together with the accompanying increase in the value of liabilities towards employees presented in ‘Provisions’.

The accumulated cost recognized for transactions settled in phantom shares for each balance sheet date until the vesting date reflects the extent of elapse of the vesting period and the number of rights to shares the rights to which – in the opinion of the Bank’s Management Board for that date based on best available estimates of the number of phantom shares – will be eventually vested.

4.7 Income tax

Income tax expense comprises current and deferred tax. The income tax expense is recognized in the income statement excluding the situations when it is recognized directly in equity. The current tax is the tax payable of the Bank entities on their taxable income for the period, calculated based on binding tax rates, and any adjustment to tax payable in respect of previous years. The receivables resulting from taxes are disclosed if the Bank’s companies has sufficient certainty that they exist and that they will be recovered.

Deferred tax assets and deferred tax liabilities are calculated, using the balance sheet method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax is determined using tax rates based on legislation enacted or substantively enacted at the balance sheet date and expected to apply when the deferred tax asset or the deferred tax liability is realized.

A deferred tax asset is recognized for negative temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.

A deferred tax liability is calculated using the balance sheet method based on identification of positive temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

4.8 Other

Contingent liabilities and commitments

The Bank enters into transactions which are not recognized in the statement of financial position as assets or liabilities, but which result in contingent liabilities and commitments. Contingent liabilities are characterized as:

- a potential obligation the existence of which will be confirmed upon occurrence or non-occurrence of uncertain future events that are beyond the control of the Bank (e.g. litigations),
- a current obligation which arises as a result of past events but is not recognized in the statement of financial position as it is improbable that it will result in an outflow of benefits to settle the obligation or the amount of the obligation cannot be reliably measured (mainly: unused credit lines and guarantees and letters of credit issued).

Financial guarantees

Financial guarantees are measured at the higher of:

- the amount of the loss allowance, or
- the amount initially recognised less the cumulative amount of income recognised in accordance with the principles of IFRS 15.

4.9 New standards, interpretations and amendments to published standards that have been approved and published by the European Union and are effective on or after 1 January 2018

IFRS 9 'Financial Instruments' and other changes

The Bank has adopted International Financial Reporting Standard 9 'Financial Instruments' with a date of transition of 1 January 2018.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 and other changes on the Bank as at 1 January 2018.

Notes to the financial statements (cont.)

(in PLN thousand)

The table below discloses at the time of the first application of IFRS 9 comparison of categories for the measurement of financial assets and their carrying amounts in accordance with IAS 39 and new categories of measurement of financial assets and their carrying amounts in accordance with IFRS 9.

	IAS 39 MEASUREMENT CATEGORY	IFRS 9 MEASUREMENT CATEGORY	IAS 39 CARRYING AMOUNT	IFRS 9 CARRYING AMOUNT
Cash and due from Central Bank	Loans and advances (Amortised cost)	Amortised cost	5 186 259	5 186 048
Loans and advances to banks	Loans and advances (Amortised cost)	Amortised cost	2 692 930	2 692 936
Financial assets held for trading	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	1 734 768	1 734 768
Derivative financial instruments	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	1 351 344	1 351 344
Hedging derivatives	Held for trading (Fair value through profit or loss)	Fair value through profit or loss (mandatory)	259 396	259 396
Loans and advances to customers	Loans and advances (Amortised cost)	Amortised cost	113 969 946	112 921 825
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through profit or loss (mandatory)	363 079	365 137
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through other comprehensive income	1 882 180	1 841 682
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Amortised cost	7 550 390	7 543 879
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Fair value through other comprehensive income	5 107 583	5 096 743
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Amortised cost	1 505 400	1 505 348
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Fair value through other comprehensive income	1 861 424	1 887 731
Investments (placement) securities – debt securities	Available for sale (Fair value through other	Amortised cost	2 229 193	2 336 021
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	30 906 852	30 906 852
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through profit or loss (mandatory)	52 339	52 339
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	70 788	263 787
Other assets	Loans and advances (Amortised cost)	Amortised cost	802 989	798 016
FINANCIAL ASSETS			**177 526 860**	**176 743 852**

Notes to the financial statements (cont.)

(in PLN thousand)

The application of IFRS 9 for the first time by the Bank had no impact on the classification and measurement of financial liabilities.
The table below presents the reconciliation of the carrying amounts of financial assets by category of measurement under IAS 39 with the carrying amounts of these items according to the category of their valuation under IFRS 9, on the date of the first application of IFRS 9, taking into account other changes introduced from 1 January 2018.

		CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
	FINANCIAL ASSETS				
	AMORTISED COST				
	Cash and due from Central Bank				
	Opening balance	5 186 259			
	Remeasurement			(211)	
	Closing balance				**5 186 048**
	Loans and advances to banks				
	Opening balance	2 692 930			
	Remeasurement			6	
	Closing balance				**2 692 936**
	Loans and advances to customers				
	Opening balance	128 873 178			
	Remeasurement			(1 048 121)	
A	Reclassification to fair value through other comprehensive income		(1 882 180)		
B	Reclassification to fair value through profit or loss		(363 079)		
C	Reclassification to investments (placement) securities at fair value through other comprehensive income		(5 107 583)		
D	Reclassification to investments (placement) securities at amortised cost		(7 550 390)		
	Closing balance				**112 921 825**
	Investments (placement) securities				
	Opening balance	3 366 824			
	Remeasurement			100 265	
D	Reclassification from loans and advances to customers		7 550 390		
E	Reclassification from available for sale		2 229 193		
F	Reclassification to fair value through other comprehensive income		(1 861 424)		
	Closing balance				**11 385 248**
	Other assets				
	Opening balance	802 989			
	Remeasurement			(4 973)	
	Closing balance				**798 016**
	MEASURED AT AMORTISED COST TOTAL				**132 984 073**

Notes to the financial statements (cont.)

(in PLN thousand)

		CARRYING AMOUNT 31.12.2017 IAS 39	RECLASSIFICATIONS	REMEASUREMENTS	CARRYING AMOUNT 01.01.2018 IFRS 9
	AVAILABLE FOR SALE				
	Investments (placement) securities				
	Opening balance	33 259 172			
E	Reclassification to amortised cost		(2 229 193)		
G	Reclassification to fair value through other comprehensive income – debt securities		(30 906 852)		
H	Reclassification to fair value through other comprehensive income – equity instruments		(70 788)		
I	Reclassification to fair value through profit or loss – equity instruments		(52 339)		
	Closing balance				**-**
	FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME				
	Investments (placement) securities (debt securities)				
	Opening balance	-			
	Remeasurement			15 467	
G	Reclassification from available for sale		30 906 852		
C,F	Reclassification from amortised cost		6 969 007		
	Closing balance				**37 891 326**
	Investments (placement) securities (equity instruments)				
	Opening balance	-			
	Remeasurement			192 999	
H	Reclassification from available for sale		70 788		
	Closing balance				**263 787**
	Loans and advances to customers				
	Opening balance	-			
	Remeasurement			(40 498)	
A	Reclassification from amortised cost		1 882 180		
	Closing balance				**1 841 682**
	MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME TOTAL				**39 996 795**
	FAIR VALUE THROUGH PROFIT OR LOSS				
	Financial assets held for trading	1 734 768			**1 734 768**
	Derivative financial instruments (held for trading)	1 351 344			**1 351 344**
	Hedging instruments	259 396			**259 396**
	Loans and advances to customers				
	Opening balance	-			
	Remeasurement			2 058	
B	Reclassification from amortised cost		363 079		
	Closing balance				**365 137**
	Investments (placement) securities – equity instruments				
	Opening balance	-			
I	Reclassification from available for sale		52 339		
	Closing balance				**52 339**
	FAIR VALUE THROUGH PROFIT OR LOSS TOTAL				**3 762 984**

Notes to the financial statements (cont.)

(in PLN thousand)

The following explains how the application of the new requirements for the classification of IFRS 9 led to the changes in the classification of certain financial assets held by the Bank as shown in the table above.

Loans and advances to customers

A) Certain loans and advances to customers (syndicated loans) are measured at fair value through other comprehensive income because they are classified into a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Before applying the requirements of IFRS 9, these loans were measured at amortized cost, in accordance with IAS 39.

B) Some of the loans and advances to customers are classified as measured at fair value through profit or loss, as their contractual cash flows failed to meet the 'solely payments of principal and interest' (SPPI) requirement, due to the leverage that increases the volatility of the contractual cash flows. This applies mainly to student loans, loans with subsidies of the Agency for Restructuring and Modernization of Agriculture and several corporate exposures. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39.

The remaining loans and advances to customers held to collect contractual cash flows and meeting the SPPI criteria are still measured at amortized cost.

Corporate and municipal debt securities

C) The Bank assessed the business model for corporate and municipal securities and identified that part of the portfolio of these securities meets the criteria of the business model, whose objective is achieved by both collecting contractual cash flows and selling financial assets. Therefore, certain securities from this portfolio were classified as measured at fair value through other comprehensive income. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39 and presented as loans and advances to customers.

D) The remaining part of the portfolio, which is held to collect contractual cash flows, has been reclassified to the item securities and is measured at amortized cost. Before applying the requirements of IFRS 9, these items were presented as Loans and advances to customers, as they were classified in the loans and receivables category in accordance with IAS 39.

Investments (placement) securities

E) The Bank assessed the business model for investment securities, which are mostly held to collect cash flows and sell, and identified that in relation to certain of these securities its past practice has been to hold to collect the contractual cash flows and the intention of the Bank remains unchanged. Therefore, the Bank assessed that the appropriate business model for these securities is a model whose objective is to hold to collect contractual cash flows and reclassified them to the amortized cost measurement. Previously, these securities were classified as available for sale and measured at fair value through other comprehensive. As at 31 December, the fair value of securities reclassified from measured at fair value through other comprehensive income to those measured at amortized cost amounted to PLN 2 300 831 thousand. If these securities had not been reclassified, the Bank would have recognized in other comprehensive income a net profit of PLN 77 021 thousand in 2018.

F) The Bank assessed the business model for held-to-maturity securities and, due to the intention to sell certain securities in this portfolio, reclassified securities to be measured at fair value through other comprehensive income, because it assessed that the appropriate business model for these securities is the model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Before applying the requirements of IFRS 9, these items were measured at amortized cost, in accordance with IAS 39. Other securities previously classified as held to maturity were classified as amortized cost.

G) Other securities previously classified as available for sale were classified as at fair value through other comprehensive income, without the change in the measurement method.

Notes to the financial statements (cont.)

(in PLN thousand)

Equity instruments

H) Certain long-term equity instruments in the Bank's portfolio have been irrevocably designated in accordance with IFRS 9 to measure at fair value through other comprehensive income. Prior to the application of IFRS 9, these instruments were measured at fair value through other comprehensive income or at cost. IFRS 9 abolished the possibility of measuring them at cost. Changes in the fair value of such securities will no longer be reclassified to profit or loss when they are disposed of.

I) Other equity instruments that, in accordance with IAS 39, were classified as available for sale and were measured at fair value through other comprehensive income, and were not irrevocably designated for measurement at fair value through other comprehensive income, were reclassified to fair value through profit or loss.

Notes to the financial statements (cont.)

(in PLN thousand)

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 and provisions for off-balance sheet liabilities calculated in accordance with IAS 37 as at 31 December 2017 to the opening balance of expected credit losses in accordance with IFRS 9 as at 1 January 2018

	IAS 39 MEASUREMENT CATEGORY	IFRS 9 MEASUREMENT CATEGORY	IMPAIRMENT ALLOWANCE IAS 39/IAS 37 31.12.2017	RECLASSIFICATIONS(*)	REMEASUREMENTS	IMPAIRMENT ALLOWANCE IFRS 9 01.01.2018
Cash and due from Central Bank	Loans and advances (Amortised cost)	Amortised cost	-	-	211	211
Loans and advances to banks	Loans and advances (Amortised cost)	Amortised cost	16 933	4 494	(6)	21 421
Loans and advances to customers	Loans and advances (Amortised cost)	Amortised cost	5 216 710	3 175 774	795 479	9 187 963
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through profit or loss (mandatory)	4 057	3 869	(7 926)	-
Loans and advances to customers	Loans and advances (Amortised cost)	Fair value through other comprehensive income	10 517	-	15 548	26 065
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Amortised cost	84 535	(31 680)	4 517	57 372
Investments (placement) securities – debt securities	Loans and advances (Amortised cost)	Fair value through other comprehensive income	12 979	-	9 209	22 188
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Amortised cost	-	-	52	52
Investments (placement) securities – debt securities	Held to maturity (Amortised cost)	Fair value through other comprehensive income	-	-	179	179
Investments (placement) securities – debt securities	Available for sale (Fair value through other comprehensive income)	Amortised cost	-	-	196	196
Investments (placement) securities – debt instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	-	-	1 846	1 846
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through profit or loss (mandatory)	-	-	-	-
Investments (placement) securities – equity instruments	Available for sale (Fair value through other comprehensive income)	Fair value through other comprehensive income	1 020	(1 020)	-	-
Other assets	Loans and advances (Amortised cost)	Amortised cost	90 884	5 926	4 973	101 783
Provisions for undrawn credit facilities and guarantees issued	Provisions	Provisions	245 993	-	35 332	281 325
		IMPAIRMENT ALLOWANCES TOTAL	**5 683 628**	**3 157 363**	**859 610**	**9 700 601**

*) The item 'Reclassifications' includes changes in the level of impairment allowance that occurred in correspondence with the corresponding change in the gross carrying amount, including: (1) increase in impairment allowances as a result of adjusting the gross carrying amount to IFRS 9 (presentation change resulting in increase in the gross carrying amount by recognition of contractual interest accrued in full against receivables in Stage 3 and, as a consequence, an analogous increase in the level of impairment allowance) and (2) a decrease in impairment allowance for loans and advances classified as POCI, which as at the initial recognition are recognized at fair value and do not show impairment allowance. As a result, the changes described above did not affect the level of the Bank's retained earnings.

Notes to the financial statements (cont.)

(in PLN thousand)

The table below presents the net impact (gross impact less tax effect) of the first application of IFRS 9 and other changes on the equity

	IMPACT OF FIRST TIME ADOPTION OF IFRS 9 AT 01.01.2018		
	BEFORE TAX	DEFERRED TAX	NET
REVALUATION RESERVES			
Revaluation reserves at 31.12.2017 under IAS 39	**(70 892)**	**13 469**	**(57 423)**
Remeasurement of debt securities / loans and advances to customers reclassified from amortised cost to fair value through other comprehensive	(48 527)	9 220	(39 307)
Remeasurement of debt securities reclassified from available for sale to amortised cost	105 030	(19 956)	85 074
Reclassification of equity instruments from available for sale to fair value through profit or loss	(3 232)	614	(2 618)
Remeasurement of equity instruments reclassified from available for sale to fair value through other comprehensive income	192 999	(36 670)	156 329
Recognition of ECL for debt securities / loans and advances to customers at fair value through other comprehensive income	50 278	(9 553)	40 725
Revaluation reserves at 01.01.2018 under IFRS 9	**225 656**	**(42 876)**	**182 780**
RETAINED EARNINGS			
Retained earnings at 31.12.2017 under IAS 39	**-**	**-**	**-**
Reclassification of equity instruments from available for sale to fair value through profit or loss	3 232	(614)	2 618
Remeasurement of loans and advances to customers mandatory at fair value through profit or loss	(5 868)	1 115	(4 753)
Recognition of ECL for financial assets and off-balance sheet commitments	(859 610)	153 049	(706 561)
Other changes	(277 665)	49 613	(228 052)
Retained earnings at 01.01.2018 under IFRS 9 and other changes	**(1 139 911)**	**203 163**	**(936 748)**
TOTAL IMPACT OF FIRST TIME ADOPTION OF IFRS 9 AND OTHER CHANGES ON EQUITY	**(843 363)**	**146 818**	**(696 545)**

Other changes presented in the table above result from changes made by the Bank in the first half of 2018 in the method of recognizing selected commissions and provisions for holiday leave and recognition of the impact of these changes in the scope relating to previous years as a retained earnings as at 1 January 2018. The comparative data have not been restated due to the insignificant impact of the introduced changes on the Bank's financial results.

Impact of IFRS 9 on capital adequacy

The Bank has decided to apply transitional arrangements specified in art. 473a of 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 as amended Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State.

The following table presents the impact of the adoption of IFRS 9 for the first time on capital adequacy with and without transitional arrangements:

	IMPACT OF IFRS 9 WITH TRANSITIONAL ARRANGEMENTS	IMPACT OF IFRS 9 WITHOUT TRANSITIONAL ARRANGEMENTS
Total capital requirement	9 006 840	8 995 466
Total own funds (Tier 1 and Tier 2)	20 947 070	20 096 308
Total Capital Ratio (%)	18.6%	17.9%

Notes to the financial statements (cont.)

(in PLN thousand)

IFRS 15 'Revenue from Contracts with Customers'
IFRS 15 'Revenue from Contracts with Customers' has been approved for application in the European Union by the Regulation of the European Commission No. 2016/1905 of 22 September 2016 and applies to financial statements issued for financial periods beginning on 1 January 2018 or later.

IFRS 15 shall be applied to all contracts with customers, except lease contracts within the scope of IAS 17 'Leases', financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments, IFRS 10 'Unconsolidated Financial Statements', IFRS 11 'Joint Arrangements', IAS 27 'Separate Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures', insurance contracts within the scope of IFRS 4 'Insurance Contracts'.

The core principle of this Standard is that the Bank shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Bank expects to be entitled in exchange for those goods or services.

In accordance with IFRS 15, the transfer of goods and services is based on the concept of transferring control to the customer, which may occur at a point in time (delivery of goods, service) or over time (for example during the service or during the creation of the ordered goods).

IFRS 15 defines a five-step revenue recognition model:

Step 1: Identifying the contract with a client
This step consists in making sure that contracts concluded with clients (in writing, orally or in accordance with other customary business practices) are valid and constitute actual transactions. According to IFRS 15, a contract with a client is a contract if it creates enforceable rights and obligations and the following criteria are met:
- the parties to the contract have approved the contract and are committed to perform their respective obligations,
- each party's rights regarding the goods or services to be transferred can be identified,
- the payment terms for the goods or services to be transferred can be identified,
- the contract has commercial substance,
- 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. In evaluating whether collectability of an amount of consideration is probable, the Bank shall consider the customer's ability and intention to pay that amount of consideration when it is due.

In some cases the Bank shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:
- the contracts are negotiated as a package with a single commercial objective,
- the amount of consideration to be paid in one contract depends on the price or performance of the other contract,
- the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

Step 2: Identifying performance obligations
The performance obligation corresponds to the promised goods or services (or their package), which may be perceived as 'distinct' from other goods or services promised in the contract.

A good or service that is promised to a customer is distinct if both of the following criteria are met:
- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (the determinant of this criterion is regular sale by the Bank of goods or services separately),
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Step 3: Determining the transaction price
The transaction price is the amount of consideration which the Bank expects to receive in exchange for the transfer of goods or services. Determining the transaction price can be complicated if the contract provides for variable consideration (eg bonuses, penalties, refunds, clauses assuming price change, etc.), significant share of financing costs, non-cash consideration or amounts due to the buyer.

Variable consideration is included in the transaction price only when there is a high probability that its inclusion will not result in a ‘significant reversal of revenue’ in the future as a result of revaluation. A significant reversal of the revenue approach takes place when the subsequent change in the estimated amount of variable consideration results in a significant decrease in the accumulated value of recognized revenues from a given customer. The variable remuneration includes each variable contractual amount, including for example performance bonuses, penalties, discounts, rebates.

Step 4: Allocating the transaction price to distinct performance obligations
If the contract contains more than one distinct performance obligation, the Bank allocates the transaction price to individual obligation based on their stand-alone selling prices.

If the transaction price includes a variable consideration, it should be analyzed whether this amount applies to all or only certain performance obligations contained in the contract. If the criteria included in the standard do not meet the variable consideration as referring only to certain obligations, it should be allocated to all performance obligations included in the contract.

Step 5: Revenue recognition
Revenue is recognised revenue when (or as) the Bank satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. Therefore revenues are recognized either at a point in time or over time.

Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset (ie good or service).

The Bank transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:
- the customer simultaneously receives and consumes the benefits provided by the Bank’s performance as the Bank performs,
- 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,
- the Bank’s performance does not create an asset with an alternative use to the Bank and the Bank has an enforceable right to payment for performance completed to date.

If a performance obligation is not satisfied over time the following indicators of the transfer of control should be considered to determine the point in time at which a customer obtains control of a promised asset:
- The Bank has transferred physical possession of the asset,
- The Bank has a present right to payment for the asset,
- The customer has accepted the asset,
- The customer has the significant risks and rewards of ownership of the asset,
- The customer has legal title to the asset.

The Bank applies IFRS 15 from 1 January 2018. The Bank analyzed the impact of implementing IFRS 15.

Notes to the financial statements (cont.)

(in PLN thousand)

The analysis covered the following types of contracts with clients:
1. Agreements with card organizations regarding marketing and promotional activities and related to the development of card activities,
2. Lease agreements in which the Bank is the lessor and, in addition to the rental rent, agree with the client (tenant) how to settle the maintenance fees for maintenance of the property. In such contracts, the Bank buys and resells, for example, municipal services and electricity,
3. Contracts for cash transport services for clients,
4. Bank accounts contracts, in relation to fees and commissions that are not included in effective interest rate,
5. Credit and loan agreements, in relation to fees and commissions that are not included in effective interest rate,
6. Agreements regarding the intermediation in the sale of insurance products,
7. Agreements regarding the investment funds management.

The Bank did not identify agreements with a variable uncertain consideration components or contracts for which the implementation of IFRS 15 could have a significant impact on the financial statements.

Other standards, interpretations and amendments to published standards that have been approved and published by the European Union and entered into force from or after 1 January 2018:

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 2 (amendment) ‘Share-based Payment’	The amendments provide requirements on the accounting for: (a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, (b) share-based payment transactions with a net settlement feature for withholding tax obligations, and (c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.	The standard’s amendments did not have a material impact on its financial statements in the period of its first application.
IFRS 4 (amendment) ‘Insurance Contracts’	The amendments address concerns arising from implementing the new financial instruments standard IFRS 9, before implementing the replacement standard that the Board is developing for IFRS 4.	The standard’s amendments did not have a material impact on its financial statements in the period of its first application.
IAS 40 (amendment) ‘Investment Property’	Amendments to IAS 40 ‘Investment Property’ - Transfers of Investment Property state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management’s intentions for the use of a property by itself does not constitute evidence of a change in use. Amendments also state that the list of evidence in paragraph 57 was designated as non-exhaustive list of examples instead of the previous exhaustive list.	The standard’s amendments did not have a material impact on its financial statements in the period of its first application.
IFRIC 22 ‘Foreign Currency Transactions and Advance Consideration’	Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.	The interpretation did not have a material impact on its financial statements in the period of its first application.
Improvements to IFRS 2014-2016	Amendments result from the annual improvement project of IFRS. Amendments relate to IFRS 1, IFRS 12 and IAS 28 and were introduced primarily with a view to removing inconsistencies and clarifying wording.	The standard’s amendments did not have a material impact on its financial statements in the period of its first application.

(in PLN thousand)

4.10 New standards, interpretations and amendments to published standards that have been published by the International Accounting Standards Board (IASB) and approved by the European Union but are not yet effective

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 9 (amendment) 'Financial Instruments'	Amendments to IFRS 9 - Prepayment Features with Negative Compensation – modify the existing requirements regarding termination rights in order to allow measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments. Under the amendments, the sign of the prepayment amount is not relevant, i. e. depending on the interest rate prevailing at the time of termination, a payment may also be made in favour of the contracting party effecting the early repayment. The calculation of this compensation payment must be the same for both the case of an early repayment penalty and the case of an early repayment gain. Date of application: annual periods beginning on or after 1 January 2019.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 28 (amendment) **'**Investments in Associates and Joint Ventures'	Amendments to IAS 28 - Long-term Interests in Associates and Joint Ventures - were introduced to clarify that an entity applies IFRS 9 including its impairment requirements, to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. Amendments also delete paragraph 41 because the Board felt that it merely reiterated requirements in IFRS 9 and had created confusion about the accounting for long-term interests. Date of application: annual periods beginning on or after 1 January 2019.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IFRIC 23 'Uncertainty over Income Tax Treatments'	It may be unclear how tax law applies to a particular transaction or circumstance, or whether a taxation authority will accept a company's tax treatment. IAS 12 Income Taxes specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. IFRIC 23 provides requirements that add to the requirements in IAS 12 by specifying how to reflect the effects of uncertainty in accounting for income taxes. Date of application: annual periods beginning on or after 1 January 2019.	The Bank claims that the interpretation will not have a material impact on its financial statements in the period of its first application.
IFRS 16 'Leases'	Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. IFRS 16 defines a lease term as the noncancellable period for which the lessee has the right to use an underlying asset including optional periods when an entity is reasonably certain to exercise an option to extend (or not to terminate) a lease. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis. Date of application: annual periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of this Standard.	The Bank did not use the option of early application of IFRS 16 and will apply the standard from 1 January 2019. In relation to the Bank as a lessor - the accounting largely remains unchanged. However the Bank might see an impact to its business model and lease products due to changes in needs and behaviours. In relation to the Bank as a lessee – the impact of first application of IFRS 16 is presented in the Note 4.1.

Notes to the financial statements (cont.)

(in PLN thousand)

4.11 New standards, interpretations and amendments to published standards that have been published by the International Accounting Standards Board (IASB) and not yet approved by the European Union

STANDARD / INTERPRETATION	DESCRIPTION	IMPACT ASSESSMENT
IFRS 17 'Insurance Contracts'	The new standard requires insurance liabilities to be measured at a current fulfillment value and provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of a consistent, principle-based accounting for insurance contracts. IFRS 17 supersedes IFRS 4 'Insurance Contracts' and related interpretations while applied. Date of application: annual periods beginning on or after 1 January 2021.	The Bank claims that the new standard will not have a material impact on its financial statements in the period of its first application.
IAS 19 (amendment) **'**Employee Benefits'	Amendments to IAS 19 'Employee Benefits' - Plan Amendment, Curtailment or Settlement – require to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. Date of application: annual periods beginning on or after 1 January 2019.	The Bank is currently analyzing the impact of those changes on the financial statements.
IFRS 3 (amendment) "Business combinations"	The amendments narrowed and clarified the definition of a business. They also permit a simplified assessment of whether an acquired set of activities and assets is a group of assets rather than a business. Date of application: annual periods beginning on or after 1 January 2020.	The Bank claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application.
IAS 1 (amendment) "Presentation of financial statements" and **IAS 8 (amendment)** "Accounting policies, changes in accounting estimates and errors"	The amendments clarify and align the definition of 'material' and provide guidance to help improve consistency in the application of that concept whenever it is used in IFRS Standards. Date of application: annual periods beginning on or after 1 January 2020.	The Bank is currently analyzing the impact of those changes on the financial statements.
Improvements to IFRS 2015-2017	Amendments to various standards resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording. The amendments clarify that: a company remeasures its previously held interest in a joint operation when it obtains control of the business (IFRS 3), a company does not remeasure its previously held interest in a joint operation when it obtains joint control of the business (IFRS 11), a company accounts for all income tax consequences of dividend payments in the same way (IAS 12), and a company treats as part of general borrowings any borrowing originally made to develop an asset when the asset is ready for its intended use or sale (IAS 23). Date of application: annual periods beginning on or after 1 January 2019.	The Bank is currently analyzing the impact of those changes on the financial statements.

5. Risk management

The risk management policy of the Bank aims at optimizing the structure of the balance sheet and off-balance sheet items taking into consideration the assumed risk-income relation and overall impact of various risks that the Bank undertakes in conducting its business activities. Risks are monitored and controlled with reference to profitability and capital coverage and are regularly reported in accordance with rules presented below.

All significant risks incurred in the course of the Bank's operations are described in the further part of the Note.

5.1 Organizational structure of risk management

Supervisory Board

The Supervisory Board provides supervision over the risk management system, assessing its adequacy and effectiveness. Moreover, the Supervisory Board also provides supervision of the compliance of the Bank's policy with respect to risk taking with the Bank's strategy and financial plan.

Management Board

The Management Board is responsible for the development, implementation and functioning of risk management processes by, among others, introduction of relevant, internal regulations, taking into consideration the results of internal audit inspections.

The Bank's Management Board is responsible for the effectiveness of the risk management system, internal control system, internal capital computation process and the effectiveness of the review of the process of computing and monitoring of internal capital. Moreover, the Management Board also introduces the essential adjustments or improvements to those processes and systems whenever necessary. This need may be a consequence of changes to risk levels of the Bank's operations, business environment factors or irregularities in the functioning of processes or systems.

Periodically, the Bank Management Board submits to the Bank's Supervisory Board concise information on the types, scale and significance of risks the Bank is exposed to, as well as on methods used in the management of such risks.

The Bank Management Board is responsible for assessing, whether activities such as identification, measurement, monitoring, reporting and control or mitigation are carried out appropriately within the scope of the risk management process. Moreover, the Management Board examines whether the management at all levels effectively manage the risks within the scope of their competence.

Committees

In performing these tasks, in terms of risk management, the Management Board is supported by the relevant committees:

- Assets, Liabilities and Risk Management Committee – in market risk management, liquidity and capital adequacy,
- Liquidity and Market Risk Committee, acting as support for the Assets, Liabilities and Risk Management Committee, – in liquidity and market risk management,
- Operational Risk Committee – in operational risk management,
- Credit Committee – in making credit decisions within the powers and in the case of issuing recommendations on the largest transactions presented to the Management Board for decision,
- Change Management Committee – in the implementation of new or modification of existing products and business and non-business processes,
- Safety Committee – in the field of security and business continuity management,
- Model Risk Committee – in model risk management.

5.2 Credit risk

Credit risk is one of the basic risks associated with activities of the Bank. The percentage share of credits and loans in the Bank's statement of financial position makes the maintenance of this risk at safe level essential to the Bank's performance. The process of credit risk management is centralized and managed mainly by Risk Management Division units, situated at the Bank Head Office or in local units.

The integration of various risks in the Risk Management Division, where apart from credit risk, market and operational risk are dealt with, facilitates effective management of all credit-related risks.

This process covers all credit functions – credit analysis, making credit decisions, monitoring and loan administration, as well as restructuring and collection.

These functions are conducted in compliance with the Bank's credit policy, adopted by the Bank's Management Board and the Bank's Supervisory Board for given year and its related guidelines. The effectiveness and efficiency of credit functions are achieved using diverse credit methods and methodologies, supported by advanced IT tools, integrated into the Bank's general IT system. The Bank's procedures facilitate credit risk mitigation. In particular those related to transaction risk evaluation, establishing collateral, setting authorization limits for granting loans and limiting of exposure to some areas of business activity in line with current client's segmentation scheme in the Bank.

The Bank's lending activity is limited by the restrictions of the external regulations as well as internal prudential standards in order to increase safety. These restrictions refer in particular to concentration limits for specific sectors of the economy, share of large exposures in the loan portfolio of the Bank and exposure limits for particular foreign countries, foreign banks and domestic financial institutions.

Credit granting limits, concentration limits for specific business activities as well as internal and external prudential standards include not only credits, loans and guarantees, but also derivatives transactions and debt securities.

The Bank established the following portfolio limits in the Bank's credit policy:

- share of large exposures in the loan portfolio of the Bank,
- customer segment limits,
- product limits (mortgage loans given to private individuals, financing commercial real estate),

Since key limits are determined by decision-making bodies which simultaneously receive and analyze reports on credit risk (presenting also the Basel parameters of credit risk), limit-related decisions take into consideration the credit risk assessments supported by internal rating systems. Moreover, the Bank limits higher risk credit transactions, marked by excess risk by restricting the decision-making powers in such cases to higher-level decision-making bodies.

The management of the Bank's credit portfolio quality is further supported by regular reviews and continuous monitoring of timely loan repayments and the financial condition of the borrowers.

Rating models utilized in the credit risk management process

For credit risk management purposes, the Bank uses the internal rating models depending on the client's segment and/or exposure type.

The rating process is a significant element of credit risk assessment in relation to clients and transactions, and constitutes a preliminary stage of the credit decision-making process of granting a new credit or changing the terms and conditions of an existing credit and of the credit portfolio quality monitoring process.

In the credit risk measurement the following three parameters are used: PD, LGD and EAD. PD is the probability of a Client's failure to meet its obligations and hence the violation of contract terms and conditions by the borrower within one year horizon, such default may be subject-matter or product-related. LGD indicates the estimated value of the loss to be incurred for any credit transaction from the date of occurrence of such default. EAD reflects the estimated value of credit exposure as at such date.

The risk parameters used in the rating models are designed for calculation of the expected losses resulted from credit risk.

The value of expected loss is one of the significant assessment criteria taken into consideration by the decision-making bodies in the course of the crediting process. In particular, this value is compared to the requested margin level.

Notes to the financial statements (cont.)

(in PLN thousand)

The level of minimum margins for given products or client segments is determined based upon risk analysis, taking into consideration the value of risk parameters assessed and comprising an element of internal rating systems.

The client and transaction rating, as well as other credit risk parameters hold a significant role in the Credit Risk Management Information System. For each rating model, the credit risk reports provide information on the comparison between the realized parameters and the theoretical values for each rating class.

Credit risk reports are generated on a monthly basis, with their scope varying depending upon the recipient of the report (the higher the management level, the more aggregated the information presented). Hence, the reports are being effectively used in the credit risk management process.

For internal purposes, within the Bank the following rating models are used, developed in accordance with provisions of 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:

1) For the private individuals, the Bank uses the following models applicable for:
   - mortgage loans,
   - consumer loans
   - renewable limits.
2) For the corporate clients, the Bank uses rating models dividing clients into:
   - non-financial enterprises,
     - corporate clients,
     - small and medium enterprises (SME),
   - specialized lending (commercial real estate financing),
   - local government units.

The following exposure types are not covered by internal rating models:

1) retail exposures immaterial in terms of size and perceived risk profile:
   - overdrafts,
   - exposures related to credit cards,
   - exposures related to the Building Society (Kasa Mieszkaniowa) unit,
   - other loans,
2) corporate clients immaterial in terms of size and perceived risk profile:
   - exposures to stock exchanges and other financial intermediators,
   - exposures to insurance companies,
   - project financing,
   - purchased receivables,
   - exposures to investment funds,
   - exposures to leasing companies and financial holding companies,
   - other loans,
3) exposures to regional governments and local authorities which are not treated as exposures to central governments, for which the number of significant counterparties is limited,
4) exposures to Pekao Group entities, subject to appropriate prudential requirements.

The tables below present the quality of the loan portfolio as at 31 December 2018.

Notes to the financial statements (cont.)

(in PLN thousand)

The distribution of rated portfolio for individual client segment (excluding impaired loans)

RATING CLASS	RANGE OF PD	31.12.2018											% PORT-FOLIO
		GROSS CARRYING AMOUNT OF ON-BALANCE EXPOSURES						NOMINAL AMOUNT OF OFF-BALANCE EXPOSURES					
		STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		TOTAL	
				INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT					INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
MORTGAGE LOANS													
1	0.00% <= PD < 0.06%	8 666 275	1 780 996			-	10 447 271	287 264	2 208			289 472	19.4%
2	0.06% <= PD < 0.19%	3 938 029	1 370 048			-	5 308 077	309 139	2 864			312 003	10.2%
3	0.19% <= PD < 0.35%	19 489 854	4 889 979			33	24 379 866	303 131	27 983			331 114	44.7%
4	0.35% <= PD < 0.73%	7 122 393	3 187 017			-	10 309 410	179 126	29 801			208 927	19.0%
5	0.73% <= PD < 3.50%	687 410	1 546 084			-	2 233 494	100 814	29 487			130 301	4.3%
6	3.50% <= PD < 14.00%	34 579	586 560			-	621 139	9 470	60 148			69 618	1.2%
7	14.00% <= PD < 100.00%	554	668 569			-	669 123	19	5 094			5 113	1.2%
Total		**39 939 094**	**14 029 253**			**33**	**53 968 380**	**1 188 963**	**157 585**			**1 346 548**	**100.0%**
CONSUMER LOANS													
1	0.00% <= PD < 0.09%	655 592	142 190			-	797 782	194	-			194	7.1%
2	0.09% <= PD < 0.18%	1 453 915	189 229			-	1 643 144	335	-			335	14.7%
3	0.18% <= PD < 0.39%	2 531 257	208 958			15	2 740 230	53	-			53	24.5%
4	0.39% <= PD < 0.90%	2 440 988	126 235			94	2 567 317	42	-			42	23.0%
5	0.90% <= PD < 2.60%	1 676 831	124 991			39	1 801 861	209	-			209	16.1%
6	2.60% <= PD < 9.00%	818 889	182 305			207	1 001 401	339	-			339	9.0%
7	9.00% <= PD < 30.00%	204 291	194 604			112	399 007	-	201			201	3.6%
8	30.00% <= PD < 100.00%	19 002	205 128			75	224 205	-	7			7	2.0%
Total		**9 800 765**	**1 373 640**			**542**	**11 174 947**	**1 172**	**208**			**1 380**	**100.0%**
LIMITS													
1	0.00% <= PD < 0.02%	2 883	5 200			-	8 083	94 494	329 639			424 133	38.9%
2	0.02% <= PD < 0.11%	17 450	37 825			-	55 275	78 153	205 964			284 117	30.5%
3	0.11% <= PD < 0.35%	20 790	57 233			-	78 023	18 333	61 019			79 352	14.2%
4	0.35% <= PD < 0.89%	9 281	51 406			-	60 687	3 861	20 794			24 655	7.7%
5	0.89% <= PD < 2.00%	4 260	31 919			-	36 179	1 082	9 613			10 695	4.2%
6	2.00% <= PD < 4.80%	2 023	22 260			1	24 284	657	6 170			6 827	2.8%
7	4.80% <= PD < 100.00%	566	12 891			1	13 458	368	5 005			5 373	1.7%
Total		**57 253**	**218 734**			**2**	**275 989**	**196 948**	**638 204**			**835 152**	**100.0%**
Individual client segment - total		**49 797 112**	**15 621 627**			**577**	**65 419 316**	**1 387 083**	**795 997**			**2 183 080**	**-**

Notes to the financial statements (cont.)

(in PLN thousand)

The distribution of rated portfolio for corporate client segment (excluding impaired loans)

RATING CLASS	RANGE OF PD	31.12.2018											% PORT-FOLIO
		GROSS CARRYING AMOUNT OF ON-BALANCE EXPOSURES						NOMINAL AMOUNT OF OFF-BALANCE EXPOSURES					
		STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		TOTAL	
				INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT					INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
CORPORATES													
1	0.00% <= PD < 0.15%	502 738	8 300			-	511 038	2 225 560	13 187			2 238 747	5.2%
2	0.15% <= PD < 0.27%	1 953 673	47 758			-	2 001 431	2 827 794	27 452			2 855 246	9.3%
3	0.27% <= PD < 0.45%	3 651 157	56 875			-	3 708 032	3 237 748	81 099			3 318 847	13.4%
4	0.45% <= PD < 0.75%	4 942 251	128 214			-	5 070 465	6 380 043	431 920			6 811 963	22.6%
5	0.75% <= PD < 1.27%	3 632 780	810 592			-	4 443 372	5 656 673	1 212 310			6 868 983	21.6%
6	1.27% <= PD < 2.25%	3 559 709	393 069			-	3 952 778	2 938 157	395 343			3 333 500	13.9%
7	2.25% <= PD < 4.00%	1 008 324	503 834			-	1 512 158	925 159	206 145			1 131 304	5.0%
8	4.00% <= PD < 8.50%	1 028 128	893 421			-	1 921 549	1 955 801	355 943			2 311 744	8.1%
9	8.50% <= PD < 100.00%	82 765	132 909			-	215 674	187 655	67 344			254 999	0.9%
Total		**20 361 525**	**2 974 972**			**-**	**23 336 497**	**26 334 590**	**2 790 743**			**29 125 333**	**100.0%**
SMEs													
1	0.00% <= PD < 0.06%	18 000	1 438			-	19 438	47 119	1 561			48 680	1.1%
2	0.06% <= PD < 0.14%	276 547	14 475			-	291 022	327 770	3 449			331 219	10.4%
3	0.14% <= PD < 0.35%	862 656	50 491			-	913 147	509 977	23 439			533 416	24.3%
4	0.35% <= PD < 0.88%	976 510	106 473			5	1 082 988	359 443	47 227			406 670	25.1%
5	0.88% <= PD < 2.10%	758 679	115 372			-	874 051	185 520	24 774			210 294	18.2%
6	2.10% <= PD < 4.00%	354 590	74 735			10	429 335	83 199	19 184			102 383	8.9%
7	4.00% <= PD < 7.00%	198 485	57 209			-	255 694	43 733	9 355			53 088	5.2%
8	7.00% <= PD < 12.00%	119 256	49 008			-	168 264	15 205	5 952			21 157	3.2%
9	12.00% <= PD < 22.00%	48 522	43 415			-	91 937	5 936	4 039			9 975	1.7%
10	22.00% <= PD < 100.00%	29 227	75 943			18	105 188	6 365	2 439			8 804	1.9%
Total		**3 642 472**	**588 559**			**33**	**4 231 064**	**1 584 267**	**141 419**			**1 725 686**	**100.0%**
Corporate client segment - total		**24 003 997**	**3 563 531**			**33**	**27 567 561**	**27 918 857**	**2 932 162**			**30 851 019**	

Notes to the financial statements (cont.)

(in PLN thousand)

The distribution of rated portfolio for local government units segment (excluding impaired loans)

RATING CLASS	RANGE OF PD	31.12.2018											
		GROSS CARRYING AMOUNT OF ON-BALANCE EXPOSURES						NOMINAL AMOUNT OF OFF-BALANCE EXPOSURES					% PORT-FOLIO
		STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		TOTAL	
				INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT					INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
LOCAL GOVERNMENT UNITS													
1	0.00% <= PD < 0.04%	650	-			-	650	10 032	-			10 032	0.4%
2	0.04% <= PD < 0.06%	344 709	-			-	344 709	55 820	-			55 820	14.8%
3	0.06% <= PD < 0.13%	337 260	-			-	337 260	15 505	-			15 505	13.0%
4	0.13% <= PD < 0.27%	347 994	-			-	347 994	162 257	-			162 257	18.8%
5	0.27% <= PD < 0.50%	636 686	-			-	636 686	45 007	-			45 007	25.1%
6	0.50% <= PD < 0.80%	686 002	-			-	686 002	8 875	-			8 875	25.6%
7	0.80% <= PD < 1.60%	33 108	-			-	33 108	11 000	-			11 000	1.6%
8	1.60% <= PD < 100.00%	17 730	-			-	17 730	25	-			25	0.7%
Total		**2 404 139**	**-**			**-**	**2 404 139**	**308 521**	**-**			**308 521**	**100.0%**

For specialized lending. the Bank adopts slotting criteria approach within internal rating method which uses supervisory categories in the process of assigning risk weigh category.

Distribution of the portfolio exposure to specialized lending (excluding impaired loans)

SUPERVISORY CATHEGORY	31.12.2018											
	GROSS CARRYING AMOUNT OF ON-BALANCE EXPOSURES						NOMINAL AMOUNT OF OFF-BALANCE EXPOSURES					% PORT-FOLIO
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		TOTAL	
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT					INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
EXPOSURE TO SPECIALIZED LENDING												
High	1 351 575	53 798			-	1 405 373	243 336	-			243 336	19.7%
Good	3 875 730	-			-	3 875 730	1 628 766	-			1 628 766	65.8%
Satisfactory	706 146	90 611			-	796 757	395 251	-			395 251	14.3%
Low	-	13 556			-	13 556	-	5 000			5 000	0.2%
Total	**5 933 451**	**157 965**			**-**	**6 091 416**	**2 267 353**	**5 000**			**2 272 353**	**100.0%**

Notes to the financial statements (cont.)

(in PLN thousand)

Portfolio of exposures not covered by the rating model (excluding impaired loans), broken down by delays in repayment

	31.12.2018											
	GROSS CARRYING AMOUNT OF ON-BALANCE EXPOSURES						NOMINAL AMOUNT OF OFF-BALANCE EXPOSURES					% PORT-FOLIO
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		TOTAL	
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT					INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
EXPOSURES NOT COVERED BY THE RATING MODEL												
Not past due	18 449 778	473 470			19	18 923 267	15 517 628	203 025			15 720 653	99.0%
Past due, of which:	110 119	202 863			1	312 983	27 842	10 062			37 904	1.0%
- up to 1 month	110 117	26 448			1	136 566	27 822	8 042			35 864	0.5%
- between 1 month and 2 months	-	12 112			-	12 112	-	714			714	0.0%
- above 2 months	2	164 303			-	164 305	20	1 306			1 326	0.5%
Total	**18 559 897**	**676 333**			**20**	**19 236 250**	**15 545 470**	**213 087**			**15 758 557**	**100.0%**

Portfolio of impaired exposures, broken down by delays in repayment

	31.12.2018											
	GROSS CARRYING AMOUNT OF ON-BALANCE EXPOSURES						NOMINAL AMOUNT OF OFF-BALANCE EXPOSURES					% PORT-FOLIO
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		TOTAL	
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT					INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
IMPAIRED EXPOSURES												
Not past due			1 247 059	231 711	531	1 479 301			274 600	6 713	281 313	22.2%
Past due, of which:			3 569 411	2 308 616	53 761	5 931 788			225 579	2 737	228 316	77.8%
- up to 1 month			76 656	186 353	308	263 317			200 912	671	201 583	5.9%
- between 1 month and 3 months			158 564	197 365	63	355 992			19 202	389	19 591	4.7%
- between 3 months and 1 year			293 838	358 077	362	652 277			355	709	1 064	8.2%
- between 1 year and 5 years			1 246 939	809 902	3 217	2 060 058			5 017	799	5 816	26.1%
- above 5 years			1 793 414	756 919	49 811	2 600 144			93	169	262	32.9%
Total			**4 816 470**	**2 540 327**	**54 292**	**7 411 089**			**500 179**	**9 450**	**509 629**	**100.0%**

Notes to the financial statements (cont.)

(in PLN thousand)

Client/transaction rating and credit risk decision-making level

Decision-making level connected with transaction approval is directly dependent upon the client's rating.

Decision-making entitlement limits are associated with the position held, determined in accordance with the Bank's organizational structure. The limits are determined taking the following matters into consideration:

- the Bank's total exposure to a client, including the amount of the requested transaction,
- type of a client,
- commitments of persons and entities associated with the client.

Validation of rating models

The internal validation of models and risk parameter assessments is focused on the quality assessment of risk models and the accuracy and stability of parameter assessments, applied by the Bank. Validation is carried out at the level of each risk model, although the Bank may apply several models for each class of exposures.

Moreover, the internal audit unit is obligated to review the Bank's rating systems and their functionality at least once a year. In particular, the internal audit unit reviews the scope of operations of credit division and estimations of risk parameters. It also verifies compliance of rating systems and their functionality with all requirements of advanced methods.

Division of loans and advances to customers for covered and not covered by internal rating models

PORTFOLIO	31.12.2018		
	GROSS CARRYING AMOUNT	IMPAIRMENT ALLOWANCE	NET CARRYING AMOUNT
Exposures with no impairment	120 718 682	(1 031 963)	119 686 719
Rated portfolio for individual client segment	65 419 316	(515 724)	64 903 592
Mortgage loans	53 968 380	(259 517)	53 708 863
Consumer loans	11 174 947	(247 538)	10 927 409
Limits	275 989	(8 669)	267 320
Rated portfolio for corporate client segment	27 567 561	(170 223)	27 397 338
Corporates	23 336 497	(106 569)	23 229 928
SMEs	4 231 064	(63 654)	4 167 410
Rated portfolio for local government units segment	2 404 139	(3 258)	2 400 881
Specialized lending exposures	6 091 416	(81 702)	6 009 714
Exposures not covered by the rating model	19 236 250	(261 056)	18 975 194
Impaired exposures	7 411 089	(5 051 323)	2 359 766
Total loans and advances to customers subject to impairment (*)	**128 129 771**	**(6 083 286)**	**122 046 485**

(*) Loans and advances to customers measured at amortised cost and measured at fair value through other comprehensive income.

Notes to the financial statements (cont.)

(in PLN thousand)

Division of off-balance sheet exposures to customers (loan commitments and financial guarantee contracts) for covered and not covered by internal rating models

PORTFOLIO	31.12.2018	
	NOMINAL AMOUNT	IMPAIRMENT ALLOWANCE
Exposures with no impairment	51 373 530	(156 587)
Rated portfolio for individual client segment	2 183 080	(4 484)
Mortgage loans	1 346 548	(2 205)
Consumer loans	1 380	(58)
Limits	835 152	(2 221)
Rated portfolio for corporate client segment	30 851 019	(79 838)
Corporates	29 125 333	(75 629)
SMEs	1 725 686	(4 209)
Rated portfolio for local government units segment	308 521	(87)
Specialized lending exposures	2 272 353	(10 973)
Exposures not covered by the rating model	15 758 557	(61 205)
Impaired exposures	509 629	(112 495)
Total off- balance sheet exposures to customers	**51 883 159**	**(269 082)**

Classification of loans and advances to banks according to Fitch ratings as at 31 December 2018

RATING	CARRYING AMOUNT						%PORTFOLIO
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT			
LOANS AND ADVANCES TO BANKS MEASURED AT AMORTISED COST							
AA+ to AA-	89 431	-	-	-	-	89 431	3.6%
A+ to A-	1 141 105	614	-	108	-	1 141 827	45.3%
BBB+ to BBB-	977 532	-	-	-	-	977 532	38.8%
BB+ to BB-	2 150	-	-	-	-	2 150	0.1%
No rating	299 056	-	8 987	-	-	308 043	12.2%
Total gross carrying amount	**2 509 274**	**614**	**8 987**	**108**	**-**	**2 518 983**	**100.0%**
Impairment allowance	(1 444)	-	(8 987)	-	-	(10 431)	
Total net carrying amount	**2 507 830**	**614**	**-**	**108**	**-**	**2 508 552**	

Notes to the financial statements (cont.)

(in PLN thousand)

Classification of exposures to debt securities according to Fitch ratings as at 31 December 2018

RATING	CARRYING AMOUNT						%PORTFOLIO
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT			
DEBT SECURITIES MEASURED AT AMORTISED COST							
A+ to A-	5 237 109	-	-	-	-	5 237 109	46.8%
BBB+ do BBB-	676 433	-	-	-	-	676 433	6.0%
No rating	5 244 567	-	31 547	-		5 276 114	47.2%
Gross carrying amount	**11 158 109**	**-**	**31 547**	**-**	**-**	**11 189 656**	**100.0%**
Impairment allowance	(27 742)	-	(31 547)	-	-	(59 289)	
Carrying amount	**11 130 367**	**-**	**-**	**-**	**-**	**11 130 367**	
DEBT SECURITIES MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME							
AAA	952 874	-	-	-	-	952 874	3.5%
A+ to A-	14 264 346	-	-	-	-	14 264 346	53.0%
BBB+ to BBB-	693 351	-	-	-	-	693 351	2.6%
No rating	10 994 003	-	-	-	-	10 994 003	40.9%
Carrying amount	**26 904 574**	**-**	**-**	**-**	**-**	**26 904 574**	**100.0%**
Impairment allowance (*)	(28 207)	-	-	-	-	(28 207)	
DEBT SECURITIES HELD FOR TRADING							
A+ to A-						679 691	76.3%
BBB+ to BBB-						14 184	1.6%
No rating						196 464	22.1%
Carrying amount						**890 339**	**100.0%**

(*) The impairment allowance for debt securities measured at fair value through other comprehensive income is included in the 'Revaluation reserve' item and does not reduce the carrying amount.

Classification of exposures to derivative financial instruments according to Fitch ratings as at 31 December 2018

	DERIVATIVES HELD FOR TRANDING			HEDGING DERIVATIVES			TOTAL	%PORTFOLIO
	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES		
AAA	251 167	297 401	-	27 308	244 370	-	820 246	46.4%
AA+ to AA-	47 748	-	-	-	-	-	47 748	2.7%
A+ to A-	163 280	540	-	14 170	-	-	177 990	10.1%
BBB+ to BBB-	188 186	-	17 060	11 791	-	-	217 037	12.3%
BB+ to BB-	117	-	-	-	-	-	117	-
B+ to B-	1 894	-	-	-	-	-	1 894	0.1%
No rating	126 081	116 219	246 283	15 926	-	-	504 509	28.4%
Total	**778 473**	**414 160**	**263 343**	**69 195**	**244 370**	**-**	**1 769 541**	**100.0%**

Notes to the financial statements (cont.)

(in PLN thousand)

Rating models – comparative data as at 31 December 2017 IAS 39

The Bank has adopted International Financial Reporting Standard 9 'Financial Instruments' with a date of transition of 1 January 2018. The Bank decided to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. IFRS 9 also significantly amended other standards dealing with financial instruments such as IFRS 7 'Financial instruments: Disclosures'. Disclosures for the comparative period are a repetition of disclosures made in previous periods.

The distribution of rated portfolio for individual client segment (excluding impaired loans) – mortgage loans

RATING CLASS	RANGE OF PD	31.12.2017	
		CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.06%	10 308 122	21.1%
2	0.06% <= PD < 0.19%	5 220 016	10.7%
3	0.19% <= PD < 0.35%	21 828 654	44.8%
4	0.35% <= PD < 0.73%	8 464 383	17.4%
5	0.73% <= PD < 3.50%	1 553 153	3.2%
6	3.50% <= PD < 14.00%	627 941	1.3%
7	14.00% <= PD < 100.00%	722 811	1.5%
Total		**48 725 080**	**100.0%**

The distribution of rated portfolio for individual client segment (excluding impaired loans) – consumer loans

RATING CLASS	RANGE OF PD	31.12.2017	
		CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.09%	763 055	7.4%
2	0.09% <= PD < 0.18%	1 597 102	15.5%
3	0.18% <= PD < 0.39%	2 555 301	24.7%
4	0.39% <= PD < 0.90%	2 423 887	23.5%
5	0.90% <= PD < 2.60%	1 603 023	15.5%
6	2.60% <= PD < 9.00%	854 202	8.3%
7	9.00% <= PD < 30.00%	335 767	3.2%
8	30.00% <= PD < 100.00%	194 236	1.9%
Total		**10 326 573**	**100.0%**

The distribution of rated portfolio for non-financial corporate client segment (excluding impaired loans)

RATING CLASS	RANGE OF PD	31.12.2017	
		CARRYING AMOUNT	%PORTFOLIO
1	0.00% <= PD < 0.15%	618 103	3.0%
2	0.15% <= PD < 0.27%	1 400 964	6.9%
3	0.27% <= PD < 0.45%	2 802 868	13.7%
4	0.45% <= PD < 0.75%	6 073 391	29.7%
5	0.75% <= PD < 1.27%	3 468 286	17.0%
6	1.27% <= PD < 2.25%	2 494 294	12.2%
7	2.25% <= PD < 4.00%	1 244 813	6.1%
8	4.00% <= PD < 8.50%	2 246 694	11.0%
9	8.50% <= PD < 100.00%	84 549	0.4%
Total		**20 433 962**	**100.0%**

Notes to the financial statements (cont.)

(in PLN thousand)

For specialized lending, the Bank adopts slotting criteria approach within internal rating method which uses supervisory categories in the process of assigning risk weigh category.

Distribution of the portfolio exposure to specialized lending (excluding impaired loans)

SUPERVISORY CATHEGORY	31.12.2017	
	CARRYING AMOUNT	%PORTFOLIO
High	1 105 911	15.3%
Good	4 863 113	67.1%
Satisfactory	1 271 661	17.5%
Low	7 080	0.1%
Total	**7 247 765**	**100.0%**

Division of loans and advances to customers for covered and not covered by internal rating models

	31.12.2017
Loans with no impairment:	**126 560 577**
Loans to individuals:	**61 262 073**
Covered by internal rating model:	59 051 653
Mortgage loans	48 725 080
Consumer loans	10 326 573
Other, not covered by internal rating model	2 210 420
Loans to corporates:	**65 298 504**
Covered by internal rating model:	20 433 962
Specialized lending exposures	7 247 765
Debt securities, not covered by internal rating model	12 657 973
Repo transactions, not covered by internal rating model	-
Other, not covered by internal rating model	24 958 804
Impaired loans	**2 312 601**
Total loans and advances to customers(*)	**128 873 178**

(*) Loans and advances to customers include receivables from financial leases.

Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2017

RATING	DEBT SECURITIES				
	HELD FOR TRADING	AVAILABLE FOR SALE	HELD TO MATURITY	REPO TRANSACTIONS (***)	TOTAL
AA+ to AA-	-	722 151	-	-	722 151
A+ to A-	1 646 757	20 695 128	3 335 371	492 419	26 169 675
no rating	88 011	11 718 765 (*)	31 453 (**)	-	11 838 229
Total	**1 734 768**	**33 136 044**	**3 366 824**	**492 419**	**38 730 055**

(*) Including NBP bills in an amount of PLN 11 066 168 thousand.
(**) Including NBP bills in an amount of PLN 31 453 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2017

RATING	DERIVATIVES HELD FOR TRANDING			HEDGING DERIVATIVES			TOTAL
	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	BANKS	OTHER FINANCIAL INSTITUTIONS	NON-FINANCIAL ENTITIES	
AAA	129	-	-	-	-	-	129
AA+ to AA-	59 784	-	-	-	-	-	59 784
A+ to A-	588 677	102 882	-	40 143	-	-	731 702
BBB+ to BBB-	40 019	-	-	-	-	-	40 019
no rating	227 026	67 080	265 747	36 653	182 600	-	779 106
Total	**915 635**	**169 962**	**265 747**	**76 796**	**182 600**	**-**	**1 610 740**

The description of the model for impairment allowance

Since 1 January 2018, the Bank has recognized impairment allowance in accordance with the IFRS 9. IFRS 9 assumes the calculation of impairment losses based on expected credit losses and taking into account forecasts and expected future economic conditions in the context of credit risk exposure assessment.

Expected credit loss model

The impairment model applies to financial assets classified, in accordance with the IFRS 9, as financial assets at amortized cost or at fair value through other comprehensive income, with the exception of equity instruments.

The impairment model in accordance with IFRS 9 is based on the allocation of exposure to one of the three stages, depending on credit quality changes compared to the initial recognition of assets in the accounting records. How to calculate the impairment loss depends on the stage.

STAGE	CLASSIFICATION CRITERION TO THE STAGE	THE METHOD OF CALCULATING THE IMPAIRMENT ALLOWANCE
Stage 1	Exposures for which no significant increase in credit risk has been identified since the initial recognition until the balance sheet date and no impairment was identified	12-month expected credit losses
Stage 2	Exposures for which a significant increase in credit risk has been identified since the initial recognition until the balance sheet date and no impairment was identified	Lifetime expected credit losses
Stage 3	Exposures for which impairment has been identified	

In addition, financial assets that were classified as POCI at the time of initial recognition are treated as POCI (i.e. purchased or originated credit-impaired) in all subsequent periods until they are derecognised. This rule applies even if, in the meantime, the asset has been healed. In other words, assets once recognized as POCI remain in this status regardless of future changes in estimates of their cash flows.

In the case of instruments with the POCI status, life-time expected credit losses are recognized throughout the lifetime of these instruments.

Calculation of expected credit losses

Calculation of expected credit losses in a lifetime horizon requires the application of multi-annual risk parameters.

For the purpose of calculating the credit loss in accordance with IFRS 9, the Bank compares the cash flows that it should receive pursuant to the agreement with the borrower and the flows estimated by the Bank that it expects to receive. The difference is discounted by the original effective interest rate.

Expected credit losses are determined in the contractual maturity period with the exception of products meeting the criteria of IFRS 9 para. 5.5.20, for which the Bank determines the expected losses in the period in which it is exposed to credit risk (i.e. in the economic maturity).

Methodology for calculating Bank parameters - PD, RR and EAD.

Multi-annual PD parameters are an assessment of the probability of a default event in the next annual intervals in the lifetime. The PD long-term curve for a given exposure depends on the current value of the 12M PD parameter (and the appropriate rating class) determined based on the internal PD models of the Bank. In the estimation, the Bank:

- estimates unbiased PD parameters without taking into account additional margins of conservatism (IFRS 9, paragraph 5.5.17 (a)),
- takes into account current and forecasted macroeconomic conditions (IFRS 9, paragraph 5.5.17 (c)).

The calculation of expected recovery rates (RR) is based on the ‘pool’ model, in which, within homogeneous groups, average monthly recoveries are calculated conditionally against the month since default (MSD). Homogeneous groups of accounts were separated on the basis of the following characteristics:

- the type of borrower,
- product type,
- ranges of the LTV parameter (for mortgages and housing loans).

As part of defined homogeneous groups, average monthly recovery rates are calculated, which consist of repayments and recoveries resulting from both the secured part and the unsecured exposure, weighted by the value of outstanding capital observed at the beginning of a given MSD.

For products for which a repayment schedule is available, the Bank sets the exposure value at the moment of default (EAD, Exposure at Default) and principal at the moment of default (PAD, Principal at Default) in the lifetime (i.e. for future repayments) based on contractual payment schedules and taking into account the following effects:

- the effect of arrears on principal and interest installments related to the expected non-payment of the last installments prior to the occurrence of the default,
- the effect of arrears of payments (principal and interest) on the date of calculation of the provision,
- the effect of settlement of the EIR adjustment over time.

For products for which a repayment schedule is not available, the Bank sets the long-term EAD and PAD using the CCF (Credit Conversion Factor) and PADf (PAD factor) parameters. The CCF parameter, which estimates the percentage utilization of the remaining part of the limit in the period of 12 months before the expected moment of the default event, is used to determine the expected value of PAD and EAD parameters in the 12M period from the reference date. The PADf parameter is used to determine the expected value of PAD and EAD parameters from 12M after the reference date to the maturity date of the account.

For exposures for which it is not possible to determine risk parameters based on internal models, the Bank adopts an approach based on using parameters from other portfolios with similar characteristics.

The models and parameters used to calculate impairment allowance are periodically validated.

The low credit risk criterion

According to par. 5.5.10 IFRS 9 exposures that are considered as low risk credit exposures at the reporting date may remain in Stage 1, regardless of the scale of the relative credit deterioration from the initial recognition. According to par. B.5.5.22 of IFRS 9, the credit risk of a financial instrument is considered low when:

- the financial instrument has a low risk of default,
- the borrower has a strong capacity to meet its contractual cash flow obligations in the near term,
- adverse changes in the economic and business conditions in the long term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

The Bank applies a low credit risk criterion for three portfolios: exposures to banks, exposures to local government units and exposures to the State Treasury and the National Bank of Poland.

Financial assets with an identified significant increase in credit risk

Financial assets for which at the balance sheet date the Bank will identify a significant increase in credit risk from the initial recognition are classified in Stage 2. The Bank recognizes that for a given asset a significant increase in credit risk has been identified if a quantitative or qualitative criterion is met in particular of contractual payments are more than 30 days past due, where the occurrence of a given criterion is verified at the exposure level.

Quantitative criteria

Taking into account the requirements of the standard, the Bank defined three basic characteristics of the quantitative model:

- the measure on the basis of which the allocation is made to stages,
- the significance of the deterioration of the credit quality,
- quantification of the level of significant deterioration.

The measure, on the basis of which the allocation to stages is made, was set by the Bank as the ratio of:

- current credit risk assessment defined as lifetime PD in the horizon from the reporting date to the maturity date determined on the basis of the characteristics effective as at the reporting date,
- the original credit risk assessment defined as lifetime PD in the period from the reporting date to the maturity date determined on the basis of the characteristics applicable as at the date of initial recognition.

(in PLN thousand)

The assessment of a significant credit risk deterioration is carried out by comparing the observed value of a relative change in the risk assessment with the theoretical value, which is the threshold above which the Bank considers that a significant deterioration in credit risk occurred.

The allocation threshold at the single exposure level is determined by a statistical model based, among others, on information on the credit risk assessment as of the date of the initial recognition and the time from the date of the initial recognition of the exposure.

Qualitative criteria

As a result of the monitoring process carried out by the Bank, the qualitative criteria for the allocation to Stage 2 are identified, such as:

- a delay in repayment over 30 days (30 DPD),
- occurrence of forbearance status,
- exposure is on the Watchlist.

In addition to the above, the Bank has defined a number of specific quality criteria for various types of portfolios, such as, inter alia, changes in the Bank's internal rating specific to customers in a given segment, changes in supervisory classes for selected segments (eg specialized financing), warning signals identified in the monitoring system and credit risk management or the results of individual monitoring.

Financial assets with identified impairment

Financial assets for which at the balance sheet date the Bank has identified occurrences of the default event are classified in Stage 3. The Bank recognizes that for a given asset a default was identified if at least one of the following occurred:

- amount of arrears above the set materiality threshold for over 90 days,
- exposure during the restructuring process,
- individual impairment trigger.

For SME and corporate segments, default is identified at the customer level, whereas for the retail segment at the customer/product group level. The criterion of days and amounts of delays is also defined at the level of identification. Similarly, if for any of the contracts under the aggregated group there is a default condition, all contracts in this group are treated as default.

The Bank applies a six-month quarantine period effective from the moment all defaults cease to exist.

Sensitivity analysis regarding the forecast of the macroeconomic situation

Changes in expected credit losses for exposures without impairment presented in the table below were assessed as a difference between expected credit losses calculated for a specific macroeconomic scenario and expected credit losses calculated taking into account all macroeconomic scenarios weighed with the probability of their implementation (in accordance with IFRS 9).

Macroeconomic scenarios include forecasts of macroeconomic factors influencing the level of expected credit losses and are prepared by the Macroeconomic Research Office on a quarterly basis. The forecasts take into account the following factors: GDP growth, registered unemployment rate and 3-month WIBOR in 3 scenarios: baseline (assumed for calculation), optimistic (assuming positive changes in factors in subsequent years against the baseline scenario) and pessimistic (assuming negative changes in factors in the following years against the baseline scenario).

31.12.2018	BASLINE SCENARIO	OPTIMISTIC SCENARIO	PESSIMISTIC SCENARIO
Changes in expected credit losses for exposures without impairment (Stages 1 and 2) assuming 100% implementation of the scenario	(18 298)	(55 645)	144 869

Notes to the financial statements (cont.)

(in PLN thousand)

The tables below present the changes in impairment allowances and gross carrying amount of financial assets not measured at fair value through profit or loss by class of financial assets:

	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
LOANS AND ADVANCES TO BANKS AND CENTRAL BANKS MEASURED AT AMORTISED COST(*)						
GROSS CARRYING AMOUNT						
GROSS CARRYING AMOUNT AS AT 1.01.2018	**5 191 846**	**1 071**	**21 014**	**113**	**-**	**5 214 044**
Transfer to Stage 1	161	(160)	-	(1)	-	-
Transfer to Stage 2	(187)	(196)	-	-	-	-
Transfer to Stage 3	(17)	(45)	-	61	-	-
New / purchased / granted financial assets	8 924 862	-	-	-	-	8 924 862
Financial assets derecognised, other than write-offs (repayments)	(1 815 360)	(414)	-	(46)	-	(1 815 820)
Financial assets written off (**)	-	-	(5 079)	-	-	(5 079)
Modifications not resulting in derecognition	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	(1 422)	(34)	(6 948)	(11)	-	(8 415)
GROSS CARRYING AMOUNT AS AT 31.12.2018	**12 299 863**	**614**	**8 987**	**108**	**-**	**12 309 592**
IMPAIRMENT ALLOWANCE						
IMPAIRMENT ALLOWANCE AS AT 1.01.2018	**506**	**-**	**21 127**	**-**	**-**	**21 633**
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
New / purchased / granted financial assets	1 114	-	-	-	-	1 114
Financial assets derecognised, other than write-offs (repayments)	(279)	-	-	-	-	(279)
Financial assets written off (**)	-	-	(5 079)	-	-	(5 079)
Changes in level of credit risk (excluding the transfers between the Stages)	102	2	-	-	-	104
Changes in models and risk parameters	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	913	(2)	(7 061)	-	-	(6 150)
IMPAIRMENT ALLOWANCE AS AT 31.12.2018	**2 356**	**-**	**8 987**	**-**	**-**	**11 343**

(*) Receivables from the Central Bank include a current account and deposits.
(**) Including the value of contractual interest subject to partial write-off in the amount of PLN 5 079 thousand

Notes to the financial statements (cont.)

(in PLN thousand)

	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
LOANS AND ADVANCES TO CUSTOMERS MEASURED AT AMORTISED COST						
GROSS CARRYING AMOUNT						
GROSS CARRYING AMOUNT AS AT 1.01.2018	**90 774 367**	**20 855 774**	**7 104 498**	**3 325 887**	**49 262**	**122 109 788**
Transfer to Stage 1	3 235 606	(3 227 122)	(46)	(8 438)	-	-
Transfer to Stage 2	(6 039 736)	6 112 908	(2 923)	(70 249)	-	-
Transfer to Stage 3	(801 476)	(548 195)	669 620	680 051	-	-
New / purchased / granted financial assets	31 885 548	-	-	-	2 116	31 887 664
Financial assets derecognised, other than write-offs (repayments)	(20 141 281)	(3 205 159)	(719 613)	(297 845)	(2 692)	(24 366 590)
Financial assets written off (*)	-	-	(2 209 476)	(1 222 760)	(17)	(3 432 253)
Modifications not resulting in derecognition	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	88 680	31 250	(25 590)	133 681	6 253	234 274
GROSS CARRYING AMOUNT AS AT 31.12.2018	**99 001 708**	**20 019 456**	**4 816 470**	**2 540 327**	**54 922**	**126 432 883**
IMPAIRMENT ALLOWANCE						
IMPAIRMENT ALLOWANCE AS AT 1.01.2018	**375 984**	**646 291**	**5 335 611**	**2 792 920**	**37 157**	**9 187 963**
Transfer to Stage 1	96 254	(91 944)	(618)	(3 692)	-	-
Transfer to Stage 2	(23 811)	57 845	(3 713)	(30 321)	-	-
Transfer to Stage 3	(22 076)	(70 811)	23 642	69 245	-	-
New / purchased / granted financial assets	146 784	-	-	-	-	146 784
Financial assets derecognised, other than write-offs (repayments)	(81 504)	(43 811)	(73 521)	(39 719)	-	(238 555)
Financial assets written off (*)	-	-	(2 209 476)	(1 222 760)	(17)	(3 432 253)
Changes in level of credit risk (excluding the transfers between the Stages)	(108 452)	163 109	260 895	220 672	1 549	537 773
Changes in models and risk parameters	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	(7 268)	(3 990)	(136 072)	15 158	13 746	(118 426)
IMPAIRMENT ALLOWANCE AS AT 31.12.2018	**375 911**	**656 689**	**3 196 748**	**1 801 503**	**52 435**	**6 083 286**

(*) Including the value of contractual interest subject to partial write-off in the amount of PLN 3 023 332 thousand.

The total value of undiscounted expected credit losses at the time of initial recognition of financial assets purchased or originated credit impaired in the period ended 31 December 2018 amounted to PLN 11 552 thousand.

Notes to the financial statements (cont.)

(in PLN thousand)

	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
LOANS AND ADVANCES TO CUSTOMERS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME						
CARRYING AMOUNT						
CARRYING AMOUNT AS AT 1.01.2018	**1 841 682**	**-**	**-**	**-**	**-**	**1 841 682**
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
New / purchased / granted financial assets	401 500	-	-	-	-	401 500
Financial assets derecognised, other than write-offs (repayments)	(590 674)	-	-	-	-	(590 674)
Financial assets written off	-	-	-	-	-	-
Modifications not resulting in derecognition	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	44 380	-	-	-	-	44 380
CARRYING AMOUNT AS AT 31.12.2018	**1 696 888**	-	-	-	-	**1 696 888**
IMPAIRMENT ALLOWANCE (*)						
IMPAIRMENT ALLOWANCE AS AT 1.01.2018	**26 065**	**-**	**-**	**-**	**-**	**26 065**
Transfer to Stage 1	**-**	**-**	**-**	**-**	**-**	**-**
Transfer to Stage 2	**-**	**-**	**-**	**-**	**-**	**-**
Transfer to Stage 3	**-**	**-**	**-**	**-**	**-**	**-**
New / purchased / granted financial assets	1 457	-	-	-	-	1 457
Financial assets derecognised, other than write-offs (repayments)	(2 629)	-	-	-	-	(2 629)
Financial assets written off	-	-	-	-	-	-
Changes in level of credit risk (excluding the transfers between the Stages)	(8 171)	-	-	-	-	(8 171)
Changes in models and risk parameters	-	-	-	--	-	-
Other, in this changes resulting from exchange rates	1	-	-	-	-	1
IMPAIRMENT ALLOWANCE AS AT 31.12.2018	**16 723**	**-**	**-**	**-**	**-**	**16 723**

(*) The impairment allowance for loans and advances to customers measured at fair value through other comprehensive income is included in the 'Revaluation reserve' item and does not reduce the carrying amount of the loan.

Notes to the financial statements (cont.)

(in PLN thousand)

	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
DEBT SECURITIES MEASURED AT AMORTISED COST						
GROSS CARRYING AMOUNT						
GROSS CARRYING AMOUNT AS AT 1.01.2018	**11 412 837**	**-**	**30 031**	**-**	**-**	**11 442 868**
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
New / purchased / granted financial assets	2 876 001	-	-	-	-	2 876 001
Financial assets derecognised, other than write-offs (repayments)	(3 223 033)	-	-	-	-	(3 223 033)
Financial assets written off	-	-	-	-	-	-
Modifications not resulting in derecognition	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	92 304	-	1 516	-	-	93 820
GROSS CARRYING AMOUNT AS AT 31.12.2018	**11 158 109**	**-**	**31 547**	**-**	**-**	**11 189 656**
IMPAIRMENT ALLOWANCE						
IMPAIRMENT ALLOWANCE AS AT 1.01.2018	**27 589**	**-**	**30 031**	**-**	**-**	**57 620**
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
New / purchased / granted financial assets	2 155	-	-	-	-	**2 155**
Financial assets derecognised, other than write-offs (repayments)	(1 929)	-	-	-	-	**(1 929)**
Financial assets written off	-	-	-	-	-	**-**
Changes in level of credit risk (excluding the transfers between the Stages)	1 325	-	-	-	-	**1 325**
Changes in models and risk parameters	-	-	-	-	-	**-**
Other, in this changes resulting from exchange rates	(1 398)	-	1 516	-	-	**118**
IMPAIRMENT ALLOWANCE AS AT 31.12.2018	**27 742**	**-**	**31 547**	**-**	**-**	**59 289**

Notes to the financial statements (cont.)

(in PLN thousand)

	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
DEBT SECURITIES MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME						
CARRYING AMOUNT						
CARRYING AMOUNT AS AT 1.01.2018	**37 891 326**	**-**	**-**	**-**	**-**	**37 891 326**
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
New / purchased / granted financial assets	131 184 662	-	-	-	-	131 184 662
Financial assets derecognised, other than write-offs (repayments)	(142 855 233)	-	-	-	-	(142 855 233)
Financial assets written off	-	-	-	-	-	-
Modifications not resulting in derecognition	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	683 819	-	-	-	-	683 819
CARRYING AMOUNT AS AT 31.12.2018	**26 904 574**	**-**	**-**	**-**	**-**	**26 904 574**
IMPAIRMENT ALLOWANCE (*)						
IMPAIRMENT ALLOWANCE AS AT 1.01.2018	**24 213**	**-**	**-**	**-**	**-**	**24 213**
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
New / purchased / granted financial assets	14 818	-	-	-	-	14 818
Financial assets derecognised, other than write-offs (repayments)	(7 049)	-	-	-	-	(7 049)
Financial assets written off	-	-	-	-	-	-
Changes in level of credit risk (excluding the transfers between the Stages)	(3 774)	-	-	-	-	(3 774)
Changes in models and risk parameters	-	-	-	-	-	-
Other, in this changes resulting from exchange rates	(1)	-	-	-	-	(1)
IMPAIRMENT ALLOWANCE AS AT 31.12.2018	**28 207**	**-**	**-**	**-**	**-**	**28 207**

(*) The impairment allowance for debt securities measured at fair value through other comprehensive income is included in the 'Revaluation reserve' item and does not reduce the carrying amount of the securities.

Notes to the financial statements (cont.)

(in PLN thousand)

Bank's exposure to credit risk

The maximum credit risk exposure

The table below presents the maximum credit risk exposure for statement of financial position and off-balance sheet positions as at the reporting date.

	31.12.2018	31.12.2017
Due from Central Bank	9 789 696	2 499 686
Loans and advances from banks and from customers	124 857 667	131 566 108
Financial assets held for trading	890 339	1 734 768
Derivative financial instruments (held for trading)	1 455 976	1 351 344
Hedging instruments	313 565	259 396
Investment securities	38 333 179	36 625 996
Other assets (*)	2 582 025	2 496 812
Balance sheet exposure (**)	**178 222 447**	**176 534 110**
Obligations to grant loans	35 341 470	34 765 034
Other contingent liabilities	20 010 888	14 180 470
Off-balance sheet exposure	**55 352 358**	**48 945 504**
Total	**233 574 805**	**225 479 614**

(*) Includes the following items of the statement of financial position: 'Investments in subsidiaries', 'Investments in associates' and part of 'Other assets' (Accrued income, Interbank and interbranch settlements, Card settlements, Other debtor).

(**) Balance sheet exposure is equal to the carrying amount presented in the statement of financial position.

Credit risk mitigation methods

Bank has established specific policies with regard to collateral accepted to secure loans and guarantees. This policy is reflected under internal rules and regulations, which are based on supervision rules, specified 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.

Notes to the financial statements (cont.)

(in PLN thousand)

The most frequently used types of collateral for credits and loans, accepted in compliance with the relevant policy of Bank, are as follows:

COLLATERAL	COLLATERAL VALUATION PRINCIPLES
MORTGAGES	
- commercial	Collateral value is defined as the fair market value endorsed by a real estate expert. Other evidenced sources of valuation are acceptable, e.g. binding purchase offer, value dependent on the stage of tendering procedure, etc.
- residential	
REGISTERED PLEDGE/ ASSIGNMENT:	
- inventories	The value is defined basing on well evidenced sources e.g. amount derived from pledge agreement, amount disclosed in last financial statements, insurance policy, stock exchange quotations, the value disclosed through foreclosure procedure supported with evidence e.g. prepared by bailiff/receiver.
- machines and appliances	The value is defined as expert appraisal or present value determined based on other, sound sources, such as current purchase offer, register of debtor's non-current assets, value evidenced by bailiff or court receiver, etc.
- vehicles	The value is defined based on available tables (e.g. from insurance companies) proving the car value depending on its producer, age, initial price, or other reliable sources e.g. value stated in the insurance policy.
- other	The value is defined upon individually. The valuation should result from reliable sources.
- securities and cash	The value is defined upon individually estimated fair market value. Recovery rate shall be assessed prudently reflecting the securities price volatility.
TRANSFER OF RECEIVABLES	
- from clients with investment rating assigned by independent rating agency or by internal rating system of the Bank	The value is defined upon individually assessed claims' amount.
- from other counterparties	The value is defined upon individually assessed claim's amount.
GUARANTIES/SURETIES (INCL. RAFTS)/ACCESSION TO DEBT	
- from banks and the State Treasury	Up to the guaranteed amount.
- from other counterparties enjoying good financial standing, particularly when confirmed by investment rating, assigned by an independent rating agency or by the internal rating system of the Bank	The value is defined upon individually assessed claim's amount.
- from other counterparties	Individually assessed fair market value.

The financial effect of pledged collaterals for exposure portfolio with recognized impairment defined individually amounts to PLN 975 738 thousand as at 31 December 2018 (PLN 1 113 719 thousand as at 31 December 2017). The level of required impairment allowances for the portfolio would increase by this amount, if the discounted cash flows from collateral were not taken into account during estimation.

Notes to the financial statements (cont.)

(in PLN thousand)

The Bank analyzes the concentration within LtV levels (the ratio of debt to the value of collateral), which is particularly important in the case of mortgage loans to individual clients.

The structure of mortgage loans to individual clients according to the LtV level is presented below:

LTV LEVEL	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT		
MORTGAGE LOANS TO INDIVIDUAL CLIENTS – GROSS CARRYING AMOUNT						
0% < LtV <= 50%	6 844 263	4 893 825	12 611	191 765	-	11 942 464
50% < LtV <= 70%	9 247 740	3 468 122	22 654	168 269	-	12 906 785
70% < LtV <= 90%	15 930 335	3 819 160	11 032	195 575	-	19 956 102
90% < LtV <= 100%	510 451	173 848	1 244	19 348	-	704 891
100% < LtV	88 948	36 443	1 985	7 134	-	134 510
Total	**32 621 737**	**12 391 398**	**49 526**	**582 091**	**-**	**45 644 752**

Credit risk concentration

According valid regulations the total exposure of the Bank to single borrower or a group of borrowers related by capital or management may not exceed 25% of the Bank's own funds. In 2018 the maximum exposure limits set in the valid regulations were not exceeded.

a) Breakdown by individual entities

As at 31 December 2018

EXPOSURE TO 10 LARGERST CLIENTS OF THE BANK	% SHARE OF PORTFOLIO
Client 1	1.3%
Client 2	1.2%
Client 3	0.8%
Client 4	0.7%
Client 5	0.7%
Client 6	0.5%
Client 7	0.5%
Client 8	0.5%
Client 9	0.5%
Client 10	0.5%
Total	**7.2%**

b) Concentration by capital groups.

As at 31 December 2018

EXPOSURE TO 5 LARGEST CAPITAL GROUPS SERVICED BY THE BANK	% SHARE OF PORTFOLIO
Group 1	1.5%
Group 2	1.2%
Group 3	1.0%
Group 4	1.0%
Group 5	0.9%
Total	**5.5%**

(in PLN thousand)

c) Breakdown by industrial sectors.

In order to mitigate credit risk associated with excessive sector concentration a system for shaping the sector credit exposure structure has been dedicated. The system involves setting concentration ratios for particular sectors, monitoring the loan portfolio and procedures for exchanging information. The system refers to credit exposure in particular types of business activity according to the classification applied by the Polish Classification of Economic Activities (Polska Klasyfikacja Działalności – PKD).

Concentration ratios are determined on the basis of of the Bank's current credit exposure to the particular sector and risk assessment of each sector. Periodic comparison of of the Bank's exposure to particular sectors with the current concentration ratio allows timely identification of the sectors in which the concentration of sector risk may become excessive. If such situation arises an analysis of the economic situation of the sector is performed considering the current and predicted trends and the quality of the current exposure to that sector. These measures enable the Bank to develop policies that reduce sector risk and allow for a timely reaction to a changing environment.

The table below presents the structure of exposures by industrial sectors

EXPOSURE'S STUCTURE BY SECTORS	31.12.2018	31.12.2017
Agriculture, forestry and fishing	0.8%	0.9%
Mining and quarrying	2.3%	2.6%
Manufacturing	19.0%	20.4%
Electricity, gas, steam and air conditioning supply	5.8%	6.6%
Water supply	2.3%	1.4%
Construction	5.5%	6.3%
Wholesale and retail trade	14.2%	14.2%
Transport and storage	4.7%	5.2%
Accommodation and food service activities	2.6%	2.1%
Information and communication	2.5%	2.1%
Financial and insurance activities	13.5%	10.1%
Real estate activities	11.8%	12.9%
Professional, scientific and technical activities	3.3%	2.5%
Administrative and support service activities	1.8%	1.3%
Public administration and defence, compulsory social security	7.2%	9.4%
Education	0.2%	0.3%
Human health services and social work activities	0.7%	0.8%
Arts, entertainment and recreation	0.6%	0.8%
Others	1.2%	0.1%
Total	**100.0%**	**100.0%**

Financial assets subject to modification

The table below presents information about financial assets that were subject to a modification that didn't result in derecognition and for which, prior to modification, an impairment loss on expected credit losses was calculated as a loan loss over the lifetime of the exposure.

	2018
FINANCIAL ASSETS WHICH WERE SUBJECT TO MODIFICATION IN THE PERIOD	
Carrying amount according to the amortised cost before modification	23 950

Notes to the financial statements (cont.)

(in PLN thousand)

Forbearance measures

Forborne exposures are debt contracts in respect of which forbearance measures have been extended and as a result of the, so called, rejection test they have been finally classified as performing forborne exposures or non-performing forborne exposures. Forbearance measures occur in situations in which the borrower is considered to be unable to meet the terms and conditions due to financial difficulties, including problems with debt service. Due to these difficulties, the Bank decides to modify the terms and conditions of the contract to allow the borrower sufficient ability to service the debt. Modification of the terms and conditions of the contract may include i.e. the reduction of the interest rate, principal, accrued interest or the rescheduling of the dates of payment of principal or interests.

The Bank determines the list of the forbearance measures, including in particular:

- the extension of initial maturity (due) date (in case of additional appendix to the contract) or signing a restructuring contract (in case of full past-due debt), in particular as a result of constant reduction of installments amount,
- the modification of the contract's terms or conditions which results in lower interests and/or principal payments to eliminate the past-due debt,
- . the refinancing by the other loan in the Bank.

The classification as forborne exposure shall be discontinued when all the following conditions are met:

- the contract is considered as a performing exposure,
- a minimum 2 year probation period has passed from the date the forborne exposure was considered as performing ,
- none of the exposures to the debtor is at least 30 days past-due at the end of the probation period of forborne exposure.

If conditions, referred to above, are not fulfilled at the end of the probation period, exposures are classified as performing or non-performing forborne exposures respectively in the probation period untill all these conditions are met. The fulfilment of the conditions is assessed at least on a quarterly basis.

Exposure is classified as forbearance only if the modification of the contractual terms is related to the financial difficulties of the borrower.

The forbearance agreements are monitored for fulfillment of contractual provisions. Dedicated units of the Bank manage the agreements with identified forbearance measures and monitor such agreements on an on-going basis.

The decision to apply the forbearance measure is undertaken by authorized unit within the credit application process.

The accounting policies in respect to the evaluation and the provisioning of the forborne exposures generally follow the principles in line with the provisions of IFRS 9,

The Bank also identifies the assets' significant credit risk increase for which the forbearance measures have been applied, for the purpose of the process of impairment allowance recognition according to IFRS 9.

Notes to the financial statements (cont.)

(in PLN thousand)

Share of forborne exposures in the Bank's loan portfolio

	31.12.2018						31.12.2017
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT			
Loans and advances measured at amortised cost, including:	**98 624 992**	**19 362 767**	**1 619 701**	**739 650**	**2 487**	**120 349 597**	**128 873 178**
Forborne exposures gross	479 885	161 514	2 551 359	429 879	813	3 623 450	3 865 242
Loss allowance	(6 444)	(6 786)	(1 485 700)	(235 467)	(509)	(1 734 906)	(1 741 687)
Forborne exposures net	473 441	154 728	1 065 659	194 412	304	1 888 544	2 123 555
Loans and advances measured at fair value through other comprehensive income, including:	**1 696 888**	**-**	**-**	**-**	**-**	**1 696 888**	**X**
Forborne exposures	-	-	-	-	-	-	X
Loss allowance (*)	-	-	-	-	-	-	X
Loans and advances measured at fair value through profit or loss, including:						**302 630**	**X**
Forborne exposures						2 063	X

(*) The impairment allowance for loans and advances to customers measured at fair value through other comprehensive income is included in the 'Revaluation reserve' item and does not reduce the carrying amount of the loan.

Notes to the financial statements (cont.)

(in PLN thousand)

The quality analysis of forborne exposures broken down by delays in repayment

	31.12.2018						31.12.2017
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT			
FORBORNE EXPOSURES MEASURED AT AMORTISED COST							
Gross carrying amount, of which:	**479 885**	**161 514**	**2 551 359**	**429 879**	**813**	**3 623 450**	**3 865 242**
- not past due	478 845	118 478	904 469	137 676	336	1 639 804	1 591 598
- up to 1 month	1 040	36 062	21 404	65 098	140	123 744	76 443
- between 1 month and 3 months	-	5 782	8 056	46 912	39	60 789	70 997
- between 3 months and 1 year	-	108	110 767	53 778	63	164 716	108 778
- between 1 year and 5 years	-	692	989 142	110 354	130	1 100 318	1 369 427
- above 5 years	-	392	517 521	16 061	105	534 079	647 999
Impairment allowances, of which:	**(6 444)**	**(6 786)**	**(1 485 700)**	**(235 467)**	**(509)**	**(1 734 906)**	**(1 741 687)**
- not past due	(6 400)	(2 873)	(221 208)	(50 640)	(143)	(281 264)	(282 018)
- up to 1 month	(44)	(2 749)	(10 142)	(25 761)	(29)	(38 725)	(18 042)
- between 1 month and 3 months	-	(699)	(4 211)	(22 510)	(39)	(27 459)	(18 512)
- between 3 months and 1 year	-	(50)	(56 719)	(32 897)	(63)	(89 729)	(43 956)
- between 1 year and 5 years	-	(241)	(733 579)	(88 176)	(130)	(822 126)	(956 366)
- above 5 years	-	(174)	(459 841)	(15 483)	(105)	(475 603)	(422 793)
FORBORNE EXPOSURES MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS							
Carrying amount, of which:						**2 063**	**X**
- not past due						243	X
- up to 1 month						28	X
- between 1 month and 3 months						-	X
- between 3 months and 1 year						-	X
- between 1 year and 5 years						1 792	X
- above 5 years						-	X

Changes in net carrying amount of forborne exposures

	2018	2017
Carrying amount at the beginning	**2 123 555**	**1 945 152**
The effect of IFRS 9 implementing	(40 197)	X
Adjusted carrying amount at the beginning	**2 083 358**	**1 945 152**
Amount of exposures recognized in the period	267 879	738 324
Amount of exposures derecognized in the period	(64 108)	(149 565)
Changes in impairment allowances	(181 330)	(114 473)
Other changes	(215 192)	(295 883)
Carrying amount at the end	**1 890 607**	**2 123 555**
Interest income	115 023	133 757

Notes to the financial statements (cont.)

(in PLN thousand)

Forborne exposures by type of forbearance activity

	31.12.2018	31.12.2017
Modification of terms and conditions	1 784 689	2 011 428
Refinancing	105 918	112 127
Carrying amount	**1 890 607**	**2 123 555**

Forborne exposures by product type

	31.12.2018	31.12.2017
Mortgage loans	1 135 977	1 197 997
Current accounts	57 330	70 271
Operating loans	353 815	402 284
Investment loans	240 975	333 211
Cash loans	79 846	86 925
Other loans and advances	22 664	32 867
Carrying amount	**1 890 607**	**2 123 555**

Forborne exposures by industrial sectors

	31.12.2018	31.12.2017
Corporates:	1 551 396	1 757 406
Real estate activities	941 806	639 386
Manufacturing	257 750	254 643
Wholesale and retail trade	91 416	92 083
Accommodation and food service activities	71 490	83 150
Construction	67 439	421 963
Professional, scientific and technical activities	49 777	201 041
Transportation and storage	31 938	39 536
Agriculture, forestry and fishing	23 757	12 250
Other sectors	16 023	13 354
Individuals	339 211	366 149
Carrying amount	**1 890 607**	**2 123 555**

Forborne exposures by geographical structure

	31.12.2018	31.12.2017
Poland	1 889 638	2 094 654
Ukraine	-	25 355
Cyprus	-	2 783
Other countries	969	763
Carrying amount	**1 890 607**	**2 123 555**

Notes to the financial statements (cont.)

(in PLN thousand)

CHF loans to individuals

Since 2003 Bank Pekao S.A. has not granted CHF loans for individuals. Almost the entire portfolio of CHF loans for individuals was granted before August 2006 by Bank BPH S.A. and then taken over by Bank Pekao S.A. as a result of the merger.

The table below presents the structure and quality of CHF loans for individuals.

	31.12.2018						31.12.2017
	STAGE 1 (12M ECL)	STAGE 2 (LIFETIME ECL - NOT CREDIT-IMPAIRED)	STAGE 3 (LIFETIME ECL - CREDIT-IMPAIRED)		PURCHASED OR ORIGINATED CREDIT-IMPAIRED (POCI)	TOTAL	TOTAL
			INDIVIDUAL ASSESSMENT	GROUP ASSESSMENT			
Gross carrying amount, of which:	**372**	**2 821 284**	**30 125**	**162 975**	**-**	**3 014 756**	**3 169 019**
denominated in CHF	372	2 807 082	30 125	161 856	-	2 999 435	3 149 127
indexed to CHF	-	14 202	-	1 119	-	15 321	19 892
Impairment allowances, of which:	**(7)**	**(30 407)**	**(15 897)**	**(81 343)**	**-**	**(127 654)**	**(74 068)**
denominated in CHF	(7)	(30 365)	(15 897)	(80 950)	-	(127 219)	(73 782)
indexed to CHF	-	(42)	-	(393)	-	(435)	(286)
Carrying amount, of which:	**365**	**2 790 877**	**14 228**	**81 632**	**-**	**2 887 102**	**3 094 951**
denominated in CHF	365	2 776 717	14 228	80 906	-	2 872 216	3 075 345
indexed to CHF	-	14 160	-	726	-	14 886	19 606

As of 31 December 2018 the average LTV for CHF loans to individuals granted by the Bank amounted to 44.2% (45.7% as at 31 December 2017), with an average LTV for the whole portfolio of mortgage loans of 62.8% (64.3% as at 31 December 2017).

Offsetting financial assets and financial liabilities

The disclosures in the tables below include financial assets and financial liabilities that are subject to an enforceable master netting agreements or similar agreements, irrespective of whether they are offset in the statement of financial position.

The netting agreements concluded by the Bank are:

- ISDA agreements and similar master netting agreements on derivatives,
- GMRA agreements on repo and reverse-repo transactions.

The netting agreements do not meet the criteria for offsetting in the statement of financial position. This is because they create for the parties to the agreement a right of set-off of recognized amounts that is enforceable only following an event of default, insolvency or bankruptcy of the one of the counterparty. At the balance, day there were no cases of offsetting financial assets and financial liabilities for these netting agreements.

The Bank receives and gives collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives,
- repo and reverse-repo transactions.

(in PLN thousand)

Such collateral is subject to standard industry terms. The collateral in the form of cash stems from an ISDA Credit Support Annex (CSA).

The securities received/given as collateral on repo and reverse-repo transaction can be pledged or sold during the term of the transaction but have to be returned on maturity of the transaction. The terms also give each party the right to terminate the related transactions on the counterparty's failure to post collateral.

Financial assets and financial liabilities subject to enforceable master netting agreements and similar agreements and which may be potentially offset in the statement of financial position.

31.12.2018	CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL RECEIVED	
FINANCIAL ASSETS				
Derivatives	1 707 743	(1 363 113)	(163 164)	181 465
TOTAL	**1 707 743**	**(1 363 113)**	**(163 164)**	**181 465**

31.12.2018	CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL PLEDGED	
FINANCIAL LIABILITIES				
Derivatives	2 779 301	(1 834 018)	(838 090)	107 193
TOTAL	**2 779 301**	**(1 834 018)**	**(838 090)**	**107 193**

31.12.2017	CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL RECEIVED	
FINANCIAL ASSETS				
Derivatives	1 330 858	(897 385)	(265 808)	167 665
TOTAL	**1 330 858**	**(897 385)**	**(265 808)**	**167 665**

31.12.2017	CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	AMOUNT OF POTENTIAL OFFSETTING		NET AMOUNT
		FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES)	CASH COLLATERAL PLEDGED	
FINANCIAL LIABILITIES				
Derivatives	2 582 790	(1 472 267)	(954 537)	155 986
TOTAL	**2 582 790**	**(1 472 267)**	**(954 537)**	**155 986**

The carrying amount of financial assets and financial liabilities disclosed in the above tables have been measured in the statement of financial position on the following bases:

- derivatives – fair value,
- assets and liabilities resulting from repo and reverse-repo transactions – amortized cost.

(in PLN thousand)

Reconciliation of the carrying amount of financial assets and financial liabilities subject to enforceable master netting agreements and similar agreements to the amounts presented in the statement of financial position.

31.12.2018	NET CARRYING AMOUNT	ITEM IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES	NOTE
FINANCIAL ASSETS					
Derivatives	1 394 178	Derivative financial instruments (held for trading)	1 455 976	61 798	26
	313 565	Hedging instruments	313 565	-	28
FINANCIAL LIABILITIES					
Derivatives	1 874 245	Derivative financial instruments (held for trading)	1 919 394	45 149	26
	905 056	Hedging instruments	905 056	-	28

31.12.2017	NET CARRYING AMOUNT	ITEM IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION	CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES	NOTE
FINANCIAL ASSETS					
Derivatives	1 254 062	Derivative financial instruments (held for trading)	1 351 344	97 282	26
	76 796	Hedging instruments	259 396	182 600	28
FINANCIAL LIABILITIES					
Derivatives	1 724 385	Derivative financial instruments (held for trading)	2 036 928	312 543	26
	858 405	Hedging instruments	862 331	3 926	28

5.3 Market risk

The Bank is exposed in its operations to market risk and other types of risk caused by changing market risk parameters.

Market risk is the risk of deteriorating financial result or capital of the Bank resulting from market changes. The main factors of market risk are as follows:

- interest rates,
- foreign exchange rates,
- stock prices,
- commodity prices.

The Bank established a market risk management system, providing structural, organizational and methodological frames for the purpose of shaping the structure of balance and off-balance items to assure the achievement of strategic goals.

The main objective of market risk management is to optimize financial results so as to assure the implementation of financial goals of the Bank while keeping the exposure to market risk within the risk appetite defined through risk limits approved by the Management Board and the Supervisory Board.

The organization of the market risk management process is based on a three-tier control system, established in compliance with the best international banking practices and recommendations from banking supervision. The process of market risk management and procedures regulating it have been developed taking into consideration the split into trading and banking books.

Notes to the financial statements (cont.)

(in PLN thousand)

Market risk of the trading book

The Bank's management of market risk of the trading book aims at optimizing the financial results and assuring the highest possible quality of customer service in reference to the market accessability (market making) while staying within the limits of risk approved by the Management Board and the Supervisory Board.

The main tool for market risk of the trading book measurement is Value at Risk model (VaR). This value corresponds to the level of a one-day loss, which will be exceeded with the probability not greater than 1%. VaR value is calculated with historical simulation method based on 2 years of historical observations of market risk factors' dynamics. The set of factors used when calculating VaR consists of all significant market factors that are taken into account for valuation of financial instruments, excluding specific credit risk of an issuer and counterparty. Estimating the impact of changes in market factors on the present value of a given portfolio is performed under the full revaluation (which is a difference between the value of the portfolio after the adjustments in market parameters' levels by historically observed changes of the parameters and the present value of the portfolio). For such a set of probable changes in the portfolio value (distribution), VaR is defined to be equal to 1% quantile.

The model is subject to continuous, statistical verification by comparing the VaR values to actual and revaluated performance figures. Results of analyses carried out in 2018 and 2017 confirmed the adequacy of the model applied.

The tables below presents the market risk exposure of the trading portfolio of the Bank measured by Value at Risk in 2018 and 2017:

	31.12.2018	MINIMUM VALUE	AVERAGE VALUE	MAXIMUM VALUE
foreign exchange risk	117	9	171	1 232
interest rate risk	1 154	472	1 083	1 733
Trading portfolio	1 129	488	1 103	2 384

	31.12.2017	MINIMUM VALUE	AVERAGE VALUE	MAXIMUM VALUE
foreign exchange risk	739	13	364	1 918
interest rate risk	791	496	1 013	1 925
Trading portfolio	1 058	533	1 150	3 030

Interest rate risk of the banking book

In managing the interest rate risk of the banking book the Bank aims at hedging the economic value of capital and achieving the planned interest result within the accepted limits. The financial position of the Bank in relation to changing interest rates is monitored through the interest rate gap (repricing gap), duration analysis, sensitivity analysis, stress testing and VaR. The interest rate risk of the banking book measurement is generally carried out on a monthly basis.

The table below presents the sensitivity levels of the contractual interest income (NII) to the interest rate change by 100 b.p. and of economic value of the Bank's equity (EVE) to the interest rate change by 200 b.p. (standard regulatory shock excluding the risk profile of own funds) for the end of December 2018 and December 2017.

SENSITIVITY IN %	31.12.2018	31.12.2017
NII	(8.65)	(8.04)
EVE	(1.07)	0.65

(in PLN thousand)

Currency risk

Currency risk management is performed simultaneously for the trading and the banking book. The objective of currency risk management is to maintain the currency profile of statement of financial position and off-balance items within the internal limits.

The tables below present the Group's foreign currency risk profile measured by Value at Risk and currency position.

	31.12.2018	31.12.2017
Currencies total (*)	54	782

(*) VaR presented in 'Currencies total' is VaR for the whole portfolio, and includes correlations among currencies.

Currency exposure of the Bank

31.12.2018	BALANCE SHEET OPERATIONS		OFF-BALANCE SHEET OPERATIONS DERIVETIVES		NET POSITION
	ASSETS	LIABILITIES	LONG POSITION	SHORT POSITION	
EUR	22 455 421	18 387 092	10 131 578	14 181 183	18 724
USD	5 483 705	8 283 535	11 114 205	8 301 420	12 955
CHF	3 007 369	578 497	4 229 992	6 664 142	(5 278)
GBP	275 357	975 357	827 920	126 347	1 573
HUF	3 219	190 119	243 818	57 151	(233)
NOK	209 725	46 549	190 749	353 895	30
CZK	53 790	71 006	246 324	229 050	58
SEK	89 227	45 522	9 862	53 484	83
Other currencies	94 500	174 422	183 285	99 929	3 434
TOTAL	**31 672 313**	**28 752 099**	**27 177 733**	**30 066 601**	**31 346**

31.12.2017	BALANCE SHEET OPERATIONS		OFF-BALANCE SHEET OPERATIONS DERIVETIVES		NET POSITION
	ASSETS	LIABILITIES	LONG POSITION	SHORT POSITION	
EUR	17 972 461	18 576 246	12 845 293	12 286 334	(44 826)
USD	4 764 950	8 140 879	9 031 037	5 582 828	72 280
CHF	3 189 863	596 078	4 130 033	6 726 102	(2 284)
GBP	267 299	946 157	786 010	104 930	2 222
CZK	188 269	336 573	158 242	9 956	(18)
Other currencies	326 178	229 077	147 429	243 119	1 411
TOTAL	**26 709 020**	**28 825 010**	**27 098 044**	**24 953 269**	**28 785**

5.4 Liquidity risk

The objective of liquidity risk management is to:

- ensure and maintain the Bank's solvency with respect to current and future payables taking into account the cost of acquiring liquidity and return on the Bank's equity,
- prevent the occurrance of crisis situations, and
- provide solutions necessary to survive a crisis situation when such circumstances occur.

The Bank has centralized liquidity risk management system covering current liquidity management and first level control performed by the responsible functions, the second level control carried out by a dedicated unit responsible of risk management and independent audit.

(in PLN thousand)

Managing the Bank's liquidity is carried out in intraday, short-term and long-term horizon. Analysing of Intraday liquidity concerns flows realized during the day, through a short-term liquidity analysis is understood liquidity measurement system which refers to the time horizon shorter than one year, long-term analysis covers period above one year. Due to the specific tools and techniques used for liquidity risk management, the Bank manages current and medium-term liquidity together with short-term liquidity.

The liquidity control is performing as a continuous process of determining and analysing the levels of various indicators and measures related to intraday, short-term and long-term liquidity. Monitoring frequency is matched to the specific liquidity aspect – e.g. daily for short-term liquidity, monthly for long-term liquidity. Liquidity ratios and measures are subject to a formal limiting process. The limits' utilisation is regularly monitored and presented to the Bank Management. In case of exceeding, escalation process is running as to inform decision-makers and ultimately to restore the liquidity risk exposures to acceptable levels.

Scenario-based stress analyses, conducted on a monthly basis, constitute an integral part of the Bank's liquidity monitoring process. Within the scope of these analyses Bank's liquidity is assessed under the conditions of crisis which is caused by financial markets or is caused by internal factors, specific to the Bank.

Managing the liquidity, the Bank pays special attention to the liquidity in foreign currencies through monitoring, limiting and controlling the liquidity individually for each currency, as well as monitoring demand for the current and future currency liquidity and in case of identification of such need the Bank hedges using currency swaps. The Bank monitors also the potential influence on the liquidity of placing required collateral deposits for derivative transaction.

In order to define the principles of contingency liquidity management, Bank introduced, approved by the Management Board, 'Contingency Liquidity Policy', which defines the contingency procedures in the event of crisis situations. This policy involves daily monitoring of the system and specific to the Bank's early-warning indicators as well as three levels of liquidity risk states depending on the level of early-warning indicators, the Bank's and market situation. It also defines the sources for covering the expected outflows from the Bank. This document sets the procedures for monitoring the liquidity states, emergency action procedures, task forces dedicated for restoring the Bank's liquidity and the Bank Management's responsibilities for taking necessary decisions to restore the required liquidity level.

Below are presented basic quantitative information concerning the Bank's liquidity at the end of 2018 year in comparison to the end of 2017. They cover the structure of financial liabilities by contractual maturity, adjusted liquidity gap and financial flows from derivative transactions.

Structure of financial liabilities by contractual maturity

31.12.2018	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
BALANCE SHEET LIABILITIES (*)						
Amounts due to banks (**)	1 563 680	51 873	171 860	720 186	466 350	2 973 949
Amounts due to customers	117 580 349	11 606 641	20 838 450	888 355	653 782	151 567 577
Debt securities issued	-	102 056	1 061 429	584 671	-	1 748 156
Subordinated liabilities	-	-	67 102	294 264	2 429 522	2 790 888
Financial liabilities held for trading	-	-	-	57 421	45 008	102 429
Total	**119 144 029**	**11 760 570**	**22 138 841**	**2 544 897**	**3 594 662**	**159 182 999**
OFF-BALANCE SHEET COMMITMENTS (*)						
Off-balance sheet commitments Financial liabilities granted	35 199 622	-	-	-	-	35 199 622
Off-balance sheet commitments Guarantees liabilities granted	19 043 911	-	-	-	-	19 043 911
Total	**54 243 533**	**-**	**-**	**-**	**-**	**54 243 533**

Notes to the financial statements (cont.)

(in PLN thousand)

31.12.2017	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
BALANCE SHEET LIABILITIES (*)						
Amounts due to banks (**)	1 928 108	17 075	1 931	573 489	984 799	3 505 402
Amounts due to customers	113 202 543	15 231 425	18 373 399	411 396	34 176	147 252 939
Debt securities issued	162 449	311 588	947 126	62 145	-	1 483 308
Subordinated liabilities	-	-	35 606	180 573	1 526 158	1 742 337
Financial liabilities held for trading	-	-	-	309 328	160 120	469 448
Total	**115 293 100**	**15 560 088**	**19 358 062**	**1 536 931**	**2 705 253**	**154 453 434**
OFF-BALANCE SHEET COMMITMENTS (*)						
Off-balance sheet commitments Financial liabilities granted	34 677 534	-	-	-	-	34 677 534
Off-balance sheet commitments Guarantees liabilities granted	13 658 150	-	-	-	-	13 658 150
Total	**48 335 684**	**-**	**-**	**-**	**-**	**48 335 684**

(*) Exposure amounts from balance liabilities, financing-related off-balance sheet commitments granted and guarantee liabilities granted have been allocated to earliest tenors, for which an outflow of assets from the Bank is possible based on contracts entered into by the Bank. However, outflows expected by the Bank are actually significantly lower than those indicated by the specification presented above. The above is a consequence of considerable diversification of amounts due to customers and stages of life of individual contracts. Risk monitoring and management in relation to the outflow of assets are provided by the Bank on continuous basis. The Bank estimates also more probable flows that are reflected in Tables 'Adjusted liquidity gap'

(**) Including Central Bank.

Adjusted liquidity gap

The adjusted liquidity gaps presented below include, inter alia, the adjustments concerning the stability of core deposits and their maturity, adjustments of flows from granted off-balance sheet commitments arising from financing, guarantees and from assets without contractual repayment schedules. On top of that, included are also the adjusted flows stemming from the Bank's security portfolio and flows resulting from earlier repayment of mortgage loans portfolio. These are the main elements differentiating the adjusted gaps from unadjusted ones. Moreover, the gaps are of static nature, i.e. they do not take into consideration the impact of changes of balance sheet and off-balance sheet items volume (i.e. new deposits) as well as the effect of non-equity related cash flows upon the liquidity profile of the Bank.

Adjusted liquidity gap

31.12.2018	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Balance sheet assets	38 469 391	4 301 852	27 945 498	54 740 456	58 889 979	184 347 176
Balance sheet liabilities	14 158 802	6 388 596	21 540 559	15 865 849	126 393 370	184 347 176
Off-balance sheet assets/liabilities (net)	(5 432 795)	(858 201)	40 105	2 806 125	2 794 283	(650 483)
Periodic gap	**18 877 794**	**(2 944 945)**	**6 445 044**	**41 680 732**	**(64 709 108)**	**(650 483)**
Cumulated gap	**-**	**15 932 849**	**22 377 893**	**64 058 625**	**(650 483)**	**-**

31.12.2017	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Balance sheet assets	41 971 214	4 892 595	26 563 183	52 608 083	56 041 933	182 077 008
Balance sheet liabilities	18 924 004	10 491 005	23 885 964	20 324 418	108 451 617	182 077 008
Off-balance sheet assets/liabilities (net)	(6 214 174)	(132 591)	77 116	2 437 234	3 158 279	(674 136)
Periodic gap	**16 833 036**	**(5 731 001)**	**2 754 335**	**34 720 899**	**(49 251 405)**	**(674 136)**
Cumulated gap	**-**	**11 102 035**	**13 856 370**	**48 577 269**	**(674 136)**	**-**

(in PLN thousand)

Off-balance derivative transactions

The following are the liabilities and financial cash flows associated with off-balance sheet derivative transactions, settled, respectively in net and gross amounts.

Off-balance sheet derivative transactions settled by the Bank in net amounts include:

- Interest Rate Swaps (IRS),
- Forward Rate Agreements (FRA),
- Foreign currency options and for gold,
- Interest rate options (Cap/Floor),
- Transactions based on equity securities and stock indexes,
- Transactions based on commodities and precious metals.

Off-balance derivative transactions settled by the Bank in gross amounts include:

- Cross-Currency Interest Rate Swaps (CIRS),
- Foreign currency forward contracts,
- Foreign currency swaps (FX-Swap),
- Forward contracts based on securities.

Liabilities from off-balance transactions on derivatives recognized in net amounts

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2018	93 469	49 950	566 715	786 415	402 470	**1 899 019**
31.12.2017	32 892	27 031	649 422	837 586	285 318	**1 832 249**

Flows related to off-balance derivative transactions settled in gross amounts

	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
31.12.2018						
Inflows	23 547 848	5 499 680	9 683 794	7 569 348	2 237 288	**48 537 958**
Outflows	24 336 212	5 496 469	10 102 035	7 633 251	2 422 687	**49 990 654**
31.12.2017						
Inflows	21 026 914	8 869 804	6 701 203	7 126 694	2 837 283	**46 561 898**
Outflows	21 031 547	8 907 287	6 812 217	7 504 531	2 923 301	**47 178 883**

5.5 Operational risk

Operational risk is defined as the risk of losses resulting from inadequacy or failure of internal processes, people, systems or external events. It includes law risk, whereas strategic risk, business risk and reputation risk are separate risk categories.

Operational risk management is based on internal procedures that are consistent with the law requirements, resolutions, recommendations and guidelines of the supervisor. Operational risk management includes identification, assessment, monitoring, preventing and reporting.

Identification and assessment of operational risk is based on an analysis of internal factors and external factors that may have a significant impact on the achievement of the objectives of the Bank. The main tools used in identifying and assessing operational risk are: internal operational events, external operational events, key risk indicators, scenario analysis and self-assessment of operational risk.

Monitoring activities are conducted on three levels of defence: risk management in operational activity of the Bank (all employees), risk management control (Integrated Risk Management Department) and internal audit (Internal Audit Department). Preventing operational risk includes definition of operational risk limits, and the obligation to initiate mitigation actions in case they are exceeded, the system of internal control, business continuity plans and insurance coverage.

(in PLN thousand)

Operational risk reporting system enables the assessment of the Bank's exposure to operational risk and the effective management of this risk, and also plays a fundamental role in the process of informing the Supervisory Board, the Management Board and executives of the Bank's exposure to operational risk. It is based in particular on the quarterly reports on operational risk control that include, among others: profile of operational risk, loss limit utilization, analysis of trends in the relevant categories of operational risk, potential losses, information on key indicators of operational risk and operational risk capital requirement.

The Supervisory Board, the Management Board and the Operational Risk Committee are involved in operational risk management. The Integrated Risk Management Department coordinates the process of operational risk management. All employees of the Bank and selected specialized units are responsible in their areas for operational risk management, due to diversified character of this risk which requires professional knowledge.

In order to ensure compliance of the operational risk management system with regulatory requirements, at least once a year verification of the operational risk management system is carried out.

The table below presents operational events by categories as defined by the Article 324 of Regulation (EU) No 575/2013 of the European Parliament and of the Council:

- internal frauds – losses resulting from acts of intended fraud, misappropriation of property, circumvention of regulations, the laws and internal policies of a company, excluding losses resulting from diversity or discrimination of employees, which concern at least one internal party,
- external frauds – losses being a consequence of acts of defraud, misappropriation of property or circumvention of regulations performed by a third party,
- employment practices and workplace safety – losses due to acts inconsistent with regulations or employment agreements, workplace health and safety agreements, payments from personal injuries claims or losses from discrimination and unequal employee treatment,
- clients, products and business practices – losses arising from failures of meeting professional obligations towards clients due to unintended or negligent acts (including custody requirements and appropriate behavior) or concerning specific features or a design of a product,
- damages to physical assets – losses due to damage or loss of tangible assets resulting from natural disasters or other events,
- business disruption and system failures – losses stemming from business or system failures,
- execution, delivery and process management – losses resulting from failed transaction settlements or process management and losses from relations with cooperating parties and vendors.

OPERATING EVENTS BY CATEGORIES	2018	2017
Clients, products and business practices Execution, delivery and process management	55.40%	3.40%
Execution, delivery and process management	17.38%	16.54%
Employment practices and workplace safety	16.98%	1.73%
Damages to physical assets	6.65%	8.84%
External frauds	2.84%	26.96%
Internal frauds	0.49%	42.02%
Business disruption and system failures	0.26%	0.51%
Total	**100.00%**	**100.00%**

5.6 Capital management

The capital management process applied by Bank has been adopted for the following purposes:

- ensuring the safe and secure functioning by maintaining the balance between the capacity to undertake risk (limited by own funds), and the risk levels generated,
- maintenance of capital for covering risk above the minimum stated levels in order to assure further business operations, taking into consideration the possible, future changes in capital requirements and to safeguard the interests of shareholders,
- maintenance of the optimal capital structure in order to maintain the desired quality of risk coverage capital,
- creation of value to shareholders by the best possible utilization of the Bank funds.

The Bank has put in place a formalized process of capital management and monitoring, established within the scope of Internal Capital Adequacy Assessment Process – ICAAP. The Finance Division under the Chief Financial Officer is responsible for functioning of the capital management process in the Bank. The ultimate responsibility for capital management is allocated to the Management Board of the Bank, supported by the Assets, Liabilities and Risk Management Committee, which approves the capital management process. The Supervisory Board supervises the capital management system, in particular approves the capital management strategy. The Capital Management Strategy defines the objectives and general rules of the management and monitoring of the Bank's capital adequacy, such as the guidelines concerning risk coverage sources, preferred structure of capital for risk coverage, long-term capital targets, capital limits system and sources of additional capital under contingency situations.

The Bank has also implemented the Capital Contingency Policy which establishes rules and obligations in the event of crisis appearance or further development that would significantly reduce capitalization level of the Bank or Group. The policy defines the principles of supervision including split of responsibilities for the purpose of early and consistent management in case of crisis situation development.

The capital adequacy of the Bank is controlled by the Assets, Liabilities and Risk Management Committee and Management Board of Bank. Periodic reports on the scale and direction of changes of the capital ratios together with indication of potential threats are prepared for the Supervisory Board, Management Board and for the Assets, Liabilities and Risk Management Committee. The level of basic types of risks is monitored according to the external limits of the banking supervision and the internal limits of the Bank. Analyses and evaluations of directions of business activities development are performed assessing the compliance with capital requirements. Forecasting and monitoring of risk weighted assets, own funds and capital ratios constitute an integral part of the planning and budgeting process, including stress tests.

The Bank also has a capital allocation process in place, with an aim of guaranteeing the shareholders a safe and effective return on invested capital. On one hand, the process requires capital allocations to products/clients/business lines, which guarantee profits adequate to the risks taken, while on the other hand taking into consideration the cost of capital associated with the business decisions taken. Risk-related efficiency ratios are used in the analyses of income generated compared against the risk taken as well as for the optimization of capital usage for different types of operations.

Regulatory capital requirements

Calculations of the regulatory capital requirements were performed based on 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, with further amendments as well as Commission Implementing and Delegated Regulations (EU) (hereinafter: 'Regulation 575/2013').

According to law, Bank is required to maintain minimal values of capital ratios resulting from Pillar I level (Regulation 575/2013), capital requirement of Pillar II resulting from The Banking Act and combined buffer requirement resulting from Act on macro-prudential supervision.

Notes to the financial statements (cont.)

(in PLN thousand)

Minimal value of capital ratios on Pillar 1 level are:

- Total capital ratio (TCR) in amount of 8%,
- Tier 1 capital ratio (T1) in amount of 6%,
- Common Equity Tier 1 capital ratio (CET 1) in amount of 4.5%.

Bank does not have any Capital requirement of Pillar 2.

Combined buffer requirement, as at 31 December 2018 consists of:

- Capital conservation buffer in amount of 1.875%,
- Countercyclical capital buffer in amount of 0.01% (countercyclical capital buffer was calculated as of 31.12.2018 at the level 0.0058%),
- Other systemically important institution buffer in amount of 0.75%,
- Systemic risk buffer in amount of 2.75% (the systemic risk buffer rate is 3% of the total risk exposure amount for all exposures located only on the territory of the Republic of Poland).

In total, Bank is required to maintain:

- Total capital ratio (TCR) in amount of 13.39%,
- Capital ratio Tier 1 (T1) in amount of 11.39%,
- Common Equity Tier (CET 1) in amount of 9.89%.

As at 31 December 2018 total capital ratio of the Bank amounted at 18.7% (as at 31 December 2017 – 18.4%).

	31.12.2018	31.12.2017
CAPITAL REQUIREMENTS		
Credit and counterparty risk including CVA	8 785 901	8 538 883
Market risk	64 437	49 129
Operational risk	450 366	450 011
Total capital requirement	**9 300 704**	**9 038 023**
OWN FUNDS		
Common Equity Tier 1 capital	19 714 754	19 529 433
Capital Tier 1	2 000 000	1 250 000
Own funds for total capital ratio	**21 714 754**	**20 779 433**
OWN FUNDS REQUIREMENTS		
Common Equity Tier 1 capital ratio (%)	**17.0%**	**17.3%**
Total capital ratio (%)	**18.7%**	**18.4%**

Total capital ratio at the end of 2018 compared with the end of 2017 increased by 0.3 p.p.

Total capital requirement increased by 2.8%, mainly due to higher credit risk capital requirement resulting mainly from increase in loan volumes.

As at 31 December 2018 Common Equity Tier 1 capital was higher by 0.9% as compared to 31 December 2017. Increase in own funds for total capital ratio calculation by 4.5% resulted from including in Tier 2 capital, after obtaining KNF approval, the amount of PLN 0.75 billion from the issue of subordinated bonds.

Notes to the financial statements (cont.)

(in PLN thousand)

For the purpose of capital requirement calculation the Bank uses:
- Standardised Approach for credit risk capital requirement calculation,
- Financial Collateral Comprehensive Method for credit risk mitigation,
- Mark-to-Market Method for counterparty credit risk capital requirement calculation,
- Standardised Approach for capital requirement calculation of specific risk and duration-based calculation for general risk of debt instruments,
- Standardised Approach for capital requirement calculation of general and specific risk of equity instruments,
- Standardised Approach for capital requirement calculation for pre-funded contributions to the default fund of a qualifying central counterparty,
- Standardised Approach for foreign-exchange risk capital requirement calculation,
- Simplified approach for commodities risk capital requirement calculation,
- Standardised Approach for capital requirements for credit risk valuation adjustment risk,
- Advanced Measurement Approach for operational risk measurement.

Own funds

The Bank defines components of own funds in line with the binding law, particularly with Regulation No 575/2013 and The Banking Act of 29 August 1997 with further amendments.

The Bank's own funds consist of Common Equity Tier 1 capital. Additional Tier 1 capital and Tier 2 capital.

	31.12.2018	31.12.2017
OWN FUNDS		
Capital	**21 821 998**	**22 258 534**
Component of the capital not included into own funds, in which:	**(2 310 600)**	**(2 088 129)**
Current year net profit	**(2 310 600)**	(2 088 129)
Regulatory adjustments, in which:	**(607 149)**	**(640 972)**
Intangible assets	**(565 402)**	(562 315)
Cash flow hedges	**(41 747)**	(5 331)
Unrealised loss from debt and capital instruments available for sale	X	-
Unrealised gain from debt and capital instruments available for sale	X	(28 386)
Adjustments mitigating impact of IFRS introduction in transitional period	850 761	X
Additional value adjustments due to prudent calculation	(40 256)	(44 940)
Common Equity Tier 1 capital	**19 714 754**	**19 529 433**
Equity Tier 2 capital	**2 000 000**	**1 250 000**
Own funds for total capital ratio	**21 714 754**	**20 779 433**

Components of capital not included into own funds:
- current year net profit – net profit of current reporting period, verified by statutory auditor responsible for auditing of the Bank's accounts reduced by all foreseeable charge and dividend, can be included into Common Equity Tier 1 capital only with the permission of KNF. As at 31 of December 2018, current profit of the Bank was not included into Common Equity Tier 1 capital.

Regulatory adjustments:
- intangible assets (after deduction of related deferred tax liabilities) decrease Common Equity Tier 1 capital, according to Article 36 of Regulation No 575/2013,
- reserves related to gains or losses on cash flow hedges of financial instruments that are not valued at fair value, including projected cash flows are excluded from the accumulated other comprehensive income, according to Article 33(a) of Regulation 575/2013,
- additional value adjustments due to prudent valuation are created for every asset measured at fair value, according to Article 34 of Regulation No 575/2013,
- adjustments in transitional period resulting from introduction of IFRS 9.

Internal capital adequacy assessment

To assess the internal capital adequacy, the Bank applies methods designed internally.

The Bank takes the following risks into consideration:

- credit risk,
- operational risk,
- market risk,
- liquidity risk,
- real estate risk,
- macroeconomic risk,
- business risk (including strategic risk),
- compliance risk,
- reputational risk,
- model risk,
- excessive leverage risk,
- bancassurance risk,
- financial investment risk.

For each risk deemed material, the Bank develops and applies adequate risk assessment and measurement methods. The Bank applies the following risk assessment methods:

- qualitative assessment – applied in case of risks which are difficult to measure (compliance, reputational and bancassurance risks) with potencial capital coverage in other risks areas,
- assessment by estimation of capital buffer, for risks that are not easily quantifiable however some aggregate assessment of their impact is possible (model risk and macroeconomic risk),
- quantitative assessment – applied for risks which can be measured with the use of economic capital (other risk types apart from liquidity risk and excessive leverage risk) or based on other risk-specific measures (liquidity risk and excessive leverage risk).

Generally, preferred methods of measuring risks and determining the resulting capital requirements are Value at Risk models, based on assumptions derived from the Bank's risk appetite. The models are developed in compliance with the best market practices and regulatory requirements and supplemented with stress tests and/or scenario analyses. In case of risk types for which such methodologies have not been finally developed or implemented, the Bank uses regulatory models supplemented with stress tests or simplified measurement methods.

Also, a consistent methodology for estimating the buffer for macroeconomic changes and model risks has been developed. The macroeconomic changes risk capital buffer is determined on the basis of the impact of the economic slowdown scenario on economic capital in the forecast horizon with additional consideration of the impact of interest rate change on net interest income as well as on changes in the valuation of the portfolios classified as HTCS.

Model risk is estimated using results of model validation and scenario analyses making it possible to evaluate the impact of potential model inconsistencies on its output. Based on the aggregated output, the model risk capital buffer is determined.

The procedure of estimating capital needs starts with the calculation of economic capital, separately for each material quantifiable risk identified by the Bank. Next, economic capital figures for individual risks are aggregated inclusive of diversification effect. The amount is then increased by the capital buffer for model and macroeconomic changes risks. The sum of economic capital (inclusive of diversification effect) and the capital buffer constitutes the internal capital of the Bank.

Notes to the financial statements (cont.)

(in PLN thousand)

5.7 Fair value of financial assets and liabilities

Financial instruments that are measured at fair value in the unconsolidated statement of financial position of the Bank

The measurement of fair value of financial instruments, for which market values from active markets are available, is based on market quotations of a given instrument (mark-to-market).

The measurement of fair value of Over-the-counter ('OTC') derivatives and instruments with limited liquidity (i.e. for which no market quotations are available), is made on the basis of other instruments quotations on active markets by replication thereof using a number of valuation techniques, including the estimation of present value of future cash flows (mark-to-model).

As of 31 December 2018 and 31 December 2017, the Bank classified the financial assets and liabilities measured at fair value into the following hierarchy of three categories based on the following hierarchy:

- Level 1: mark-to-market, applies to securities quoted on active markets,
- Level 2: mark-to-model valuation with model parameterization, based on quotations from active markets for given type of instrument, applies to illiquid government, municipal, corporate and central bank debt securities, linear and non-linear derivative instruments of interest rate markets (including forward transactions on debt securities), equity, commodity and foreign currency exchange markets, except for those cases that meet the criteria of Level 3,
- Level 3: mark-to-model valuation with partial model parameterization, based on estimated risk factors, applicable to loans and advances, corporate and municipal debt securities and for linear and non-linear derivative instruments of interest rate, equity, commodity and foreign currency exchange markets for which unobservable parameters (e.g. credit risk factors) are recognized as significant.

The measurement at fair value is performed directly by an organizational unit within Risk Management Division, independent of front-office units. The methodology of fair value measurement, including the changes of its parameterization, is subject to approval of Assets and Liabilities Committee (ALCO). The adequacy of measurement methods is subject to on-going analysis and periodical reviews in the framework of model risk management. The same Risk Management Division unit performs the assessment of adequacy and significance of risk factors and assignment of valuation models to appropriate method class, according to established hierarchy of classification.

Notes to the financial statements (cont.)

(in PLN thousand)

Assets and liabilities measured at fair value in breakdown by fair value hierarchy levels

31.12.2018	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:	**12 494 171**	**10 091 049**	**9 211 582**	**31 796 802**
Financial assets held for trading	632 316	159 022	99 001	890 339
Derivative financial instruments, including:	-	1 454 746	1 230	1 455 976
- Banks	-	777 243	1 230	778 473
- Customers	-	677 503	-	677 503
Hedging instruments, including:	-	313 565	-	313 565
- Banks	-	69 195	-	69 195
- Customers	-	244 370	-	244 370
Securities measured at fair value through other comprehensive income	11 861 855	8 163 716	7 111 833	27 137 404
Loans and advances to customers measured at fair value through other comprehensive income	-	-	1 696 888	1 696 888
Loans and advances to customers measured at fair value through profit or loss	-	-	302 630	302 630
Liabilities:	**102 429**	**2 824 450**	**-**	**2 926 879**
Financial liabilities held for trading	102 429	-	-	102 429
Derivative financial instruments, including:	-	1 919 394	-	1 919 394
- Banks	-	686 757	-	686 757
- Customers	-	1 232 637	-	1 232 637
Hedging instruments, including:	-	905 056	-	905 056
- Banks	-	882 460	-	882 460
- Customers	-	22 596	-	22 596

31.12.2017	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:	**19 692 416**	**16 185 012**	**727 252**	**36 604 680**
Financial assets held for trading	1 624 890	95 667	14 211	1 734 768
Derivative financial instruments, including:	-	1 350 126	1 218	1 351 344
- Banks	-	914 417	1 218	915 635
- Customers	-	435 709	-	435 709
Hedging instruments, including:	-	259 396	-	259 396
- Banks	-	76 796	-	76 796
- Customers	-	182 600	-	182 600
Securities available for sale	18 067 526	14 479 823	711 823	33 259 172
Liabilities:	**456 510**	**2 912 197**	**-**	**3 368 707**
Financial liabilities held for trading	456 510	12 938	-	469 448
Derivative financial instruments, including:	-	2 036 928	-	2 036 928
- Banks	-	822 329	-	822 329
- Customers	-	1 214 599	-	1 214 599
Hedging instruments, including:	-	862 331	-	862 331
- Banks	-	858 274	-	858 274
- Customers	-	4 057	-	4 057

Notes to the financial statements (cont.)

(in PLN thousand)

Change in fair value of financial assets measured at fair value according to Level 3 by the Bank

2018	FINANCIAL ASSETS HELD FOR TRADING	DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS)	LOANS AND ADVANCES TO CUSTOMERS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME	LOANS AND ADVANCES TO CUSTOMERS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS	SECURITIES MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME
Opening balance	**14 211**	**1 218**	**-**	**-**	**711 823**
Initial application of IFRS 9	-	-	1 841 682	365 137	4 360 232
Opening balance - restated	**14 211**	**1 218**	**1 841 682**	**365 137**	**5 072 055**
Increases, including:	1 511 412	12	480 016	8 976	3 094 204
Reclassification	392	-	-	-	10 869
Derivatives transactions made in 2018	-	-	-	2 745	-
Acquisition	1 510 007	-	408 520	-	3 034 342
Gains on financial instruments	1 013	12	71 496	6 231	48 993
recognized in the income statement	1 013	12	39 931	6 231	48 993
recognized in revaluation reserves	-	-	31 565	-	-
Decreases, including:	(1 426 622)	-	(624 810)	(71 483)	(1 054 426)
Reclassification	(14 211)	-	-	-	(124 275)
Settlement/redemption	(738)	-	(36 789)	(71 483)	(45 018)
Sale	(1 411 659)	-	(588 021)	-	(825 745)
Losses on financial instruments	(14)	-	-	-	(59 388)
recognized in the income statement	(14)	-	-	-	-
recognized in revaluation reserves	-	-	-	-	(59 388)
Closing balance	**99 001**	**1 230**	**1 696 888**	**302 630**	**7 111 833**
Unrealized income from financial instruments held in portfolio at the end of the period, recognized in:	**46**	**12**	**66 705**	**6 095**	**28 486**
Income statement:	46	12	34 098	6 095	40 133
net interest income	40	-	28 479	2 287	40 133
net impairment losses on financial assets and off-balance sheet commitments	-	-	5 619	-	-
result on financial assets and liabilities held for trading	6	12	-	3 808	-
Other comprehensive income	-	-	32 607	-	(11 647)

Notes to the financial statements (cont.)

(In PLN thousand)

Change in fair value of financial assets measured at fair value according to Level 3 by the Bank

2017	FINANCIAL ASSETS HELD FOR TRADING	DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS)	SECURITIES AVAILABLE FOR SALE
Opening balance	**66 113**	**-**	**317 481**
Increases, including:	1 388 818	2 353	717 283
Reclassification	-	-	674 519
Acquisition	1 387 394	-	-
Settlement	-	-	-
Derivatives transactions made in 2017	-	2 353	-
Gains on financial instruments	1 424	-	42 764
recognized in the income statement	1 424	-	41 152
recognized in revaluation reserves	-	-	1 612
Decreases, including:	(1 440 720)	(1 135)	(322 941)
Reclassification	-	-	-
Settlement / redemption	(1 020)	-	(290 030)
Sale	(1 439 693)	-	-
Loss on financial instruments	(7)	(1 135)	(32 911)
recognized in the income statement	(7)	(1 135)	(9 955)
recognized in revaluation reserves	-	-	(22 956)
Closing balance	**14 211**	**1 218**	**711 823**
Unrealized income from financial instruments held in portfolio until end of period, recognized in:	**400**	**(1 135)**	**2 853**
Income statement:	400	(1 135)	23 456
net interest income	178	-	23 456
result on financial assets and liabilities held for trading	222	(1 135)	-
Other comprehensive income	-	-	(20 603)

Transfers of instruments between fair value hierarchy levels are based on changes in availability of active market quotations as at the end of the reporting periods.

In the period from 1 January to 31 December 2018 the following transfers of financial instruments between the levels of the fair value hierarchy were made:

- from level 2 to level 1: a government bond denominated in PLN for which quotes were available on the active market,
- from Level 3 to Level 2: municipal and corporate bonds which were valued based on information on the prices of comparable financial instruments, corporate bonds with immaterial impact of the estimated credit parameters on the valuation, government bonds in PLN with immaterial impact of estimated benchmark bond spread on the valuation and capital market derivative instruments for which impact of the unobservable factor (correlation) on the valuation was immaterial,
- from level 2 to level 3: municipal and corporate bonds, for which impact of estimated credit parameters was material and capital market derivative instruments with material impact of the estimated factor (correlation) on the valuation.

(In PLN thousand)

The impact of estimated parameters on measurement of financial instruments for which the Bank applies fair value valuation according to Level 3 as at 31 December 2018 and as at 31 December 2017 is as follows:

FINANCIAL ASSET/LIABILITY	FAIR VALUE AS AT 31.12.2018	VALUATION TECHNIQUE	UNOBSERVABLE FACTOR	ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE)	IMPACT ON FAIR VALUE AS AT 31.12.2018	
					POSITIVE SCENARIO	NEGATIVE SCENARIO
Corporate and municipal debt securities	7 021 454	Discounted cash flow	Credit spread	0.35%-1.04%	87 509	(87 509)
Derivatives	1 230	Black Scholes Model	Correlation	0-1	558	(684)
Loans and advances measured at fair value through profit or loss	302 630	Discounted cash flow	Credit spread	0.43%-1.11%	3 066	(3 015)
Loans and advances measured at fair value through other comprehensive income	1 696 888	Discounted cash flow	Credit spread	2.07%-2.75%	11 524	(8 854)

FINANCIAL ASSET/LIABILITY	FAIR VALUE AS AT 31.12.2017	VALUATION TECHNIQUE	UNOBSERVABLE FACTOR	ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE)	IMPACT ON FAIR VALUE AS AT 31.12.2017	
					POSITIVE SCENARIO	NEGATIVE SCENARIO
Municipal debt securities	652 597	Discounted cash flow	Credit spread	0.45%-0.87%	3 856	(3 856)
Government debt securities	14 211	Discounted cash flow	Benchmark bond spread	0.09%-0.46%	448	(448)
Derivatives	1 218	Black Scholes Model	Correlation	0-1	966	(578)

Financial instruments that are not measured at fair value in the statement of financial position of the Bank

The Bank also holds financial instruments which are not presented at fair value in the financial statements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

As of 31 December 2018 and 31 December 2017, the Bank classified the financial assets and liabilities not measured at fair value in the unconsolidated statement of financial position into the following three categories based on the valuation level:

- Level 1: mark-to-market, applies to government securities quoted on the liquid market and cash,
- Level 2: mark-to-model valuation with model parameterization, based on quotations from active markets for given type of instrument, applies to interbank deposits, own issues, illiquid government, municipal, corporate and central bank debt securities,
- Level 3: mark-to-model valuation with partial model parameterization, based on estimated risk factors, is applicable to corporate and municipal debt securities and loans and deposits for which the applied credit risk factor (an unobservable parameter) is recognized significant.

In case of certain groups of financial assets, recognized at the amount to be received with impairment considered, the fair value was assumed to be equal to carrying amount. The above applies in particular to cash and other financial assets and liabilities.

In the case of loans for which no quoted market values are available, the fair values presented are generally estimated using valuation techniques taking into consideration the assumption, that at the moment when the loan is granted its fair value is equal to its carrying amount. Fair value of non-impaired loans is equal to the sum of future expected cash flows, discounted at the balance sheet date, less expected credit loss. The discount rate is defined as the appropriate market risk-free rate plus the liquidity risk margin and current sales margin for the given loan products group. The margin is computed on loans granted broken down by loan product groups and maturity.

Notes to the financial statements (cont.)

(In PLN thousand)

For the purpose of the fair value of foreign currency loans estimation, the margin on PLN loans adjusted by the cross-currency basis swap quotes and FX-Swap is used. The fair value of impaired loans is defined as equal to the sum of expected recoveries, discounted with the use of effective interest rate, since the average expected recovery values take the element of credit risk fully into consideration. In case of loans without repayment schedule (loans in current account, overdrafts and credit cards), the fair value was assumed as equal to the carrying amount.

Since no quoted market prices are available for deposits, their fair values have been generally estimated using valuation techniques with the assumption that the fair value of a deposit at the moment of its receipt is equal to its carrying amount. The fair value of term deposits is equal to the sum of future expected cash flows, discounted at the relevant balance sheet date. The cash flow discount rate is defined as the relevant market risk-free rate, increased by the sales margin. The margin is computed on deposits acquired during last three months broken down by deposit product Banks and maturity. In case of short term deposits (current deposits, overnights, saving accounts), the fair value was assumed as equal to the carrying amount.

The fair value of deposits and loans, apart from cash and mortgage loans denominated in PLN and CHF for which prepayment model is used, is calculated based on contractual cash flows.

The mark-to-model valuation of own issue debt instruments is based on the method of discounting the future cash flows. Variable cash flows are estimated based upon rates adopted for specific markets (depending upon issue specifications). Both the fixed and implied cash flows are discounted using interbank money market rates.

Assets and liabilities not measured at fair value in the financial statement in breakdown by fair value hierarchy levels

31.12.2018	CARRYING AMOUNT	FAIR VALUE	OF WHICH:		
			LEVEL 1	LEVEL 2	LEVEL 3
ASSETS					
Cash and due from Central Bank	12 972 575	12 970 021	3 182 868	9 787 153	-
Loans and advance to banks	2 508 553	2 509 509	-	1 241 170	1 268 339
Loans and advances to customers measured at amortised cost	120 349 597	120 878 815	-	-	120 878 815
Debt securities measured at amortised cost	11 130 367	11 225 335	5 136 636	1 188 734	4 899 965
Total Assets	**146 961 092**	**147 583 680**	**8 319 504**	**12 217 057**	**127 047 119**
LIABILITIES					
Amounts due to Central Bank	5 067	5 070	-	-	5 070
Amounts due to other banks	2 921 955	2 952 856	-	278 288	2 674 568
Amounts due to customers	150 132 028	150 134 795	-	347 902	149 786 893
Debt securities issued	1 732 596	1 729 580	-	1 729 580	-
Subordinated liabilities	2 012 485	2 013 376	-	2 013 376	-
Total Liabilities	**156 804 131**	**156 835 677**	**-**	**4 369 146**	**152 466 531**

Notes to the financial statements (cont.)

(In PLN thousand)

31.12.2017	CARRYING AMOUNT	FAIR VALUE	OF WHICH:		
			LEVEL 1	LEVEL 2	LEVEL 3
ASSETS					
Cash and due from Central Bank	5 186 259	5 186 259	2 686 573	2 499 686	-
Receivables from banks	2 692 930	2 692 271	-	1 101 094	1 591 177
Loans and advances to customers	128 873 178	128 024 820	-	8 153 945	119 870 875
Debt securities held to maturity	3 366 824	3 400 630	3 369 179	31 451	-
Total assets	**140 119 191**	**139 303 980**	**6 055 752**	**11 786 176**	**121 462 052**
LIABILITIES					
Amounts due to Central Bank	6 079	6 080	-	-	6 080
Amounts due to other banks	3 438 801	3 433 767	-	671 642	2 762 125
Amounts due to customers	146 898 298	147 081 381	-	788 437	146 292 944
Debt securities issued	2 727 188	2 727 212	-	2 727 212	-
Total liabilities	**153 070 366**	**153 248 440**	**-**	**4 187 291**	**149 061 149**

6. Custody activity

Custody activities are performed by virtue of a permit, issued by the Polish Financial Supervision Authority. The Bank's clients include a number of domestic and foreign financial institutions, banks offering custody and investment services, insurance companies, investment and pension funds, as well as non-financial institutions. The Bank provides custody services, including, inter alia, the settlement of transactions effected on domestic and international markets, custody of clients' assets, running of securities accounts, valuation of assets and services related to dividend and interest payments. The Bank also performs the activities of investment and pension funds depository.

As at 31 December 2018 the Bank maintained 13 001 securities accounts and omnibus accounts (in comparison to 12 517 accounts as at 31 December 2017).

7. Brokerage activity

Bank Pekao S.A. provides access to a wide range of the capital market services and products offered by the separated organizational unit of the Bank – Dom Maklerski Pekao, designed to sell capital market products.

The objective of Dom Maklerski Pekao is to provide the highest quality brokerage services within the Bank's offer. The comprehensive offer enables investors, in particular the individual clients of the Bank, to invest in financial instruments with diverse characteristics, which are listed on the regulated market and on the alternative trading system organized by the Warsaw Stock Exchange (GPW S.A.) and by the BondSpot S.A. (i.e. shares, treasury and corporate bonds, derivatives – futures and options, ETF, certificates, warrants) as well as the instruments traded on the specific foreign markets offered via any customer service channel (i.e. website, mobile service, telephone, and in the form of direct service provided by Customer Advisors through the branches). As part of the cooperation within the entities of the Capital Group, the entity provides intermediary services of Closed-end Investment Funds offered by TFI PZU, acts as the Offeror and accepts subscriptions for mortgage bonds issued by Pekao Bank Hipoteczny S.A. and also acts as an intermediary in sales of the Structured Certificates of Deposit issued by Bank Pekao S.A. As part of retail consortia, Dom Maklerski Pekao offers investors to acquire instruments in the IPOs serviced by the entity as well as to make transactions on the non-public market. The direct service is provided in 379 Brokerage Services Spots located in the Bank Pekao S.A.'s branches throughout Poland and via remote channels of Pekao24Makler (website, telephone, mobile application) fully integrated with the Bank's electronic banking platform Pekao24.

Notes to the financial statements (cont.)

(In PLN thousand)

Dom Maklerski Pekao is a member of the Warsaw Stock Exchange S.A. (GPW) and a direct participant in the National Depository of Securities S.A. (KDPW).

Dom Maklerski Pekao conform to the Good Practices Code of Brokerage Firms guaranteeing comprehensive services in accordance with highest ethics standards. Dom Maklerski Pekao actively participates in capital market development in Poland.

Information about the financial instruments of the clients held on securities accounts or stored in a form of document

	31.12.2018		31.12.2017	
	QUANTITY (PCS)	VALUE	QUANTITY (PCS)	VALUE
CLIENTS' FINANCIAL INSTRUMENTS				
Held on securities accounts	1 002 377 159	16 364 804	710 345 757	2 840 005
Equity securities and rights to such financial assets	1 001 966 031	15 695 591	709 650 397	2 441 801
Debt instruments and rights to such financial assets	411 128	669 213	695 360	398 204

Customers' cash on brokerage accounts

	31.12.2018	31.12.2017
Deposited on cash accounts in brokerage house and paid for securities bought in IPO or on the primary market	315 324	294 437
Other customers' cash	1 156	2 749
Total	**316 480**	**297 186**

Settlements due to unsettled transactions

	31.12.2018	31.12.2017
Receivables from executed transactions	2 419	2 924
Liabilities from executed transactions	5	130

Settlements with the National Depository of Securities S.A. (KDPW), KDPW_CCP S.A. and other stock exchange clearing houses

	31.12.2018	31.12.2017
Receivables from clearing fund	840	1 016
Receivables from margin deposits	10 172	13 156
Other receivables	55	64
Total receivables	**11 067**	**14 236**

Items concerning participation in the compensation fund managed by the National Depository of Securities S.A. (KDPW)

	31.12.2018	31.12.2017
Receivables from compensation fund	531	474
Prepaid expenses - system maintenance payments	191	148
Deferred income - benefits from system	(722)	(622)
Total net balance sheet items concerning participation In the compensation fund	**-**	**-**

Notes to the financial statements (cont.)

(In PLN thousand)

8. Interest income and expense

Interest income

	2018				2017
	FINANCIAL ASSETS MEASURED AT AMORTISED COST	FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME	FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER PROFIT OR LOSS	TOTAL	
Loans and other receivables from customers	4 695 301	34 657	7 612	4 737 570	4 596 628
Interbank placements	52 940	-	-	52 940	80 792
Reverse repo transactions	27 059	-	-	27 059	30 427
Investment securities	290 772	665 187	-	955 959	667 367
Hedging derivatives	-	-	155 547	155 547	123 610
Financial assets held for trading	-	-	12 101	12 101	12 429
Total	**5 066 072**	**699 844**	**175 260**	**5 941 176**	**5 511 253**

Interest expense

	2018	2017
Deposits from customers	(940 779)	(924 150)
Interbank deposits	(16 087)	(16 301)
Repo transactions	(34 782)	(55 274)
Loans and advances received	(8 559)	(10 807)
Debt securities issued	(71 956)	(17 977)
Total	**(1 072 163)**	**(1 024 509)**

The amounts shown above contain interest expense relating to the financial liabilities measured at amortised cost.

Notes to the financial statements (cont.)

(In PLN thousand)

9. Fee and commission income and expense

Fee and commission income

	2018	2017
Accounts maintenance, payment orders and cash transactions	622 694	605 256
Payment cards	596 925	586 843
Loans and advances	359 464	414 696
Margin on foreign exchange transactions with clients	461 308	439 623
Investment products sales intermediation	178 307	187 614
Securities operations	14 602	16 717
Custody activity	63 296	67 488
Guarantees, letters of credit and similar transactions	63 426	55 062
Other	32 563	30 696
Total	**2 392 585**	**2 403 995**

Fee and commission expense

	2018	2017
Payment cards	(269 052)	(229 717)
Money orders and transfers	(21 364)	(20 757)
Securities and derivatives operations	(27 005)	(22 941)
Accounts maintenance	(28 350)	(31 173)
Custody activity	(16 125)	(14 781)
Acquisition services	(4 695)	(5 036)
Other	(2 735)	(1 493)
Total	**(369 326)**	**(325 898)**

10. Dividend income

	2018	2017
Subsidiaries	235 263	168 402
Issuers of securities available for sale	X	19 668
Issuers of securities measured at fair value through profit or loss	485	X
Issuers of equity instruments designated at fair value through profit or loss	19 616	X
Total	**255 364**	**188 070**

Notes to the financial statements (cont.)

(In PLN thousand)

11. Result on financial assets and liabilities measured at fair value through profit or loss

	2018	2017
Gains (losses) on loans and advances to customers measured mandatorily at fair value through profit or loss	(4 866)	X
Gains (losses) on securities measured mandatorily at fair value through profit or loss	7 937	X
Foreign currency exchange result	803	(31 802)
Gains (losses) on derivatives	42 108	44 338
Gains (losses) on securities held for trading	20 728	19 286
Total	**66 710**	**31 822**

12. Result on derecognition of financial assets and liabilities not measured at fair value through profit or loss

Realized gains

	2018	2017
Financial assets measured at amortised cost	12 050	X
Financial assets measured at fair value through other comprehensive income	128 871	X
Financial liabilities not measured at fair value through profit and loss	1	X
Total	**140 922**	**X**

Realized losses

	2018	2017
Financial assets measured at fair value through other comprehensive income	(185)	X
Financial liabilities not measured at fair value through profit and loss	(85)	X
Total	**(270)**	**X**

Net realized profit	**140 652**	**X**

(In PLN thousand)

13. Gains (losses) on disposal of financial assets and liabilities

Realized gains

	2018	2017
Loans and other financial receivables (*)	X	146 046
Available for sale financial assets – debt instruments	X	34 537
Available for sale financial assets – equity instruments	X	5 875
Held to maturity investments	X	638
Total	**X**	**187 096**

(*) In 2017 the Bank sold loans with a total debt of PLN 1 188 million. The realized gross result on the transaction was PLN 142.7 million.

Realized losses

	2018	2017
Loans and other financial receivables	X	(65)
Held to maturity investments	X	(2)
Debt securities issued	X	(272)
Total	X	**(339)**

Net realized profit	**X**	**186 757**

The change in fair value of financial assets available for sale transferred in 2017 directly to equity amounted to PLN 270 013 thousand (increase).

The change in fair value of financial assets, transferred in 2017 from equity to financial income amounted to PLN 40 412 thousand (profit).

14. Net impairment losses on financial assets and off-balance sheet commitments

	2018	2017
Loans and other financial assets measured at amortized cost (*) (**)	(446 942)	X
Debt securities measured at amortized cost	(1 550)	X
Loans measured at fair value through other comprehensive income	9 343	X
Debt securities measured at fair value through other comprehensive income	(3 995)	X
Off-balance sheet commitments	(57 303)	X
Total financial assets and off-balance sheet commitments	**(500 447)**	**X**

(*)Item includes impairment losses on loans and advances to banks and receivables from financial leases.
(**) In 2018 the Bank sold loans with a total debt of PLN 280.7 million. The realized gross result on the transaction was PLN 36.4 million.

	2018	2017
Loans and advances to banks measured at amortized cost	X	443
Loans and advances to customers measured at amortized cost	X	(495 004)
Off-balance sheet commitments	X	(21 344)
Total financial assets and off-balance sheet commitments	**X**	**(515 905)**

Notes to the financial statements (cont.)

(In PLN thousand)

15. Administrative expenses

Personnel expenses

	2018	2017
Wages and salaries	(1 492 614)	(1 462 194)
Insurance and other charges related to employees	(271 755)	(258 023)
Share-based payments expenses	(17 598)	(19 767)
Total	**(1 781 967)**	**(1 739 984)**

Other administrative expenses

	2018	2017
General expenses	(947 579)	(912 718)
Taxes and charges	(34 722)	(35 310)
Bank Guarantee Fund fee	(265 099)	(266 425)
Financial supervision authority fee (KNF)	(16 516)	(11 717)
Tax on certain financial institutions	(561 992)	(522 281)
Total	**(1 825 908)**	**(1 748 451)**

Total administrative expenses	**(3 607 875)**	**(3 488 435)**

From 1 January 2017 new rules for making contributions to Bank Guarantee Fund (hereinafter 'BGF'), defined in the Act of 10 June 2016 on Bank Guarantee Fund, deposit guarantee schemes and resolution of banks (hereinafter 'BGF Act'), have to be applied.

In accordance with BGF Act, the banks are committed to make quarterly contributions to deposit guarantee fund of banks and annual contribution to resolution fund of banks. Such contributions are expenses not deductible for tax purposes. The obligation to make quarterly contribution to deposit guarantee fund of banks arises at the first day of each quarter, whereas the obligation to make annual contribution to resolution fund of banks arises at 1 January of the year concerned.

As a result of application of the Interpretation IFRIC 21 *Levies* for recognition of the above obligations, the costs of year 2018 contribution to deposit guarantee fund of banks in the amount of PLN 121 856 thousand (PLN 89 529 thousand in 2017) and the costs of annual contribution to resolution fund of banks in the amount of PLN 143 243 thousand (PLN 176 897 thousand in 2017) are charged to the income statement for 2018.

16. Depreciation and amortization

	2018	2017
Property, plant and equipment	(166 150)	(164 557)
Investment property	(293)	(330)
Intangible assets	(171 736)	(164 253)
Total	**(338 179)**	**(329 140)**

Notes to the financial statements (cont.)

(In PLN thousand)

17. Net other operating income and expenses

Other operating income

	2018	2017
Rental income	24 178	23 280
Miscellaneous income	5 410	10 020
Recovery of debt collection costs	11 777	13 484
Excess payments, repayments	5 045	1 617
Compensation, recoveries, penalty fees and fines received	24 686	81 641
Refunding of administrative expenses	-	4 418
Income from written off liabilities	9	93
Releases of impairment allowances for litigation and other assets	246	9 660
Other	1 439	4 404
Total	**72 790**	**148 617**

Other operating expenses

	2018	2017
Credit insurance expenses	(3 675)	(7 870)
Sundry expenses	(2 135)	(6 490)
Reimbursement and deficiencies	(3 066)	(2 921)
Customers complaints expenses	(1 025)	(1 551)
Impairment allowance for litigations and other assets	(6 511)	(238)
Costs of litigation and claims	(1 398)	(1 894)
Compensation, penalty fees and fines paid	(630)	(717)
Other	(13 143)	(13 343)
Total	**(31 583)**	**(35 024)**

Net other operating income and expenses	**41 207**	**113 593**

18. Total gains (losses) from subsidiaries and associates

	2018	2017
Impairment allowances for equity investments	(11 069)	-
Total gains (losses) from subsidiaries and associates	**(11 069)**	**-**

19. Gains (losses) on disposal of property, plant and equipment, and intangible assets

	2018	2017
Gains (losses) on disposal of property, plant and equipment classified as assets held for sale	34 715	1 491
Gains (losses) on de-recognition of property, plant and equipment and intangible assets other than classified as assets held for sale	61 341	(1 399)
Total gains (losses) on disposal of property, plant and equipment and intangible assets	**96 056**	**92**

Notes to the financial statements (cont.)

(In PLN thousand)

20. Income tax

Reconciliation between tax calculated by applying the current tax rate to accounting profit and the actual tax charge presented in the consolidated income statement.

	2018	2017
Profit before income tax	**3 020 751**	**2 727 771**
Tax charge according to applicable tax rate 19%	**573 943**	**518 276**
Permanent differences:	**136 208**	**121 380**
Non taxable income	(51 447)	(38 928)
Non tax deductible costs	194 577	169 296
Impact of other tax rates applied in accordance with art.19.1.2 of CIT Act	-	-
Tax relieves not included in the income statement	40	109
Other	(6 962)	(9 097)
Effective income tax charge on gross profit	**710 151**	**639 656**

The applicable tax rate of 19% is corporate income tax rate binding in Poland.

The basic components of income tax charge presented in the income statement and equity

	2018	2017
INCOME STATEMENT		
Current tax	**(701 505)**	**(608 566)**
Current tax charge in the income statement	(708 463)	(621 041)
Adjustments related to the current tax from previous years	7 150	12 796
Other taxes (e.g. withholding tax)	(192)	(321)
Deferred tax	**(8 646)**	**(31 090)**
Occurrence and reversal of temporary differences	(8 646)	(31 090)
Tax charge in the unconsolidated income statement	**(710 151)**	**(639 656)**
EQUITY		
Current tax	**53**	**X**
Deferred tax	**(5 415)**	**(38 959)**
Income and costs disclosed in other comprehensive income:		
revaluation of financial instruments - cash flows hedges	(8 542)	6 297
revaluation of available for sale financial assets – debt securities	X	(41 545)
fair value revaluation through other comprehensive income	(2 370)	X
fair value revaluation through other comprehensive income – equity securities	X	(2 079)
Tax on items that are or may be reclassified subsequently to profit or loss	**(10 912)**	**(37 327)**
Tax charge on items that never be reclassified to profit and loss	**5 497**	**(1 632)**
fair value revaluation through other comprehensive income – equity securities	5 774	X
sale of the shares - equity securities	(200)	X
revaluation of the defined benefit liabilities	(77)	(1 632)
Total charge	**(715 513)**	**(678 615)**

Notes to the financial statements (cont.)

(In PLN thousand)

	CHANGES IN TEMPORARY DIFFERENCES IN 2018									
	OPENING BALANCE			CHANGES RECOGNIZED IN		CHANGES RESULTING FROM CHANGES IN THE SCOPE OF CONSOLIDATION AND OTHER		OPENING BALANCE		
	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	EQUITY	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY
DEFFERED TAX LIABILITY										
Accrued income – securities	11 800	11 800	-	(8 760)	-	(3 040)	-	-	-	-
Accrued income – loans	138 433	138 433	-	(6 506)	-	-	-	131 927	131 927	-
Change in revaluation of financial assets	137 220	133 658	3 562	40 601	598	-	61 084	239 503	174 259	65 244
Accelerated depreciation	114 625	114 625	-	326	-	-	-	114 951	114 951	-
Investment relief	4 199	4 199	-	(366)	-	-	-	3 833	3 833	-
Paid intermediation costs	111 039	111039	-	22 129	-	(781)	-	132 387	132 387	-
Other	1 607	1 607	-	859	-	-	-	2 466	2 466	-
Gross deferred tax liability	**518 923**	**515 361**	**3 562**	**48 283**	**598**	**(3 821)**	**61 084**	**625 067**	**559 823**	**65 244**
DEFFERED TAX ASSET										
Accrued expenses - securities	-	-	-	5 873	-	-	-	5 873	5 873	-
Accrued expenses - deposits and loans	35 371	35 371	-	465	-	-	-	35 836	35 836	-
Downward revaluation of financial assets	367 406	367 406	-	30 890	-	(615)	-	397 681	397 681	-
Income received to be amortized over time from loans and current accounts	197 778	197 778	-	44 033	-	44 858	-	286 669	286 669	-
Loan provisions charges	489 743	489 743	-	(46 988)	(4 741)	152 056	4 741	594 811	594 811	-
Personnel related provisions	110 134	93 103	17 031	1 200	(76)	3 043	-	114 301	97 346	16 955
Accruals	16 393	16 393	-	4 102	-	-	-	20 495	20 495	-
Previous year losses	-	-	-	-	-	-	-	-	-	-
Other	10 327	10 327	-	62	-	-	-	10 389	10 389	-
Gross deferred tax asset	**1 227 152**	**1 210 121**	**17 031**	**39 637**	**(4 817)**	**199 342**	**4 741**	**1 466 055**	**1 449 100**	**16 955**
Deferred tax charge	**X**	**X**	**X**	**(8 646)**	**(5 415)**	**203 163**	**(56 343)**	**X**	**X**	**X**
Net deferred tax assets	**708 229**	**694 760**	**13 469**	**X**	**X**	**X**	**X**	**840 988**	**889 277**	**(48 289)**
Net deferred tax provision	**-**	**-**	**-**	**X**	**X**	**X**	**X**	**-**	**-**	**-**

Notes to the financial statements (cont.)

(In PLN thousand)

	CHANGES IN TEMPORARY DIFFERENCES IN 2017							
	OPENING BALANCE			CHANGES RECOGNIZED IN		CLOSING BALANCE		
	TOTAL DEFERRED TAX	RECOGNIZED IN THE INCOME STATEMENT	IN EQUITY	THE INCOME STATEMENT	IN EQUITY	TOTAL DEFERRED TAX	IN THE INCOME STATEMENT	IN EQUITY
DEFFERED TAX LIABILITY								
Accrued income – securities	46 022	46 022	-	(34 222)	-	11 800	11 800	-
Accrued income – loans	137 003	137 003	-	1 430	-	138 433	138 433	-
Change in revaluation of financial assets	7 711	-	7 711	133 658	(4 149)	137 220	133 658	3 562
Accelerated depreciation	114 194	114 194	-	431	-	114 625	114 625	-
Investment relief	4 481	4 481	-	(282)	-	4 199	4 199	-
Paid intermediation costs	97 338	97 338	-	13 701	-	111 039	111 039	-
Other	2 377	2 377	-	(770)	-	1 607	1 607	-
Gross deferred tax liability	**409 126**	**401 415**	**7 711**	**113 946**	**(4 149)**	**518 923**	**515 361**	**3 562**
DEFFERED TAX ASSET								
Accrued expenses - securities	-	-	-	-	-	-	-	-
Accrued expenses - deposits and loans	37 868	37 868	-	(2 497)	-	35 371	35 371	-
Downward revaluation of financial assets	299 876	258 400	41 476	109 006	(41 476)	367 406	367 406	-
Income received to be amortized over time from loans and current accounts	176 922	176 922	-	20 856	-	197 778	197 778	-
Loan provisions charges	512 459	512 459	-	(22 716)	-	489 743	489 743	-
Personnel related provisions	111 788	93 125	18 663	(22)	(1 632)	110 134	93 103	17 031
Accruals	12 034	12 034	-	4 359	-	16 393	16 393	-
Previous year losses	-	-	-	-	-	-	-	-
Other	36 457	36 457	-	(26 130)	-	10 327	10 327	-
Gross deferred tax asset	**1 187 404**	**1 127 265**	**60 139**	**82 856**	**(43 108)**	**1 227 152**	**1 210 121**	**17 031**
Deferred tax charge	**x**	**x**	**x**	**(31 090)**	**(38 959)**	**X**	**X**	**X**
Net deferred tax assets	**778 278**	**725 850**	**52 428**	**X**	**X**	**708 229**	**694 760**	**13 469**
Net deferred tax provision	**-**	**-**	**-**	**X**	**X**	**-**	**-**	**-**

Notes to the financial statements (cont.)

(In PLN thousand)

In the opinion of the Bank the deferred tax asset in the amount of PLN 840 988 thousand reported as at 31 December 2018 is sustainable in total amount. The analysis was performed based on the past results of the company and assumed results in the future periods. The analysis assumed the five years' time horizon.

As at 31 December 2018 and 31 December 2017, there were no temporary differences related to investments in subsidiaries and associates, for which deferred tax liability was not created as a result of meeting the conditions of controlling the terms of temporary differences' reversing and being probable that these differences will not reverse in foreseeable future.

As at 31 December 2018 and 31 December 2017, there were no temporary differences, unused tax losses and unused tax relieves which were not included in the deferred tax assets.

21. Earnings per share

Basic earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to equity holders of the Bank by the weighted average number of the ordinary shares outstanding during the period.

	2018	2017
Net profit	2 310 600	2 088 129
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Earnings per share (in PLN per share)	8.80	7.96

Diluted earnings per share

Diluted earnings per share are calculated by dividing the net profit attributable to equity holders of the Bank by the weighted average number of the ordinary shares outstanding during the given period adjusted for all potential dilution of ordinary shares.

As at 31 December 2018 there were no diluting instruments in the form of convertible bonds in the Bank.

	2018	2017
Net profit	2 310 600	2 088 129
Weighted average number of ordinary shares in the period	262 470 034	262 470 034
Weighted average number of ordinary shares for the purpose of calculation of diluted earnings per share	262 470 034	262 470 034
Diluted earnings per share (in PLN per share)	8.80	7.96

22. Dividends

The Management Board of the Bank has decided to propose to the Ordinary General Meeting of Shareholders a dividend payment for 2018 in the amount of PLN 6.60 per share. Total dividend proposed to be paid amounts to PLN 1 732 302 thousand. The dividend has not been recognized as liabilities and there are no tax consequences for the Bank.

The final decision on the distribution of net profit and its allocating to dividend will be made by the General Meeting of Shareholders.

Notes to the financial statements (cont.)

(In PLN thousand)

23. Cash and balances with Central Bank

CASH AND DUE FROM CENTRAL BANK	31.12.2018	31.12.2017
Cash	3 182 868	2 686 561
Current account at Central Bank	9 790 608	2 264 686
Other	11	235 012
Gross carrying amount	**12 973 487**	**5 186 259**
Impairment allowances	(912)	-
Net carrying amount	**12 972 575**	**5 186 259**

AMOUNTS DUE TO CENTRAL BANK	31.12.2018	31.12.2017
Term deposits	5 067	6 079
Total	**5 067**	**6 079**

Receivables and liabilities to the Central Bank are measured at amortized cost.

Cash and balances with Central Bank by currency

31.12.2018	ASSETS	LIABILITIES
PLN	10 417 622	5 067
EUR	1 980 231	-
USD	211 636	-
CHF	78 688	-
Other currencies	284 398	-
Total	**12 972 575**	**5 067**

31.12.2017	ASSETS	LIABILITIES
PLN	4 302 520	6 079
EUR	463 160	-
USD	168 562	-
CHF	58 882	-
Other currencies	193 135	-
Total	**5 186 259**	**6 079**

Bank is required to held on current account in the Central Bank the average monthly balance comply with the mandatory reserve declaration.

As at 31 December 2018 the interest rate of funds held on the mandatory reserve account is at 0.5% (0.9 of NBP reference rate). As at 31 December 2017 the interest rate was at 1.35% (0.9 of NBP reference rate).

(In PLN thousand)

24. Loans and advances to banks

Loans and advances to banks by product type

	31.12.2018	31.12.2017
Current accounts	272 635	334 688
Interbank placements	843 804	271 823
Loans and advances	262 067	95 755
Cash collaterals	984 843	1 006 332
Reverse repo transactions	126 442	494 706
Cash in transit	29 193	506 559
Total gross amount	**2 518 984**	**2 709 863**
Impairment allowances	(10 431)	(16 933)
Total net amount	**2 508 553**	**2 692 930**

Loans and advances to banks are measured at amortised cost.

Loans and advances to banks by contractual maturity

	31.12.2018	31.12.2017
Loans and advances to banks, including:		
up to 1 month	2 242 866	2 618 664
between 1 and 3 months	49 890	7
between 3 months and 1 year	125 022	67 160
between 1 and 5 years	88 031	29
over 5 years	51	50
past due	13 124	23 953
Total gross amount	**2 518 984**	**2 709 863**
Impairment allowances	(10 431)	(16 933)
Total net amount	**2 508 553**	**2 692 930**

Loans and advances to banks by currency

	31.12.2018	31.12.2017
PLN	614 043	700 872
CHF	31 935	23 340
EUR	1 641 379	1 413 116
USD	159 804	209 142
Other currencies	61 392	346 460
Total	**2 508 553**	**2 692 930**

Notes to the financial statements (cont.)

(In PLN thousand)

25. Financial assets and liabilities held for trading

Financial assets and liabilities held for trading by product type

	31.12.2018	31.12.2017
FINANCIAL ASSETS		
Debt securities	890 339	1 734 768
Total financial assets	**890 339**	**1 734 768**
FINANCIAL LIABILITIES		
Debt securities	102 429	469 448
Total financial liabilities	**102 429**	**469 448**

Financial assets and liabilities held for trading are measured at fair value through profit or loss.

Debt securities held for trading

	31.12.2018	31.12.2017
FINANCIAL ASSETS		
Debt securities issued by central governments	637 765	1 646 757
T- bills	-	-
T- bonds	637 765	1 646 757
Debt securities issued by banks	48 582	50 258
Debt securities issued by business entities	203 992	37 753
Total financial assets	**890 339**	**1 734 768**
FINANCIAL LIABILITIES		
Debt securities issued by central governments	102 429	469 448
T- bonds	102 429	469 448
Total financial liabilities	**102 429**	**469 448**

Debt securities held for trading by maturity

	31.12.2018	31.12.2017
FINANCIAL ASSETS		
Debt securities, including:		
up to 1 month	1 720	123 505
between 1 and 3 months	63 434	-
between 3 months and 1 year	146 883	21 516
between 1 and 5 years	612 870	1 461 522
over 5 years	65 432	128 225
unspecified term	-	-
Total financial assets	**890 339**	**1 734 768**
FINANCIAL LIABILITIES		
Debt securities, including:		
up to 1 month	-	-
between 1 and 3 months	-	-
between 3 months and 1 year	-	-
between 1 and 5 years	57 421	309 328
over 5 years	45 008	160 120
Total financial liabilities	**102 429**	**469 448**

(In PLN thousand)

Debt securities held for trading by currency

	31.12.2018	31.12.2017
FINANCIAL ASSETS		
PLN	880 457	1 727 112
EUR	8 634	4 542
USD	1 248	3 114
Total financial assets	**890 339**	**1 734 768**
FINANCIAL LIABILITIES		
PLN	102 429	469 448
Total financial liabilities	**102 429**	**469 448**

26. Derivative financial instruments (held for trading)

Derivative financial instruments at the Bank

In its operations the Bank uses different financial derivatives that are offered to the clients and are used for managing risks involved in the Bank's business. The majority of derivatives at the Bank include over-the-counter contracts. Regulated stock exchange contracts (mainly futures) represent a small part of those derivatives.

Derivative foreign exchange transactions include the obligation to buy or sell foreign and domestic currency assets. Forward foreign exchange transactions are based on the foreign exchange rates, specified on the transaction date for a predefined future date. These transactions are valued using the discounted cash flow model. Cash flows are discounted according to zero-coupon yield curves, relevant for a given market.

Foreign exchange swaps are a combination of a swap of specific currencies as at spot date and of reverse a transaction

as at forward date with foreign exchange rates specified in advance on transaction date. Transactions of such type are settled by an exchange of assets These transactions are valued using the discounted cash flow model. Cash flows are discounted according to zero-coupon yield curves relevant for a given market.

Foreign exchange options with delivery are defined as contracts, where one of the parties, i.e. the option buyer, purchases from the other party, referred to as the option writer, at a so-called premium price the right without the obligation to buy (call option) or to sell (put option), at a specified point of time in the future or during a specified time range a foreign currency amount specified in the contract at the exchange rate set during the conclusion of the option agreement. In case of options settled in net amounts, upon acquisition of the rights, the buyer receives an amount of money equal to the product of notional and difference between spot ad strike price.

Barrier option with one barrier is a type of option where exercise of the option depends on the underlying crossing or reaching a given barrier level. A barrier may be reached starting from lower ('UP') or from higher ('DOWN') level of the underlying instrument. 'IN' options start their lives worthless and only become active when a predetermined knock-in barrier price is breached. 'OUT' options start their lives active and become null and void when a certain knock-out barrier price is breached.

Foreign exchange options are priced using the Garman-Kohlhagen valuation model (and in case of barrier and Asian options using the so-called expanded Garman-Kohlhagen model). Parameters of the model based on market quotations of plain-vanilla at-the-money options and market spreads for out-of-the-money and in-the-money options (volatility smile) for standard maturity.

Derivatives related to interest rates enable the Bank and its customers to transfer, modify or limit interest rate risk.

In the case of Interest Rate Swaps (IRS), counterparties exchange between each other the flows of interest payments, accrued on the nominal amount identified in the contract. These transactions are valued using the discounted cash flow model. Floating (implied) cash flows are estimated on base of respective IRS rates. Floating and fixed cash flows are discounted by relevant zero-coupon yield curves.

Notes to the financial statements (cont.)

(In PLN thousand)

Forward Rate Agreements (FRA) involve both parties undertaking to pay interest on a predefined nominal amount for a specified period starting in the future and charged according to the interest rate determined on the day of the agreement. The parties settle the transaction on value date using the reference rate as a discount rate in the process of discounting the difference between the FRA rate (forward rate as at transaction date) and the reference rate. These transactions are valued using the discounted cash flow model.

Cross currency IRS involves both parties swapping capital and interest flows in different currencies in a specified period. These transactions are valued using the discounted cash flow model. Valuation of Basis Swap transactions (cross currency IRS with floating coupon) takes into account market quotations of basis spread (Basis swap spread).

In the case of forward transactions on securities, counterparties agree to buy or sell specified securities on a forward date for a payment fixed on the date of transaction. Such transactions are measured based upon the valuation of the security (mark-to-market or mark-to-model) and valuation of the related payment (method of discounting cash flows by money market rate).

Interest rate options (cap/floor) are contracts where one of the parties, the option buyer, purchases from the other party, the option writer, at a so-called premium price, the right without the obligation to borrow (cap) or lend (floor) at specified points of time in the future (independently) amounts specified in the contract at the interest rate set during the conclusion of the option. Contracts are net-settled (without fund location) at agreed time. Transactions of this type are valued using the Normal model. The model is parameterized based upon market quotations of options as at standard quoted maturities.

Interest rate futures transactions refer to standardized forward contracts purchased on the stock market. Futures contracts are measured based upon quotations available directly from stock exchanges.

Commodity swap contracts are obligations to net settlement equivalent to the execution of a commodity buy or sell transaction at the settlement price according to determination rules set at the trade inception. Commodity instruments are valued with the discounted cash flows method, which includes commodity prices term structure.

Asian commodity options are contracts with the right to buy or sell a certain amount of commodity on an expiry date at the specified price, where settlement price is based on an average level established on the basis of a series of commodity price observations in the period preceding the maturity date of the option. Commodity options are valued with the Black-Scholes model that includes moment matching of commodity price distribution for the arithmetic average.

Derivative financial instruments embedded in other instruments

The Bank uses derivatives financial instruments embedded in complex financial instruments, i.e. such as including both a derivative and base agreement, which results in part of the cash flows of the combined instrument changing similarly to cash flows of an independent derivative. Derivatives embedded in other instruments cause part or all cash flows resulting from the base agreement to be modified as per a specific interest rate, price of a security, foreign exchange rate, price index or interest rate index.

Call options in some of the corporate, municipal bonds and own equity placements are derivatives embedded in balance sheet financial instruments. In this case, embedded financial instruments are closely related to the base contract and thus the embedded derivative does not need to be isolated or recognized and valuated separately.

The Bank has deposits and certificates of deposits on offer which include embedded derivatives. As the nature of such instrument is not strictly associated with the nature of the deposit agreement, the embedded instrument is separated and classified into the portfolio held-for-trading. The valuation of such instrument is recognized in the income statement. Embedded instruments include simple options (plain vanilla) and exotic options for single stocks, commodities, indices and other market indices, including interest rate indices, foreign exchange rates and their related baskets. All embedded options are immediately closed back-to-back on the interbank market.

Currency options embedded in deposits are valued as other currency options.

Exotic options embedded in deposits as well as their close positions are valued using the Monte-Carlo simulation technique assuming Geometric Brownian Motion model of risk factors. Model parameters are determined first of all on the basis of quoted options and futures contracts and in their absence based on statistical measures of the underlying instrument dynamic.

The Bank carried out an analysis of the portfolio of credit agreements and of regular agreements in order to isolate embedded derivatives and decided that the agreements in question do not require isolation and separate treatment of embedded instruments.

Risk involved in financial derivatives

Market risk and credit risk are the basic types of risk, associated with derivatives.

At the beginning, financial derivatives usually have a small market value or no market value at all. It is a consequence of the fact that derivatives require no initial net investments, or require a very small net investment compared to other types of contracts, which display a similar reaction to changing market conditions.

Derivatives gain positive or negative value as a result of change in specific interest rates, prices of securities, prices of commodities, currency exchange rates, price index, credit standing or credit index or another market parameter. In case of such changes, the derivatives held become more or less advantageous than instruments with the same residual maturity, available at that moment on the market.

Credit risk related to derivative contracts is a potential cost of concluding a new contract on the original terms and conditions if the other party to the original contract fails to meet its obligations. In order to assess the potential cost of replacement the Bank uses the same method as for credit risk assessment. In order to control its credit risk levels the Bank performs assessments of other contract parties using the same methods as for credit decisions.

(In PLN thousand)

The following tables present nominal amounts of financial derivatives and fair values of such derivatives. Nominal amounts of certain financial instruments are used for comparison with balance sheet instruments but need not necessarily indicate what the future cash flow amounts will be or what the current fair value of such instruments is and therefore do not reflect the Bank's credit or price risk level.

Fair value of trading derivatives

31.12.2018	ASSETS	LIABILITIES
Interest rate transactions		
Interest Rate Swaps (IRS)	1 154 369	1 595 812
Forward Rate Agreements (FRA)	1 609	776
Options	6 822	2 122
Other	529	1 175
Foreign currency and gold transactions		
Cross-Currency Interest Rate Swaps (CIRS)	37 859	29 475
Currency Forward Agreements	56 147	114 757
Currency Swaps (FX-Swap)	55 514	34 253
Options for currency and gold	39 434	39 699
Transactions based on equity securities and stock indexes		
Options	2 714	2 693
Other	-	-
Transactions based on commodities and precious metals		
Options	55 222	53 415
Other	45 757	45 217
Total	**1 455 976**	**1 919 394**

31.12.2017	ASSETS	LIABILITIES
Interest rate transactions		
Interest Rate Swaps (IRS)	967 793	1 533 696
Forward Rate Agreements (FRA)	176	-
Options	6 161	2 252
Other	461	416
Foreign currency and gold transactions		
Cross-Currency Interest Rate Swaps (CIRS)	56 601	32 407
Currency Forward Agreements	120 421	185 923
Currency Swaps (FX-Swap)	87 610	173 735
Options for currency and for gold	27 932	24 955
Transactions based on equity securities and stock indexes		
Options	10 225	10 219
Other	-	-
Transactions based on commodities and precious metals		
Options	14 739	14 366
Other	59 225	58 959
Total	**1 351 344**	**2 036 928**

Derivative financial instruments are measured at fair value through profit or loss.

Notes to the financial statements (cont.)

(In PLN thousand)

Nominal value of trading derivatives

31.12.2018	CONTRACTUAL MATURITY					TOTAL
	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	
Interest rate transactions						
Interest Rate Swaps (IRS)	6 273 879	2 949 405	22 245 907	58 730 301	20 813 961	111 013 453
Forward Rate Agreements (FRA)	1 950 000	3 200 000	7 100 000	300 000	-	12 550 000
Options	-	-	872 972	3 143 618	81 448	4 098 038
Other	2 490 966	-	-	-	-	2 490 966
Foreign currencies and in gold transactions						
Cross-Currency Interest Rate Swaps (CIRS) – currency bought	-	57 249	269 208	4 888 647	731 927	5 947 031
Cross-Currency Interest Rate Swaps (CIRS) – currency sold	-	52 095	267 651	4 892 043	731 933	5 943 722
Currency Forward Agreements – currency bought	6 512 520	2 168 174	4 539 882	1 415 653	-	14 636 229
Currency Forward Agreements – currency sold	6 516 088	2 181 576	4 601 423	1 421 946	-	14 721 033
Currency Swaps (FX-Swap) – currency bought	14 560 296	2 444 391	990 310	433 276	-	18 428 273
Currency Swaps (FX-Swap) – currency sold	14 557 574	2 441 497	975 955	403 277	-	18 378 303
Options bought	258 944	773 298	2 684 757	1 453 805	-	5 170 804
Options sold	261 917	777 948	2 688 626	1 453 805	-	5 182 296
Transactions based on equity securities and stock indexes						
Options	-	-	68 404	49 972	-	118 376
Other	-	-	-	-	-	-
Transactions based on commodities and precious metals						
Options	85 477	242 350	1 261 812	523 425	-	2 113 064
Other	210 460	318 852	371 803	72 384	-	973 499
Total	**53 678 121**	**17 606 835**	**48 938 710**	**79 182 152**	**22 359 269**	**221 765 087**

31.12.2017	CONTRACTUAL MATURITY					TOTAL
	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	
Interest rate transactions						
Interest Rate Swaps (IRS)	1 781 188	1 815 069	18 506 468	49 917 986	11 372 737	83 393 448
Forward Rate Agreements (FRA)	-	500 000	450 000	-	-	950 000
Options	-	270 951	1 349 236	3 860 482	11 248	5 491 917
Other	785 253	-	-	-	-	785 253
Foreign currencies and in gold transactions						
Cross-Currency Interest Rate Swaps (CIRS) – currency bought	129 765	330 611	911 633	2 661 861	1 164 672	5 198 542
Cross-Currency Interest Rate Swaps (CIRS) – currency sold	127 707	323 370	910 417	2 651 187	1 164 672	5 177 353
Currency Forward Agreements – currency bought	7 090 041	3 030 242	3 239 011	735 665	-	14 094 959
Currency Forward Agreements – currency sold	7 078 207	3 075 685	3 286 933	740 000	-	14 180 825
Currency Swaps (FX-Swap) – currency bought	13 075 025	5 315 571	1 263 965	-	-	19 654 561
Currency Swaps (FX-Swap) – currency sold	13 169 617	5 320 541	1 241 015	-	-	19 731 173
Options bought	428 084	807 930	2 414 151	502 929	-	4 153 094
Options sold	429 477	799 227	2 418 390	502 929	-	4 150 023
Transactions based on equity securities and stock indexes						
Options	73 865	-	-	68 404	-	142 269
Other	-	-	-	-	-	-
Transactions based on commodities and precious metals						
Options	4 526	44 052	418 842	135 353	-	602 773
Other	104 966	147 378	233 076	189 527	-	674 947
Total	**44 277 721**	**21 780 627**	**36 643 137**	**61 966 323**	**13 713 329**	**178 381 137**

Notes to the financial statements (cont.)

(In PLN thousand)

27. Loans and advances to customers

Loans and advances to customers by product type

	31.12.2018				31.12.2017
	AMORTISED COST	FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME	FAIR VALUE THROUGH PROFIT OR LOSS	TOTAL	TOTAL
Mortgage loans	62 442 290	1 295 388	26 826	63 764 504	58 268 309
Current accounts	12 154 351	-	-	12 154 351	11 247 655
Operating loans	14 685 725	401 500	27 750	15 114 975	16 595 277
Investment loans	19 009 562	-	95 669	19 105 231	18 844 017
Cash loans	13 681 398	-	-	13 681 398	12 190 872
Payment cards receivables	1 141 961	-	-	1 141 961	1 081 499
Factoring	2 459 439	-	-	2 459 439	2 153 913
Other loans and advances	794 079		152 385	946 464	1 018 105
Debt securities	-	-	-	-	12 749 288
Reverse repo transactions	-	-	-	-	-
Cash in transit	64 078	-	-	64 078	53 041
Gross carrying amount	**126 432 883**	**1 696 888**	**302 630**	**128 432 401**	**134 201 976**
Impairment allowances (*)	(6 083 286)	-	-	(6 083 286)	(5 328 798)
Carrying amount	**120 349 597**	**1 696 888**	**302 630**	**122 349 115**	**128 873 178**

(*) The impairment allowance for loans and advances to customers measured at fair value other comprehensive income in the amount of PLN 16 723 thousand is included in the 'Revaluation reserve' item and does not reduce the carrying amount of the loan.

Corporate and municipal debt securities were transferred to the 'Investment (placement) securities' item. Before applying the requirements of IFRS 9, these items were presented as loans and advances to customers, as they were classified in the Loans and receivables category in accordance with IAS 39.

Due to the classification of some loans and advances to customers (ie loans in the part intended for syndication) to the business model, whose objective is achieved by both collecting contractual cash flows and selling financial assets, these loans are measured at fair value through other comprehensive income.

The Bank identified a portfolio of loans that do not meet the SPPI criterion due to the leverage element in contracts increasing the volatility of cash flows, which includes student loans, loans with subsidies of the Agency for Restructuring and Modernization of Agriculture and several corporate exposures. Therefore, despite the business model, whose objective is to hold financial assets in order to collect contractual cash flows, for these loan portfolios there is a need to measure at fair value through the profit and loss account.

According to IFRS 9 at the moment of recognizing the impairment, the interest recognized in the income statement is calculated based on the amount reduced by an allowance for expected credit losses (net carrying amount), whereas in the balance sheet accrued interest is calculated on the gross amount of the exposure. The difference is included in the impairment allowance. The increase in the amount of impairment allowance, besides the increase resulting from the expected credit losses approach reflected in the Bank's retained earnings, includes also changes reflecting the new approach to interest recognition.

Notes to the financial statements (cont.)

(In PLN thousand)

Loans and advances to customers by customer type

	31.12.2018				31.12.2017
	AMORTISED COST	FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME	FAIR VALUE THROUGH PROFIT OR LOSS	TOTAL	TOTAL
Corporate	52 738 662	1 696 888	56 407	54 491 957	60 676 737
Individuals	70 329 019	-	152 385	70 481 404	63 442 059
Budget entities	3 365 202	-	93 838	3 459 040	10 083 180
Gross carrying amount	**126 432 883**	**1 696 888**	**302 630**	**128 432 401**	**134 201 976**
Impairment allowances (*)	(6 083 286)	-	-	(6 083 286)	(5 328 798)
Carrying amount	**120 349 597**	**1 696 888**	**302 630**	**122 349 115**	**128 873 178**

(*) The impairment allowance for loans and advances to customers measured at fair value other comprehensive income in the amount of PLN 16 723 thousand is included in the 'Revaluation reserve' item and does not reduce the carrying amount of the loan.

Loans and advances to customers by contractual maturity

	31.12.2018				31.12.2017
	AMORTISED COST	FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME	FAIR VALUE THROUGH PROFIT OR LOSS	TOTAL	TOTAL
Loans and advances to customers, including:					
up to 1 month	15 495 044	-	2 332	15 497 376	14 278 559
between 1 and 3 months	3 535 849	-	15 097	3 550 946	4 550 183
between 3 months and 1 year	14 602 154	122 967	52 597	14 777 718	11 110 492
between 1 and 5 years	36 129 694	536 191	168 618	36 834 503	43 865 360
over 5 years	51 956 261	1 037 730	61 071	53 055 062	55 107 893
past due	4 713 881	-	2 915	4 716 796	5 289 489
Gross carrying amount	**126 432 883**	**1 696 888**	**302 630**	**128 432 401**	**134 201 976**
Impairment allowances (*)	(6 083 286)	-	-	(6 083 286)	(5 328 798)
Carrying amount	**120 349 597**	**1 696 888**	**302 630**	**122 349 115**	**128 873 178**

(*) The impairment allowance for loans and advances to customers measured at fair value other comprehensive income in the amount of PLN 16 723 thousand is included in the 'Revaluation reserve' item and does not reduce the carrying amount of the loan.

Loans and advances to customers by currency

	31.12.2018				31.12.2017
	AMORTISED COST	FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME	FAIR VALUE THROUGH PROFIT OR LOSS	TOTAL	TOTAL
PLN	101 521 368	48 039	302 630	101 872 037	109 437 147
CHF	2 895 803	-	-	2 895 803	3 107 444
EUR	13 803 852	1 648 849	-	15 452 701	13 611 471
USD	1 754 991	-	-	1 754 991	2 485 846
Other currencies	373 583	-	-	373 583	231 270
Total	**120 349 597**	**1 696 888**	**302 630**	**122 349 115**	**128 873 178**

(In PLN thousand)

28. Hedge accounting

The Bank decided to take advantage of the choice given by IFRS 9 and continues to apply hedge accounting procedures according to IAS 39. This decision concerns all hedging relationships, for which the Bank applies and will apply hedge accounting in the future.

As of 31 December 2018 the Bank applies fair value hedge accounting and cash flow hedge accounting.

- **FVH** - fair value hedge accounting:

- Interest rate swaps (IRS) designated to hedge debt securities denominated in PLN, EUR and USD (hereafter: **FVH IRS bonds**),

- **CFH** - cash flow hedge accounting:
- Interest rate swaps (IRS) designated to hedge floating rate loans and securities denominated in PLN (hereafter: **CFH IRS loans/bonds**),
- Interest rate swaps (IRS) designated to hedge deposits denominated in PLN and EUR, which economically reflect long-term variable-rate liability (hereafter: **CFH IRS deposits**),
- cross-currency interest rate swaps (basis swap) designated to hedge floating rate loans denominated in CHF and liabilities denominated in PLN, which economically reflect long-term variable-rate liability (hereafter: **CFH CIRS deposits/loans**),
- FX-Swaps designated to hedge floating rate loans denominated in EUR and term and negotiable deposits denominated in USD (hereafter: **CFH FXSwap loans**).

Fair value hedge accounting

The Bank applies fair value hedge accounting for fixed coupon debt securities denominated in PLN, EUR and USD, hedged with interest rate swap (IRS) transactions in the same currencies. The Bank hedges component of interest rate risk related to the fair value changes of the hedged item resulting exclusively from the volatility of market interest rates (WIBOR, EURIBOR, LIBOR USD). The IRS transactions receive floating-rate flows, and pay fixed-rate flows. In the past, hedged risk component accounted for a significant portion of changes in fair value of the hedged item.

The approach of the Bank to market risk managemant, including interest rate risk, is presented in Note 5.2. Details regarding exposure of the Bank to interest rate risk is disclosed in Note 5.2.

The use of derivative instruments to hedge the exposure to changes in interest rates generates counterparty credit risk of derivative transactions. The Bank mitigates this risk by requiring the counterparties to post collateral deposits and by settling derivative transactions through Central Counterparty Clearing Houses (CCPs) whch apply a number of mechanisms allowing systemic reduction of the risk of default on obligations under concluded transactions.

The Bank applies fair value hedge accounting to a hedging relationship if it is justified to expect that the hedge will be highly effective in achieving offsetting fair value changes attributable to the hedged risk in the future and if assessment of hedge effectiveness indicates high effectiveness in all financial reporting periods for which the hedge was designated.

According to the approach of the Bank, hedge ratio is determined as ratio of fair value of the hedged item to fair value of the hedging instrument. A hedging relationship is considered effective if all of the following criteria are met:

- high effectiveness of the hedge can be expected on the basis of comparison of critical terms of the hedged item and the hedging instrument,
- in each reporting period, hedge ratio is within 80% - 125% range or relation of inefficiency amount to nominal value of the hedged item is less or equal than the threshold specified in documentation of the hedging relationship, where inefficiency amount is calculated as the sum of cumulative fair value changes of the hedged item and the hedging instrument,
- in each reporting period, simulation of hedge ratio in assumed evoluation of market reference rates scenarios is within 80% - 125% range.

Notes to the financial statements (cont.)

(In PLN thousand)

As regards fair value hedge relationships, the main sources of ineffectiveness are:

- impact of the counterparty credit risk and own credit risk of the Bank on the fair value of the hedging transactions (IRS), which is not reflected in the fair value of the hedged item,
- differences in maturities of the interest rate swaps and debt securities,
- differences in coupon amounts generated by the hedged item and hedging instruments.

The tables below present interest rate swaps which are used by the Bank as instruments hedging interest rate risk in fair value hedge accounting as of 31 December 2018 and 31 December 2017.

Nominal values and interest rates of hedging derivatives - fair value hedge

31.12.2018			CONTRACTUAL MATURITY					
HEDGING RELATIONSHIP	CURRENCY		UP TO 1 MONTH	BETWEEN1 AND 3 MONTHS	BETWEEN 3 MONTHS TO 1 YEAR	BETWEEN 1 TO 5 YEARS	OVER 5 YEARS	TOTAL
FVH IRS bonds	PLN	Nominal value	-	-	-	280 000	200 000	480 000
		Average fixed interest rate (%)	-	-	-	1.8	1.8	1.8
	EUR	Nominal value	262 300	-	-	883 650	836 350	1 982 300
		Average fixed interest rate (%)	0.2	-	-	0.9	0.1	0.5
	USD	Nominal value	-	-	127 830	244 381	499 138	871 349
		Average fixed interest rate (%)	-	-	6.9	4.9	3.7	4.5
Total nominal value			**262 300**	**-**	**127 830**	**1 408 031**	**1 535 488**	**3 333 649**

31.12.2017			CONTRACTUAL MATURITY					
HEDGING RELATIONSHIP	CURRENCY		UP TO 1 MONTH	BETWEEN1 AND 3 MONTHS	BETWEEN 3 MONTHS TO 1 YEAR	BETWEEN 1 TO 5 YEARS	OVER 5 YEARS	TOTAL
FVH IRS bonds	PLN	Nominal value	-	115 000	-	510 500	200 000	825 500
		Average fixed interest rate (%)	-	1.8	-	1.8	1.8	1.8
	EUR	Nominal value	-	-	-	1 028 127	894 658	1 922 785
		Average fixed interest rate (%)	-	-	-	0.6	0.2	0.4
	USD	Nominal value	-	-	-	205 397	601 429	806 826
		Average fixed interest rate (%)	-	-	-	5.6	2.7	3.4
Total nominal value			**-**	**115 000**	**-**	**1 744 024**	**1 696 087**	**3 555 111**

Notes to the financial statements (cont.)

(In PLN thousand)

Impact of fair value hedge (interest rate risk hedging) on balance sheet and financial result

31.12.2018	FVH IRS BONDS – IRS HEDGING DEBT SECURITIES MEASURED AT:		TOTAL
	AMORTISED COST	FAIR VALUE THROUGHT OTHER COMPREHENSIVE INCOME	
Hedging instruments			
Nominal value	200 000	3 133 649	3 333 649
Carrying amount – assets	-	21 166	21 166
Carrying amount – liabilities	9 592	134 080	143 672
Balance sheet item in which hedging instrument is reported	Hedging instruments	Hedging instruments	Hedging instruments
Amount of changes in fair value of the hedging instrument in the reporting period used for estimating hedge inefficiency	(7 560)	48 638	41 078
Amount of hedge ineffectiveness recognized in the income statement 'Result on fair value hedge accounting'	(78)	2 933	2 855
Hedged item			
Carrying amount – assets	208 402	3 335 538	3 543 940
Accumulated amount of the adjustment to the fair value of the hedged item included in the carrying amount of the hedged item recognized in the balance sheet - assets	8 700	124 954	133 654
Balance sheet item in which hedged item is reported	Hedging instruments	Hedging instruments	Hedging instruments
Change in the value of hedged item used for estimating hedge inefficiency in the reporting period	7 476	(45 707)	(38 231)
Accumulated amount of the adjustment to the fair value of the hedged item remaining in the balance sheet for those hedged items for which adjustments of the balance sheet item for adjustment to fair value has been discontinued	-	-	-

(In PLN thousand)

31.12.2017	FVH IRS BONDS – IRS HEDGING DEBT SECURITIES MEASURED AT: AMORTISED COST	FAIR VALUE THROUGHT OTHER COMPREHENSIVE INCOME	TOTAL
Hedging instruments			
Nominal value	255 500	3 299 611	3 555 111
Carrying amount – assets	365	16 131	16 496
Carrying amount – liabilities	2 357	183 745	186 102
Balance sheet item in which hedging instrument is reported	Hedging instruments	Hedging instruments	Hedging instruments
Amount of changes in fair value of the hedging instrument in the reporting period used for estimating hedge inefficiency	40	67 220	67 260
Amount of hedge ineffectiveness recognized in the income statement 'Result on fair value hedge accounting'	51	4 494	4 545
Hedged item			
Carrying amount – assets	257 067	3 607 290	3 864 357
Accumulated amount of the adjustment to the fair value of the hedged item included in the carrying amount of the hedged item recognized in the balance sheet - assets	1 224	220 649	221 873
Balance sheet item in which hedged item is reported	Loans and advances to customers	Investment securities Available for sale	
Change in the value of hedged item used for estimating hedge inefficiency in the reporting period	(40)	(62 575)	(62 615)
Accumulated amount of the adjustment to the fair value of the hedged item remaining in the balance sheet for those hedged items for which adjustments of the balance sheet item for adjustment to fair value has been discontinued	-	-	-

Cash flow hedge accounting

The Bank applies:

- cross-currency interest rate swaps (basis swap) to hedge exposure to interest rate risk related to volatility of market reference rates (WIBOR, LIBOR CHF) and exposure to currency risk. Portfolios of variable-rate loans denominated in CHF and deposits in PLN (which economically reflects to long-term variable-rate liability) are hedged items in this hedging relationship. CIRS transactions are decomposed into the part hedging the portfolio of assets and the part hedging the portfolio of liabilities,
- interest rate swaps (IRS) to hedge the exposure to interest rate risk related to the volatility of market reference rates (WIBOR), generated by portfolios of variable-rate loans denominated in PLN,
- currency swap (FX-Swap) to hedge the exposure to interest rate risk related to the volatility of market reference rates (EURIBOR, LIBOR USD), and the exposure to the currency risk, generated by both, portfolios of variable-rate of loans denominated in EUR and portfolios of term and negotiable deposits denominated in USD,
- interest rate swaps (IRS) to hedge the exposure to interest rate risk related to the volatility of market reference rates (WIBOR, EURIBOR), generated by portfolio of deposits denominated in PLN and EUR, which economically reflect a long-term, variable-rate liability.

Approach of the Bank to hedging interest rate risk through cash flow hedge accounting is the same as the approach applied in the fair value hedge accounting as described above, i.e. only the component of interest rate risk related exclusively to volatility of market reference rates (in the case of cash flows hedge: WIBOR, EURIBOR, LIBOR USD, LIBOR CHF) is hedged.

Notes to the financial statements (cont.)

(In PLN thousand)

Approach of the Bank to market risk management, including interest rate risk and currency risk, is presented in Note 5.2. Details regarding the Bank's interest rate risk and currency risk exposure are disclosed in Note 5.2.

As in the case of the fair value hedge, using derivative instruments to hedge the exposure to interest rate risk and currency risk generates counterparty credit risk of the derivative transactions, which is not compensated by the hedged item. The Bank manages this risk in a way similar to fair value hedge.

The Bank applies cash flow hedge accounting to a hedging relationship if it is justified to expect that the hedge will be highly effective in achieving offsetting cash flow changes attributable to the hedged risk in the future and if assessment of hedge effectiveness indicates high effectiveness in all financial reporting periods for which the hedge was designated. The assessment is conducted using hypothetical derivative method.

According to the approach of the Bank, a hedging relationship is considered effective if all of the following criteria are met:

- correlation coefficient between market reference rate of hedged items and market reference rate of hedging instrument is high,
- forecasted interest flows generated by hedged items are not lower than forecasted interest flows generated by hedging instruments,
- in each reporting period, ratio of the fair value of the hedged item to the fair value of the hedging instrument is within 80% - 125% range or relation of inefficiency amount to nominal value of the hedged item is less or equal to the threshold specified in documentation of the hedging relationship, where inefficiency amount is calculated as the sum of cumulative fair value changes of the hedged item and the hedging instrument,
- In each reporting period, ratio of fair value changes of the hedged item to the hedging instrument due to parallel fall or rise in yield curves by 100 basis point is within 80% - 125% range.

In the case of hedging interest rate and currency risk of portfolios of loans and deposits, the manner of managing these portfolios was adopted allowing for regular inclusion of new transactions in the hedging relationship and exclusion of transactions from the hedging relationship as a result of repayment or classification to non-performing category. As a result, the exposure of these portfolios to interest rate and currency risk is constantly changing. Because of frequent changes to term structure of the portfolio, the Bank dynamically assigns the hedged items and allows for matching of hedging instruments to these changes.

As regards cash flow hedge relationships, the main sources of ineffectiveness are:

- impact of counterparty and the Bank's own credit risk on the fair value of the hedging instruments, i.e. interest rate swap (IRS), cross-currency interest rate swap (basis swap), currency swap (FX swap) which is not reflected in the fair value of the hedged item;
- differences in repricing frequency of the hedging instruments and and hedged loans and deposits.

Notes to the financial statements (cont.)

(In PLN thousand)

Nominal values of hedging derivatives – cash flow hedge

31.12.2018 HEDGING RELATIONSHIP	CURRENCY		CONTRACTUAL MATURITY UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS TO 1 YEAR	BETWEEN 1 TO 5 YEARS	OVER 5 YEARS	TOTAL
CFH IRS loans	PLN	Nominal value	1 400 000	-	200 000	2 800 000	4 200 000	8 600 000
		Average fixed interest rate (%)	3.7	-	3.5	3.4	2.6	3.0
CFH IRS deposits	PLN	Nominal value	-	-	-	242 000	207 000	449 000
		Average fixed interest rate (%)	-	-	-	1.8	1.8	1.8
	EUR	Nominal value	-	-	-	658 760	-	658 760
		Average fixed interest rate (%)	-	-	-	(0.3)	-	(0.3)
CFH CIRS deposits/ loans	CHF/PLN	Nominal value	-	-	6 745 876	1 747 759	3 196 115	11 689 750
		Average fixed interest rate (%)	-	-	-	-	-	-
		Average fixed interest rate CHF/PLN	-	-	-	-	-	-
CFH FX Swap deposits/loans	EUR/PLN	Nominal value	2 420 194	864 917	1 395 524	-	-	4 680 635
		Average fixed interest rate EUR/USD	4.3	4.3	4.4	-	-	4.4
	EUR/USD	Nominal value	826 421	786 249	-	-	-	1 612 670
		Average fixed interest rate EUR/PLN	1.1	1.2	-	-	-	1.2
Total nominal value			**4 646 615**	**1 651 166**	**8 341 400**	**5 448 519**	**7 603 115**	**27 690 815**

31.12.2017 HEDGING RELATIONSHIP	CURRENCY		CONTRACTUAL MATURITY UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS TO 1 YEAR	BETWEEN 1 TO 5 YEARS	OVER 5 YEARS	TOTAL
CFH IRS loans	PLN	Nominal value	-	-	-	3 600 000	-	3 600 000
		Average fixed interest rate (%)	-	-	-	3.7	-	3.7
CFH IRS deposits	PLN	Nominal value	-	-	15 000	-	197 000	212 000
		Average fixed interest rate (%)	-	-	1.8	-	1.8	1.8
	EUR	Nominal value	-	-	-	363 702	-	363 702
		Average fixed interest rate (%)	-	-	-	(0.3)	-	(0.3)
CFH CIRS deposits/ loans	CHF/PLN	Nominal value	-	-	1 635 139	7 842 510	3 431 241	12 908 890
		Average fixed interest rate (%)	-	-	-	-	-	-
		Average fixed interest rate CHF/PLN	-	-	-	-	-	-
CFH FX Swap deposits/loans	EUR/PLN	Nominal value	602 846	381 072	1 025 307	-	-	2 009 225
		Average fixed interest rate EUR/PLN	4.4	4.3	4.4	-	-	4.4
Total nominal value			**602 846**	**381 072**	**2 675 446**	**11 806 212**	**3 628 241**	**19 093 817**

Notes to the financial statements (cont.)

(In PLN thousand)

Impact of cash of hedge on balance sheet and financial result

31.12.2018	INTEREST RATE RISK		INTEREST RATE RISK / CURRENCY RISK	
HEDGE IN RELATIONSHIP	CFH IRS LOANS	CFH IRS DEPOSITS	CFH CIRS DEPOSITS/LOANS	CFH FX SWAP DEPOSITS/LOANS
Hedging instruments				
Nominal value	8 600 000	1 107 760	11 689 750	6 293 305
Carrying amount – assets	261 759	-	-	30 640
Carrying amount – liabilities	-	15 613	745 171	600
Balance sheet item in which hedging instrument is reported	Hedging instruments	Hedging instruments	Hedging instruments	Hedging instruments
Change in the fair value of the hedging instrument used for estimating hedge ineffectiveness	(101 639)	(10 856)	9 369	(175)
Gains or losses resulting from hedging, recognized in other comprehensive income	-	-	-	-
Amount of hedge ineffectiveness recognized in the income statement in item 'Result on financial assets and liabilities measured at fair value through profit or loss'	205	-	(23)	7
Amount transferred from the revaluation reserves due to cash flow hedge accounting to the income statement as a reclassification adjustment	-	-	-	-
Income statement item in which reclassification adjustment is reported	Result on financial assets and liabilities measured at fair value through profit or loss	Result on financial assets and liabilities measured at fair value through profit or loss	Result on financial assets and liabilities measured at fair value through profit or loss	Result on financial assets and liabilities measured at fair value through profit or loss
Hedged item				
Amount of change in the fair value of a hypothetical derivative representing the hedged item used for estimating the hedge ineffectiveness in the reporting period	101 639	10 856	(13 313)	185
Revaluation reserve due to cash flow hedge accounting for relationships for which hedge accounting will be continued after the end of the reporting period	150 374	(11 975)	(86 447)	(412)
Revaluation reserve due to cash flow hedge accounting for relationships for which hedge accounting is no longer applied	-	-	-	-

Notes to the financial statements (cont.)

(In PLN thousand)

31.12.2017	INTEREST RATE RISK		INTEREST RATE RISK / CURRENCY RISK	
HEDGE IN RELATIONSHIP	CFH IRS LOANS	CFH IRS DEPOSITS	CFH CIRS DEPOSITS/LOANS	CFH FX SWAP DEPOSITS/LOANS
Hedging instruments				
Nominal value	3 600 000	575 702	12 908 890	2 009 225
Carrying amount – assets	199 832	839	-	42 229
Carrying amount – liabilities	-	1 700	674 529	-
Balance sheet item in which hedging instrument is reported	Hedging instruments	Hedging instruments	Hedging instruments	Hedging instruments
Change in the fair value of the hedging instrument used for estimating hedge ineffectiveness	(59 492)	1 007	23 185	2 207
Gains or losses resulting from hedging, recognized in other comprehensive income	-	-	-	-
Amount of hedge ineffectiveness recognized in the income statement in item „Result on financial assets and liabilities measured at fair value through profit or loss”	(190)	-	(36)	(2)
Amount transferred from the revaluation reserves due to cash flow hedge accounting to the income statement as a reclassification adjustment	-	-	-	-
Income statement item in which reclassification adjustment is reported	Result on financial assets and liabilities measured at fair value through profit or loss	Result on financial assets and liabilities measured at fair value through profit or loss	Result on financial assets and liabilities measured at fair value through profit or loss	Result on financial assets and liabilities measured at fair value through profit or loss
Hedged item				
Amount of change in the fair value of a hypothetical derivative representing the hedged item used for estimating the hedge ineffectiveness in the reporting period	59 492	(1 007)	(43 838)	(2 191)
Revaluation reserve due to cash flow hedge accounting for relationships for which hedge accounting will be continued after the end of the reporting period	101 635	1 008	(95 804)	(258)
Revaluation reserve due to cash flow hedge accounting for relationships for which hedge accounting is no longer applied	-	-	-	-

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in the revaluation reserves from the valuation of hedging derivatives in cash flow hedge accounting

	2018	2017
Opening balance	**6 581**	**39 724**
INTEREST RATE RISK		
Gains or losses resulting from hedging, recognized in other comprehensive income during the reporting period	35 756	(58 480)
Part of the loss transferred to the income statement due to the lack of expectation of materialization of the hedged item	-	(56)
Amount transferred from the revaluation reserves due to cash flow hedge accounting to the income statement as a reclassification adjustment, including:	-	-
Net interest income	-	-
Foreign exchange result	-	-
Amount transferred from the revaluation reserves due to cash flow hedge accounting and recognized as an adjustment to the carrying value of a non-financial asset or liability that is the subject of the hedged transaction	-	-
INTEREST RATE RISK / CURRENCY RISK		
Gains or losses resulting from hedging, recognized in other comprehensive income during the reporting period	9 203	25 393
Part of the loss transferred to the income statement due to the lack of expectation of materialization of the hedged item	-	-
Amount transferred from the revaluation reserves due to cash flow hedge accounting to the income statement as a reclassification adjustment, including:	-	-
Net interest income	-	-
Foreign exchange result	-	-
Amount transferred from the revaluation reserves due to cash flow hedge accounting and recognized as an adjustment to the carrying value of a non-financial asset or liability that is the subject of the hedged transaction	-	-
Closing balance	**51 540**	**6 581**

(In PLN thousand)

29. Investment (placement) securities

	31.12.2018	31.12.2017
Debt securities measured at amortised cost	11 130 367	X
Debt securities measured at fair value through other comprehensive income	26 904 574	X
Equity instruments designated at fair value through other comprehensive income	232 830	X
Equity instruments mandatorily measured at fair value through profit or loss	65 408	X
Debt securities available for sale (AFS)	X	33 136 044
Equity securities available for sale (AFS)	X	123 128
Debt securities held to maturity (HTM)	X	3 366 824
Total	**38 333 179**	**36 625 996**

The Bank transferred Corporate and municipal debt securities from 'Loans and advances to customers' to the 'Investment (placement) securities' item. Before applying the requirements of IFRS 9, these items were presented as loans and advances to customers, as they were classified in the Loans and receivables category in accordance with IAS 39.

Debt securities measured at amortised cost

	31.12.2018	31.12.2017
Debt securities issued by central governments	5 111 495	X
T-bills	-	X
T-bonds	5 111 495	X
Debt securities issued by Central Banks	13 798	X
Debt securities issued by business entities	3 426 605	X
Debt securities issued by local governments	2 578 469	X
Total	**11 130 367**	**X**
including impairment of assets	(59 289)	X

Debt securities measured at fair value through other comprehensive income

	31.12.2018	31.12.2017
Debt securities issued by central governments	15 447 380	X
T-bills	-	X
T-bonds	15 197 169	X
Other	250 211	X
Debt securities issued by Central Banks	2 985 696	X
Debt securities issued by banks	3 418 866	X
Debt securities issued by business entities	1 985 860	X
Debt securities issued by local governments	3 066 772	X
Total	**26 904 574**	**X**
Impairment of assets (*)	(28 207)	X

(*) The impairment allowance for debt securities measured at fair value through other comprehensive income is included in the 'Revaluation reserve' item and does not reduce the carrying amount.

Notes to the financial statements (cont.)

(In PLN thousand)

Debt securities available for sale (AFS)

	31.12.2018	31.12.2017
Debt securities issued by central governments	X	21 417 279
T-bills	X	-
T-bonds	X	21 417 279
Debt securities issued by Central Banks	X	11 066 168
Debt securities issued by business entities	X	-
Debt securities issued by local governments	X	652 597
Total	**X**	**33 136 044**
including impairment of assets	X	-

Debt securities held to maturity (HTM)

	31.12.2018	31.12.2017
Debt securities issued by central governments	X	3 335 371
T- bills	X	-
T- bonds	X	3 335 371
Debt securities issued by Central Banks	X	31 453
Total	**X**	**3 366 824**
including impairment of assets	X	-

The portfolio of equity instruments designated for measurement at fair value through other comprehensive income includes the investments that the Bank considers as strategic.

	FAIR VALUE AS AT 31.12.2018	DIVIDENDS RECOGNIZED IN 2018
Entity X from construction sector	38 299	-
Entity Y from construction sector	5 151	-
Entity providing credit information	172 561	18 833
Infrastructure entity of Polish banking sector	13 136	784
Intermediary in transactions among financial entities	3 683	-
Stock exchange	**232 830**	**19 617**

In 2018, as a result of the decisions taken, the Bank sold the following investments in equity instruments designated for measurement at fair value through other comprehensive income. The realized result on the sale of these investments was transferred to the item 'Other reserve capital'.

	FAIR VALUE AT THE DERECOGNITON DATE	NET RESULT FROM SALE
Entity X from construction sectorj	823	8
Entity Y from construction sector	766	621
Intermediary in transactions among financial entities	151	63
Total	**1 740**	**692**

Notes to the financial statements (cont.)

(In PLN thousand)

Equity instruments mandatorily measured at fair value through profit or loss

	31.12.2018	31.12.2017
Shares	65 408	X
Total	**65 408**	**X**

Equity securities for sale (AFS)

	31.12.2018	31.12.2017
Shares	X	123 128
Total	**X**	**123 128**
including impairment of assets	X	(1 020)

Investment debt securities according to contractual maturity

	31.12.2018	31.12.2017
Debt securities, including:		
up to 1 month	3 724 720	11 097 621
between 1 and 3 months	134 911	121 753
between 3 months and 1 year	2 919 847	6 037 318
between 1 and 5 years	19 591 668	11 599 628
over 5 years	11 663 795	7 646 548
Total	**38 034 941**	**36 502 868**

Investment debt securities by currency

	31.12.2018	31.12.2017
PLN	31 926 297	32 742 429
EUR	2 967 951	2 091 122
USD	3 140 693	1 669 317
Total	**38 034 941**	**36 502 868**

(In PLN thousand)

30. Assets and liabilities held for sale

According to IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' the Bank identified non-current assets meeting requirements of IFRS 5 (concerning classification of non-current assets as held for sale) in the item 'Assets held for sale'.

As at 31 December 2018 non-current assets classified as held for sale are as follows:

- real estate,
- other property, plant and equipment.

Assets held for sale are presented below:

	31.12.2018	31.12.2017
ASSETS HELD FOR SALE		
Property, plant and equipment	11 550	28 082
Other assets	-	23 368
Total assets	**11 550**	**51 450**

The table below presents changes in the balance of non-current assets held for sale

ASSETS HELD FOR SALE	2018	2017
Opening balance	**51 450**	**48 277**
Increases, including:	14	4 362
transfer from property, plant and equipment	-	2 580
transfer from investment properties	-	15
other	14	1 767
Decreases, including:	(39 914)	(1 189)
transfer to property, plant and equipment	(28 425)	-
disposal	(10 637)	(302)
other	(852)	(887)
Closing balance	**11 550**	**51 450**

The effect of disposal of other assets is as follows:

	2018	2017
Sales revenues	47 245	1 798
Net carrying amount of disposed assets (including sale costs)	(12 530)	(307)
Profit/loss on sale before income tax	**34 715**	**1 491**

Notes to the financial statements (cont.)

(In PLN thousand)

31. Investments in subsidiaries

Condensed information about subsidiaries as at 31 December 2018 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT /LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
Centralny Dom Maklerski Pekao S.A.	Warsaw	Brokerage services	884 512	738 735	97 642	24 805	100.00	56 332
Pekao Investment Banking S.A.	Warsaw	Brokerage services	331 246	68 325	45 497	9 637	100.00	274 334
Pekao Faktoring Sp. z o.o.	Lublin	Factoring	2 270 156	2 205 183	52 766	13 676	100.00.	50 268
Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation)	Warsaw	Business consulting	52 512	44	584	377	100.00	51 380
Pekao Powszechne Towarzystwo Emerytalne S.A. (in liquidation)	Warsaw	Pension funds management	63 554	1 164	7 663	3 004	100.00	61 834
Pekao Financial Services Sp. z o.o.	Warsaw	Transferable agent	42 780	8 479	53 796	3 926	66.50	4 500
Pekao Leasing Sp. z o.o.	Warsaw	Lease services	5 910 200	5 412 467	194 174	47 625	100.00	278 798
Centrum Kart S.A.	Warsaw	Additional financial services	44 993	13 182	160	332	100.00	17 592
Pekao Bank Hipoteczny S.A.	Warsaw	Banking services	2 414 484	2 096 196	66 724	2 554	100.00	233 823
Pekao Property S.A.	Warsaw	Real estate development services	26 271	40	272	(114)	100.00	26 460
Centrum Bankowości Bezpośredniej Sp. z o.o.	Cracow	Call-center services	21 427	9 192	24 510	3 243	100.00	522
Pekao Investment Management S.A. (**)	Warsaw	Holding	310 235	28 676	343 082	90 201	100.00	605 794
Dom Inwestycyjny Xelion Sp. z o.o.	Warsaw	Financial intermediation	96 341	60 425	54 103	5 034	100.00	21 119
Total								**1 682 756**

(*) Data available at the date of financial statements.
(**) Consolidated data together a company of Pekao TFI SA

Notes to the financial statements (cont.)

(In PLN thousand)

Condensed information about subsidiaries as at 31 December 2017 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT /LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
Centralny Dom Maklerski Pekao S.A.	Warsaw	Brokerage services	885 067	730 125	120 135	33 128	100.00	56 332
Pekao Investment Banking S.A.	Warsaw	Brokerage services	403 785	146 034	46 580	4 697	100.00	274 334
Pekao Faktoring Sp. z o.o.	Lublin	Factoring	1 335 539	1 273 190	44 057	11 000	100.00	50 268
Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation)	Warsaw	Business consulting	52 152	61	596	373	100.00	51 380
Pekao Powszechne Towarzystwo Emerytalne S.A.	Warsaw	Pension funds management	46 699	7 175	18 002	(3 116)	100.00	72 589
Pekao Financial Services Sp. z o.o.	Warsaw	Transferable agent	33 427	5 387	37 505	5 967	100.00	4 500
Pekao Leasing Sp. z o.o.	Warsaw	Lease services	4 730 736	4 242 964	165 691	34 824	100.00	278 798
Centrum Kart S.A.	Warsaw	Additional financial services	44 805	12 616	197	755	100.00	17 592
Pekao Bank Hipoteczny S.A.	Warsaw	Banking services	1 966 897	1 636 798	66 117	5 774	100.00	233 823
Pekao Property S.A.	Warsaw	Real estate development services	47 588	21 243	13	(24 476)	100.00	26 774
Centrum Bankowości Bezpośredniej Sp. z o.o.	Cracow	Call-center services	19 506	8 750	22 056	3 805	100.00	522
Pekao Investment Management S.A. (**)	Warsaw	Holding	366 753	33 634	29 370	5 811	100.00	605 794
Dom Inwestycyjny Xelion Sp. z o.o.	Warsaw	Financial intermediation	66 603	35 720	5 159	316	100.00	21 119
Total								**1 693 825**

(*) Data available at the date of financial statements.
(**) Consolidated data together a company of Pekao TFI SA

Changes in investment into subsidiaries

	2018	2017
Opening balance	**1 063 825**	**1 063 050**
Increases, including:	-	635 375
acquisition	-	596 995
transfer from Investments in associates	-	27 551
settlement hedge accounting	-	10 829
Decreases, including	(11 069)	(4 600)
changes of impairment allowances	(11 069)	(4 600)
liquidation	-	-
Closing balance	**1 682 756**	**1 693 825**

(In PLN thousand)

The structure of investments in subsidiaries

	31.12.2018	31.12.2017
Investment in subsidiaries, including:		
banks	233 823	233 823
other financial institutions	1 371 093	1 381 326
non-financial institutions	77 840	78 676
Total	**1 682 756**	**1 693 825**

32. Investments in associates

Information about associates as at 31 December 2018 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT/LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
CPF Management	Tortola, British Virgin Islands	Advisory services– currently does not provide its services	n/a	n/a	n/a	n/a	40.00	-
Total								**-**

(*) Data available at the date of financial statements.

Information about associates as at 31 December 2017 (*)

NAME OF ENTITY	LOCATION	ACTIVITIES	ASSETS	LIABILITIES	REVENUES	NET PROFIT/LOSS	% OF SHARES	CARRYING AMOUNT OF SHARES
CPF Management	Tortola, British Virgin Islands	Advisory services– currently does not provide its services	n/a	n/a	n/a	n/a	40.00	-
Total								**-**

(*) Data available at the date of financial statements.

Changes in investment in associates

	2018	2017
Opening balance	**-**	**27 552**
Decreases, including	-	(27 552)
Investments in subsidiaries	-	(27 552)
Closing balance	**-**	**-**

As at 31 December 2018 and 31 December 2017, the Bank did not have the investment in entities under common control.

(In PLN thousand)

33. Intangible assets

	31.12.2018	31.12.2017
Intangible assets, including:	580 530	576 686
research and development expenditures	3	1 073
licenses and patents	428 767	471 554
other	5 434	5 344
assets under construction	146 326	98 715
Goodwill	52 635	52 635
Total	**633 165**	**629 321**

The item 'Goodwill' contains:

- goodwill that was transferred to Bank Pekao S.A. on integration with Bank BPH S.A. It represents the goodwill recognized upon acquisition of Pierwszy Komercyjny Bank S.A. in Lublin ('PKBL') by Bank BPH S.A. and relates to those branches of the PKBL which were transferred to Bank Pekao S.A. as a result of integration with Bank BPH S.A. It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 51 675 thousand,
- goodwill recognized upon acquisition of Spółdzielcza Kasa Oszczędnościowo – Kredytowa im. Mikołaja Kopernika by Bank Pekao S.A. It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 960 thousand.

In respect to the goodwill, the impairment tests are performed annually, irrespective of whether there is any indication that it may be impaired.

The impairment tests are performed by comparing the carrying amount of the CGU, including the goodwill, with the recoverable amount of the CGU. The recoverable amount is estimated on the basis of value in use of the CGU. The value in use is the present, estimated value of the future cash flows for the period of 5 years, taking into account the residual value of the CGU. The residual value of the CGU is calculated based on an extrapolation of cash flows projections beyond the forecast period using the growth rate of 2.5%. The forecasts of the future cash flows are based on the assumptions included the budget for 2019 and financial plan for 2020-2023. To discount the future cash flows, it is applied the discount rate of 8.88%, which includes the risk-free rate and the risk premium.

The impairment tests performed as at 31 December 2018 showed the surplus of the recoverable amount over the carrying amount of the CGU, and therefore no CGU impairments were recognized.

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Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Intangibles assets' in the course of the reporting period

2018	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	GOODWILL	TOTAL
GROSS VALUE						
Opening balance	**89 929**	**2 439 080**	**35 412**	**98 715**	**52 635**	**2 715 771**
Increases, including:	-	126 458	1 681	177 114	-	305 253
Acquisitions	-	-	-	168 582	-	168 582
Other	-	3	-	8 532	-	8 535
transfer from investments outlays	-	126 455	1 681	-	-	128 136
Decreases, including:	(17 474)	(21 663)	(2 537)	(129 503)	-	(171 177)
Liquidation	(17 474)	(21 663)	(1 199)	-	-	(40 336)
Sale	-	-	(1 338)	-	-	(1 338)
Other	-	-	-	(1 367)	-	(1 367)
transfer from investments outlays	-	-	-	(128 136)	-	(128 136)
Closing balance	**72 455**	**2 543 875**	**34 556**	**146 326**	**52 635**	**2 849 847**
ACCUMULATED AMORTIZATION						
Opening balance	**88 856**	**1 967 526**	**30 068**	**-**	**-**	**2 086 450**
Amortization	1 070	169 107	1 559	-	-	171 736
Liquidation	(17 474)	(21 529)	(1 167)	-	-	(40 170)
Sale	-	-	(1 338)	-	-	(1 338)
Other	-	4	-	-	-	4
Closing balance	**72 452**	**2 115 108**	**29 122**	**-**	**-**	**2 216 682**
IMPAIRMENT						
Opening balance	**-**	**-**	**-**	**-**	**-**	**-**
Closing balance	**-**	**-**	**-**	**-**	**-**	**-**
NET VALUE						
Opening balance	**1 073**	**471 554**	**5 344**	**98 715**	**52 635**	**629 321**
Closing balance	**3**	**428 767**	**5 434**	**146 326**	**52 635**	**633 165**

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Intangibles assets' in the course of the reporting period

2017	RESEARCH AND DEVELOPMENT COSTS	LICENSES AND PATENTS	OTHER	ASSETS UNDER CONSTRUCTION	GOODWILL	TOTAL
GROSS VALUE						
Opening balance	**90 173**	**2 332 019**	**35 176**	**69 620**	**52 635**	**2 579 623**
Increases, including:	-	191 812	1 594	221 377	-	414 783
Acquisitions	-	-	-	221 377	-	221 377
Other	-	-	1 124	-	-	1 124
transfer from investments outlays	-	191 812	470	-	-	192 282
Decreases, including:	(244)	(84 751)	(1 358)	(192 282)	-	(278 635)
Liquidation	(244)	(84 747)	(1 358)	-	-	(86 349)
Sale	-	(4)	-	-	-	(4)
Other	-	-	-	-	-	-
transfer from investments outlays	-	-	-	(192 282)	-	(192 282)
Closing balance	**89 929**	**2 439 080**	**35 412**	**98 715**	**52 635**	**2 715 771**
ACCUMULATED AMORTIZATION						
Opening balance	**87 149**	**1 893 910**	**27 488**	**-**	**-**	**2 008 547**
Amortization	1 951	158 364	3 938	-	-	164 253
Liquidation	(244)	(84 744)	(1 358)	-	-	(86 346)
Sale	-	(4)	-	-	-	(4)
Other	-	-	-	-	-	-
Closing balance	**88 856**	**1 967 526**	**30 068**	**-**	**-**	**2 086 450**
IMPAIRMENT						
Opening balance	**-**	**-**	**-**	**-**	**-**	**-**
Closing balance	**-**	**-**	**-**	**-**	**-**	**-**
NET VALUE						
Opening balance	**3 024**	**438 109**	**7 688**	**69 620**	**52 635**	**571 076**
Closing balance	**1 073**	**471 554**	**5 344**	**98 715**	**52 635**	**629 321**

In the period from 1 January to 31 December 2018 the Bank acquired intangible assets in the amount of PLN 168 582 thousand (in 2017 – PLN 221 377 thousand).

In the period from 1 January to 31 December 2018 and in 2017 there have been no intangible assets whose title is restricted and pledged as security for liabilities.

Contractual commitments

As at 31 December 2018 the contractual commitments for the acquisition of intangible assets amounted to PLN 42 494 thousand, whereas as at 31 December 2017 - PLN 32 054 thousand.

(In PLN thousand)

34. Property, plant and equipment

	31.12.2018	31.12.2017
Non-current assets, including:	1 242 536	1 303 502
land and buildings	924 412	977 090
machinery and equipment	213 216	245 312
transport vehicles	33 584	44 766
other	71 324	36 334
Non-current assets under construction and prepayments	141 667	97 789
Total	**1 384 203**	**1 401 291**

Changes in 'Property, plant and equipment' in the course of the reporting period

2018	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	**2 259 914**	**1 382 802**	**74 034**	**303 231**	**97 789**	**4 117 770**
Increases, including:	31 868	54 088	4 897	167 498	150 388	408 739
acquisitions	-	-	-	-	150 388	150 388
other	9 084	7	4 897	137 959	-	151 947
transfer from non-current assets under construction	22 784	54 081	-	29 539	-	106 404
Decreases, including:	(30 287)	(160 242)	(4 858)	(15 389)	(106 510)	(317 286)
liquidation and sale	(30 166)	(22 524)	(4 858)	(15 389)	-	(72 937)
transfer to non-current assets held for sale	-	-	-	-	-	-
other	(121)	(137 718)	-	-	(106)	(137 945)
transfer from non-current assets under construction	-	-	-	-	(106 404)	(106 404)
Closing balance	**2 261 495**	**1 276 648**	**74 073**	**455 340**	**141 667**	**4 209 223**
ACCUMULATED DEPRECIATION						
Opening balance	**1 278 440**	**1 134 781**	**29 268**	**266 816**	**-**	**2 709 305**
Increases, including:	73 527	66 517	15 490	132 355	-	287 889
depreciation	70 444	66 510	15 490	13 706	-	166 150
other	3 083	7	-	118 649	-	121 739
Decreases, including:	(19 212)	(140 464)	(4 269)	(15 241)	-	(179 186)
liquidation and sale	(19 089)	(21 815)	(4 269)	(15 241)	-	(60 414)
transfer to non-current assets held for sale	-	-	-	-	-	-
other	(123)	(118 649)	-	-	-	(118 772)
Closing balance	**1 332 755**	**1 060 834**	**40 489**	**383 930**	**-**	**2 818 008**
IMPAIRMENT						
Opening balance	**4 384**	**2 709**	**-**	**81**	**-**	**7 174**
Increases	-	-	-	5	-	5
Decreases	(56)	(111)	-	-	-	(167)
Closing balance	**4 328**	**2 598**	**-**	**86**	**-**	**7 012**
NET VALUE						
Opening balance	**977 090**	**245 312**	**44 766**	**36 334**	**97 789**	**1 401 291**
Closing balance	**924 412**	**213 216**	**33 584**	**71 324**	**141 667**	**1 384 203**

Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Property, plant and equipment' in the course of the reporting period

2017	LANDS AND BUILDINGS	MACHINERY AND EQUIPMENT	MEANS OF TRANSPORTATION	OTHER	NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS	TOTAL
GROSS VALUE						
Opening balance	**2 235 446**	**1 392 373**	**67 634**	**307 658**	**112 300**	**4 115 411**
Increases, including:	43 386	90 723	39 319	7 250	131 125	311 803
acquisitions	-	-	-	-	131 125	131 125
other	-	12	39 319	2	-	39 333
transfer from non-current assets under construction	43 386	90 711	-	7 248	-	141 345
Decreases, including:	(18 918)	(100 294)	(32 919)	(11 677)	(145 636)	(309 444)
liquidation and sale	(11 515)	(99 870)	(32 919)	(11 605)	-	(155 909)
transfer to non-current assets held for sale	(7 403)	(412)	-	(72)	-	(7 887)
other	-	(12)	-	-	(4 291)	(4 303)
transfer from non-current assets under construction	-	-	-	-	(141 345)	(141 345)
Closing balance	**2 259 914**	**1 382 802**	**74 034**	**303 231**	**97 789**	**4 117 770**
ACCUMULATED DEPRECIATION						
Opening balance	**1 226 359**	**1 156 699**	**48 383**	**271 113**	**-**	**2 702 554**
Increases, including:	68 034	76 140	12 941	6 921	-	164 036
depreciation	68 034	76 130	12 941	6 921	-	164 026
other	-	10	-	-	-	10
Decreases, including:	(15 953)	(98 058)	(32 056)	(11 218)	-	(157 285)
liquidation and sale	(11 130)	(97 661)	(32 056)	(11 146)	-	(151 993)
transfer to non-current assets held for sale	(4 823)	(386)	-	(72)	-	(5 281)
other	-	(11)	-	-	-	(11)
Closing balance	**1 278 440**	**1 134 781**	**29 268**	**266 816**	**-**	**2 709 305**
IMPAIRMENT						
Opening balance	**3 853**	**3 786**	**-**	**118**	**-**	**7 757**
Increases	531	-	-	-	-	531
Decreases	-	(1 077)	-	(37)	-	(1 114)
Closing balance	**4 384**	**2 709**	**-**	**81**	**-**	**7 174**
NET VALUE						
Opening balance	**1 005 234**	**231 888**	**19 251**	**36 427**	**112 300**	**1 405 100**
Closing balance	**977 090**	**245 312**	**44 766**	**36 334**	**97 789**	**1 401 291**

In the period from 1 January to 31 December 2018 the Bank acquired property, plant and equipment in the amount of PLN 150 388 thousand (in 2017 - PLN 131 125 thousand), while the value of property, plant and equipment sold amounted to PLN 11 238 thousand (in 2017 - PLN 3 thousand).

The amount of compensations received from third parties for impairment of loss of property, plant and equipment items recognized in the income statement for 2018 stood at PLN 2 166 thousand (PLN 3 526 thousand in 2017).

In the period from 1 January to 31 December 2018 and in 2017 there have been no property, plant and equipment whose title is restricted and pledged as security for liabilities.

Contractual commitments

As at 31 December 2018 the contractual commitments for the acquisition of property, plant and equipment amounted to PLN 7 402 thousand, whereas as at 31 December 2017 - PLN 20 114 thousand.

(In PLN thousand)

35. Investment property

The Bank values investment property using the historical cost model.
The rights to sell the investment property and the rights to transfer related revenues and profits are not a subject to limitations.
Changes in the 'Investment property' in the course of the reporting period

	2018	2017
GROSS VALUE		
Opening balance	**19 860**	**21 358**
Increases, including:	-	97
acquisitions	-	-
other	-	97
Decreases, including:	(1 042)	(1 595)
sale of real estate	(1 042)	-
transfer to non-current assets held for sale	-	(1 595)
other	-	-
Closing balance	**18 818**	**19 860**
ACCUMULATED DEPRECIATION		
Opening balance	**7 379**	**7 769**
Increases, including:	293	330
depreciation	293	330
other	-	-
Decreases, including:	(41)	(720)
sale of real estate	(41)	-
transfer to non-current assets held for sale	-	(720)
other	-	-
Closing balance	**7 631**	**7 379**
IMPAIRMENT		
Opening balance	**19**	**879**
Increases, including:	-	-
impairment charges	-	-
Decreases, including:	-	(860)
sale of real estate	-	-
transfer to non-current assets held for sale	-	(860)
Closing balance	**19**	**19**
NET VALUE		
Opening balance	**12 462**	**12 710**
Closing balance	**11 168**	**12 462**

The fair value of investment property as at 31 December 2018 stood at PLN 13 168 thousand (PLN 14 478 thousand as at 31 December 2017). The fair value of investment property are categorized in Level 3 of the fair value hierarchy. The fair value was measured based on valuations of the property appraisers, having appropriate professional qualifications and recent experience in the location of the properties being valued. The valuations of investment property are based on investment method or profits method, taking into account such unobservable input data as expected rental growth rate, void periods, occupancy rate, discount rate.

The following amounts of revenues and costs associated with investment properties have been recognized in the income statement

	2018	2017
Rental revenues from investment properties	2 460	2 215
Direct operating expenses associated with investment properties (including repair and maintenance costs) which generated rental revenues during the reporting period	(519)	(610)
Direct operating expenses associated with investment properties (including repair and maintenance costs) which did not generate rental revenues during the reporting period	-	-

Notes to the financial statements (cont.)

(In PLN thousand)

36. Other assets

	31.12.2018	31.12.2017
Prepaid expenses	31 199	30 239
Perpetual usufruct rights	35 807	13 834
Accrued income	177 097	70 957
Interbank and interbranch settlements	44	2
Other debtors	96 914	158 709
Card settlements	618 983	573 321
Total	**960 044**	**847 062**

Prepaid expenses represent expenditures, which will be amortized against income statement in the forthcoming reporting periods.

37. Assets pledged as security for liabilities

As at 31 December 2018 the Bank held the following financial assets pledged as security for liabilities

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transactions	bonds	417 979	352 714	415 119
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	738 038	690 000	-
Coverage of payment commitments to the guarantee fund for the Bank Guarantee Fund	bonds	71 227	70 000	63 415
Coverage of payment commitments to the resolution fund for the Bank Guarantee Fund	bonds	108 876	107 000	96 042
Lombard and technical loan	bonds	3 700 090	3 652 863	-
Other loans	bonds	236 083	221 100	206 151
Coverage of the Guarantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	cash deposits	10 559	10 559	-
Derivatives	bonds	529 569	520 445	470 905

(In PLN thousand)

As at 31 December 2017 the Bank held the following financial assets pledged as security for liabilities

TYPE OF TRANSACTION	SECURITY	CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES	VALUE OF LIABILITIES SUBJECT TO SECURITY
Repo transactions	bonds	1 088 646	1 045 716	1 089 876
Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund	bonds	763 727	770 000	-
Coverage of payment commitments to the guarantee fund for the Bank Guarantee Fund	bonds	32 488	32 000	26 858
Coverage of payment commitments to the resolution fund for the Bank Guarantee Fund	bonds	62 946	62 000	53 069
Lombard and technical loan	bonds	4 697 247	4 587 519	-
Other loans	bonds	320 074	317 300	234 731
Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW)	cash deposit	13 156	13 156	-
Derivatives	bonds	648 671	653 999	574 882

The freeze on securities is a consequence of:

- in case of Repo and Sell-buy-back transactions – binding money market standards for such transactions,
- in case of freeze to the benefit of BFG – binding provisions of the Law on Banking Guaranty Fund BFG,
- in case of lombard and technical loans – policy and standards, applied by the National Bank of Poland NBP,
- in case of other loans, deposits and derivatives – terms and conditions of the agreement, entered between Bank Pekao S.A. and its clients,
- in case of issue of mortgage bonds – binding provisions of the Law on Mortgage Bonds and Mortgage Banks,
- in case of freeze to the benefit of KDPW – with the status of the clearing member for brokerage transactions.

38. Amounts due to other banks

Amounts due to other banks by product type

	31.12.2018	31.12.2017
Current accounts	1 065 658	962 813
Interbank deposits and other liabilities	394 155	642 961
Loans and advances received	1 354 225	1 507 313
Repo transactions	67 447	301 439
Cash in transit	40 470	24 275
Total	**2 921 955**	**3 438 801**

Amounts due to other banks are measured at amortised cost.

Amounts due to other banks by currency

	31.12.2018	31.12.2017
PLN	1 269 471	1 570 970
CHF	227 132	257 553
EUR	1 329 859	1 523 157
USD	55 435	76 977
Other currencies	40 058	10 144
Total	**2 921 955**	**3 438 801**

Notes to the financial statements (cont.)

(In PLN thousand)

39. Amounts due to customers

Amounts due to customers by entity and product type

	31.12.2018	31.12.2017
Amounts due to corporate, including:	54 853 054	58 822 796
current accounts	39 973 872	39 036 375
term deposits and other liabilities	14 879 182	19 786 421
Amounts due to budget entities, including:	10 946 851	12 192 073
current accounts	9 753 945	9 392 005
term deposits and other liabilities	1 192 906	2 800 068
Amounts due to individuals, including:	83 789 393	74 891 544
current accounts	49 259 984	42 618 570
term deposits and other liabilities	34 529 409	32 272 974
Repo transactions	347 672	788 436
Cash in transit	195 058	203 449
Total	**150 132 028**	**146 898 298**

Amounts due to other banks are measured at amortised cost.

Amounts due to customers by currency

	31.12.2018	31.12.2017
PLN	123 652 417	120 695 015
CHF	350 391	336 054
EUR	16 572 028	16 451 858
USD	8 099 778	7 924 185
Other currencies	1 457 414	1 491 186
Total	**150 132 028**	**146 898 298**

40. Debt securities issued

Debt securities issued by type

	31.12.2018	31.12.2017
Liabilities from bonds	-	-
Certificates of deposit	1 732 596	1 470 000
Mortgage bonds	-	-
Total	**1 732 596**	**1 470 000**

Amounts debt securities issued are measured at amortised cost.

The Bank redeems its own debt securities issued on a timely basis.

Debt securities issued by currency

	31.12.2018	31.12.2017
PLN	1 732 596	1 470 000
EUR	-	-
USD	-	-
Total	**1 732 596**	**1 470 000**

(In PLN thousand)

41. Subordinated liabilities

On 30 October 2017, the Bank issued 10 years subordinated bonds with a total nominal value of PLN 1.25 billion. The funds from the issue were designated – after receiving the approval of the Polish Financial Supervision Authority on 21 December 2017 – to increase the Bank's supplementary capital, pursuant to art. 127 para. 2 point 2 of the Banking Law and art. 63 of Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. The bonds were introduced to trading on the ASO Catalyst market.

On 15 October 2018, the Bank issued 10 years subordinated bonds with a total nominal value of PLN 0.55 billion. The funds from the issue were designated – after receiving the approval of the Polish Financial Supervision Authority on 16 November 2018 – to increase the Bank's supplementary capital, pursuant to art. 127 para. 2 point 2 of the Banking Law and art. 63 of Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. The bonds were introduced to trading on the ASO Catalyst market.

On 15 October 2018, the Bank issued 15 years subordinated bonds with a total nominal value of PLN 0.20 billion. The funds from the issue were designated – after receiving the approval of the Polish Financial Supervision Authority on 18 October 2018 – to increase the Bank's supplementary capital, pursuant to art. 127 para. 2 point 2 of the Banking Law and art. 63 of Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. The bonds were introduced to trading on the ASO Catalyst market.

Subordinated liabilities by type

TYPE OF TRANSACTION AS AT 31.12.2018	NOMINAL AMOUNT	CURRENCY	INTEREST RATE	ISSUE DATE	MATURITY DATE	SPECIAL TERMS	BALANCE SHEET VALUE AS AT 31.12.2018
Subordinated bonds	1 250 000	PLN	variable, WIBOR 6M + margin	30.10.2017	29.10.2027	Call option giving the Bank the right of early redemption within 5 years from the issue date, subject to the approval of the PFSA	1 257 025
Subordinated bonds	550 000	PLN	variable, WIBOR 6M + margin	15.10.2018	16.10.2028	Call option giving the Bank the right of early redemption within 5 years from the issue date, subject to the approval of the PFSA	553 926
Subordinated bonds	200 000	PLN	variable, WIBOR 6M + margin	15.10.2018	14.10.2033	Call option giving the Bank the right of early redemption within 10 years from the issue date, subject to the approval of the PFSA	201 534

TYPE OF TRANSACTION AS AT 31.12.2017	NOMINAL AMOUNT	CURRENCY	INTEREST RATE	ISSUE DATE	MATURITY DATE	SPECIAL TERMS	BALANCE SHEET VALUE AS AT 31.12.2017
Subordinated bonds	1 250 000	PLN	variable, WIBOR 6M + margin	30.10.2017	29.10.2027	Call option giving the Bank the right of early redemption within 5 years from the issue date, subject to the approval of the PFSA	1 257 188

(In PLN thousand)

42. Provisions

Changes in provisions in the reporting period

2018	PROVISIONS FOR LITIGATION AND CLAIMS	PROVISONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	**15 204**	**295 551**	**245 993**	**36 887**	**593 635**
Initial application of IFRS 9	-	-	35 332	-	35 332
Opening balance - restated	**15 204**	**295 551**	**281 325**	**36 887**	**628 967**
Provision charges/revaluation	14 892	27 691	226 848	17 598	287 029
Provision utilization	(3 418)	(38 205)	(24 808)	(9 756)	(76 187)
Provision releases	(229)	-	(169 545)	-	(169 774)
Foreign currency exchange differences	-	-	1 549	-	1 549
Other changes	27 539	(403)	(43 760)	-	(16 624)
Closing balance	**53 988**	**284 634**	**271 609**	**44 729**	**654 960**
Short term	2 715	11 240	53 051	-	67 006
Long term	51 273	273 394	218 558	44 729	587 954

2017	PROVISIONS FOR LITIGATION AND CLAIMS	PROVISONS FOR DEFINED BENEFIT PLANS	PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED	OTHER PROVISIONS	TOTAL
Opening balance	**7 002**	**290 611**	**226 322**	**36 548**	**560 483**
Provision charges/revaluation	7 225	27 489	75 745	41 714	152 173
Provision utilization	(3 253)	(13 959)	-	(5 376)	(22 588)
Provision releases	(699)	-	(54 401)	-	(55 100)
Foreign currency exchange differences	-	-	(1 673)	-	(1 673)
Other changes	4 929	(8 590)	-	(35 999)	(39 660)
Closing balance	**15 204**	**295 551**	**245 993**	**36 887**	**593 635**
Short term	2 401	33 206	51 119	-	86 726
Long term	12 803	262 345	194 874	36 887	506 909

Provisions for litigation and claims
Provisions for litigation and claims include court, administrative and other legal proceedings. The provisions were estimated in the amount of expected outflow of resources embodying economic benefits.

Provisions for defined benefits plans
Provisions for defined benefits plans consist of provisions for retirement benefits and death-in-service benefits.The present value of such obligations is measured by an independent actuary using the projected unit credit method.

Other provisions
Other provisions include in particular provisions for other employee benefits.

Notes to the financial statements (cont.)

(In PLN thousand)

43. Other liabilities

	31.12.2018	31.12.2017
Deferred income	131 493	116 700
Provisions for holiday leave	59 977	48 230
Provisions for other employee-related liabilities	211 987	198 735
Provisions for administrative costs	123 961	101 229
Other costs to be paid (*)	92 695	95 969
Other creditors	457 333	364 259
Interbank and interbranch settlements	572 840	1 385 384
Card settlements	300 984	286 755
Total	**1 951 270**	**2 597 261**

(*) in this as at 31 December 2018 PLN 69 388 thousand of provision for future refunds of the part of the remuneration for sale of insurance products linked to loans (PLN 81 842 thousand as at 31 December 2017).

44. Defined benefit plans

Based on internal regulations in respect to remuneration, the employees of the Bank or their families are entitled to defined benefits other than remuneration:

a) retirement benefits,

b) death-in-service benefits.

The present value of such obligations is measured by an independent actuary using the projected unit credit method.

The amount of the retirement benefits and death-in-service benefits is dependent on length of service and amount of remuneration. The expected amount of the benefits is discounted actuarially, taking into account the financial discount rate and the probability of an individual get to the retirement age or die while working respectively. The financial discount rate is determined by reference to market yields at the end of reporting period on government bonds. The probability of an individual get to the retirement age or die while working is determined using the multiple decrement model, taking into consideration the following risks: possibility of dismissal from service, risk of total disability to work and risk of death.

These defined benefit plans expose the Bank to actuarial risk, such as:

- interest rate risk – the decrease in market yields on government bonds would increase the defined benefit plans obligations,
- remuneration risk – the increase in remuneration of the Bank's employees would increase the defined benefit plans obligations,
- longevity risk – the increase in life expectancy of the Bank's employees would increase the defined benefit plans obligations.

The principal actuarial assumptions as at 31 December 2018 are as follows:

- the discount rate at the level of 2.7% (3.20% as at 31 December 2017),
- the future salary growth rate at the level of 2.50% (2.50% as at 31 December 2017),
- the probable number of leaving employees calculated on the basis of historical data concerning personnel rotation in the Bank,
- the mortality adopted in accordance with Life Expectancy Tables for men and women, published the Central Statistical Office, adequately adjusted on the basis of historical data of the Bank.

Notes to the financial statements (cont.)

(In PLN thousand)

Reconciliation of the present value of defined benefit plans obligations

The following table presents a reconciliation from the opening balances to closing balances for the present value of defined benefit plans obligations.

	2018	2017
Opening balance	**295 551**	**290 611**
Current service cost	18 234	17 317
Interest expense	9 457	10 171
Remeasurements of the defined benefit obligations:	(403)	(8 589)
actuarial gains and losses arising from changes in demographic assumptions	(515)	(2 780)
actuarial gains and losses arising from changes in financial assumptions	12 759	7 455
actuarial gains and losses arising from experience adjustments	(12 647)	(13 264)
Contributions paid by the employer	(38 205)	(13 959)
Closing balance	**284 634**	**295 551**

Sensitivity analysis

The following table presents how the impact on the defined benefits obligations would have increased (decreased) as a result of a change in the respective actuarial assumptions by one percent.

31.12.2018	DEFINED BENEFIT PLANS OBLIGATIONS	
	1 PERCENT INCREASE	1 PERCENT DECREASE
Discount rate	(24 620)	28 563
Future salary growth rate	27 693	(24 379)

31.12.2017	DEFINED BENEFIT PLANS OBLIGATIONS	
	1 PERCENT INCREASE	1 PERCENT DECREASE
Discount rate	(23 615)	27 451
Future salary growth rate	26 166	(23 026)

Maturity of defined benefit plans obligations

The following table presents the maturity profile of the defined benefit plans obligations.

	31.12.2018	31.12.2017
The weighted average duration of the defined benefit plans obligations (in years)	9.3	8.6

(In PLN thousand)

45. Share-based payments

Incentive programs

In the current and comparative reporting periods the following incentive programs granted to employees of the Bank:

The long-term UniCredit Group Incentive Program 2008 in respect to share options was completed. The rights to exercise the option were acquired in 2012. According to the rules, the options has expied on the tenth anniversary of granting.

The above mentioned share-based payments are recognized as cash-settled transactions.

The fair value of share options and shares of UniCredit S.p.A. was established based on the Hull and White model.

The tables below present changes in the number of stock options and performance shares of UniCredit S.p.A., as well as the weighted average exercise prices

2018	STOCK OPTIONS	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE
Opening balance	1 072 660	-
Granted during the year	-	-
Redeemed during the year	(231 843)	-
Exercised during the year	-	-
Terminated during the year	(840 817)	-
Existing at the period-end	-	-
Executable at the period-end	-	-

2017	STOCK OPTIONS	
	NUMBER	WEIGHTED AVERAGE EXECUTION PRICE (*)
Opening balance	2 093 140	17.51
Granted during the year	-	-
Redeemed during the year	(542 469)	-
Exercised during the year	-	-
Terminated during the year	(478 011)	-
Existing at the period-end	1 072 660	17.51
Executable at the period-end	1 072 660	17.51

(*)The value of PLN 17.51 relates to the stock options program 2008.

The liabilities of granted rights to shares under Employee Share Ownership Plan until 31 December 2018 amounted to PLN 220 thousand as at 31 December 2018 (PLN 220 thousand as at 31 December 2017).

In 2018 Bank there were no cost relating to the incentive programs granted to the emloyees of the Bank by UniCredit Group (The cost of 2017 - PLN 54 thousand).

Notes to the financial statements (cont.)

(In PLN thousand)

System of Variable Remuneration for the Management Team

The system of variable remuneration is addressed to Employees defined in the Bank as persons in managerial positions,who have a significant impact on the risk profile of the Bank and who are key employees for the fulfillment of the Bank's strategy, risk management and long-term increase of the Bank's income.

The aim of the system is to support the execution of the Bank's operational strategy, its risk management and to limit conflict of interests.

Under the system the participant can receive the variable compensation, which is paid out based on a bonus pool approach providing for a comprehensive performance measurement at individual level, level of his/her organizational unit and results of the entire Bank as well as risk assessment, verification of the Participant's compliant behaviour with respect to law provisions and standards adopted by the Bank.

The compensation consists of cash payment and cash-settled share based payment realized in the form of phantom shares as cash equivalent amounting to the value of granted phantom shares.

In November 2018, a resolution of the Bank's Shareholders General Meeting on adjusting the remuneration of Management Board Members to the requirements of the Act on the principles of shaping the remuneration of persons managing certain companies, was implemented.

Notes to the financial statements (cont.)

(In PLN thousand)

During the reporting period ending on 31 December 2018 the Bank had the following share-based payments transactions:

	SYSTEM 2014(*)	SYSTEM 2015(*)	SYSTEM 2016(*)	SYSTEM 2017(*)	SYSTEM 2018(**)
Transaction type	Cash-settled share based payments				
Start date of the assessment period	1 January 2014	1 January 2015	1 January 2016	1 January 2017	1 January 2018
Program announcement date	June 2014	July 2015	June 2016	April 2017	April 2018
Program granting date	30 April 2015	16 June 2016	19 April 2017	21 June 2018	Date of Supervisory Board meeting
Number of instruments granted (pcs)	68 040	93 359	127 256	43 578	Will be defined on granting date
Maturity date	31 July 2020	31 July 2021	31 July 2022	31 July 2023	31 July 2024
Vesting date for Management Board Members and Executive Vice President	• 40% in the year of program granting (settlement after 3 years retention period) • 30% after 3 years from program granting date (settlement after 1 year retention period) • 20% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 2 years retention period) • 24% after 2 years from program granting date (settlement after 1 year retention period) • 12% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)	• 40% in the year of program granting (settlement after 1 year retention period) • 12% after 2 years from program granting date (settlement after 1 year retention period) • 24% after 3 years from program granting date (settlement after 1 year retention period) • 24% after 4 years from program granting date (settlement after 1 year retention period)
Vesting date for remaining participants	• 60% in the year of program granting (settlement after 3 years retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period) • 20% after 4 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 3 years retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period) • 20% after 4 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 2 years retention period) • 20% after 2 years from program granting date (settlement after 1 year retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 2 years retention period) • 20% after 2 years from program granting date (settlement after 1 year retention period) • 20% after 3 years from program granting date (settlement after 1 year retention period)	• 60% in the year of program granting (settlement after 1 year retention period) • 13.34% after 1 year from program granting date (settlement after 1 year retention period) • 13.34% after 2 years from program granting date (settlement after 1 year retention period) • 13.32% after 3 years from program granting date (settlement after 1 year retention period)
Vesting conditions	Risk assessment, Compliance assessment, Continuous employment, Reaching the aim based on financial results of the Bank for a given period				
Program settlement	(*)The participant will receive a cash payment amounting to the number the possessed phantom shares times the arithmetic mean of the Bank's share prices at the Warsaw Stock Exchange: • in case of the settlement made at the dates of instalment after the mandatory retention period, for a month preceding the day of General Meeting approving the financial statements for a given year, • in case of settlement made in the voluntary retention period, for 10 working days following the day of release of the financial report in a given quarter, and benefits from acquired phantom shares in the amount equivalent to dividend paid to shareholders in the retention period for shares acquired by the participant. (**)The participant will receive a cash payment amounting to the number the possessed phantom shares times the average closing price of the Bank's shares at the Warsaw Stock Exchange for 30 calendar days preceding the day of the Supervisory Board meeting, where it evaluates the Bank's financial statements for a given year and benefits from acquired phantom shares in the amount corresponding to the dividend paid to shareholders during the mandatory retention period for shares acquired by the participant.				

(In PLN thousand)

For the System 2014, 2015, 2016 and 2017 the fair value of the program was estimated based upon the Bank's shares price on the WSE as of the balance sheet date and expected number of phantom shares to which the rights will be acquired.

For the System 2018, as of 31 December 2018 the Bank prepared the program valuation, presuming that the phantom shares were granted on 31 December 2018. This value will be changed at the actual date of granting the program.

The system of variable remuneration realized in the form of phantom shares is a program settled in cash, and therefore its fair value is adjusted on each balance sheet date until the the program settlement, which in case of this program coincides with the vesting date.

The carrying amount of liabilities for cash - settled phantom shares amounted to PLN 44 729 thousand as at 31 December 2018 (as at 31 December 2017 – PLN 36 887 thousand).

The total intrinsic value of liabilities for vested rights to phantom shares amounted to PLN 30 145 thousand as at 31 December 2018 (as at 31 December 2017 – PLN 38 524 thousand).

The remuneration expenses for 2018 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 17 598 thousand (in 2017 - PLN 19 714 thousand).

The table below presents changes in the number of Bank's phantom shares.

	2018	2017
Opening balance	297 483	210 223
Granted during the year	43 578	127 256
Redeemed during the year	-	-
Exercised during the year	(64 498)	(39 996)
Terminated during the year	-	-
Existing at the period-end	276 563	297 483

As of 31.12.2018 no variable remuneration was granted to the Memebers of the Management Board for 2017.

The table above does not present the number of shares granted in respect of System 2018. This number will be determined in 2019 after evaluation of the financial statements for 2018 by the Supervisory Board. The hypothetical number of shares determined on the basis of the base value of the granted bonus to each of the program participants and arithmetic mean of the Bank's share price on the WSE in December 2018 amounts to 115 909.

46. Operating and finance leases

Bank as a Lessor

In operating lease of buildings classified as investment properties the Bank acts as a lessor.

The amount of future minimum lease payments expected to be received under non-cancellable operating lease can be summarized as follows:

	31.12.2018	31.12.2017
Up to 1 year	5 513	6 522
Between 1 and 5 years	2 414	3 513
Over 5 years	380	816
Total	**8 307**	**10 851**

The amount of the minimum operating lease payments classified as income in 2018 amounted to PLN 22 236 thousand (PLN 21 674 thousand in 2017).

Notes to the financial statements (cont.)

(In PLN thousand)

Bank as a Lessee

The Bank is a lessee of buildings' lease contracts classified as operating lease.

The amount of future minimum lease payments expected to be paid under non-cancellable operating lease can be summarized as follows:

	31.12.2018	31.12.2017
Up to 1 year	99 107	95 815
Between 1 and 5 years	224 513	188 583
Over 5 years	33 635	17 865
Total	**357 255**	**302 263**

The amount of the minimum operating lease payments recognized as an expense in 2018 amounted to PLN 156 256 thousand (expense in 2017 amounted to PLN 160 837 thousand).

The lease agreements are usually entered into for an indefinite period. In case of lease agreements concluded for an indefinite term, the minimum lease payments are determined based upon notice of termination periods ensuing from relevant contracts. The notice period is usually fixed at 3 or 6 months. Lease agreements are denominated in PLN as well as in foreign currencies. Payments are made in PLN, regardless of the contract currency.

Finance leases

In addition, the Bank as a lessee of cars concludes finance lease contracts with its subsidiary Pekao Leasing Sp. z o.o.

His contract gives the Bank opportunity to buy an asset after termination of lease contract.

The carrying amount of net assets being subject of finance lease contracts as at 31 December 2018 amounted to PLN 33 584 thousand and as at 31 December 2017 amounted to PLN 44 766 thousand.

	31.12.2018	31.12.2017
Gross liabilities on finance leases	43 387	60 487
Unrealized financial costs	(7 479)	(13 996)
Present value of minimum lease payments	**35 908**	**46 491**

The amount of future minimum lease payments under finance lease by maturity dates can be summarized as follows:

	31.12.2018	31.12.2017
Up to 1 year	19 755	22 254
Between 1 and 5 years	23 632	38 233
Total	**43 387**	**60 487**

(In PLN thousand)

47. Contingent commitments

Lawsuits

As at 31 December 2018 the following lawsuits for payment are ongoing with involvement of the Bank, that are important in view of the value of the subject of dispute:

1) in the group of liabilities (against the Bank):

- brought by a legal person – lawsuit for payment by virtue of inadequate performance of agreement; value of the subject of dispute 17 521 646 EUR (which as at 31 December 2018 at mid NBP rate was equivalent to 75 343 077.80 PLN); litigation initiation date – 19 July 2018; in the present factual and legal state the Bank assesses the funds outflow risk as possible,
- brought by the receiver for a joint stock company in liquidation bankruptcy – lawsuit for payment of compensation for a damage incurred as a result of the Bank's demanding immediate payment of the amounts due in virtue of payment of the price from the credit liabilities transfer agreement and conducting enforcement collection of the portion of the price remaining for payment; value of the subject of dispute 57 450 130 PLN; litigation initiation date – 30 April 2015; in the present factual and legal state the Bank assesses the funds outflow risk as possible,
- brought by a beneficiary of warranty – lawsuit for payment of a claim by virtue of the warranty issued by the Bank; value of the subject of dispute 55 996 064.23 PLN; litigation initiation date – 20 May 2014. On 10 October 2018 the Plaintiff withdrew the lawsuit,
- brought by a natural person – lawsuit for payment by the Bank of an amount charged by virtue of settlement of forward financial transactions; value of the subject of dispute 38 916 555.18 PLN; litigation initiation date – 2 October 2016; in the present factual and legal state the Bank assesses the funds outflow risk as possible,
- brought by a beneficiary of warranty – lawsuit for payment of a claim by virtue of the warranty issued by the Bank; value of the subject of dispute 32 750 000 PLN; litigation initiation date – 14 January 2014; in the present factual and legal state the Bank assesses the funds outflow risk as remote,
- brought by a beneficiary of warranty – lawsuit for payment of a claim by virtue of the warranty issued by the Bank; value of the subject of dispute 29 204 684 PLN; litigation initiation date – 16 January 2015. On 10 October 2018 the Plaintiff withdrew the lawsuit.

2) in the group of receivables (brought by the Bank):

- Bank's main intervention lawsuit against the parties of the main lawsuit – the subject of the intervention is the demand for payment by virtue of the assignment of receivables securing Bank's liabilities; value of the subject of dispute 321 979 666.87 PLN; litigation initiation date – 26 October 2018,
- Bank's lawsuit for payment against limited debtor by virtue of mortgage collateralizing repayment of the granted loan; value of the subject of dispute 132 877 901 PLN; litigation initiation date – 21 January 2016,
- Bank's main intervention lawsuit against the parties of the main lawsuit – the subject of the intervention is the demand for payment by virtue of the assignment of receivables securing Bank's liabilities; value of the subject of dispute 119 020 334 PLN; litigation initiation date – 26 October 2018,
- Bank's mutual lawsuit for payment of amounts due by virtue of the transfer of liabilities; value of the subject of dispute 89 977 886 PLN; litigation initiation date – 28 February 2013,
- Bank's main intervention lawsuit against the parties of the main lawsuit – the subject of the intervention is the demand to execute (pay) the liabilities purchased by the Bank from one of the defendants against the other defendant; value of the subject of dispute 67 432 617.21 PLN; litigation initiation date – 23 January 2006.

None of the litigations ongoing in the fourth quarter of 2018 before a court, authority competent for arbitrary proceedings or a body of public administration posed a threat for financial liquidity of the Bank.

The Bank has not created provisions for above mentioned litigations against the Bank, in which in the present factual and legal state the risk of funds outflow is assessed as possible or remote.

As at 31 December 2018, the Bank created provisions for litigations against the Bank which, according to the legal opinion, are connected with a risk of the funds outflow resulting from the fulfillment of the obligation. The value of the above provisions as at 30 June 2018 is PLN 53 988 thousand (PLN 15 204 thousand as at 31 December 2017).

Notes to the financial statements (cont.)

(In PLN thousand)

Financial commitments granted

Financial commitments granted by entities

	31.12.2018	31.12.2017
Financial commitments granted to:		
financial entities	4 468 542	2 574 403
non - financial entities	30 068 526	31 543 959
budget entities	662 554	559 172
Total	**35 199 622**	**34 677 534**

Guarantees issued

Guarantees issued by entities

	31.12.2018	31.12.2017
Issued to financial entities:	7 695 871	3 276 855
guarantees	4 782 913	3 166 855
sureties	2 907 900	110 000
confirmed export letters of credit	5 058	-
Issued to non - financial entities:	11 185 500	9 946 558
guarantees	6 787 174	6 726 612
securities' underwriting guarantees	4 320 967	3 070 727
sureties	77 359	149 219
Issued to budget entities:	162 540	434 737
guarantees	13 192	13 186
securities' underwriting guarantees	149 348	421 551
Total	**19 043 911**	**13 658 150**

Securities underwriting

As at 31 December 2018, the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client1	bonds	929 500	23.07.10 - 30.06.20
Client 2	bonds	484 880	22.10.13 - 31.05.22
Client 3	bonds	5 891	26.07.17 - 31.03.19
Client 3	bonds	19 059	26.07.17 - 31.03.19
Client 3	bonds	16 480	29.11.18 - 31.05.19
Client 3	bonds	60 000	29.11.18 - 30.12.20
Client 4	bonds	109 870	24.05.16 - 31.12.20
Client 5	bonds	33 650	21.05.16 - 31.12.19
Client 5	bonds	5 350	13.11.16 - 31.12.20
Client 5	bonds	1 990	21.05.16 - 31.12.20
Client 6	bonds	293 256	31.08.16 - 30.12.20
Client 6	bonds	22 000	31.08.16 - 30.12.20
Client 7	bonds	42 820	20.12.16 - 31.12.20
Client 8	bonds	5 000	03.03.17 - 31.12.19
Client 9	bonds	2 066	27.06.17 - 31.12.19
Client 10	bonds	10 500	09.03.16 - 30.06.19
Client 10	bonds	11 250	09.03.16 - 30.06.19

Notes to the financial statements (cont.)

(In PLN thousand)

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 11	bonds	4 400	08.09.17 - 31.12.19
Client 12	bonds	23 945	15.09.17 - 29.12.19
Client 12	bonds	91 122	15.09.17 - 29.06.19
Client 13	bonds	20 625	26.09.17 - 31.12.19
Client 13	bonds	18 975	25.09.17 - 31.12.19
Client 13	bonds	16 363	25.09.17 - 31.12.19
Client 14	bonds	2 000	27.09.17 - 31.12.19
Client 15	bonds	27 200	11.10.17 - 31.03.22
Client 15	bonds	27 800	11.10.17 - 20.04.22
Client 15	bonds	11 800	11.10.17 - 31.03.20
Client 15	bonds	37 710	11.10.17 - 20.04.22
Client 16	bonds	34 200	24.10.17 - 31.12.19
Client 17	bonds	22 000	24.10.17 - 30.06.20
Client 17	bonds	3 000	24.10.17 - 30.06.20
Client 18	bonds	30 000	03.11.17 - 31.08.19
Client 19	bonds	10 000	15.11.17 - 31.12.20
Client 19	bonds	12 000	15.11.17 - 31.12.20
Client 19	bonds	6 510	15.11.17 - 31.12.20
Client 19	bonds	7 000	15.11.17 - 31.12.20
Client 19	bonds	9 000	15.11.17 - 31.12.20
Client 20	bonds	8 000	15.11.17 - 31.12.19
Client 21	bonds	2 600	11.12.17 - 31.12.19
Client 22	bonds	8 400	13.12.17 - 31.12.19
Client 23	bonds	112 282	18.12.17 - 31.12.19
Client 23	bonds	13 796	18.12.17 - 31.12.19
Client 24	bonds	13 000	11.12.17 - 31.12.19
Client 25	bonds	12 500	21.12.17 - 31.12.19
Client 25	bonds	13 500	21.12.17 - 31.12.19
Client 25	bonds	22 000	21.12.17 - 31.12.19
Client 25	bonds	8 050	21.12.17 - 30.11.19
Client 26	bonds	7 959	30.11.18 - 30.04.19
Client 27	bonds	16 000	26.06.18 - 31.12.20
Client 27	bonds	2 500	26.06.18 - 31.12.20
Client 28	bonds	30 340	29.06.18 - 30.12.20
Client 28	bonds	20 000	29.06.18 - 30.12.20
Client 29	bonds	75 000	29.06.18 - 31.01.19
Client 29	bonds	17 250	29.06.18 - 31.01.19
Client 30	bonds	1 719	03.08.18 - 31.12.19
Client 31	bonds	26 000	28.09.18 - 30.06.20
Client 31	bonds	2 000	28.09.18 - 30.06.20
Client 32	bonds	20 000	17.10.18 - 31.12.20

Notes to the financial statements (cont.)

(In PLN thousand)

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 33	bonds	117 000	12.09.18 - 31.12.22
Client 34	bonds	1 058 780	13.12.18 - 31.12.21
Client 34	bonds	128 227	13.12.18 - 31.12.21
Client 35	bonds	134 200	18.12.18 - 30.12.20
Client 35	bonds	30 000	18.12.18 - 31.12.20
Client 36	bonds	100 000	23.02.15 - 30.11.22

Securities covered by the Bank underwriting are classified as securities, unquoted on stock exchanges and not subject to regulated over-the-counter trading.

Notes to the financial statements (cont.)

(In PLN thousand)

As at 31 December 2017 the following securities programs have been in place, covered by underwriting

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 1	bonds	1 009 000	23.07.10 - 30.06.20
Client 2	bonds	484 880	23.10.13 - 31.05.22
Client 3	bonds	60 775	26.07.17 - 31.03.19
Client 4	bonds	32 600	27.01.14 - 27.04.18
Client 5	bonds	83 300	30.06.14 - 24.02.18
Client 6	bonds	2 940	15.09.14 - 30.06.18
Client 7	bonds	150 000	24.05.14 - 31.03.18
Client 8	bonds	100 000	23.02.15 - 30.11.22
Client 9	bonds	12 500	14.10.15 - 31.12.18
Client 10	bonds	33 576	18.12.15 - 27.04.18
Client 11	bonds	57 000	21.05.16 - 21.06.19
Client 12	bonds	4 000	06.07.16 - 31.12.18
Client 13	bonds	79 480	31.08.16 - 31.12.18
Client 14	bonds	323 600	31.08.16 - 30.12.19
Client 15	bonds	4 300	23.12.16 - 31.12.18
Client 16	bonds	2 050	23.12.16 - 31.12.18
Client 17	bonds	53 235	20.12.16 - 31.12.18
Client 18	bonds	9 000	03.03.17 - 31.12.19
Client 19	bonds	14 083	03.03.17 - 31.12.18
Client 20	bonds	1 530	03.03.17 - 31.12.18
Client 21	bonds	23 210	09.06.17 - 31.12.18
Client 22	bonds	4 132	27.06.17 - 31.12.19
Client 23	bonds	2 500	22.06.17 - 31.12.18
Client 24	bonds	1 000	28.06.17 - 31.12.18
Client 25	bonds	3 000	27.06.17 - 31.12.18
Client 26	bonds	49 844	09.03.16 - 30.06.19
Client 27	bonds	1 500	04.07.17 - 31.12.18
Client 28	bonds	5 000	17.07.17 - 31.12.18
Client 29	bonds	9 739	23.08.17 - 31.12.18
Client 30	bonds	8 700	06.09.17 - 31.12.18
Client 31	bonds	6 200	08.09.17 - 31.12.19
Client 32	bonds	4 500	13.09.17 - 31.12.18
Client 33	bonds	116 900	15.09.17 - 29.06.19
Client 34	bonds	20 900	25.09.17 - 31.12.18
Client 35	bonds	20 625	26.09.17 - 31.12.19
Client 36	bonds	35 338	25.09.17 - 31.12.19
Client 37	bonds	10 400	27.09.17 - 31.12.19
Client 38	bonds	51 800	11.10.17 - 31.03.22
Client 39	bonds	67 800	11.10.17 - 20.04.22
Client 40	bonds	98 000	24.10.17 - 31.12.19
Client 41	bonds	25 000	24.10.17 - 31.12.19
Client 42	bonds	3 500	03.11.17 - 31.12.18
Client 43	bonds	80 000	03.11.17 - 31.08.19

Notes to the financial statements (cont.)

(In PLN thousand)

NAME OF ISSUER	TYPE OFSECURITIES	OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF	CONTRACT LIFE
Client 44	bonds	51 041	15.11.17 - 31.12.20
Client 45	bonds	2 000	21.11.17 - 31.12.18
Client 46	bonds	3 750	09.11.17 - 31.12.18
Client 47	bonds	17 000	15.11.17 - 31.12.19
Client 48	bonds	4 100	05.12.17 - 31.12.18
Client 49	bonds	7 000	11.12.17 - 31.12.19
Client 50	bonds	8 400	31.12.17 - 31.12.19
Client 51	bonds	6 000	15.12.17 - 31.12.18
Client 52	bonds	115 000	19.12.17 - 31.12.19
Client 53	bonds	17 100	11.12.17 - 31.12.19
Client 54	bonds	4 900	19.12.17 - 31.12.18
Client 55	bonds	5 000	21.12.17 - 31.12.18
Client 56	bonds	5 000	22.12.17 - 31.12.18
Client 57	bonds	8 500	27.12.17 - 31.12.18
Client 58	bonds	70 050	21.12.17 - 31.12.18

Securities covered by the Bank underwriting are classified as securities, unquoted on stock exchanges and not subject to regulated over-the-counter trading.

Off-balance sheet commitments received

Off-balance sheet commitments received by entity

	31.12.2018	31.12.2017
Financial received from:	556 713	176 416
financial entities	556 713	176 416
non - financial entities	-	-
budget entities	-	-
Guarantees received from:	19 686 788	13 865 863
financial entities	3 607 728	3 111 013
non - financial entities	15 075 918	9 824 811
budget entities	1 003 142	930 039
Total	**20 243 501**	**14 042 279**

Moreover, the Group has the ability to obtain financing from National Bank of Poland secured securities.

48. Share capital

Shareholding structure

CLASS/ISSUE	TYPE OF SHARES	NUMBER OF SHARES	NOMINAL VALUE OF CLASS/ISSUE	EQUITY COVERAGE	DATE OF REGISTRATION	DIVIDEND RIGHTS (FROM DATE)
A	Common bearer stock	137 650 000	137 650	Fully paid-up	21.12.1997	01.01.1998
B	Common bearer stock	7 690 000	7 690	Fully paid-up	06.10.1998	01.01.1998
C	Common bearer stock	10 630 632	10 631	Fully paid-up	12.12.2000	01.01.2000
D	Common bearer stock	9 777 571	9 777	Fully paid-up	12.12.2000	01.01.2000
E	Common bearer stock	373 644	374	Fully paid-up	29.08.2003	01.01.2003
F	Common bearer stock	621 411	621	Fully paid-up	29.08.2003	19.05.2006 16.05.2007
G	Common bearer stock	603 377	603	Fully paid-up	29.08.2003	15.05.2008
H	Common bearer stock	359 840	360	Fully paid-up	12.08.2004	01.01.2004
I	Common bearer stock	94 763 559	94 764	Fully paid-up	29.11.2007	01.01.2008
Total number of Shares (pcs)		**262 470 034**				
Total share capital in PLN thousand			**262 470**			
Nominal value per share = PLN 1.00						

Change in the number of shares (pcs)

2018	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

2017	ISSUED AND FULLY PAID-UP SHARES	TOTAL
Opening balance	262 470 034	262 470 034
Closing balance	262 470 034	262 470 034

(In PLN thousand)

49. Other capital and reserves, retained earnings and profit for the period

The table below presents the structure of the Banks's equity attributable to equity holders of the Bank

	31.12.2018	31.12.2017
Reserve capital, including:	9 326 529	9 326 529
issue of shares above face value	9 137 221	9 137 221
other	189 308	189 308
Revaluation reserve, including:	205 011	(57 422)
remeasurements of the defined benefit liabilities	(72 282)	(72 609)
Revaluation of debt financial instruments measured at fair value through other comprehensive income (net of tax)	96 890	X
Revaluation or sale of investments in equity instruments designated at fair value through other comprehensive income (net of tax)	138 656	X
revaluation of financial assets portfolio available for sale	X	9 857
revaluation of financial hedging instruments portfolio	41 747	5 330
Foreign currency translation differences	-	-
General Banking Risk Fund	1 982 459	1 982 459
Other reserve capital	8 627 858	8 612 550
Bonds convertible into shares- capital component	28 819	28 819
Funds for brokerage activities	15 000	15 000
Total other capital	**20 185 676**	**19 907 935**
Profit (loss) from previous periods	(936 748)	-
Net profit for the period	2 310 600	2 088 129
Total retained earnings and profit for the period	**1 373 852**	**2 088 129**
Total	**21 559 528**	**21 996 064**

The net profit of the Bank for 2017 in the amount of PLN 2 088 129 thousand was distributed in the following way: PLN 2 073 513 thousand – to dividend, PLN 14 616 thousand – to Other Reserve Capital.

From 1982 to 1984 and from 1988 to 1996, the Bank operated in a hyperinflationary economic environment.

IAS 29 (Financial Reporting in Hyperinflationary Economies) requires restatement of each component of owners' equity (except for retained earnings and revaluation surplus) by applying a general price index for the period of hyperinflation. This retrospective application would have resulted in an increase in share capital and other reserves and a decrease in retained earnings in equivalent amounts. This restatement would not have any effect on the total amount of the Bank's equity.

Notes to the financial statements (cont.)

(In PLN thousand)

50. Additional information to the unconsolidated cash flow statement

Cash and cash equivalents

	31.12.2018	31.12.2017
Cash and amounts due from Central Bank	12 972 575	5 186 259
Loans and receivables from banks with maturity up to 3 months	2 260 195	2 107 448
Cash and Cash equivalents presented in the cash flow statement	**15 232 770**	**7 293 707**

Restricted availability cash and cash equivalents as at 31 December 2018 amounted to PLN 5 101 972 thousand (PLN 4 786 930 thousand as at 31 December 2017).

Changes in liabilities arising from financing activities

	BALANCE AS AT 1 JANUARY 2018	CHANGES FROM FINANCING CASH FLOWS	NON-CASH CHANGES				BALANCE AS AT 31 DECEMBER 2018
			CHANGES ARISING FROM OBTAINING OR LOSING CONTROL OF SUBSIDIARIES OR OTHER BUSINESSES	THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES	CHANGES IN FAIR VALUES	OTHER CHANGES	
Debt securities issued	1 470 000	267 924	-	-	-	(5 328)	1 732 596
Subordinated liabilities	1 257 188	750 000	-	-	-	5 297	2 012 485
Loans and advances received	1 507 313	(206 987)	-	53 853	-	46	1 354 225
Total	**4 234 501**	**810 937**	**-**	**53 853**	**-**	**15**	**5 099 306**

	BALANCE AS AT 1 JANUARY 2017	CHANGES FROM FINANCING CASH FLOWS	NON-CASH CHANGES				BALANCE AS AT 31 DECEMBER 2017
			CHANGES ARISING FROM OBTAINING OR LOSING CONTROL OF SUBSIDIARIES OR OTHER BUSINESSES	THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES	CHANGES IN FAIR VALUES	OTHER CHANGES (*)	
Debt securities issued	300 945	1 163 140	-	-	-	5 915	1 470 000
Subordinated liabilities	-	1 250 000	-	-	-	7 188	1 257 188
Loans and advances received	1 764 184	(139 462)	-	(117 358)	-	(51)	1 507 313
Total	**2 065 129**	**2 273 678**	**-**	**(117 358)**	**-**	**13 052**	**4 234 501**

51. Related party transactions

The transactions between the Bank and related parties are typical transactions arising from current operating activities conducted by the Bank. Such transactions mainly include loans, deposits, foreign currency transactions and guarantees.

The credit granting process applicable to the Bank's management and entities related to the Bank

According to the Banking Act, credit transactions with Members of the Bank's Management Board and Supervisory Board, persons holding managerial positions at the Bank, with the entities related financially or organizationally therewith, shall be effected according to Regulation adopted by the Supervisory Board of the Bank.

The Regulation provides detailed decision-making procedures, applicable to transactions with such persons and entities, also defining the decision-making levels authorized to take decisions. In particular, the transactions with the Members of the Bank's Management Board or Supervisory Board or with an entity related therewith financially or organizationally, are subject to decisions taken by the Bank's Management Board and Supervisory Board.

Members of the Bank's Management Board and entities related therewith financially or organizationally may take advantage of credit products offered by the Bank on standard terms and conditions of the Bank. In particular, the Bank may not offer more advantageous credit interest rates to such persons or entities.

Credit risk assessment is performed using the methodology applied by the Bank, tailored to the client's segment and type of transaction.

In case of entities related to the Bank, the standard credit procedures are applied, with transaction-related decisions taken exclusively at level of the Bank's Head Office.

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions

Related party transactions as at 31 December 2018

NAME OF ENTITY	RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
PZU S.A. – the Bank ‘s parent entity	4	-	104	98	23 722	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group	294	-	2 663	2 076	54 158	547	-
Bank Pekao S.A. Group entities							
Subsidiaries							
Pekao Investment Banking S.A.	-	-	-	50	248 709	-	50
Pekao Leasing Sp. z o.o.	773 004	125 110	199	-	95 880	744	31 539
Pekao Faktoring Sp. z o.o.	2 163 824	-	-	-	6 499	-	-
Centralny Dom Maklerski Pekao S.A.	-	-	-	-	703 124	-	161
Pekao Fundusz Kapitałowy Sp. z o.o. (in liguidation)	-	-	-	-	52 511	-	-
Pekao Powszechne Towarzystwo Emerytalne S.A. (in liguidation)	-	-	-	-	33 338	-	-
Centrum Kart S.A.	-	-	-	-	20 424	-	10 621
Pekao Financial Services Sp. z o. o.	-	-	-	-	8 655	-	-
Pekao Bank Hipoteczny S.A.	244 450	10 015	5 588	-	13 011	5 876	-
Pekao Property S.A.	6 230	-	-	-	26 203	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	16	-	-	19	10 150	-	6 500
FPB – Media Sp. z o. o.	8 971	-	-	-	280	-	-
Dom Inwestycyjny Xelion Sp. z o.o.	-	-	-	2	64 061	-	-
Pekao Investment Management S.A.	-	-	-	-	136 211	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	-	-	-	7 471	132 599	-	-
Total of Bank Pekao S.A. Group entieties	**3 196 495**	**135 125**	**5 787**	**7 542**	**1 551 655**	**6 620**	**48 871**
Key management personnel of the Bank Pekao S.A.	440	-	-	-	6 608	-	-
Total	**3 197 233**	**135 125**	**8 554**	**9 716**	**1 636 143**	**7 167**	**48 871**

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

31.12.2018	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank ‘s parent entity	-	4	-	-	-	-	4
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	4	290	-	-	-	-	294
Bank Pekao S.A. Group entities							
Subsidiaries	728 240	407 815	62 469	1 793 829	194 343	9 799	3 196 495
Key management personnel of the Bank Pekao S.A.	-	-	-	39	9	392	440
Total	**728 244**	**408 109**	**62 469**	**1 793 868**	**194 352**	**10 191**	**3 197 233**

(*) Current receivables include Nostro account and cash collaterals

Liabilities due to loans and deposits by contractual maturity

31.12.2018	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank ‘s parent entity	23 722	-	-	-	-	-	23 722
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	49 406	4 752	-	-	-	-	54 158
Bank Pekao S.A. Group entities							
Subsidiaries	1 017 020	204 804	189 318	122 113	18 400	-	1 551 655
Key management personnel of the Bank Pekao S.A.	6 498	3	1	106	-	-	6 608
Total	**1 096 646**	**209 559**	**189 319**	**122 219**	**18 400**	**-**	**1 636 143**

(*) Current receivables include Loro account and cash collaterals

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2018	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank 's parent entity	-	-	-	4	-	4
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	294	-	294
Bank Pekao S.A. Group entities						
Subsidiaries	413 477	1 375	208	2 779 831	1 604	3 196 495
Key management personnel of the Bank Pekao S.A.	-	-	392	48	-	440
Total	**413 477**	**1 375**	**600**	**2 780 177**	**1 604**	**3 197 233**

Liabilities due to loans and deposits by currency

31.12.2018	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank 's parent entity	34	-	-	23 688	-	23 722
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	743	1 356	232	50 319	1 508	54 158
Bank Pekao S.A. Group entities						
Subsidiaries	102 622	36 635	1 557	1 406 937	3 904	1 551 655
Key management personnel of the Bank Pekao S.A.	3 207	130	16	3 253	2	6 608
Total	**106 606**	**38 121**	**1 805**	**1 484 197**	**5 414**	**1 636 143**

Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions as at 31 December 2017

NAME OF ENTITY	RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS	SECURITIES	RECEIVABLES FROM REVALUATION OF DERIVATIVES	OTHER RECEIVABLES	LIABILITIES FROM LOANS AND DEPOSITS	LIABILITIES FROM REVALUATION OF DERIVATIVES	OTHER LIABILITIES
PZU S.A. – the Bank ‘s parent entity	-	-	-	877	477 485	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group	1 010	-	489	16	489 057	5 062	-
Bank Pekao S.A. Group entities							
Subsidiaries							
Pekao Investment Banking S.A.	-	-	-	11 002	311 268	-	-
Pekao Leasing Sp. z o.o.	2 783 176	8 911	167	20 443	40 941	-	17 348
Pekao Faktoring Sp. z o.o.	1 244 100	-	-	3	4 272	-	-
Centralny Dom Maklerski Pekao S.A.	-	-	-	-	722 510	-	-
Pekao Fundusz Kapitałowy Sp. z o.o. (in liguidation)	-	-	-	-	52 148	-	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	-	-	-	98	14 778	-	-
Centrum Kart S.A.	-	-	-	90	24 172	-	9 700
Pekao Financial Services Sp. z o. o.	-	-	-	4	13 373	-	-
Pekao Bank Hipoteczny S.A.	67 155	-	3 262	136	11 108	6 854	-
Pekao Property S.A.	6 230	-	-	-	33 402	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	16	-	-	-	5 225	-	6 666
FPB – Media Sp. z o. o.	9 144	-	-	-	643	-	-
Dom Inwestycyjny Xelion Sp. z o.o.	-	-	-	3	34 087	-	-
Pekao Investment Management S.A.	-	-	-	13 220	197 118	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	-	-	-	-	126 952	-	-
Total of Bank Pekao S.A. Group entieties	**4 109 821**	**8 911**	**3 429**	**44 999**	**1 591 997**	**6 854**	**33 714**
Key management personnel of the Bank Pekao S.A.	458	-	-	-	8 111	-	-
Total	**4 111 289**	**8 911**	**3 918**	**45 892**	**2 566 650**	**11 916**	**33 714**

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

31.12.2017	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank ‘s parent entity	-	-	-	-	-	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	900	110	-	-	-	-	1 010
Bank Pekao S.A. Group entities							
Subsidiaries	249 748	60 468	173 454	2 057 393	1 511 056	57 702	4 109 821
Key management personnel of the Bank Pekao S.A.	-	-	-	6	28	424	458
Total	**250 648**	**60 578**	**173 454**	**2 057 399**	**1 511 084**	**58 126**	**4 111 289**

(*) Current receivables include Nostro account and cash collaterals

Liabilities due to loans and deposits by contractual maturity

31.12.2017	CURRENT (*)	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1AND 5 YEARS	OVER 5 YEARS	TOTAL
PZU S.A. – the Bank ‘s parent entity	3 978	473 507	-	-	-	-	477 485
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	6 249	482 808	-	-	-	-	489 057
Bank Pekao S.A. Group entities							
Subsidiaries	983 072	161 815	409 884	9 413	27 813	-	1 591 997
Key management personnel of the Bank Pekao S.A.	5 504	-	2 607	-	-	-	8 111
Total	**998 803**	**1 118 130**	**412 491**	**9 413**	**27 813**	**-**	**2 566 650**

(*) Current receivables include Loro account and cash collaterals

Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

31.12.2017	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank ‘s parent entity	-	-	-	-	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	1 010	-	1 010
Bank Pekao S.A. Group entities						
Subsidiaries	621 173	16 817	479	3 465 140	6 212	4 109 821
Key management personnel of the Bank Pekao S.A.	-	-	387	71	-	458
Total	**621 173**	**16 817**	**866**	**3 466 221**	**6 212**	**4 111 289**

Liabilities due to loans and deposits by currency

31.12.2017	EUR	USD	CHF	PLN	OTHER	TOTAL
PZU S.A. – the Bank ‘s parent entity	301	-	-	477 184	-	477 485
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	93	1	247	488 716	-	489 057
Bank Pekao S.A. Group entities						
Subsidiaries	44 457	39 171	6 073	1 499 756	2 540	1 591 997
Key management personnel of the Bank Pekao S.A.	3 483	185	5	4 435	3	8 111
Total	**48 334**	**39 357**	**6 325**	**2 470 091**	**2 543**	**2 566 650**

Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2018 to 31 December 2018

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSIO EXPENSE	INCOME FROM DERIVATIVES AND OTHER	EXPENSES FROM DERIVATIVES AND OTHER
PZU S.A. – the Bank ‘s parent entity	990	(238)	850	-	376	(6 473)
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	290	(512)	4 691	(147)	6 855	(1 233)
Bank Pekao S.A. Group entities						
Subsidiaries						
Pekao Investment Banking S.A.	2	(2 727)	183	(94)	69	(5)
Centralny Dom Maklerski Pekao S.A.	-	(2 353)	1 288	(3 913)	3 100	(2 655)
Pekao Leasing Sp. z o.o.	40 292	(6 338)	9 572	(12)	1 066	(450)
Pekao Faktoring Sp. z o.o.	22 581	(11)	873	-	325	-
Pekao Powszechne Towarzystwo Emerytalne S.A. (in liguidation)	-	(301)	557	-	3	-
Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation)	-	(584)	5	-	28	-
Centrum Kart S.A.	-	(161)	955	-	1 015	(49 710)
Pekao Financial Services Sp. z o.o.	-	(93)	68	-	54	-
Pekao Bank Hipoteczny S.A.	2 153	(639)	1 652	-	1 083	(5 967)
Centrum Bankowości Bezpośredniej Sp. z o.o.	-	(5)	5	(23 081)	1 665	(42 946)
Pekao Property S.A.	-	(272)	3	-	21	-
FPB - Media Sp. z o.o.	280	(3)	3	-	-	-
Dom Inwestycyjny Xelion Sp. z o.o.	-	(508)	50	-	22	-
Pekao Investment Management S.A.	-	(1 943)	10	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	-	(1 422)	155 920	-	-	-
Total of Bank Pekao S.A. Group entities	**65 308**	**(17 360)**	**171 144**	**(27 100)**	**8 451**	**(101 733)**
Key management personnel of the Bank Pekao S.A.	2	(64)	1	-	-	-
Total	**66 590**	**(18 174)**	**176 686**	**(27 247)**	**15 682**	**(109 439)**

Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2017 to 31 December 2017

NAME OF ENTITY	INTEREST INCOME	INTERES EXPENSE	FEE AND COMMISSION INCOME	FEE AND COMMISSION EXPENSE	INCOME FROM DERIVATIVES AND OTHER	EXPENSES FROM DERIVATIVES AND OTHER
PZU S.A. – the Bank ‘s Pekao S.A. parent entity (*)	49	(88)	1 239	-	48	(182)
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities (*)	436	(255)	1 307	(79)	788	(52)
UniCredit S.p.A. – the Bank's Pekao S.A. parent entity (**)	154	(153)	391	(1 197)	1 510	(3 825)
Entities of UniCredit Group excluding the Bank Pekao S.A. Group entities (**)	3 275	(1 253)	3 321	(62)	14 472	(1 725)
Bank Pekao S.A. Group entities						
Subsidiaries						
Pekao Investment Banking S.A.	1	(2 815)	157	(5 966)	71	-
Centralny Dom Maklerski Pekao S.A.	-	(4 003)	1 347	(2 043)	2 950	(2 793)
Pekao Leasing Sp. z o.o.	67 918	(8 106)	2 418	-	2 067	(30)
Pekao Faktoring Sp. z o.o.	20 156	-	154	-	292	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	-	(175)	1 341	-	6	-
Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation)	-	(596)	6	-	31	-
Centrum Kart S.A.	-	(198)	1 006	-	1 023	(48 606)
Pekao Financial Services Sp. z o.o.	-	(130)	43	-	39	-
Pekao Bank Hipoteczny S.A.	1 057	55	1 016	-	1 123	(7 709)
Centrum Bankowości Bezpośredniej Sp. z o.o.	-	(5)	5	(21 685)	1 625	(38 942)
Pekao Property S.A.	107	(14)	3	-	18	-
FPB - Media Sp. z o.o.	325	(5)	2	-	-	-
Dom Inwestycyjny Xelion Sp. z o.o. (***)	-	(33)	4	-	2	-
Pekao Investment Management S.A. (***)	-	(241)	1	-	-	-
Pekao TFI S.A. (jednostka zależna PIM S.A.) (***)	-	(123)	14 184	-	-	-
Associates						
Dom Inwestycyjny Xelion Sp. z o.o. (****)	-	(366)	39	-	163	-
Pekao Investment Management S.A. (****)	-	(1 800)	9	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary) (****)	-	(1 189)	152 509	-	-	-
Total of Bank Pekao S.A. Group entities	**89 564**	**(19 744)**	**174 244**	**(29 694)**	**9 410**	**(98 080)**
Key management personnel of the Bank Pekao S.A.	108	(198)	2	-	-	-
Total	**93 586**	**(21 691)**	**180 504**	**(31 032)**	**26 228**	**(103 864)**

(*) data from the date of taking control by PZU S.A.
(**) data until the day of loss of control by UniCredit S.p.A.
(***) data from the date when the Group has taken control over the entities (discontinuation of the eguity method valuation)
(****) data till the date when the Group has taken control over the entities (discontinuation of the equity method valuation)

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees as at 31 December 2018

NAME OF ENTITY	GRANTED		RECEIVED	
	FINANCIAL	GUARANTEES	FINANCIAL	GUARANTEES
PZU S.A. – the Bank ‘s parent entity	2 818	15 000	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	617	16 000	-	6 000
Bank Pekao S.A. Group entities				
Subsidiaries				
Pekao Investment Banking S.A.	124	-	-	-
Pekao Leasing Sp. z o.o.	2 375 537	6 114 794	-	-
Pekao Faktoring Sp. z o.o.	677 320	-	-	-
Centralny Dom Maklerski Pekao S.A.	60	-	-	-
Pekao Powszechne Towarzystwo Emerytalne S.A. (in liguidation)	60	-	-	-
Centrum Kart S.A.	83	3 000	-	-
Pekao Financial Services Sp. z o. o.	65	1 086	-	-
Pekao Bank Hipoteczny S.A.	507 203	310 253	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	34	-	-	-
Dom Inwestycyjny Xelion Sp. z o.o.	5	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	89	-	-	-
Total of Bank Pekao S.A. Group entities	**3 560 580**	**6 429 133**	**-**	**-**
Key management personnel of the Bank Pekao S.A.	488	-	-	-
Total	**3 564 503**	**6 460 133**	**-**	**6 000**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees granted by contractual maturity

31.12.2018	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Financial commitments granted							
PZU S.A. – the Bank 's parent entity	-	-	-	-	2 818	-	2 818
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	20	-	-	597	-	617
Bank Pekao S.A. Group entities							
Subsidiaries	-	-	507 116	3 052 873	591	-	3 560 580
Key management personnel of the Bank Pekao S.A.	-	-	-	75	412	1	488
Total	**-**	**20**	**507 116**	**3 052 948**	**4 418**	**1**	**3 564 503**
Guarantees issued							
PZU S.A. – the Bank 's parent entity	-	49	11	14 940	-	-	15 000
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	50	6 040	9 910	-	-	16 000
Bank Pekao S.A. Group entities							
Subsidiaries	-	609 400	635 000	1 451 075	1 239 658	2 494 000	6 429 133
Total	**-**	**609 499**	**641 051**	**1 475 925**	**1 239 658**	**2 494 000**	**6 460 133**
Guarantees received							
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	6 000	-	-	-	6 000
Total	**-**	**-**	**6 000**	**-**	**-**	**-**	**6 000**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees granted by currency

31.12.2018	EUR	USD	CHF	PLN	INNE	TOTAL
Financial commitments granted						
PZU S.A. – the Bank ‘s parent entity	-	-	-	2 818	-	2 818
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	617	-	617
Bank Pekao S.A. Group entities						
Subsidiaries	-	-	-	3 560 580	-	3 560 580
Key management personnel of the Bank Pekao S.A.	-	-	-	488	-	488
Total	**-**	**-**	**-**	**3 564 503**	**-**	**3 564 503**
Guarantees issued						
PZU S.A. – the Bank ‘s parent entity	-	-	-	15 000	-	15 000
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	16 000	-	16 000
Bank Pekao S.A. Group entities						
Subsidiaries	3 002 009	-	-	3 427 124	-	6 429 133
Total	**3 002 009**	**-**	**-**	**3 458 124**	**-**	**6 460 133**
Guarantees received						
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	6 000	-	6 000
Total	**-**	**-**	**-**	**6 000**	**-**	**6 000**

Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees as at 31 December 2017

NAME OF ENTITY	GRANTED		RECEIVED	
	FINANCIAL	GUARANTEES	FINANCIAL	GUARANTEES
PZU S.A. – the Bank 's parent entity	2 509	-	-	-
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	599	-	-	-
Bank Pekao S.A. Group entities				
Subsidiaries				
Pekao Investment Banking S.A.	122	-	-	-
Pekao Leasing Sp. z o.o.	767 159	1 822 737	-	-
Pekao Faktoring Sp. z o.o.	588 420	-	-	-
Centralny Dom Maklerski Pekao S.A.	80	-	-	-
Pekao Powszechne Towarzystwo Emerytalne S.A.	60	-	-	-
Centrum Kart S.A.	64	3 000	-	-
Pekao Financial Services Sp. z o. o.	45	790	-	-
Pekao Bank Hipoteczny S.A.	432 875	356 720	-	-
Centrum Bankowości Bezpośredniej Sp. z o.o.	34	-	-	-
Pekao Investment Management S.A.	15	-	-	-
Pekao TFI S.A. (PIM S.A. subsidiary)	98	-	-	-
Total of Bank Pekao S.A. Group entities	**1 788 972**	**2 183 247**	**-**	**-**
Key management personnel of the Bank Pekao S.A.	553	-	-	-
Total	**1 792 633**	**2 183 247**	**-**	**-**

Notes to the financial statements (cont.)

(in PLN thousand)

Off-balance sheet financial commitments and guarantees granted by contractual maturity

31.12.2017	CURRENT	UP TO 1 MONTH	BETWEEN 1 AND 3 MONTHS	BETWEEN 3 MONTHS AND 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	TOTAL
Financial commitments granted							
PZU S.A. – the Bank ‘s parent entity	-	-	-	-	2 509	-	2 509
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	20	-	-	579	-	599
Bank Pekao S.A. Group entities							
Subsidiaries	-	-	432 849	1 271 946	84 177	-	1 788 972
Key management personnel of the Bank Pekao S.A.	10	-	-	24	126	393	553
Total	**10**	**20**	**432 849**	**1 271 970**	**87 391**	**393**	**1 792 633**
Guarantees issued							
Bank Pekao S.A. Group entities							
Subsidiaries	-	-	1 719	112 621	492 198	1 576 709	2 183 247
Total	**-**	**-**	**1 719**	**112 621**	**492 198**	**1 576 709**	**2 183 247**

Off-balance sheet financial commitments and guarantees granted by currency

31.12.2017	EUR	USD	CHF	PLN	INNE	TOTAL
Financial commitments granted						
PZU S.A. – the Bank ‘s parent entity	-	-	-	2 509	-	2 509
Entities of PZU S.A. Group excluding the Bank Pekao S.A. Group entities	-	-	-	599	-	599
Bank Pekao S.A. Group entities						
Subsidiaries	6 673	13 125	-	1 759 868	9 306	1 788 972
Key management personnel of the Bank Pekao S.A.	-	-	-	553	-	553
Total	**6 673**	**13 125**	**-**	**1 763 529**	**9 306**	**1 792 633**
Guarantees issued						
Bank Pekao S.A. Group entities						
Subsidiaries	1 712 455	-	356 720	114 072	-	2 183 247
Total	**1 712 455**	**-**	**356 720**	**114 072**	**-**	**2 183 247**

Notes to the financial statements (cont.)

(in PLN thousand)

Remuneration expenses of the Bank's Management Board and Supervisory Board Members

	VALUE OF BENEFITS	
	2018	**2017**
Management Board of the Bank		
Short-term employee benefits (*)	12 817	15 072
Post-employment benefits	1 169	448
Long-term benefits (**)	1 350	2 266
Paid termination benefits	2 808	6 642
Share-based payments (***)	2 975	7 050
Total	**21 119**	**31 478**
Supervisory Board of the Bank		
Short-term employee benefits (*)	1 279	1 225
Total	**1 279**	**1 225**

(*) Short-term employee benefits include: base salary, bonuses and other benefits due in next 12 months from the date of the balance sheet.
(**) The item 'Other long-term benefit' includes: provisions for deferred bonus payments.
(***) The value of share-based payments is a part of Personnel Expenses, recognized according to IFRS 2 during the reporting period in the income statement, representing the settlement of fair value of share options and shares, including phantom shares, granted to the Members of the Bank's Management Board.

The Bank's Management Board and Supervisory Board Members did not receive any remuneration from subsidiaries and associates in the period from 1 January to 31 December 2018 and in the period from 1 January to 31 December 2017.

52. Repo and reverse repo transactions

The Bank increases its funds through the sale of financial instruments with the repurchase promise granted (repo and sell-buy back) at the same price increased by interest.

Securities composing the balance sheet portfolio of the Bank as well as securities with obligation of resale (reverse repo and buy-sell back transactions) may be a subject to repo and sell-buy back transactions.

Notes to the financial statements (cont.)

(in PLN thousand)

Securities composing the balance sheet portfolio of the Bank and treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Bank holds all benefits and risk deriving from these assets.

	31.12.2018		31.12.2017	
	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RELATED LIABILITIES	FAIR VALUE OF ASSETS	CARRYING AMOUNT OF RELATED LIABILITIES
Financial assets held for trading				
up to 1 month	67 432	67 447	123 797	123 812
Total financial assets held for trading	**67 432**	**67 447**	**123 797**	**123 812**
Financial assets measured at fair value through other comprehensive income				
up to 1 month	225 248	225 424	X	X
Total financial assets measured at fair value through other comprehensive income	**225 248**	**225 424**	**X**	**X**
Financial assets measured at amortised cost				
up to 1 month	41 314	40 092	X	X
from 1 to 3 months	84 672	82 156	X	X
Total financial assets measured at amortised cost	**125 986**	**122 248**	**X**	**X**
Financial assets available for sale				
up to 1 month	X	X	915 423	916 637
from 1 to 3 months	X	X	49 425	49 427
Total financial assets available for sale	**X**	**X**	**964 848**	**966 064**
Total	**418 666**	**415 119**	**1 088 645**	**1 089 876**

The Bank purchases financial instruments with the obligations of repurchase or resale (reverse-repo and buy-sell back) at the same price increased by interest.

Securities treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Bank holds all the benefits and the risk deriving from these assets.

	31.12.2018		31.12.2017	
	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGING ASSETS	CARRYING AMOUNT OF ASSETS	FAIR VALUE OF HEDGING ASSETS
Loans and advances from banks				
up to 1 month	126 440	125 810	494 706	492 418
Total loans and advances from banks	**126 440**	**125 810**	**494 706**	**492 418**
Total	**126 440**	**125 810**	**494 706**	**492 418**

Financial assets which are subject to reverse repo and buy-sell back transactions constitute collateral accepted by the Bank, which the Bank has the right to sell or pledge.

	31.12.2018	31.12.2017
Fair value of assets pledged as collaterals, in this:	125 810	492 418
Short sale	102 429	469 448
Reverse repo transactions/ buy-sell-back	-	-

(in PLN thousand)

53. Company Social Benefits Fund ('ZFŚS')

The Social Benefits Fund Act of 4 March 1994 with subsequent amendments introduced the requirement to create a Company's Social Benefits Fund by all employers employing over 20 employees. The Bank has created the ZFŚS Fund and is making periodic charges to the ZFŚS Fund in amounts required by the Act. The basic aim of the ZFŚS Fund is to subsidize social assistance in benefit of the employees, former employees (pensioners and the retired) and entitled members of their families.

The liabilities of the ZFŚS Fund represent the accumulated value of charges made by the Company towards the ZFŚS Fund decreased by the amount of non-returnable expenditures of the ZFŚS Fund.

In the statement of financial position, the Bank netted the ZFŚS Fund assets against the ZFŚS Fund value, due to the fact that the assets of the ZFŚS Fund do not represent the assets of the Bank. For this reason the amount pertaining to the ZFŚS Fund in the unconsolidated statement of financial position as at 31 December 2018 and 31 December 2017 was nil.

The table below presents the assets according to type and book value, the balance of the Fund and costs related to ZFŚS.

	31.12.2018	**31.12.2017**
Loans granted to employees	27 803	33 027
Cash at ZFŚS account	4 115	1 561
ZFŚS assets	**31 918**	**34 588**
ZFŚS value	**31 918**	**34 588**
	2018	**2017**
Deductions made to ZFŚS during fiscal period	23 460	24 614

54. Subsequent events

Lawsuit brought after the balance-sheet day

On 16 January 2019 the Bank was delivered a lawsuit brought by a legal person for payment of the amount 12 074 828 PLN by virtue of undue benefit payment. The Bank is preparing response to the lawsuit and estimating probability of the funds outflow risk.

Signatures of the Management Board Members

Date	Name/Surname	Position/Function	Signature
25.02.2019	Michał Krupiński	President of the Management Board	
25.02.2019	Tomasz Kubiak	Vice President of the Management Board	
25.02.2019	Michał Lehmann	Vice President of the Management Board	
25.02.2019	Marek Lusztyn	Vice President of the Management Board	
25.02.2019	Tomasz Styczyński	Vice President of the Management Board	
25.02.2019	Marek Tomczuk	Vice President of the Management Board	
25.02.2019	Magdalena Zmitrowicz	Vice President of the Management Board	

Glossary

IFRS – International Financial Reporting Standards – the standards, interpretations and their structure adopted by the International Accounting Standards Board (IASB.)

IAS – International Accounting Standards – previous name of the standards forming part of the current IFRS.

IFRIC – International Financial Reporting Interpretations Committee – the committee operating under the International Accounting Standards Board publishing interpretations of IFRS.

CIRS – Currency Interest Rate Swap – the transaction exchange of principal amounts and interest payments in different currencies between two counterparties.

IRS – Interest Rate Swap – the agreement between two counterparties, under which the counterparties pay each other (at specified intervals during the contract life) interest on contractual principal of the contract, charged at a different interest rate.

FRA – Forward Rate Agreement – the contract under which two counterparties fix the interest rate that will apply in the future for a specified amount expressed in currency of the transaction for a predetermined period.

CAP – the financial agreement, which limits the risk borne by lender on a variable interest rate, exposed to the potential loss as a result of increase in interest rates. Cap option is a series of call options on interest rates, in which the issuer guarantees the buyer the compensation of the additional interest costs, that the buyer must pay if the interest rate on loan increases above the fixed interest rate.

FLOOR –the financial agreement, which limits the risk of incurring losses resulting from decrease in interest rates by the lender providing the loan at a variable interest rate. Floor option is a series of put options on interest rates, in which the issuer guarantees the interest to be paid on the loan if the interest rate on the loan decreases below the fixed interest rate.

IBNR – Incurred but Not Reported losses.

PD – Probability Default – the parameter used in Internal Ratings-Based Approach which determines the likelihood that the debtor will be unable to meet its obligation. PD is a financial term describing the likelihood of a default over an one year time horizon.

LGD – Loss Given Default – the percentage of loss over the total exposure when bank's counterparty goes to default.

EAD – Exposure at Default.

EL – Expected Loss.

CCF – Credit Conversion Factor.

VaR – Value at Risk – the risk measure by which the market value of an asset or portfolio may be reduced for a given assumptions, probability and time horizon.

ICAAP – Internal Capital Adequacy Assessment Process – the process of assessing internal capital adequacy.

FVH – fair value hedge accounting.

CFH – cash flow hedge accounting.