



CAPITAL GROUP OF
BANK HANDLOWY W WARSZAWIE S.A.

ANNUAL REPORT 2016

MARCH 2017

| SELECTED FINANCIAL DATA | PLN'000 | | EUR'000** | |
|---|-------------|-------------|-------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Interest income | 1,258,604 | 1,232,413 | 287,635 | 294,497 |
| Fee and commission income | 639,348 | 709,435 | 146,113 | 169,527 |
| Profit before tax | 764,328 | 790,775 | 174,676 | 188,964 |
| Net profit | 601,580 | 626,419 | 137,482 | 149,689 |
| Total comprehensive income | 551,381 | 410,813 | 126,010 | 98,168 |
| Increase/decrease of net cash | (1,681,470) | 621,437 | (384,275) | 148,499 |
| Total assets | 45,209,916 | 49,506,792 | 10,219,240 | 11,617,222 |
| Amounts due to banks | 2,310,742 | 6,963,561 | 522,320 | 1,634,063 |
| Amounts due to customers | 33,936,511 | 31,586,303 | 7,671,002 | 7,412,015 |
| Shareholders' equity | 6,790,450 | 6,850,656 | 1,534,912 | 1,607,569 |
| Share capital | 522,638 | 522,638 | 118,137 | 122,642 |
| Number of shares (in pcs) | 130,659,600 | 130,659,600 | 130,659,600 | 130,659,600 |
| Book value per share (PLN/EUR) | 51.97 | 52.43 | 11.75 | 12.30 |
| Total capital adequacy ratio (in %) | 17.4 | 17.1 | 17.4 | 17.1 |
| Earnings per share (PLN/EUR) | 4.60 | 4.79 | 1.05 | 1.15 |
| Diluted net earnings per share (PLN/EUR) | 4.60 | 4.79 | 1.05 | 1.15 |
| Declared or paid dividends per share (PLN/EUR)* | 4.53 | 4.68 | 1.02 | 1.10 |

*The presented ratios are related to declared dividend from the appropriation of the 2016 profit and dividend paid in 2016 from the appropriation of the 2015 profit.

**The following foreign exchange rates were applied to convert PLN into EUR: for the consolidated statement of financial position - NBP mid exchange rate as at 31 December 2016 - PLN 4.4240 (as at 31 December 2015: PLN 4.2615); for the consolidated income statement, consolidated statement of comprehensive income and consolidated cash flow statement – the arithmetic mean of NBP end-of-month exchange rates in 2016 – PLN 4.3757 (in 2015: PLN 4.1848).



THE ANNUAL CONSOLIDATED FINANCIAL STATEMENTS
OF THE CAPITAL GROUP OF
BANK HANDLOWY W WARSZAWIE S.A.
FOR THE FINANCIAL YEAR ENDED
31 DECEMBER 2016

MARCH 2017

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Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A.
for the financial year ended 31 December 2016

Consolidated income statement

| | For the period | 2016 | 2015 |
|---|----------------|--------------------|--------------------|
| PLN'000 | Note | | |
| Interest and similar income | 4 | 1,258,604 | 1,232,413 |
| Interest expense and similar charges | 4 | (255,033) | (255,813) |
| Net interest income | 4 | 1,003,571 | 976,600 |
| Fee and commission income | 5 | 639,348 | 709,435 |
| Fee and commission expense | 5 | (78,119) | (78,085) |
| Net fee and commission income | 5 | 561,229 | 631,350 |
| Dividend income | 6 | 8,050 | 7,382 |
| Net income on trading financial instruments and revaluation | 7 | 347,197 | 293,118 |
| Net gain on debt investment securities available-for-sale | | 44,746 | 145,246 |
| Net gain on capital investment instruments available-for-sale | | 95,913 | 2,232 |
| Net gain on hedge accounting | 8 | 9,553 | 7,949 |
| Other operating income | 9 | 40,134 | 40,139 |
| Other operating expenses | 9 | (28,929) | (52,309) |
| Net other operating income | 9 | 11,205 | (12,170) |
| General administrative expenses | 10 | (1,132,301) | (1,207,875) |
| Depreciation expense | 11 | (69,922) | (70,422) |
| Profit/loss on sale of other assets | 12 | 116 | 102 |
| Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted | 13 | (45,768) | 17,202 |
| Operating profit | | 833,589 | 790,714 |
| Share in net profits of entities valued at equity method | | 50 | 61 |
| Tax on some financial institutions | | (69,311) | - |
| Profit before tax | | 764,328 | 790,775 |
| Income tax expense | 14 | (162,748) | (164,356) |
| Net profit | | 601,580 | 626,419 |
| Including: | | | |
| Net profit attributable to the Bank's shareholders | | 601,580 | 626,419 |
| Weighted average number of ordinary shares (in pcs) | 15 | 130,659,600 | 130,659,600 |
| Net earnings per share (PLN) | 15 | 4.60 | 4.79 |
| Diluted net earnings per share (PLN) | 15 | 4.60 | 4.79 |

Explanatory notes on pages 11-86 are an integral part of the annual consolidated financial statements.

Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A.
for the financial year ended 31 December 2016

Consolidated statement of comprehensive income

| | For the period | 2016 | 2015 |
|---|----------------|-----------------|------------------|
| <i>PLN'000</i> | Note | | |
| Net profit | | 601,580 | 626,419 |
| Other comprehensive income, that might be subsequently reclassified to profit or loss: | | | |
| Net valuation of financial assets available-for-sale | 16 | (51,230) | (216,486) |
| Foreign exchange differences | | 753 | (6) |
| Other comprehensive income, that might not be subsequently reclassified to profit or loss: | | | |
| Net actuarial profits on specific services program valuation | 16 | 278 | 886 |
| Other comprehensive income after tax | | (50,199) | (215,606) |
| Total comprehensive income for the period | | 551,381 | 410,813 |
| Including: | | | |
| Comprehensive income attributable to the Bank's shareholders | | 551,381 | 410,813 |

Explanatory notes on pages 11-86 are an integral part of the annual consolidated financial statements.

Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A.
for the financial year ended 31 December 2016

Consolidated statement of financial position

| | As at | 31.12.2016 | 31.12.2015 |
|--|-------|-------------------|-------------------|
| PLN'000 | Note | | |
| ASSETS | | | |
| Cash and balances with the Central Bank | 17 | 665,755 | 2,170,237 |
| Amounts due from banks | 18 | 587,087 | 757,103 |
| Financial assets held-for-trading | 19 | 3,781,405 | 6,987,284 |
| Hedging derivatives | 20 | 12,244 | 1,795 |
| Debt securities available-for-sale | 21 | 19,072,371 | 18,351,259 |
| Equity investments valued at equity method | 22 | 10,471 | 7,768 |
| Equity investments available-for-sale | 23 | 22,842 | 67,744 |
| Amounts due from customers | 24 | 18,860,053 | 18,975,471 |
| Tangible fixed assets | 25 | 342,971 | 354,080 |
| Intangible assets | 26 | 1,350,861 | 1,371,879 |
| Current income tax receivables | | 13,901 | 20,673 |
| Deferred income tax asset | 28 | 198,383 | 161,586 |
| Other assets | 29 | 289,644 | 277,985 |
| Non-current assets held-for-sale | | 1,928 | 1,928 |
| Total assets | | 45,209,916 | 49,506,792 |
| LIABILITIES | | | |
| Amounts due to banks | 30 | 2,310,742 | 6,963,561 |
| Financial liabilities held-for-trading | 19 | 1,305,614 | 3,247,523 |
| Hedging derivatives | 20 | 39,897 | 112,383 |
| Amounts due to customers | 31 | 33,936,511 | 31,586,303 |
| Provisions | 32 | 22,856 | 23,494 |
| Other liabilities | 33 | 803,846 | 722,872 |
| Total liabilities | | 38,419,466 | 42,656,136 |
| EQUITY | | | |
| Share capital | 35 | 522,638 | 522,638 |
| Supplementary capital | 35 | 3,003,082 | 3,001,525 |
| Revaluation reserve | 35 | (214,843) | (163,613) |
| Other reserves | 35 | 2,885,044 | 2,869,509 |
| Retained earnings | | 594,529 | 620,597 |
| Total equity | | 6,790,450 | 6,850,656 |
| Total liabilities and equity | | 45,209,916 | 49,506,792 |

Explanatory notes on pages 11-86 are an integral part of the annual consolidated financial statements.

Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A.
for the financial year ended 31 December 2016

Consolidated statement of changes in equity

| <i>PLN'000</i> | Share capital | Supplementary capital | Revaluation reserve | Other reserves | Retained earnings | Non-controlling interest | Total equity |
|--|----------------|-----------------------|---------------------|------------------|-------------------|--------------------------|------------------|
| As at 1 January 2016 | 522,638 | 3,001,525 | (163,613) | 2,869,509 | 620,597 | - | 6,850,656 |
| Total comprehensive income including: | - | - | (51,230) | 1,031 | 601,580 | - | 551,381 |
| net profit | - | - | - | - | 601,580 | - | 601,580 |
| exchange rate differences from foreign units' conversion | - | - | - | 753 | - | - | 753 |
| valuation of financial assets available-for-sale (net) | - | - | (51,230) | - | - | - | (51,230) |
| net actuarial profits on specific services program valuation | - | - | - | 278 | - | - | 278 |
| Dividends paid | - | - | - | - | (611,587) | - | (611,587) |
| Transfer to capital | - | 1,557 | - | 14,504 | (16,061) | - | - |
| As at 31 December 2016 | 522,638 | 3,003,082 | (214,843) | 2,885,044 | 594,529 | - | 6,790,450 |

Note: 16, 35

| <i>PLN'000</i> | Share capital | Supplementary capital | Revaluation reserve | Other reserves | Retained earnings | Non-controlling interest | Total equity |
|--|----------------|-----------------------|---------------------|------------------|-------------------|--------------------------|------------------|
| As at 1 January 2015 | 522,638 | 3,000,298 | 52,873 | 2,893,523 | 941,428 | - | 7,410,760 |
| Total comprehensive income, including: | - | - | (216,486) | 880 | 626,419 | - | 410,813 |
| net profit | - | - | - | - | 626,419 | - | 626,419 |
| exchange rate differences from foreign units' conversion | - | - | - | (6) | - | - | (6) |
| valuation of financial assets available-for-sale (net) | - | - | (216,486) | - | - | - | (216,486) |
| net actuarial profits on specific services program valuation | - | - | - | 886 | - | - | 886 |
| Dividends paid | - | - | - | - | (970,917) | - | (970,917) |
| Transfer to capital | - | 1,227 | - | (24,894) | 23,667 | - | - |
| As at 31 December 2015 | 522,638 | 3,001,525 | (163,613) | 2,869,509 | 620,597 | - | 6,850,656 |

Note: 16, 35

Explanatory notes on pages 11-86 are an integral part of the annual consolidated financial statements.

Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A.
for the financial year ended 31 December 2016

Consolidated cash flow statement

| | For the period | 2016 | 2015 |
|--|----------------|--------------------|--------------------|
| <i>PLN'000</i> | | | |
| A. Cash flows from operating activities | | | |
| I. Net profit | | 601,580 | 626,419 |
| II. Adjustments to reconcile net profit or loss to net cash provided by operating activities: | | (2,624,803) | 228,647 |
| Current and deferred income tax recognized in income statement | | 162,748 | 164,356 |
| Share in net profits/losses of entities valued at equity method | | (50) | (61) |
| Depreciation expense | | 69,922 | 70,422 |
| Net impairment due to financial assets value loss | | 49,005 | (14,416) |
| Net provisions (recoveries) | | 8,426 | 13,911 |
| Net interest income | | (1,003,571) | (976,600) |
| Profit/loss on sale of investments | | (86) | (77) |
| Net unrealized exchange differences | | 1,813 | (14,533) |
| Other adjustments | | (12,102) | 7,110 |
| Cash flows from operating income before changes in operating assets and liabilities | | (723,895) | (749,888) |
| Change in operating assets (excl. cash and cash equivalents) | | 2,267,213 | 614,873 |
| Change in amounts due from banks | | (6,145) | 1,279,141 |
| Change in amounts due from customers | | 75,417 | (2,187,882) |
| Change in debt securities available-for-sale | | (932,036) | (4,285,478) |
| Change in equity investments available-for-sale | | 656 | 3,502 |
| Change in financial assets held-for-trading | | 3,147,247 | 5,696,941 |
| Change in assets hedge derivatives | | (10,449) | (1,795) |
| Change in other assets | | (7,477) | 110,444 |
| Change in operating liabilities (excl. cash and cash equivalents) | | (4,168,121) | 363,662 |
| Change in amounts due to banks | | (4,577,923) | 1,992,079 |
| Change in amounts due to customers | | 2,349,347 | 1,956,310 |
| Change in liabilities held-for-trading | | (1,941,909) | (3,523,399) |
| Change in amounts due to hedging derivatives | | (72,486) | 112,383 |
| Change in other liabilities | | 74,850 | (173,711) |
| Interest received | | 1,517,624 | 1,308,427 |
| Interest paid | | (258,049) | (255,530) |
| Income tax paid | | (187,564) | (128,577) |
| III. Net cash flows from operating activities | | (951,212) | 1,779,386 |
| B. Cash flows from investing activities | | | |
| Purchase of tangible fixed assets | | (28,951) | (34,502) |
| Disposal of tangible fixed assets | | 1,358 | 6,259 |
| Purchase of intangible assets | | (15,441) | (20,873) |
| Disposal of fixed assets available-for-sale | | 73 | 250 |
| Other investing inflows | | 57 | 58 |
| Net cash flows from investing activities | | (42,904) | (48,808) |
| C. Cash flows from financing activities | | | |
| Dividends paid | | (611,587) | (970,917) |
| Expenditure on the acquisition of own shares | | (2,711) | - |
| Inflows due to long-term loans from financial sector entities | | 21,873 | 56,461 |
| Repayment of long-term loans from financial sector entities | | (99,610) | (202,379) |
| Net cash flows from financing activities | | (692,035) | (1,116,835) |
| D. Exchange rates differences resulting from cash and cash equivalents conversion | | 4,681 | 7,694 |
| E. Net increase/ decrease in cash and cash equivalents | | (1,681,470) | 621,437 |
| F. Cash at the beginning of the period | | 2,354,352 | 1,732,915 |
| G. Cash at the end of the period (see Note 44) | | 672,882 | 2,354,352 |

Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A.
for the financial year ended 31 December 2016

Explanatory notes on pages 11-86 are an integral part of the annual consolidated financial statements.

Explanatory notes to the consolidated financial statements

1. General information about the Bank and the Capital Group ("the Group")

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

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

The parent entity and the entities of the Group were set up for an unspecified period of time.

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

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

The Bank is a universal commercial bank that offers a wide range of banking services for individuals and corporate clients on domestic and foreign markets. Additionally, the Group operates in the following segments of business through its subsidiaries:

- brokerage operations;
- leasing services;
- investment operations.

These annual consolidated financial statements of the Capital Group of Bank Handlowy w Warszawie S.A. show the data for the Bank as the parent and its subsidiaries (jointly "Group").

The Group consists of the Bank and the following subsidiaries:

| Subsidiaries | Registered office | % of share capital/votes at the General Meeting | |
|---|-------------------|---|------------|
| | | 31.12.2016 | 31.12.2015 |
| Entities fully consolidated | | | |
| Dom Maklerski Banku Handlowego S.A. | Warsaw | 100.00 | 100.00 |
| Handlowy-Leasing Sp. z o.o. | Warsaw | 100.00 | 100.00 |
| Handlowy Investments S.A. | Luxembourg | 100.00 | 100.00 |
| PPH Spomasz Sp. z o.o. w likwidacji | Warsaw | 100.00 | 100.00 |
| Entities accounted for under the equity method | | | |
| Handlowy-Inwestycje Sp. z o.o. | Warsaw | 100.00 | 100.00 |

Financial information on subsidiaries, 31.12.2016

Subsidiaries fully consolidated

| PLN'000 | | | | | | | | | |
|-------------------------------------|------------|---------------------|----------------------|----------------------|--------------------------|-------------|---------|----------|-------------|
| Name of subordinate | Location | Activity | Capital relationship | Share in equity [%]* | Assets | Liabilities | Equity | Revenues | Profit/loss |
| HANDLOWY – LEASING Sp. z o.o. | Warsaw | Leasing | Subsidiary | 97.47 | 44,921 | 9,022 | 35,899 | 7,772 | 7,691 |
| HANDLOWY INVESTMENTS S.A. | Luxembourg | Investment activity | Subsidiary | 100.00 | 19,303 | 447 | 18,856 | 421 | (55) |
| DOM MAKLEKSKI BANKU HANDLOWEGO S.A. | Warsaw | Brokerage | Subsidiary | 100.00 | 406,650 | 297,426 | 109,224 | 66,034 | 12,694 |
| PPH SPOMASZ Sp. z o.o. w likwidacji | Warsaw | - | Subsidiary | 100.00 | Entity under liquidation | | | | |

* direct share

Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A.
for the financial year ended 31 December 2016

Other entities

PLN'000

| Name of subordinate | Location | Activity | Capital relationship | Share in equity [%]* | Book value of shares | Assets | Liabilities | Equity | Revenues | Profit |
|-------------------------------------|----------|---------------------|----------------------|----------------------|----------------------|--------|-------------|--------|----------|--------|
| HANDLOWY – INWESTYCJE Sp. z o.o. 1/ | Warsaw | Investment activity | Subsidiary | 100.00 | 964 | 10,913 | 28 | 10,885 | 212 | 50 |

* direct share

The explanation of indirect relationships:

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

PLN'000

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

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

Financial information on subsidiaries 31.12.2015

Subsidiaries fully consolidated

PLN'000

| Name of subordinate | Location | Activity | Capital relationship | Share in equity [%]* | Assets | Liabilities | Equity | Revenues | Profit/Loss |
|-------------------------------------|------------|---------------------|----------------------|----------------------|---------|-------------|--------------------------|----------|-------------|
| HANDLOWY – LEASING Sp. z o.o. | Warsaw | Leasing | Subsidiary | 97.47 | 184,632 | 45,505 | 139,127 | 15,187 | 3,928 |
| HANDLOWY INVESTMENTS S.A. 1/ | Luxembourg | Investment activity | Subsidiary | 100.00 | 44,397 | 25,764 | 18,633 | 1,792 | (1,578) |
| DOM MAKLERSKI BANKU HANDLOWEGO S.A. | Warsaw | Brokerage | Subsidiary | 100.00 | 348,412 | 234,009 | 114,403 | 76,470 | 19,453 |
| PPH SPOMASZ Sp. z o.o. w likwidacji | Warsaw | - | Subsidiary | 100.00 | | | Entity under liquidation | | |

* direct share

Other entities

PLN'000

| Name of subordinate | Location | Activity | Capital relationship | Share in equity [%]* | Book value of shares | Assets | Liabilities | Equity | Revenues | Profit |
|-------------------------------------|----------|---------------------|----------------------|----------------------|----------------------|--------|-------------|--------|----------|--------|
| HANDLOWY – INWESTYCJE Sp. z o.o. 1/ | Warsaw | Investment activity | Subsidiary | 100.00 | 7,768 | 10,930 | 37 | 10,893 | 222 | 57 |

* direct share

The explanation of indirect relationships:

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

PLN'000

| Name of subordinate | Location | Activity | Capital relationship | Share in equity [%] | Book value of shares | Assets | Liabilities | Equity | Revenues | Profit |
|---------------------|----------|----------|----------------------|---------------------|----------------------|---------|-------------|---------|----------|--------|
| HANDLOWY - LEASING | Warsaw | Leasing | Subsidiary | 2.53 | 3,125 | 184,632 | 45,505 | 139,127 | 15,187 | 3,928 |

The above presented financial data of the entities available at the time of preparation of the financial statements originate from the audited financial statements of the entities except for, PPH Spomasz Sp. z o.o. in liquidation. Financial data of Handlowy Investments S.A. originate from the audited financial statements prepared as at 29 February 2016, which was the entity's balance sheet date.

The financial data of a subsidiary that is not fully consolidated are immaterial to the consolidated financial statements. As at 31 December 2016, the financial data amounted to 0.02% of the Group's assets (as at 31 December 2015: 0.02%) and 0.01% of the Group's net profit (as at 31 December 2015: 0.01%), excluding elimination of transactions within the Group.

2. Significant accounting policies

Declaration of conformity

The annual consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS") 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 2013, item 330 with further amendments) and respective operating regulations.

The annual consolidated financial statements have been approved by the Management Board of the Bank for publication on 21 March 2017. The financial statements will be finally approved by the General Shareholders' Meeting of the Bank.

The annual standalone financial statements were approved by the Management Board of the Bank for publication on 21 March 2017. The financial statements will be finally approved by the General Shareholders' Meeting of the Bank.

Basis of preparation

These annual consolidated financial statements of the Group have been prepared for the period from 1 January 2016 to 31 December 2016 and for the consolidated statements of financial situation as at 31 December 2016. The comparable financial data are presented for the period from 1 January 2015 to 31 December 2015 and for the consolidated statements of financial situation as at 31 December 2015.

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

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

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

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

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

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

Standards and interpretations approved or awaiting European Union's approval that can have an influence on financial statements of the Group:

- IFRS 9 "Financial Instruments" approved by EU's , was published by IASB on 24th July 2014 and is the final version superseding the previously published ones. The new standard implements changes in relation to IAS 39 in respect of the classification and measurement of financial assets and financial liabilities, impairment methodology that will focus on expected credit risk losses, and hedge accounting. IFRS 9 does not comprise hedge accounting of a portfolio of financial assets or financial liabilities. The standard will be in force from the 1st January 2018. The Group is in the process of work related to the analysis of the requirements of the new standard, estimation of the potential impact on its financial statement and implementation of IFRS 9 into accounting and operational processes in the Group. At present the Group claims that the new standard will have an impact on the presentation and measurement of certain financial instruments in the financial statements as well as the calculation of impairment of financial assets (IFRS 9 implementation progress is described below).
- IFRS 15 "Revenue from Contracts with Customers" awaiting EU's endorsement, was published by IASB on 28th May 2014. The core principle of the new Standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The revenue is recognized when the control over the goods or services is transferred to the customer. The Group is in the process of estimation of the potential impact of the standard on its financial statement.
- IFRS 16 "Leases" awaiting EU's endorsement, was published by IASB on 13th January 2016. This standard

replaces requirements introduced by IAS 17 "Leases". Under the new standard, the Bank will recognize lease contracts in the balance sheet. It will be necessary to recognize a right-of-use asset and a lease liability. The Group is in the process of estimating of the potential impact of the standard on its financial statement.

Other changes to standards awaiting European Union endorsement:

- amendment to IAS 40 explaining conditions for classification of investment property,
- annual improvements cycle 2014-2016 including: IFRS 1 regarding specific exclusions for first time IFRS adopters, IFRS 12 explaining disclosures for interests in other entities,
- amendments to IFRS 2 regarding classification and measurement of share based payment, especially in form of shares settled in equity,
- amendments to IAS 12 in respect of recognition of unrealized losses from debt instruments in deferred tax, have no impact on financial statements.

IFRS 9 "Financial instruments"

Bank carried out the analysis of financial contracts held for the purpose of assessment of contract characteristics in respect of classification and measurement under IFRS 9. For specific cases there is still work to be performed to reach final conclusions in the assessment of classification and measurement.

In the corporate loan portfolio Bank identified mismatch of the tenor of the interest rate and its reset frequency. Solely payments of principal and interest (SPPI) test is designed for the purpose of confirmation, that those contracts will remain measured using amortized cost methodology. Also Bank assessed that specific contract clauses that could modify interest are related with customer credit risk and compliant with SPPI concept. Based on initial assessment Bank does not consider fair value measurement of corporate loans.

In the retail loan portfolio Bank holds credit card products and installment loans for credit card customers in which there is a leverage formula. It is not foreclosed that in the near future there may be a decision to modify existing contracts using formulas compliant with IFRS 9 SPPI logic in order to present them in the financial statements according to the current practice and logic that is coherent with the way it is managed and how it performs. However, it should be considered that Bank will measure the above mentioned portfolios using fair value methodology. Soon work will be started to create respective models to carry out that task. For now it is not possible to estimate impact of that measurement on the financial statement of the Bank. Bank infers that other retail products will be measured amortized cost methodology.

In the area of treasury products Bank, based on initial assessment, does not identify change to current logic of classification and measurement of securities. It is to be expected that securities that so far have been measured in the category of available for sale will be measured the same way in the portfolio of fair value through other comprehensive income (FVOCI), so they will be measured at fair value recognized the changes in other comprehensive income.

Based on the history and plans for approach to management of assets in respect of the way cash flows from loan contracts are realized, Bank infers that business model assessment does not provoke changes in classification and measurement compared current practice under IAS 39. Bank grants loans and other forms of financing currently classified as loans under IAS 39 in order to obtain cash flows resulting from repayment of principal and interest only. Portfolio sales take place very rarely. In retail area Bank sold a significant credit deteriorated portfolio only once in 2016 and once in 2016. In 2017 no sales are planned. For corporate loans sales are also very rare and concern single exposures. All sales concerned credit deteriorated portfolios, exposures. So business model criteria determine that amortized cost is the right approach to measurement (assuming the SPPI is met).

Bank has not purchased any portfolios and in the processes of restructuring of contracts have not identified situations requiring derecognition from balance sheet. It is so neither to be expected that according to IFRS 9 Bank will present purchased or originated credit-impaired assets (POCI) nor that interest income will be impacted, as it will be recognized in the same manner as under IAS 39.

All the above aspects, in order to obtain assurance that conclusions reached by Bank and requirements identified are correct, will be verified in the first half of 2017 by independent professional entity.

There will be no changes to hedge accounting program used by Bank both in terms of the nature of the hedge relationship, as well as in respect of amounts. Modifications related to the need to adopt IFRS 9 are limited to internal documentation update and adjustment of the appropriate processes.

The Bank started implementation of IFRS 9 in 2016, at first focusing on checking the adequacy of the existing in Bank tools and models to the impairment requirements defined in Standard as well as on identifying gaps in the processes used to calculate provisions. Review has covered all existing products and portfolios. Bank adopted implementation schedule according to identified needs.

Implementation plan includes quantitative elements related to the analytical part, understood as the development of existing and construction of new risk assessment tools / models as well as qualitative elements, including changes in internal rules governing process of credit exposures management, provisions calculation and reporting, in particular internal documents regulating these processes. Bank striving to optimize the workload assumed that most of the tasks will be performed in parallel, allowing efficient flow of information between various organizational units of the institution. Activities related to the construction of models and documentation should be completed by the end of second quarter of

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2017 to allow parallel run. Second half of 2017 will be dedicated to model validation as well as changes in credit processes and internal regulations.

The key assumption standing behind implementation schedule was to provide sufficient time for Model Validation Bureau to conduct independent validation of newly prepared tools. The review is to cover a wide range of aspects including: correctness of methodological assumptions, assessment whether regulatory requirements are met, adequacy of the data used, quantitative tests and correctness of tools implementation in Bank's production environment. Publication of the validation report, including an evaluation of the correctness of implementation in the Bank's systems is scheduled for the fourth quarter of 2017 year.

The last point in the schedule planned for the end of 2017 is a series of training courses for Bank employees aimed at broadening knowledge about the changes.

The whole process of implementation, as per expectations of European Securities and Markets Authority, will be monitored by the Audit Committee.

According to the adopted schedule analytical work will be divided into two main parts. For customers from Corporate and Commercial sectors work will be focused on adjusting existing tools used to assess the creditworthiness of the customer to the requirements of IFRS 9. Due to high credit quality of the portfolio, and hence low default rates, the biggest challenge is to calibrate PD Life Time model. To achieve this objective Bank is collaborating with Citigroup to maximize the potential standing behind shared databases. It should be noted, however, that the final product will have to pass rigorous requirements of the internal model risk management policy which emphasizes the need of the correctness of the model fit to local conditions.

Second stream of the work is devoted to customers from Retail Banking Sector for which Bank assumes to use existing scorecards and based on them build new models for the provision calculation. The main focus is on development, for all major Bank's portfolios, coherent, uniform and stable methodology that will allow to identify all causes standing behind changes in the reserve levels. As a starting point Bank adopted current credit and collection policies including cut-offs levels as well as early-warning indicators that allow for identification in advance clients with increased risk.

In connection with the implementation of standard Bank assumes an increase in provision levels which, as expected, will be reflected in the following years in the Bank's capital. The increase in provisions is related to performing portfolio and has a twofold ground:

- a) increase in the coverage for Stage 1 accounts from the period of LIP (Loss Identification Period) to 12 months,
- b) necessity for the accounts qualified to Stage 2 to recognize the losses over the entire horizon of a account's life.

Therefore, much emphasis must be put on defining clear and transparent criteria standing behind significant increase in credit risk concept. These criteria should be constant over time, which will enable to conduct an analysis of the reasons for changes in provisions.

It should also be noted that the implementation of these regulations shall not affect the Bank's business model.

Bank carries out the work of implementation under the guidance of the Steering Committee, which includes, among others, board members responsible for the areas of finance and risk. The work schedule is dependent on the final conclusions of agreement analysis and verification by the professional external entity. It is assumed that before half year of 2017end, the Bank will have the final, verified conclusions regarding the classification and valuation method for key products.

As signaled, in probable case of valuation of selected exposures at fair value, the Bank assumes that by the end of the third quarter of 2017, a model for the implementation of this obligation will be developed.

In the second half of 2017 internal documentation and processes required to implement the obligations arising from IFRS 9 will be adjusted.

Standards demanding applications for the first time in 2016

In 2016 the following standards became applicable, but their implementation has no significant impact on the financial statement:

- amendments to IAS 1 – concerns significance and decomposition of information in the financial statement
- amendments to IFRS 11 – regards obligation of application of accounting for acquisitions of interests in joint operations
- amendments to IAS 16 – eliminates option of amortization of tangible fixed asset based on income generation
- amendments to IAS 19 – describes change of discount rate estimation for measurement of employee benefits
- amendment to IAS 38 - eliminates option of amortization of intangible asset based on income generation
- amendments to IAS 27 – allows use of equity method in separate financial statements
- annual improvements to IFRS cycles 2010-2012 and 2012-2014 – regard insignificant standards changes without impact to Group.

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Other standards, amendments to the standards and IFRIC interpretations recently endorsed, including awaiting the European Union's approval are either not relevant to the Group's activity or would not have a material impact on the financial statements and annual financial result.

In 2015 according to the opinion of the Ministry of Finance and the statement of Financial Supervision Authority mentioned above, in order to ensure compliance with the recommended approach and comparability of the financial statements across the banking sector in respect to accounting for Bank Guarantee Fund costs, the Bank decided to amortize those costs over 2015, the same way as in previous years.

If Bank had recognized Bank Guarantee Fund costs immediately, the costs of operations and general management presented in this condensed interim financial statement for the 1st half of 2015 would increase by PLN 33,672 thousand. As a result, the consolidated net profit of the Bank for the 1st half of 2015 would be reduced by PLN 28,613 thousand.

In 2016, the amendment of the Act on Bank Guarantee Fund of 14 December 1994 changed the way and dates of calculating payments for Bank Guarantee Fund from annual to quarterly. Tax expenses in both periods are comparable.

Basis of consolidation

Subsidiaries – definition

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

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Any identifiable purchased assets and assumed liabilities, including contingent liabilities, acquired in a business combination, are measured initially at fair value at the acquisition date, irrespective of the extent of any minority interest. Any excess of the cost of acquisition over the fair value of the Group's interest in the acquired identifiable net assets is recognized as goodwill. If the cost of acquisition is lower than the fair value of the net assets of the acquired subsidiary, the difference is recognized directly in the income statement.

Intra-group transactions and balances are eliminated on consolidation. Material unrealized gains and losses on transactions between Group companies are also eliminated.

Accounting policies of subsidiaries have been changed, where necessary, to ensure consistency in all material aspects with the accounting policies adopted by the Group.

Subsidiaries which are not fully consolidated due to the immateriality of their financial statements in the consolidated financial statements of the Group, are presented in accordance with the equity method.

Foreign currency

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

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

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

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

| PLN | 31 December 2016 | 31 December 2015 |
|-------|------------------|------------------|
| 1 USD | 4.1793 | 3.9011 |
| 1 CHF | 4.1173 | 3.9394 |
| 1 EUR | 4.4240 | 4.2615 |

Financial assets and liabilities

Classification

The Group classifies its financial instruments into the following categories:

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

In the reporting period, the Group did not classify assets to investments held-to-maturity.

The Group classifies financial assets to particular categories on the date of their first recognition.

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

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

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

(b) Loans and receivables

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

(c) Financial assets available-for-sale

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

(d) Other financial liabilities

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

Cash

Cash is cash in hand and receivables on current balances in banks, described in detail in note 44 "Cash flow statement".

Recognition and derecognition

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

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

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

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

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

Valuation

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

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

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

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

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

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

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

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

Finance lease receivables

The Group enters into lease agreements under which the Group transfers to the lessee, in return for a fee or benefits, the right to use an asset for an agreed period.

Assets under leases where the Group transfers substantially all the risk and rewards incidental to ownership of the leased assets are not included in the consolidated statement of financial position. A receivable representing an amount equal to the net investment in the finance lease is recognized.

The recognition of interest income under finance lease is based on an effective interest rate method reflecting a constant periodic rate of return on the Group's net investment in the finance lease.

Equity investments – shares in other entities

Shares in entities other than subordinated entities are classified as financial assets available-for-sale or financial assets held-for-trading.

Derivatives

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

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

Hedge accounting

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

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

Fair value hedge is recognized in the following way: profits or losses resulting from valuation of fair value of hedging

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

Offsetting financial instruments

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

Cash pooling

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

Repurchase and resale agreements, repo / reverse repo transactions

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

Impairment of assets measured at amortized cost

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

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

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

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

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

Forbearance

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

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

Impairment allowances for incurred but not recognized credit losses

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

Impairment allowances for individually significant assets

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

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

Impairment allowances for individually not significant assets

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

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

Impairment of financial assets available-for-sale

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

Impairment of financial assets measured at cost

The group of financial assets measured at cost in the financial statements of the Group consists of shares in entities other than dependent entities classified as available-for-sale for which the fair value cannot be reasonably measured (for example the assets are not quoted on an active market). In the case of objective evidence of impairment of equity investments, the amount of impairment is measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted at the current market rate for similar financial assets. Losses related to impairment of shares in entities other than subordinated entities classified as available-for-sale where the fair value cannot be reliably measured are not reversed through profit or loss.

Impairment of assets other than financial assets

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

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

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

Calculation of recoverable amount

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

Reversal of revaluation write-offs

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

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

Goodwill

In the consolidated financial statements of the Group, goodwill represents the difference between the cost of the acquisition and the fair value of the Group's interest in identifiable assets, liabilities and contingent liabilities acquired at the business combination date. Goodwill is included in intangible assets. Goodwill is stated at cost minus any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortized, but is tested annually for impairment independently of objective evidence of impairment. The revaluation write-off for impairment for goodwill can not be reversed.

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

Property and equipment and intangible assets (excluding goodwill)

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

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

Depreciation and amortization are calculated using the straight-line method over the expected useful life of an asset on the basis of rates that are approved in the depreciation and amortization plan for 2016.

| Illustrative annual depreciation and amortization rates applied by the Group are presented in the table below: | |
|--|-------------|
| Buildings and structures | 1.5%-4.5% |
| Motor vehicles | 14.0%-20.0% |
| Computers | 34.0% |
| Office equipment | 20.0% |
| Other tangible fixed assets | 7.0%-20.0% |
| Computer software and licenses (except the main operating systems, which are depreciated at the rate of 10% and 20%) | 34.0% |
| Other intangible fixed assets | 20.0% |
| Leasehold improvements - compliant with lease agreement period | |

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

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

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

Property and equipment includes rights to perpetual usufruct of land.

Items of property and equipment and intangibles are tested for impairment whenever events or changes in

circumstances indicate that the carrying amount may not be recoverable. The carrying amount of an item of property and equipment or intangible asset is written down to its recoverable amount if the carrying amount exceeds the recoverable amount. The recoverable amount of an item of property and equipment is the higher of its fair value less costs of sale and value in use.

Employee benefits

Short-term employee benefits

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

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

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

Share-based payments

Within the equity compensation plans, the selected employees get under stock award programs based on shares of Citigroup common stock in the form of deferred stock (CAP) and under stock award programs based on phantom shares of Bank Handlowy w Warszawie S.A. In 2015 the SOP programme was completed. All the options which had not been completed until the 29th October 2015 expired.

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

Long-term employee benefits

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

A component of variable remuneration granted to the Management Board and to the persons holding managerial positions, having a significant impact on the Bank's risk profile, is also the deferred cash prize described in detail in Note 47 "Employee benefits".

Defined contribution plans

The Group enables its employees to join a pension plan, which is described in detail in Note 47. The Group pays contributions for employees who participate in the plan into a separate fund and has no subsequent obligation to pay further contributions; hence, this is a defined contribution plan in accordance with IAS 19 ("Employee Benefits"). Contributions are recognized as an expense in the related period.

Provisions

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

Restructuring provision

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

Equity

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

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

Accruals and prepayments

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

Calculating net income

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

Interest income and interest expenses

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

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

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

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

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

Fee and commission income and expenses

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

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

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

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

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

Income and expense from distribution of insurance products

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

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

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

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

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

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

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

Hedge accounting income

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

Other operating income and expenses

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

Income tax

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

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

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

Segment reporting

A segment is a separate part of the Group's operations, generating income and expenses (including from transactions within the Group), whose operating results are regularly analyzed by the Management Board as the main decision-making body, in order to allocate resources and assess its performance.

The Group is managed at the level of two main business segments - the Corporate Bank and Consumer Bank. Detailed information about the segments of the Group is presented in Note 3.

Assets and liabilities, revenues and financial results of particular segments are measured in accordance with the accounting policies and standards adopted by the Group.

Non-current assets held-for-sale

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

classification of the assets or group of assets.

Non-current assets held-for-sale are measured at the lower of their carrying amount and fair value less costs to sell and are not subject to depreciation. No depreciation or amortization applies to such assets.

Accounting estimates and judgments

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

Fair value of derivatives

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

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

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

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

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

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

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

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

Impairment of loans

At each balance sheet date, the Group assesses whether there is an objective evidence of impairment of loan exposures. If so, the Group records an impairment loss equal to the difference between the carrying value and the estimated present value of the future cash flows from a given loan exposure. The Group applies collective analysis of financial assets in respect of which evidence of impairment has not been identified individually, or in spite of finding the evidence of impairment, the individual assessment of the given asset has not indicated the necessity of recording an impairment loss. For the purpose of collective evaluation of impairment, the credit exposures are grouped in order to ensure the uniformity of credit risk attached to the given portfolio. For the purpose of calculation of the amount to be provisioned against balance sheet exposures analyzed collectively, the Group has applied, among others, the probability of default (PD) and loss resulting from default (LGD).

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

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

Impairment of goodwill

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

Employee benefits

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

3. Segment reporting

A segment is a separable component of the Group engaged in business activities, generating income and expenses (including intergroup transactions), whose operating results are regularly reviewed by the Management Board of the parent entity as the chief operating decision-maker of the Group in order to allocate resources and assess its performance.

The Group is managed at the level of two main business segments – the Institutional Bank and Consumer Bank. The valuation of a segment's assets and liabilities as well as calculation of financial results comply with the Group's accounting policies applied in the preparation of the financial statements, including intergroup transactions between segments.

The allocation of the Group's assets, liabilities, revenues and expenses to segments was made on the basis of internal information prepared for management purposes. Transfer of funds between the Group's segments is based on market prices. Transfer prices are calculated using the same rules for both segments and any difference results only from maturity and currency structure of assets and liabilities. The basis for assessment of the segment performance is gross profit or loss.

The Group conducts its operations solely on the territory of Poland.

Institutional Bank

Within the Institutional Bank segment, the Group offers products and renders services to business entities, local government units and the public sector. Apart from traditional banking services including credit and deposit activities, the segment provides services in the area of cash management, trade financing, leases, brokerage, custody services in respect of securities and offers treasury products on financial and commodity markets. In addition, the segment offers investment banking services on the local and international capital markets, including advisory services, obtaining and underwriting financing via public and non-public issues of financial instruments. The activities of the segment also include proprietary transactions in the equity, debt and derivative instruments markets.

Consumer Bank

Within the Consumer Bank segment, the Group provides products and financial services to individuals as well as to micro-enterprises and individual entrepreneurs within the framework of CitiBusiness offer. Apart from keeping bank accounts and providing credit and deposit offers, the Group offers cash loans, mortgage loans, credit cards, provides asset management services, and acts as an agent in the sale of investment and insurance products.

Income statement of the Group by business segment

| For the period | 2016 | | | 2015 | | |
|--|--------------------|---------------|-----------|--------------------|---------------|---------|
| PLN'000 | Institutional Bank | Consumer Bank | Total | Institutional Bank | Consumer Bank | Total |
| Net interest income | 439,590 | 563,981 | 1,003,571 | 420,852 | 555,748 | 976,600 |
| Internal net interest income, including: | (36,403) | 36,403 | - | (53,265) | 53,265 | - |
| internal income | - | 36,403 | 36,403 | - | 53,265 | 53,265 |

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| For the period | 2016 | | | 2015 | | |
|--|--------------------|----------------|----------------|--------------------|----------------|----------------|
| PLN'000 | Institutional Bank | Consumer Bank | Total | Institutional Bank | Consumer Bank | Total |
| internal costs | (36,403) | - | (36,403) | (53,265) | - | (53,265) |
| Net fee and commission income | 275,333 | 285,896 | 561,229 | 279,948 | 351,402 | 631,350 |
| Dividend income | 1,537 | 6,513 | 8,050 | 1,667 | 5,715 | 7,382 |
| Net income on trading financial instruments and revaluation | 315,565 | 31,632 | 347,197 | 265,928 | 27,190 | 293,118 |
| Net gain on debt investment securities available for sale | 44,746 | - | 44,746 | 145,246 | - | 145,246 |
| Net gain on capital investment instruments available for sale | 29,436 | 66,477 | 95,913 | 2,232 | - | 2,232 |
| Net gain on hedge accounting | 9,553 | - | 9,553 | 7,949 | - | 7,949 |
| Net other operating income | 21,348 | (10,143) | 11,205 | 17,570 | (29,740) | (12,170) |
| General administrative expenses | (492,989) | (639,312) | (1,132,301) | (544,279) | (663,596) | (1,207,875) |
| Depreciation expense | (20,985) | (48,937) | (69,922) | (23,298) | (47,124) | (70,422) |
| Profit/loss on sale of other assets | 116 | - | 116 | 47 | 55 | 102 |
| Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted | 25,477 | (71,245) | (45,768) | 3,489 | 13,713 | 17,202 |
| Operating profit | 648,727 | 184,862 | 833,589 | 577,351 | 213,363 | 790,714 |
| Share in net profits of entities valued at equity method | 50 | - | 50 | 61 | - | 61 |
| Tax on some financial institutions | (50,173) | (19,138) | (69,311) | - | - | - |
| Profit before tax | 598,604 | 165,724 | 764,328 | 577,412 | 213,363 | 790,775 |
| Income tax expenses | | | (162,748) | | | (164,356) |
| Net profit | | | 601,580 | | | 626,419 |

| As at | 31.12.2016 | | | 31.12.2015 | | |
|---|--------------------|-------------------|-------------------|--------------------|-------------------|-------------------|
| PLN'000 | Institutional Bank | Consumer Bank | Total | Institutional Bank | Consumer Bank | Total |
| Total assets | 38,493,344 | 6,716,572 | 45,209,916 | 43,034,095 | 6,472,697 | 49,506,792 |
| Total liabilities and equity, including: | 32,836,784 | 12,373,132 | 45,209,916 | 38,188,084 | 11,318,708 | 49,506,792 |
| Liabilities | 27,443,762 | 10,975,704 | 38,419,466 | 32,930,579 | 9,725,557 | 42,656,136 |

4. Net interest income

| PLN'000 | 2016 | 2015 |
|---|------------------|------------------|
| Interest and similar income due to: | | |
| Balances with Central Bank | 17,918 | 16,726 |
| Amounts due from banks | 19,926 | 38,185 |
| Amounts from customers, including: | 837,348 | 778,316 |
| financial sector entities | 31,069 | 21,362 |
| non-financial sector entities | 806,279 | 756,954 |
| Debt securities available-for-sale | 311,412 | 297,497 |
| Debt securities held-for-trading | 48,151 | 73,416 |
| Liabilities with negative interest rate | 3,676 | - |
| Hedging derivatives | 20,173 | 28,273 |
| | 1,258,604 | 1,232,413 |
| Interest expense and similar charges due to: | | |
| Amounts due to Central Bank | (82) | - |
| Amounts due to banks | (41,546) | (40,967) |
| Amounts due to financial sector entities | (54,354) | (48,985) |

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| <i>PLN'000</i> | 2016 | 2015 |
|--|------------------|------------------|
| Amounts due to non-financial sector entities | (111,355) | (115,952) |
| Loans and advances received | (866) | (1,648) |
| Assets with negative interest rate | (945) | - |
| Derivatives in hedge accounting | (45,885) | (48,261) |
| | (255,033) | (255,813) |
| Net interest income | 1,003,571 | 976,600 |

Net interest income for 2016 includes interest accrued on impaired loans of PLN 13,408 thousand (for 2015: PLN 16,921 thousand).

5. Net fee and commission income

| <i>PLN'000</i> | 2016 | 2015 |
|--|-----------------|-----------------|
| Fee and commission income | | |
| Insurance and investment products (agency) | 79,564 | 119,656 |
| Payment and credit cards | 158,912 | 188,001 |
| Payment services | 105,469 | 110,993 |
| Custody services | 108,376 | 123,637 |
| Charges from cash loans | 1,351 | 2,606 |
| Brokerage operations | 48,173 | 53,999 |
| Cash management services on customers' accounts | 25,437 | 26,454 |
| Guarantees granted | 18,435 | 16,343 |
| Financial liabilities granted | 5,882 | 5,420 |
| Other | 87,749 | 62,326 |
| | 639,348 | 709,435 |
| Fee and commission expense | | |
| Payment and credit cards | (27,623) | (24,977) |
| Brokerage operations | (13,324) | (16,679) |
| Fees paid to the National Depository for Securities (KDPW) | (17,481) | (19,367) |
| Broker's fees | (4,246) | (4,512) |
| Other | (15,445) | (12,550) |
| | (78,119) | (78,085) |
| Fee and commission income | 561,229 | 631,350 |

The net fee and commission income for 2016 comprises commission income (other than income covered by the calculation of the effective interest rate process) related to financial assets and liabilities not measured at fair value through profit or loss in the amount of PLN 165,169 thousand (for 2015: PLN 194,649 thousand) and commission expenses in the amount of PLN 27,623 thousand (for 2015: PLN 24,977 thousand).

6. Dividend income

| <i>PLN'000</i> | 2016 | 2015 |
|-------------------------------|--------------|--------------|
| Securities available-for-sale | 7,297 | 7,018 |
| Securities held-for-trading | 753 | 364 |
| Total dividend income | 8,050 | 7,382 |

7. Net income on trading financial instruments and revaluation

| <i>PLN'000</i> | 2016 | 2015 |
|--|-------------|-------------|
| Net income on financial instruments measured at fair value through profit of loss from: | | |
| Debt instruments | (53 747) | (29 914) |

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| <i>PLN'000</i> | 2016 | 2015 |
|--|-----------------|----------------|
| Equity instruments | (684) | (8 035) |
| Derivative instruments, including: | 42 809 | 64 559 |
| Interest rate derivatives | 39 854 | 53 614 |
| | (11 622) | 26 610 |
| Net profit on foreign exchange | | |
| Net profit on foreign currency derivatives | 468 071 | 361 841 |
| Revaluation | (109 252) | (95 333) |
| | 358 819 | 266 508 |
| Net income on trading financial instruments and revaluation | 347 197 | 293 118 |

The net income on trading financial instruments and revaluation for 2016 contains movement in (net) adjustment of the valuation of derivatives from adjustment of the valuation of derivatives reflecting the counterparty credit risk and own credit risk in the amount of PLN 18,894 thousand (in 2015: PLN (11,170) thousand).

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

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

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

8. Hedge accounting income

| <i>PLN'000</i> | 2016 | 2015 |
|---|--------------|--------------|
| Fair value hedge accounting | | |
| Net gain on hedged transaction valuation | (37,135) | 94,294 |
| Net gain on hedging transaction valuation | 46,688 | (86,345) |
| Hedge accounting income | 9,553 | 7,949 |

Detailed information on hedge accounting applied in the Group is presented in the further part of these Financial Statements in note 38.

9. Net other operating income

| <i>PLN'000</i> | 2016 | 2015 |
|---|-----------------|-----------------|
| Other operating income | | |
| Services for related parties | 9,905 | 8,968 |
| Rental of office space | 9,405 | 9,539 |
| Reversal of provision on litigation | 3,391 | - |
| Other | 17,433 | 21,632 |
| | 40,134 | 40,139 |
| Other operating expenses | | |
| Amicable procedure and debt collection expenses | (11,416) | (19,509) |
| Fixed assets held-for-sale maintenance cost | (118) | (173) |
| Creation of provisions for litigations (net) | - | (15,568) |
| Other | (17,395) | (17,059) |
| | (28,929) | (52,309) |
| Net other operating income | 11,205 | (12,170) |

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10. General administrative expenses

| <i>PLN'000</i> | 2016 | 2015 |
|--|--------------------|--------------------|
| Staff expenses | | |
| Remuneration costs, including: | (398,387) | (404,501) |
| Provisions for retirement allowances | (29,576) | (25,130) |
| Bonuses and rewards, including: | (88,368) | (94,351) |
| Payments related to own equity instruments | (9,787) | (10,254) |
| Rewards for long time employment | (36) | (45) |
| Social insurance costs | (65,963) | (66,911) |
| | (552,718) | (565,763) |
| Administrative expenses | | |
| Telecommunication fees and hardware purchases | (189,622) | (200,464) |
| Costs of external services, including advisory, audit, consulting services | (55,356) | (66,253) |
| Building maintenance and rent costs | (84,469) | (82,157) |
| Advertising and marketing costs | (27,543) | (10,666) |
| Cash management service, KIR service and other transactional costs | (39,247) | (42,580) |
| Costs of external services related to the distribution of banking products | (18,183) | (15,717) |
| Postal services, office supplies and printmaking costs | (11,195) | (10,262) |
| Training and education costs | (2,629) | (2,742) |
| Banking and capital supervision costs | (1,435) | (3,744) |
| Bank Guarantee Funds costs | (75,070) | (130,934) |
| Other expenses | (74,834) | (76,593) |
| | (579,583) | (642,112) |
| Total general administrative expenses | (1,132,301) | (1,207,875) |

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

| <i>PLN'000</i> | 2016 | 2015 |
|------------------------------|---------------|---------------|
| Short-term employee benefits | 12,885 | 12,536 |
| Long-term employee benefits | 3,706 | 4,397 |
| Capital assets | 3,727 | 3,705 |
| | 20,318 | 20,638 |

11. Depreciation expense

| <i>PLN'000</i> | 2016 | 2015 |
|--|-----------------|-----------------|
| Depreciation of property and equipment | (32,229) | (35,853) |
| Amortization of intangible assets | (37,693) | (34,569) |
| Depreciation expense, total | (69,922) | (70,422) |

12. Sale of other assets

| <i>PLN'000</i> | 2016 | 2015 |
|------------------------------------|-------------|-------------|
| Profits on: | | |
| Sale of tangible fixed assets | 43 | 60 |
| Sale of fixed assets held-for-sale | 73 | 43 |
| | 116 | 103 |
| Losses on: | | |
| Sale of tangible fixed assets | - | (1) |
| | - | (1) |

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| | | |
|----------------------|-----|-----|
| Sale of other assets | 116 | 102 |
|----------------------|-----|-----|

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

| PLN'000 | 2016 | | | |
|---|-------------------------|------------------|----------------|------------------|
| | Institutional customers | Retail customers | Banks | Total |
| Impairment allowances for financial assets: | | | | |
| Amounts due from banks and customers | (50,989) | (138,634) | (3,426) | (193,049) |
| Amounts due from matured transactions in derivative instruments | (73) | - | - | (73) |
| | (51,062) | (138,634) | (3,426) | (193,122) |
| Reversals of impairment allowances for financial assets: | | | | |
| Amounts due from banks and customers | 55,870 | 50,742 | 4,592 | 111,204 |
| Amounts due from matured transactions in derivative instruments | 7,693 | - | - | 7,693 |
| Recovery on the sale of debt | 9,438 | 10,067 | - | 19,505 |
| Other | (2,296) | 8,012 | - | 5,716 |
| | 70,705 | 68,821 | 4,592 | 144,118 |
| Net impairment due to financial assets value losses | 19,643 | (69,813) | 1,166 | (49,004) |
| Establish of provisions for granted financial and guarantee commitments | (17,913) | - | - | (17,913) |
| Release of provisions for granted financial and guarantee commitments | 21,097 | 52 | - | 21,149 |
| Net impairment due to provisions for granted financial and guarantee commitments | 3,184 | 52 | - | 3,236 |
| Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted | 22,827 | (69,761) | 1,166 | (45,768) |
| | | | | |
| PLN'000 | 2015 | | | |
| | Institutional customers | Retail customers | Banks | Total |
| Impairment write-offs of financial assets: | | | | |
| Amounts due from banks and customers | (63,544) | (110,977) | (3,900) | (178,421) |
| Amounts due from matured transactions in derivative instruments | (766) | - | - | (766) |
| | (64,310) | (110,977) | (3,900) | (179,187) |
| Reversals of impairment write-offs of financial assets: | | | | |
| Amounts due from banks and customers | 63,486 | 91,436 | 4,972 | 159,894 |
| Amounts due from matured transactions in derivative instruments | 1,871 | - | - | 1,871 |
| Recovery on the sale of debt | (224) | 27,929 | - | 27,705 |
| Other | (2,745) | 6,877 | - | 4,132 |
| | 62,388 | 126,242 | 4,972 | 193,602 |
| Net impairment due to financial assets value losses | (1,922) | 15,265 | 1,072 | 14,415 |
| Establishment of provisions for granted financial and guarantee commitments | (25,950) | (6) | - | (25,956) |
| Release of provisions for granted financial and guarantee commitments | 28,062 | 681 | - | 28,743 |
| Net impairment due to provisions for granted financial and guarantee commitments | 2,112 | 675 | - | 2,787 |
| Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted | 190 | 15,940 | 1,072 | 17,202 |

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14. Income tax expense

Recognized in the income statement

| PLN'000 | 2016 | 2015 |
|---|------------------|------------------|
| Current tax | | |
| Current year | (168,689) | (117,857) |
| Adjustments for prior years | (18,903) | (194) |
| | (187,592) | (118,051) |
| Deferred tax | | |
| Origination and reversal of temporary differences | 24,844 | (46,305) |
| | 24,844 | (46,305) |
| Total income tax expense in income statement | (162,748) | (164,356) |

Reconciliation of effective tax rate

| PLN'000 | 2016 | 2015 |
|--|------------------|------------------|
| Profit before tax | 764,328 | 790,775 |
| Income tax at the domestic corporate tax rate of 19% | (145,222) | (150,247) |
| Impairment write-offs not constituting deductible expenses | (5,334) | (11,592) |
| Deductible income not recognized in the income statement | (513) | (642) |
| Deductible expenses not recognized in the income statement | (3,858) | (3,083) |
| Non-taxable income | 7,591 | 5,414 |
| Other permanent differences, including other non-deductible expenses | (15,412) | (4,206) |
| Total tax expenses | (162,748) | (164,356) |
| Effective tax rate | 21.29% | 20.78% |

Deferred tax recognized directly in equity

Deferred tax recognized directly in equity as at 31 December 2016 is related to debt and equity instruments available-for-sale and valuation of defined benefit plan and amounted to PLN 51,506 thousand (31 December 2015: PLN 39,554 thousand).

15. Earnings per share

As at 31 December 2016, earnings per share amounted to PLN 4.60 (31 December 2015: PLN 4.79).

The calculation of earnings per share as at 31 December 2016 was based on profit attributable to shareholders of PLN 601,580 thousand (31 December 2015: PLN 626,419 thousand) and the weighted average number of ordinary shares outstanding during the year ended 31 December 2016 of 130,659,600 (31 December 2015: 130,659,600).

The Bank does not have any ordinary shares that may have a dilution impact or any other dilutive instruments.

16. Changes in other comprehensive income

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

| PLN'000 | Gross amount | Deferred income tax | Net amount |
|---|------------------|---------------------|------------------|
| As at 1 January 2016 | (208,178) | 39,553 | (168,625) |
| AFS valuation change | (107,993) | 20,519 | (87,474) |
| Valuation of sold AFS moved to income statement | 44,746 | (8,502) | 36,244 |
| Net actuarial profits on a defined benefit plan | 342 | (64) | 278 |
| As at 31 December 2016 | (271,083) | 51,506 | (219,577) |

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| <i>PLN'000</i> | Gross amount | Deferred income tax | Net amount |
|---|---------------------|----------------------------|-------------------|
| As at 1 January 2015 | 57,994 | (11,019) | 46,975 |
| AFS valuation change | (122,019) | 23,182 | (98,837) |
| Valuation of sold AFS moved to income statement | (145,246) | 27,597 | (117,649) |
| Net actuarial losses on a defined benefit plan | 1,093 | (207) | 886 |
| As at 31 December 2015 | (208,178) | 39,553 | (168,625) |

17. Cash and balances with the Central Bank

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|---|-------------------|-------------------|
| Cash in hand | 380,757 | 477,105 |
| Current balances with Central Bank | 3,587 | 1,693,132 |
| Deposits | 281,411 | - |
| Cash and balances with the Central Bank, total | 665,755 | 2,170,237 |

On the current account in the National Bank of Poland (NBP), the Bank maintains an obligatory reserve which may be used only under the condition that the sum of the average monthly balance on the current account in NBP is not lower than the declared balance.

Declared balance of obligatory reserve amounted as at 31 December 2016 to PLN 1,149,911 thousand (31 December 2015: PLN 1,277,754 thousand).

18. Amounts due from banks

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|--|-------------------|-------------------|
| Current accounts | 8,899 | 184,445 |
| Deposits | - | 28,111 |
| Loans and advances | 913 | 4,461 |
| Unlisted debt securities | - | 28,455 |
| Receivables due to purchased securities with a repurchase agreement | 418,283 | 215,166 |
| Deposits pledged as collateral of derivative instruments and stock market transactions | 159,169 | 286,641 |
| Other receivables | - | 11,574 |
| Total gross amount | 587,264 | 758,853 |
| Impairment write-offs | (177) | (1,750) |
| Total net amount due from banks | 587,087 | 757,103 |

The movement in amounts due from banks is as follows:

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|--------------------------|-------------------|-------------------|
| As at 1 January | (1,750) | (2,880) |
| Increases (due to): | | |
| Write-offs creation | (3,426) | (3,900) |
| Decreases (due to): | | |
| Write-offs release | 4,592 | 4,972 |
| Other | 407 | 58 |
| As at 31 December | (177) | (1,750) |

As at 31 December 2016 and 31 December 2015, recognized impairment on amounts due from banks concerned incurred but not reported (IBNR) write-offs.

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19. Financial assets and liabilities held-for-trading

Financial assets held-for-trading

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|------------------|------------------|
| Debt securities held-for-trading | | |
| Bonds and notes issued by: | | |
| Banks* | 482 | 379,866 |
| Other financial entities | 58,299 | 33,054 |
| Central governments | 2,546,247 | 4,279,640 |
| | 2,605,028 | 4,692,560 |
| Including: | | |
| Listed on active market | 2,605,028 | 4,297,762 |
| Unlisted on active market | - | 394,798 |
| Equity instruments held-for-trading | 9,243 | 27,592 |
| Including: | | |
| Listed on active market | 9,243 | 27,592 |
| Derivative financial instruments | 1,167,134 | 2,267,132 |
| Financial assets held-for-trading, total | 3,781,405 | 6,987,284 |

*As at 31 December 2016, some of the securities (bonds) issued by banks in the amount of PLN 482 thousand are covered by Government guarantees (31 December 2015: PLN 406 thousand).

Financial liabilities held-for-trading

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|------------------|------------------|
| Short positions in financial assets | 208,106 | 988,102 |
| Derivative financial instruments | 1,097,508 | 2,259,421 |
| Financial liabilities held-for-trading | 1,305,614 | 3,247,523 |

As at 31 December 2016 and 31 December 2015, the Group did not hold any financial assets and liabilities designated at fair value through profit or loss at initial recognition.

As at 31 December 2016 and 31 December 2015, financial assets from derivatives transactions were not adjusted due to counterparty credit risk.

Derivative financial instruments as at 31 December 2016

| PLN'000 | Nominal amount with remaining life of | | | | Total | Fair value | |
|-------------------------------------|---------------------------------------|-----------------------------|----------------------------|-------------------|--------------------|----------------|----------------|
| | less than 3 months | between 3 months and 1 year | between 1 year and 5 years | more than 5 years | | Assets | Liabilities |
| Interest rate instruments | 19,554,407 | 23,382,572 | 57,901,103 | 24,179,834 | 125,017,916 | 873,191 | 913,240 |
| FRA | 15,100,000 | 12,295,600 | 750,000 | - | 28,145,600 | 1,352 | 1,458 |
| Interest rate swaps (IRS) | 2,590,538 | 7,406,664 | 46,239,791 | 14,195,451 | 70,432,444 | 475,564 | 531,287 |
| Currency-interest rate swaps (CIRS) | 1,695,111 | 3,680,308 | 8,821,662 | 9,984,383 | 24,181,464 | 386,873 | 370,946 |
| Interest rate options | 80,890 | - | 2,089,650 | - | 2,170,540 | 9,402 | 9,350 |
| Futures* | 87,868 | - | - | - | 87,868 | - | 199 |
| Currency instruments | 13,847,064 | 5,701,087 | 2,130,378 | 37,014 | 21,715,543 | 254,131 | 143,840 |
| FX forward | 2,222,894 | 1,710,653 | 337,921 | 37,014 | 4,308,482 | 82,173 | 42,147 |
| FX swap | 9,689,383 | 784,910 | 1,562,143 | - | 12,036,436 | 117,387 | 46,958 |
| Foreign exchange options | 1,934,787 | 3,205,524 | 230,314 | - | 5,370,625 | 54,571 | 54,735 |
| Securities transactions | 766,911 | 1,342 | - | - | 768,253 | 2,812 | 3,331 |
| Futures* | 8,291 | 1,342 | - | - | 9,633 | - | - |
| Securities purchased / sold pending | 758,620 | - | - | - | 758,620 | 2,812 | 3,331 |

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| PLN'000 | Nominal amount with remaining life of | | | | Total | Fair value | |
|-------------------------------------|---------------------------------------|-----------------------------|----------------------------|-------------------|--------------------|------------------|------------------|
| | less than 3 months | between 3 months and 1 year | between 1 year and 5 years | more than 5 years | | Assets | Liabilities |
| delivery | | | | | | | |
| Commodity transactions | 149,986 | 358,250 | 41,072 | - | 549,308 | 37,000 | 37,097 |
| Swaps | 70,024 | 306,423 | 41,072 | - | 417,519 | 23,775 | 23,824 |
| Options | 79,962 | 51,827 | - | - | 131,789 | 13,225 | 13,273 |
| Total derivative instruments | 34,318,368 | 29,443,251 | 60,072,553 | 24,216,848 | 148,051,020 | 1,167,134 | 1,097,508 |

*Exchange-traded products

Derivative financial instruments as at 31 December 2015

| PLN'000 | Nominal amount with remaining life of | | | | Total | Fair value | |
|--|---------------------------------------|-----------------------------|----------------------------|-------------------|--------------------|------------------|------------------|
| | less than 3 months | between 3 months and 1 year | between 1 year and 5 years | more than 5 years | | Assets | Liabilities |
| Interest rate instruments | 29,606,742 | 25,704,772 | 65,253,560 | 17,039,073 | 137,604,147 | 1,833,332 | 1,910,807 |
| FRA | 14,448,907 | 5,482,363 | 2,360,000 | - | 22,291,270 | 8,191 | 6,617 |
| Interest rate swaps (IRS) | 11,139,647 | 15,847,092 | 52,692,575 | 12,731,037 | 92,410,351 | 1,533,367 | 1,636,670 |
| Currency-interest rate swaps (CIRS) | 3,103,899 | 4,375,317 | 9,855,708 | 4,308,036 | 21,642,960 | 289,872 | 265,389 |
| Interest rate options | - | - | 345,277 | - | 345,277 | 1,748 | 1,748 |
| Futures* | 914,289 | - | - | - | 914,289 | 154 | 383 |
| Currency instruments | 22,998,714 | 7,398,703 | 2,842,795 | 49,994 | 33,290,206 | 337,491 | 249,663 |
| FX forward | 1,798,010 | 1,300,349 | 923,125 | 49,994 | 4,071,478 | 53,699 | 34,668 |
| FX swap | 19,188,781 | 2,359,480 | - | - | 21,548,261 | 231,367 | 162,205 |
| Foreign exchange options | 2,011,923 | 3,738,874 | 1,919,670 | - | 7,670,467 | 52,425 | 52,790 |
| Securities transactions | 1,790,280 | - | - | - | 1,790,280 | 1,575 | 4,252 |
| Securities purchased / sold pending delivery | 1,790,280 | - | - | - | 1,790,280 | 1,575 | 4,252 |
| Commodity transactions | 175,897 | 446,005 | 260,071 | - | 881,973 | 94,734 | 94,699 |
| Swap | 122,107 | 430,807 | 260,071 | - | 812,985 | 94,720 | 94,685 |
| Options | 53,790 | 15,198 | - | - | 68,988 | 14 | 14 |
| Total derivative instruments | 54,571,633 | 33,549,480 | 68,356,426 | 17,089,067 | 173,566,606 | 2,267,132 | 2,259,421 |

*Exchange-traded products

20. Hedging derivatives

Assets - Positive valuation

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|------------|------------|
| Balance sheet valuation of instruments hedging the fair value of securities | | |
| IRS transactions | 12,244 | 1,795 |

Liabilities – Negative valuation

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|------------|------------|
| Balance sheet valuation of instruments hedging the fair value of securities | | |
| IRS transactions | 39,897 | 112,383 |

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Hedging derivatives as at 31 December 2016

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

Hedging derivatives as at 31 December 2015

| PLN'000 | Nominal amount with remaining life of | | | | Total |
|---------------------------|---------------------------------------|-----------------------------------|----------------------------------|----------------------|-----------|
| | less than 3 months | between 3 months and 1 year | between 1 year and 5 years | more than 5 years | |
| Interest rate instruments | | | | | |
| Interest rate swaps (IRS) | - | - | 3,058,015 | 1,373,000 | 4,431,015 |

21. Debt securities available-for-sale

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|-------------------|-------------------|
| Bonds and notes issued by: | | |
| Central bank | 2,239,715 | - |
| Other banks* | 66,384 | 1,509,007 |
| Central governments, including: | 16,766,272 | 16,842,252 |
| bonds subject to fair value hedge accounting | 4,794,696 | 4,657,996 |
| Debt securities available-for-sale, total | 19,072,371 | 18,351,259 |
| Including: | | |
| Listed on active market instruments | 16,832,656 | 17,730,251 |
| Unlisted on active market instruments | 2,239,715 | 621,008 |

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

| PLN'000 | 2016 | 2015 |
|--|-------------------|-------------------|
| As at 1 January | 18,351,259 | 14,435,099 |
| Increases (due to): | | |
| Purchases | 41,491,375 | 172,338,701 |
| Exchange differences | 260,691 | 213,522 |
| Depreciation of discount, premium and interest | 164,552 | 241,808 |
| Decreases (due to): | | |
| Sale | (40,907,900) | (168,634,720) |
| Revaluation | (50,431) | (243,151) |
| Depreciation of premium | (237,175) | - |
| As at 31 December | 19,072,371 | 18,351,259 |

*As at 31 December 2016, some of the securities (bonds) issued by other banks in the amount of PLN 66,384 thousand are covered by Government guarantees (31 December 2015: PLN 556,274 thousand).

22. Equity investments valued using the equity method

| PLN'000 | 31.12.2016 | 31.12.2015 |
|------------------------|------------|------------|
| Shares in subsidiaries | 10,471 | 7,768 |
| Including: | | |
| Unlisted instruments | 10,471 | 7,768 |

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The movement in equity investments valued at equity method is as follows:

| <i>PLN'000</i> | 2016 | 2015 |
|--------------------------|---------------|--------------|
| As at 1 January | 7,768 | 7,765 |
| Increases (due to): | | |
| Revaluation | 2 703 | 3 |
| As at 31 December | 10,471 | 7,768 |

23. Equity investments available-for-sale

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|---|-------------------|-------------------|
| Stocks and shares in other entities | 29,669 | 77,229 |
| Impairment | (6,827) | (9,485) |
| Other equity investments available-for-sale, total | 22,842 | 67,744 |
| Including: | | |
| Listed on active market instruments | 1,119 | 1,006 |
| Unlisted on active market instruments | 21,723 | 66,738 |

The movement in equity investments available-for-sale is as follows:

| <i>PLN'000</i> | 2016 | 2015 |
|--------------------------|---------------|---------------|
| As at 1 January | 67,744 | 8,211 |
| Increases (due to): | | |
| Revaluation | - | 63,050 |
| Decreases (due to): | | |
| Revaluation | (44,246) | - |
| Sale | (656) | (3,517) |
| As at 31 December | 22,842 | 67,744 |

In the 2016 the following events took place:

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

In the 2015 the following events took place:

- there was a positive valuation up to the fair value of shares in the Visa Europe Ltd. company as on the amount of PLN 63,323 thousand as of the 31 December 2015. That was an outcome of the acquisition transaction of Visa Europe Ltd. shares by Visa Inc. and conditions of Visa Europe Ltd shares sale transaction received by the Bank. The difference between the previous value of the share of PLN 45 and determined fair value was recognised into the other comprehensive income, additional information is contained in Note 39;
- there was a sale of shares in Polski Koncern Mięsny DUDA S.A representing 2.81% of the share in the capital and 2.81% of votes at the General Meeting. The carrying/ book value of sold shares amounted to PLN 3,517 thousand and the profit on sales to PLN 2,232 thousand.

24. Amounts due from customers

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|--|-------------------|-------------------|
| Amounts due from financial sector entities | | |
| Loans and advances | 293,117 | 307,402 |
| Debt securities unlisted | 1,199,671 | 199,724 |
| Receivables subject to securities sale and repurchase agreements | - | 1,356,247 |
| Guarantee funds and deposits pledged as collateral | 211,360 | 186,007 |
| Other receivables | 3,916 | 1,605 |
| Total gross amount | 1,708,064 | 2,050,985 |

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| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|---|-------------------|-------------------|
| Impairment write-offs | (17,810) | (17,270) |
| Total net amount | 1,690,254 | 2,033,715 |
| Amounts due from non-financial sector entities | | |
| Loans and advances | 16,051,239 | 15,254,953 |
| Unlisted debt securities | 514,401 | 1,075,891 |
| Purchased receivables | 1,116,054 | 1,102,720 |
| Effectuated guarantees | 1,056 | 1,577 |
| Other receivables* | 32,660 | 74,751 |
| Total gross amount | 17,715,410 | 17,509,892 |
| Impairment write-offs | (545,611) | (568,136) |
| Total net amount | 17,169,799 | 16,941,756 |
| Total net amounts due from customers | 18,860,053 | 18,975,471 |

*"Other receivables" includes leasing receivables in the amount of PLN 13,678 thousand (31 December 2015: PLN 66,895 thousand).

The Group decided to invest in securities based on economic calculation, measuring return on investment against the potential risks. The Group that owns the portfolio (the Initiator) founds a special purpose company (SPV) in order to issue debt securities in each securitization transaction. The issued debt securities are solely repaid from the cash flows generated by securitized receivables portfolio which the SPV bought from the Initiator. Until now the Group acted as investor and acquired the senior tranche in the amount of PLN 1,199,611 thousand. Securities purchased by the Group are not traded on the market. The Group intends to maintain investments until the maturity date. The main risk of securitisation transactions is credit risk. Group's maximum exposure to loss from involvement in these entities is equal to their carrying gross value, as at 31 December 2016 in the amount of PLN 1,199,671 thousand (31 December 2015: PLN 199,724 thousand). The carrying value of assets relating to Bank participation in unconsolidated structured entities as at 31 December 2016 in the amount of PLN 1,199,611 thousand (31 December 2015: PLN 199,714 thousand).

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

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|---|-------------------|-------------------|
| Portfolio impairment loss | (228,081) | (224,106) |
| Individual impairment loss | (255,605) | (296,332) |
| Incurred but not reported losses (IBNR) | (79,735) | (64,968) |
| Impairment loss, total | (563,421) | (585,406) |

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

| | 2016 | | | 2015 | | |
|---|--------------------------------|-------------------------|------------------|--------------------------------|-------------------------|------------------|
| <i>PLN'000</i> | Institutional customers | Retail customers | Total | Institutional customers | Retail customers | Total |
| As at 1 January | (321,490) | (263,916) | (585,406) | (403,578) | (395,318) | (798,896) |
| Increases (due to): | | | | | | |
| Creation of write-offs | (50,989) | (138,634) | (189,623) | (63,544) | (110,977) | (174,521) |
| Other | (12,831) | 607 | (12,224) | (3,253) | 433 | (2,820) |
| Decreases (due to): | | | | | | |
| Restating receivables | 23,074 | 24,272 | 47,346 | 41,530 | 58,338 | 99,868 |
| Net write-offs on receivables on taken instruments transactions | 7,620 | - | 7,620 | 1,105 | - | 1,105 |
| Write-offs release | 55,870 | 50,742 | 106,612 | 63,486 | 91,436 | 154,922 |
| Sale of receivables | 20,107 | 42,147 | 62,254 | 42,764 | 92,172 | 134,936 |
| As at 31 December | (278,639) | (284,782) | (563,421) | (321,490) | (263,916) | (585,406) |

Finance lease receivables

The Group operates on the leasing market through its subsidiary Handlowy-Leasing Sp. z o.o. The Group provides finance leases of vehicles, machines and equipment.

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Included in "Amounts due from customers" are the following amounts relating to finance lease receivables from non-financial sector entities:

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|--------------------------------------|-------------------|-------------------|
| Gross finance lease receivables | 13,868 | 68,127 |
| Unrealized financial income | (190) | (1,232) |
| Net finance lease receivables | 13,678 | 66,895 |

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

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|-----------------------|-------------------|-------------------|
| Less than 1 year | 13,066 | 57,957 |
| Between 1 and 5 years | 802 | 10,170 |
| | 13,868 | 68,127 |

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

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|-----------------------|-------------------|-------------------|
| Less than 1 year | 12,884 | 56,933 |
| Between 1 and 5 years | 794 | 9,962 |
| | 13,678 | 66,895 |

As at 31 December 2016, impairment of finance lease receivables amounted to PLN 4,204 thousand (as at 31 December 2015: PLN 8,010 thousand).

Finance lease income is presented in interest income.

25. Tangible fixed assets

Movements of tangible fixed assets in 2016

| <i>PLN'000</i> | Land and buildings | Machines and equipment | Vehicles | Other | Under construction | Total |
|------------------------------------|---------------------------|-------------------------------|-----------------|----------------|---------------------------|----------------|
| Gross amount | | | | | | |
| As at 1 January 2016 | 613,671 | 96 | 2,982 | 292,034 | 9,457 | 918,240 |
| Increases: | | | | | | |
| Purchases | 158 | - | 688 | 3,878 | 24,227 | 28,951 |
| Other increases | 45 | - | - | 251 | - | 296 |
| Decreases: | | | | | | |
| Disposals | - | - | (2,455) | - | - | (2,455) |
| Liquidation | (25,560) | - | - | (22,002) | - | (47,562) |
| Other decreases | (20) | - | - | (1,207) | - | (1,227) |
| Transfers | 4,477 | - | - | 5,158 | (14,219) | (4,584) |
| As at 31 December 2016 | 592,771 | 96 | 1,215 | 278,112 | 19,465 | 891,659 |
| Depreciation | | | | | | |
| As at 1 January 2016 | 305,483 | 96 | 1,467 | 257,121 | (7) | 564,160 |
| Increases: | | | | | | |
| Amortization change for the period | 17,038 | - | 298 | 14,893 | - | 32,229 |
| Other increases | 8 | - | - | 400 | 7 | 415 |
| Decreases: | | | | | | |
| Disposals | - | - | (1,109) | - | - | (1,109) |
| Liquidation | (24,163) | - | - | (21,653) | - | (45,816) |
| Other decreases | - | - | (146) | (1,045) | - | (1,191) |
| As at 31 December 2016 | 298,366 | 96 | 510 | 249,716 | - | 548,688 |

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| <i>PLN'000</i> | Land and buildings | Machines and equipment | Vehicles | Other | Under construction | Total |
|-------------------------------|--------------------|------------------------|------------|---------------|--------------------|----------------|
| Carrying amount | | | | | | |
| As at 1 January 2016 | 308,188 | - | 1,515 | 34,913 | 9,464 | 354,080 |
| As at 31 December 2016 | 294,405 | - | 705 | 28,396 | 19,465 | 342,971 |

Movements of tangible fixed assets in 2015

| <i>PLN'000</i> | Land and buildings | Machines and equipment | Vehicles | Other | Under construction | Total |
|------------------------------------|--------------------|------------------------|---------------|----------------|--------------------|----------------|
| Gross amount | | | | | | |
| As at 1 January 2015 | 601,749 | 101 | 16,896 | 307,290 | 10,149 | 936,185 |
| Increases: | | | | | | |
| Purchases | 806 | - | 188 | 6,206 | 27,302 | 34,502 |
| Other increases | - | - | - | 854 | - | 854 |
| Decreases: | | | | | | |
| Disposals | - | (5) | (14,093) | (194) | - | (14,292) |
| Liquidation | (1,381) | - | - | (32,702) | - | (34,083) |
| Other decreases | - | - | (9) | (73) | - | (82) |
| Transfers | 12,497 | - | - | 10,653 | (27,994) | (4,844) |
| As at 31 December 2015 | 613,671 | 96 | 2,982 | 292,034 | 9,457 | 918,240 |
| Depreciation | | | | | | |
| As at 1 January 2015 | 289,412 | 99 | 7,393 | 272,424 | - | 569,328 |
| Increases: | | | | | | |
| Amortization charge for the period | 17,452 | 2 | 1,750 | 16,649 | - | 35,853 |
| Other increases | - | - | 40 | 827 | - | 867 |
| Decreases: | | | | | | |
| Disposals | - | (5) | (7,706) | (326) | (7) | (8,044) |
| Liquidation | (1,381) | - | - | (32,390) | - | (33,771) |
| Other decreases | - | - | (10) | (63) | - | (73) |
| As at 31 December 2015 | 305,483 | 96 | 1,467 | 257,121 | (7) | 564,160 |
| Carrying amount | | | | | | |
| As at 1 January 2015 | 312,337 | 2 | 9,503 | 34,866 | 10,149 | 366,857 |
| As at 31 December 2015 | 308,188 | - | 1,515 | 34,913 | 9,464 | 354,080 |

26. Intangible assets

Movements of intangible assets in 2016

| <i>PLN'000</i> | Goodwill | Patents, licenses etc. | Software | Other intangible assets | Prepayments | Total |
|-------------------------------|------------------|------------------------|----------------|-------------------------|---------------|------------------|
| Gross amount | | | | | | |
| As at 1 January 2016 | 1,245,976 | 2,560 | 406,003 | 18,519 | 10,331 | 1,683,389 |
| Increases: | | | | | | |
| Purchases | - | - | 812 | - | 14,629 | 15,441 |
| Decreases: | | | | | | |
| Liquidation | - | - | (4,609) | - | 1 | (4,608) |
| Other decreases | - | (15) | - | - | - | (15) |
| Transfers | - | - | 13,638 | - | (12,271) | 1,367 |
| As at 31 December 2016 | 1,245,976 | 2,545 | 415,844 | 18,519 | 12,690 | 1,695,574 |

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| <i>PLN'000</i> | Goodwill | Patents, licenses etc. | Software | Other intangible assets | Prepayments | Total |
|------------------------------------|------------------|------------------------------|----------------|-------------------------------|---------------|------------------|
| Depreciation | | | | | | |
| As at 1 January 2016 | - | 2,320 | 290,678 | 18,512 | - | 311,510 |
| Increases: | | | | | | |
| Amortization charge for the period | - | 42 | 37,644 | 7 | - | 37,693 |
| Decreases: | | | | | | |
| Liquidation | - | - | (4,475) | - | - | (4,475) |
| Other decreases | - | (15) | - | - | - | (15) |
| As at 31 December 2016 | - | 2,347 | 323,847 | 18,519 | - | 344,713 |
| Carrying amount | | | | | | |
| As at 1 January 2016 | 1,245,976 | 240 | 115,325 | 7 | 10,331 | 1,371,879 |
| As at 31 December 2016 | 1,245,976 | 198 | 91,997 | - | 12,690 | 1,350,861 |

Movements of intangible assets in 2015

| <i>PLN'000</i> | Goodwill | Patents, licenses etc. | Software | Other intangible assets | Prepayments | Total |
|------------------------------------|------------------|------------------------------|----------------|-------------------------------|---------------|------------------|
| Gross amount | | | | | | |
| As at 1 January 2015 | 1,245,976 | 2,444 | 401,614 | 18,519 | 5,789 | 1,674,342 |
| Increases: | | | | | | |
| Purchases | - | 116 | 865 | - | 19,892 | 20,873 |
| Decreases: | | | | | | |
| Liquidation | - | - | (10,251) | - | - | (10,251) |
| Transfers | - | - | 13,775 | - | (15,350) | (1,575) |
| As at 31 December 2015 | 1,245,976 | 2,560 | 406,003 | 18,519 | 10,331 | 1,683,389 |
| Depreciation | | | | | | |
| As at 1 January 2015 | - | 2,289 | 265,803 | 18,505 | - | 286,597 |
| Increases: | | | | | | |
| Amortization charge for the period | - | 31 | 34,531 | 7 | - | 34,569 |
| Other increases | - | - | 405 | - | - | 405 |
| Decreases: | | | | | | |
| Liquidation | - | - | (10,061) | - | - | (10,061) |
| As at 31 December 2015 | - | 2,320 | 290,678 | 18,512 | - | 311,510 |
| Carrying amount | | | | | | |
| As at 1 January 2015 | 1,245,976 | 155 | 135,811 | 14 | 5,789 | 1,387,745 |
| As at 31 December 2015 | 1,245,976 | 240 | 115,325 | 7 | 10,331 | 1,371,879 |

As at 31 December 2016, goodwill includes the amount of PLN 1,243,645 thousand arising from the merger of Bank Handlowy w Warszawie S.A. and Citibank (Poland) S.A. as at 28 February 2001 and the amount of PLN 2,331 thousand as a result of the purchase of an organized part of the enterprise of ABN AMRO Bank (Poland) S.A. as at 1 March 2005.

27. Impairment test for goodwill

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

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

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Book value of goodwill allocated to unit

| PLN'000 | 31.12.2016 |
|----------------|------------------|
| Corporate Bank | 851,944 |
| Consumer Bank | 394,032 |
| | 1,245,976 |

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

The discount rate is assessed on the basis of the capital assets pricing model (CAPM) using a beta coefficient for the banking sector, a risk premium and Treasury bond yield curves. In 2016, the discount rate amounted to 9.20% (9.10% at the end of 2015).

Extrapolation of cash flows which exceed the period covered by the financial plan has been based on growth rates reflecting the long-term NBP inflation target that amounted to 2.5 pp as at 31 December 2016.

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

28. Deferred income tax asset and liabilities

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--------------------------------------|----------------|----------------|
| Deferred income tax asset | 406,659 | 568,132 |
| Deferred income tax liability | 208,276 | 406,546 |
| Deferred income tax net asset | 198,383 | 161,586 |

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

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

Deferred tax asset is attributable to the following:

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|----------------|----------------|
| Interest accrued and other expense | 9,957 | 14,652 |
| Revaluation impairment write-offs | 28,303 | 25,767 |
| Unrealized premium from securities | 46,370 | 8,273 |
| Negative valuation of derivative financial instruments | 158,457 | 374,132 |
| Negative valuation of securities held-for-trading | 2,938 | 2,892 |
| Income collected in advance | 26,341 | 19,023 |
| Valuation of shares | 2,039 | 2,545 |
| Commissions | 8,181 | 8,526 |
| Debt and equity securities available-for-sale | 50,395 | 38,378 |
| Staff expenses and other costs due to pay | 57,764 | 56,744 |
| Differences between balance-sheet and tax value of leases | (6,335) | (4,768) |
| Other | 22,249 | 21,968 |
| Deferred tax asset | 406,659 | 568,132 |

Deferred tax liability is attributable to the following:

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|------------|------------|
| Interest accrued (income) | 39,412 | 21,587 |
| Positive valuation of derivative financial instruments | 127,598 | 318,957 |
| Unrealized securities discount | 7,372 | 1,105 |
| Income to receive | 4,842 | 4,131 |
| Positive valuation of securities held-for-trading | (69) | 1,950 |
| Debt and equity securities available-for-sale | 9,313 | 18,602 |

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| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|--------------------------------------|-------------------|-------------------|
| Investment relief | 12,334 | 13,236 |
| Valuations of shares | 1,884 | 1,875 |
| Other | 5,590 | 25,103 |
| Deferred tax liability | 208,276 | 406,546 |
| Net deferred income tax asset | 198,383 | 161,586 |

Movement in temporary differences during the year 2016

The movement in temporary differences relating to deferred tax asset:

| <i>PLN'000</i> | As at 1 January 2016 | Adjustments recognized in income | Adjustments recognized in equity | As at 31 December 2016 |
|---|---------------------------------|---|---|-----------------------------------|
| Interest accrued and other expense | 14,652 | (4,695) | - | 9,957 |
| Revaluation impairment write-offs | 25,767 | 2,536 | - | 28,303 |
| Unrealized premium from securities | 8,273 | 38,097 | - | 46,370 |
| Negative valuation of derivative financial instruments | 374,132 | (215,675) | - | 158,457 |
| Negative valuation of securities held-for-trading | 2,892 | 46 | - | 2,938 |
| Income collected in advance | 19,023 | 7,318 | - | 26,341 |
| Valuation of shares | 2,545 | (506) | - | 2,039 |
| Commissions | 8,526 | (345) | - | 8,181 |
| Debt and equity securities available-for-sale | 38,378 | - | 12,017 | 50,395 |
| Staff expenses and other costs due to pay | 56,744 | 1,084 | (64) | 57,764 |
| Differences between balance-sheet and tax value of leases | (4,768) | (1,567) | - | (6,335) |
| Other | 21,968 | 281 | - | 22,249 |
| | 568,132 | (173,426) | 11,953 | 406,659 |

The movement in temporary differences relating to deferred tax provision:

| <i>PLN'000</i> | As at 1 January 2016 | Adjustments recognized in income | Adjustments recognized in equity | As at 31 December 2016 |
|--|---------------------------------|---|---|-----------------------------------|
| Interest accrued (income) | 21,587 | 17,825 | - | 39,412 |
| Positive valuation of derivative financial instruments | 318,957 | (191,359) | - | 127,598 |
| Unrealized securities discount | 1,105 | 6,267 | - | 7,372 |
| Income to receive | 4,131 | 711 | - | 4,842 |
| Positive valuation of securities held-for-trading | 1,950 | (2,019) | - | (69) |
| Debt and equity securities available-for-sale | 18,602 | (9,289) | - | 9,313 |
| Investment relief | 13,236 | (902) | - | 12,334 |
| Valuations of shares | 1,875 | 9 | - | 1,884 |
| Other | 25,103 | (19,513) | - | 5,590 |
| | 406,546 | (198,270) | - | 208,276 |
| Change in net deferred income tax assets | 161,586 | 24,844 | 11,953 | 198,383 |

Movement in temporary differences during the year 2015

The movement in temporary differences relating to deferred tax asset:

| <i>PLN'000</i> | As at 1 January 2015 | Adjustments recognized in income | Adjustments recognized in equity | As at 31 December 2015 |
|------------------------------------|---------------------------------|---|---|-----------------------------------|
| Interest accrued and other expense | 23,217 | (8,565) | - | 14,652 |
| Revaluation impairment write-offs | 51,768 | (26,001) | - | 25,767 |
| Unrealized premium from securities | 10,531 | (2,258) | - | 8,273 |

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| <i>PLN'000</i> | As at 1 January 2015 | Adjustments recognized in income | Adjustments recognized in equity | As at 31 December 2015 |
|--|-------------------------|--|--|---------------------------|
| Negative valuation of derivative financial instruments | 956,637 | (582,505) | - | 374,132 |
| Negative valuation of securities held-for-trading | 3,866 | (974) | - | 2,892 |
| Income collected in advance | 8,469 | 10,554 | - | 19,023 |
| Valuation of shares | 2,916 | (371) | - | 2,545 |
| Commissions | 7,511 | 1,015 | - | 8,526 |
| Debt and equity securities available-for-sale | - | - | 38,378 | 38,378 |
| Staff expenses and other cost due to pay | 65,189 | (8,238) | (207) | 56,744 |
| Differences between balance-sheet and tax value of leases | 790 | (5,558) | - | (4,768) |
| Other | 24,933 | (2,965) | - | 21,968 |
| | 1,155,827 | (625,866) | 38,171 | 568,132 |

The movement in temporary differences relating to deferred tax liability:

| <i>PLN'000</i> | As at 1 January 2015 | Adjustments recognized in income | Adjustments recognized in equity | As at 31 December 2015 |
|--|-------------------------|--|--|---------------------------|
| Interest accrued (income) | 28,936 | (7,349) | - | 21,587 |
| Positive valuation of derivative financial instruments | 929,863 | (610,906) | - | 318,957 |
| Unrealized securities discount | 789 | 316 | - | 1,105 |
| Income to receive | 4,864 | (733) | - | 4,131 |
| Positive valuation of securities held-for-trading | 1,533 | 417 | - | 1,950 |
| Debt and equity securities available-for-sale | 14,430 | 16,574 | (12,402) | 18,602 |
| Investment relief | 14,351 | (1,115) | - | 13,236 |
| Valuations of shares | 1,863 | 12 | - | 1,875 |
| Other | 1,879 | 23,224 | - | 25,103 |
| | 998,508 | (579,560) | (12,402) | 406,546 |
| Change in net deferred income tax assets | 157,319 | (46,305) | 50,572 | 161,586 |

29. Other assets

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|---|----------------|----------------|
| Interbank settlements | 3,556 | 4,357 |
| Settlements related to brokerage activity | 125,766 | 114,456 |
| Income to receive | 65,843 | 66,509 |
| Staff loans out of the Social Fund | 17,719 | 17,722 |
| Sundry debtors | 72,064 | 67,192 |
| Prepayments | 4,696 | 7,046 |
| Other | - | 703 |
| Other assets, total | 289,644 | 277,985 |
| Including financial assets* | 219,105 | 204,430 |

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

30. Amounts due to banks

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
|--|------------|------------|
| Current accounts | 1,466,809 | 681,202 |
| Term deposits | 503,520 | 4,460,693 |
| Loans and advances received | 128,026 | 198,203 |
| Liabilities due to sold securities under repurchase agreements | 212,372 | 1,623,456 |

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| PLN'000 | 31.12.2016 | 31.12.2015 |
|-----------------------------------|------------------|------------------|
| Other liabilities | 15 | 7 |
| Total amounts due to banks | 2,310,742 | 6,963,561 |

31. Amounts due to customers

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|-------------------|-------------------|
| Deposits from financial sector entities | | |
| Current accounts | 671,625 | 226,438 |
| Term deposits | 4,024,501 | 3,154,694 |
| | 4,696,126 | 3,381,132 |
| Deposits from non-financial sector entities | | |
| Current accounts, including: | 22,301,469 | 20,194,711 |
| institutional customers | 10,895,348 | 10,454,683 |
| individual customers | 8,280,082 | 7,074,422 |
| public sector units | 3,126,039 | 2,665,606 |
| Term deposits, including: | 6,821,412 | 7,699,698 |
| institutional customers | 5,041,859 | 5,972,704 |
| individual customers | 1,668,893 | 1,667,610 |
| public sector units | 110,660 | 59,384 |
| | 29,122,881 | 27,894,409 |
| Total deposits | 33,819,007 | 31,275,541 |
| Other liabilities | | |
| Securities sold under repurchase agreements | - | 188,505 |
| Other liabilities, including: | 117,504 | 122,257 |
| liabilities due to deposits | 80,622 | 99,207 |
| Total other liabilities | 117,504 | 310,762 |
| Total amounts due to customers | 33,936,511 | 31,586,303 |

32. Provisions

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|---------------|---------------|
| Litigation | 3,823 | 10,522 |
| Granted financial and guarantee liabilities | 7,215 | 10,451 |
| Workforce restructuring | 4,171 | 680 |
| Restructuring of the branch network | 7,647 | 1,841 |
| Provisions, total | 22,856 | 23,494 |

The movement in provisions is as follows:

| PLN'000 | 2016 | 2015 |
|---|---------------|---------------|
| As at 1 January | 23,494 | 26,409 |
| Provisions for: | | |
| Litigation | 10,522 | 9,634 |
| Granted financial and guarantee commitments | 10,451 | 13,238 |
| Workforce restructuring | 680 | 158 |
| Restructuring of the branch network | 1,841 | 3,379 |
| Increases: | | |
| Charges to provisions in the period: | 35,514 | 44,720 |

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| PLN'000 | 2016 | 2015 |
|---|---------------|---------------|
| litigation | 1,571 | 16,775 |
| granted financial and guarantee commitments | 17,913 | 25,956 |
| workforce restructuring | 4,056 | 680 |
| restructuring of the branch network | 11,974 | 1,309 |
| Decreases: | | |
| Release of provisions in the period | (27,088) | (30,808) |
| litigation | (4,962) | (1,207) |
| granted financial and guarantee commitments | (21,149) | (28,743) |
| employment restructuring | - | (158) |
| restructuring of the branch network | (977) | (700) |
| Provisions used in the period, including: | (9,064) | (16,827) |
| litigation | (3,308) | (14,680) |
| workforce restructuring | (565) | - |
| restructuring of the branch network | (5,191) | (2,147) |
| As at 31 December | 22,856 | 23,494 |

33. Other liabilities

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|----------------|----------------|
| Staff benefits | 43,823 | 48,212 |
| Interbank settlements | 145,531 | 95,534 |
| Inter-branch settlements | 718 | - |
| Settlements related to brokerage activity | 129,071 | 118,405 |
| Settlements with Tax Office and National Insurance (ZUS) | 25,684 | 20,120 |
| Sundry creditors | 144,561 | 115,900 |
| Accruals: | 289,420 | 298,774 |
| Provision for employee payments | 93,949 | 107,759 |
| Provision for employee retirement | 41,936 | 38,084 |
| IT services and bank operations support | 62,098 | 78,939 |
| Consultancy services and business support | 24,091 | 21,942 |
| Other | 67,346 | 52,050 |
| Deferred income | 25,038 | 25,927 |
| Other liabilities, total | 803,846 | 722,872 |
| Including financial liabilities* | 753,124 | 676,825 |

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

34. Financial assets and liabilities by contractual maturity

As at 31 December 2016

| PLN'000 | Note | Total | Up to 1 month | Between 1 and 3 months | Between 3 months and 1 year | Between 1 and 5 years | More than 5 years |
|--|------|------------|---------------|------------------------|-----------------------------|-----------------------|-------------------|
| Amounts due from banks (gross) | 18 | 587,264 | 381,399 | 205,865 | - | - | - |
| Financial assets held-for-trading | | | | | | | |
| Debt securities held-for-trading | 19 | 2,605,028 | 313,250 | - | 246,232 | 1,492,755 | 552,791 |
| Financial assets available-for-sale | | | | | | | |
| Debt securities available-for-sale | 21 | 19,072,371 | 2,239,715 | - | - | 15,163,320 | 1,669,336 |
| Amounts due from customers (gross) | | | | | | | |
| Amounts due from financial sector entities | 24 | 1,708,064 | 198,132 | 70,000 | 239,932 | 1,200,000 | - |
| Amounts due from non-financial sector entities | 24 | 17,715,410 | 6,803,454 | 1,228,782 | 2,064,510 | 5,557,378 | 2,061,286 |
| Amounts due to banks | 30 | 2,310,742 | 2,140,202 | 20,897 | 34,627 | 114,977 | 39 |

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| PLN'000 | Note | Total | Up to 1 month | Between 1 and 3 months | Between 3 months and 1 year | Between 1 and 5 years | More than 5 years |
|--|------|------------|------------------|---------------------------|-----------------------------------|--------------------------|----------------------|
| Amounts due to customers | | | | | | | |
| Amounts due to financial sector entities | 31 | 4,696,177 | 4,650,566 | 41,959 | 3,633 | - | 19 |
| Amounts due to non-financial sector entities | 31 | 29,240,334 | 28,254,705 | 706,906 | 261,019 | 17,651 | 53 |

As at 31 December 2015

| PLN'000 | Note | Total | Up to 1 month | Between 1 and 3 months | Between 3 months and 1 year | Between 1 and 5 years | More than 5 years |
|--|------|------------|------------------|---------------------------|-----------------------------------|--------------------------|----------------------|
| Amounts due from banks (gross) | | | | | | | |
| Financial assets held-for-trading | | | | | | | |
| Debt securities held-for-trading | 19 | 4,692,560 | 163,238 | - | 1,822,346 | 1,198,152 | 1,508,824 |
| Financial assets available-for-sale | | | | | | | |
| Debt securities available-for-sale | 21 | 18,351,259 | - | - | 131,604 | 11,781,131 | 6,438,524 |
| Amounts due from customers (gross) | | | | | | | |
| Amounts due from financial sector entities | 24 | 2,050,985 | 1,527,285 | 70,135 | 213,565 | 240,000 | - |
| Amounts due from non-financial sector entities | 24 | 17,509,892 | 7,456,761 | 1,357,325 | 2,328,206 | 4,904,883 | 1,462,717 |
| Amounts due to banks | 30 | 6,963,561 | 5,986,214 | 750,000 | 69,848 | 157,468 | 31 |
| Amounts due to customers | | | | | | | |
| Amounts due to financial sector entities | 31 | 3,569,648 | 3,451,621 | 112,616 | 4,755 | 639 | 17 |
| Amounts due to non-financial sector entities | 31 | 28,016,655 | 27,237,673 | 519,395 | 247,844 | 11,690 | 53 |

35. Capital and reserves

Share capital

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

The par value of 1 share amounts to PLN 4.00

As at 31 December 2016, the Bank's share capital amounted to PLN 522,638,400 divided into 130,659,600 common bearer shares with a nominal value of PLN 4 each, which has not changed since 31 December 2015.

The Bank has not issued preferred shares.

Both in 2016 and 2015, there was no increase in the share capital by shares issuance.

Principal shareholders

The following table presents the shareholders who, as at 31 December 2016 and 31 December 2015, held at least 5% of the total number of votes at the General Meeting or at least 5% of the Bank's share capital:

| | Value of shares (PLN'000) | Number of shares | % shares | Number of votes at GM | % votes at GM |
|---|---------------------------------|---------------------|----------|--------------------------|------------------|
| Citibank Overseas Investment Corporation, USA | 391,979 | 97,994,700 | 75.0 | 97,994,700 | 75.0 |

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| | | | | | |
|--------------------|----------------|--------------------|--------------|--------------------|--------------|
| Other shareholders | 130,659 | 32,664,900 | 25.0 | 32,664,900 | 25.0 |
| | 522,638 | 130,659,600 | 100.0 | 130,659,600 | 100.0 |

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

Supplementary capital

As at 31 December 2016, supplementary capital was PLN 3,003,082 thousand (31 December 2015: PLN 3,001,525 thousand). Supplementary capital is designated for offsetting financial losses or for other purposes including payment of dividends to the shareholders. The General Shareholders' Meeting of the Bank decides upon the utilization of supplementary capital, but a portion of its balance amounting to one third of total share capital may be used exclusively for offsetting losses shown in the financial statements.

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

Revaluation reserve

| | | |
|--|-------------------|-------------------|
| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
| Revaluation of financial assets available-for-sale | (214,843) | (163,613) |

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

Other reserves

| | | |
|---|-------------------|-------------------|
| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 |
| Reserve capital | 2,356,107 | 2,349,602 |
| General risk reserve | 529,000 | 521,000 |
| Net actuarial losses on specific services program valuation | (4,735) | (5,012) |
| Foreign currency translation adjustment | 4,672 | 3,919 |
| Other reserves, total | 2,885,044 | 2,869,509 |

On 21 June 2016, the Ordinary General Meeting of Shareholders of Bank Handlowy w Warszawie S.A. adopted a resolution on distribution of the net profit for 2015, deciding to appropriate the amount of PLN 740 thousand for reserve capital.

Reserve capital

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

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

General risk reserve

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

Dividends

Dividends paid for 2015

At the meeting on June 21, 2016, the Ordinary General Meeting of Shareholders of the Bank Handlowy w Warszawie S.A. (hereinafter WZ) adopted a resolution on distribution of the net profit for 2015. The WZ resolved to appropriate the amount of PLN 611,486,928.00 to the dividend payment, which means that the dividend per one ordinary share is PLN

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4.68. The number of shares covered by the dividend is 130,659,600.

Simultaneously, the WZ resolved to set the day of the right to the dividend for July 4, 2016 (day of dividend) and the day of the dividend payment for July 21, 2016 (day of the dividend payment).

Declared dividends

On 14 March 2017, the Bank's Management Board adopted a resolution on the proposed distribution of profit for 2016. The Bank's Management Board has proposed to allocate the amount of PLN 591,887,988.00 for the dividend payment. The dividend has a cash character. This means that the dividend per share amounts to PLN 4.53. The number of shares covered by dividends is 130,659,600. The dividend record date was designated as 3 July 2017 and the dividend payment date was designated as 20 July 2017. This proposal of the Bank's Management Board will be submitted to the Supervisory Board for an opinion and then to the General Shareholders' Meeting for approval.

36. Repurchase and reverse repurchase agreements

Repurchase agreements

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

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

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

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

*including interest

As at 31 December 2015, assets sold under repurchase agreements were as follows:

| PLN'000 | Fair value of underlying assets | Carrying amount of corresponding liabilities* | Repurchase dates | Repurchase price |
|------------------------------------|---------------------------------|---|------------------|------------------|
| Debt securities held for trading | 374,878 | 374,869 | Up to 1 week | 374,901 |
| Debt securities available-for-sale | 1,460,086 | 1,437,092 | Up to 1 week | 1,437,254 |

*including interest

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

As at 31 December 2016 and as at 31 December 2015, assets sold through repo cannot be further traded.

In 2016, the total interest expense on repurchase agreements was PLN 6,495 thousand (in 2015: PLN 7,158 thousand).

Reverse repurchase agreements

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

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

| PLN'000 | Carrying amount of receivable* | Fair value of assets held as collateral | Resale date | Resale price |
|------------------------|--------------------------------|---|----------------|--------------|
| Amounts due from banks | 212,361 | 207,952 | Up to 1 week | 212,377 |
| | 205,922 | 181,933 | Up to 3 months | 178,886 |

*including interest

As at 31 December 2015, assets purchased subject to agreements to resell were as follows:

| PLN'000 | Carrying amount of receivable* | Fair value of assets held as collateral | Resale date | Resale price |
|------------------------|--------------------------------|---|---------------|--------------|
| Amounts due from banks | 18,142 | 18,169 | Up to 1 week | 18,144 |
| | 196,965 | 182,177 | Up to 2 years | 178,886 |

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Amounts due from customers:

| | | | | |
|--------------------------------|-----------|-----------|--------------|-----------|
| from financial sector entities | 1,356,247 | 1,360,227 | Up to 1 week | 1,356,441 |
|--------------------------------|-----------|-----------|--------------|-----------|

**including interest*

As at 31 December 2016 and 31 December 2015, the Group held the option to pledge or sell the assets acquired through reverse repo.

In 2016, the total interest income on reverse repurchase agreements was PLN 10,522 thousand (in 2015: PLN 36,175 thousand).

As at 31 December 2016, the liabilities due to short sale of securities purchased in reverse repo transactions amounted to PLN 208,106 thousand (as at 31 December 2015: PLN 988,102 thousand).

37. Offsetting of financial assets and financial liabilities

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

The table below presents the fair values of derivatives (from the trading portfolio and designated as hedging instruments) as well as collateral, which may be legal effective offset under the master agreements in certain circumstances.

| PLN'000 | 31.12.2016 | | 31.12.2015 | |
|---|------------------|-----------------------|------------------|-----------------------|
| | Financial assets | Financial liabilities | Financial assets | Financial liabilities |
| Fair value of derivatives | 1,239,184 | 1,173,839 | 2,172,436 | 2,184,726 |
| Value of collateral received/placed | (286,475) | (208,094) | (94,442) | (220,020) |
| Assets and liabilities subject to offsetting under the master agreement | 952,709 | 965,745 | 2,077,994 | 1,964,706 |
| Maximum amount of potential offset | (680,079) | (680,079) | (1,913,847) | (1,913,847) |
| Assets and liabilities subject to offsetting under the master agreement considering the maximum amount of potential offset | 272,630 | 285,666 | 164,147 | 50,859 |

38. Hedge accounting

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

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

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

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

Fair value of instruments within fair value hedge accounting of securities

| PLN'000 | 31.12.2016 | | 31.12.2015 | |
|------------------------------------|---------------|------------|---------------|------------|
| | Nominal value | Fair value | Nominal value | Fair value |
| Hedged instruments | | | | |
| Debt securities available-for-sale | | | | |
| Treasury bonds | 4,604,396 | 4,794,696 | 4,431,015 | 4,657,996 |
| Hedging instruments | | | | |
| Derivative instruments | | | | |

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| | | | | |
|--|-----------|--------|-----------|---------|
| Interest rate swaps – positive valuation | 2,431,660 | 12,244 | 780,220 | 1,795 |
| Interest rate swaps – negative valuation | 2,172,736 | 39,897 | 3,650,795 | 112,383 |

39. Fair value information

Fair value of financial assets and liabilities

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

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

As at 31 December 2016

| PLN'000 | Note | Held-for-trading | Loans, advances and other receivables | Available-for-sale | Other financial assets/liabilities | Total carrying value | Fair value |
|--|------|------------------|---------------------------------------|--------------------|------------------------------------|----------------------|-------------------|
| Financial assets | | | | | | | |
| Cash and balances with Central Bank | 17 | - | 665,755 | - | - | 665,755 | 665,755 |
| Amounts due from banks | 18 | - | 587,087 | - | - | 587,087 | 587,071 |
| Financial assets held-for-trading | 19 | 3,781,405 | - | - | - | 3,781,405 | 3,781,405 |
| Hedging derivatives | 20 | 12,244 | - | - | - | 12,244 | 12,244 |
| Debt securities available-for-sale | 21 | - | - | 19,072,371 | - | 19,072,371 | 19,072,371 |
| Equity investments valued at equity method | 22 | - | - | - | 10,471 | 10,471 | 10,471 |
| Equity investments available-for-sale | 23 | - | - | 22,842 | - | 22,842 | 22,842 |
| Amounts due from customers | 24 | - | 18,860,053 | - | - | 18,860,053 | 18,878,719 |
| | | 3,793,649 | 20,112,895 | 19,095,213 | 10,471 | 43,012,228 | 43,030,878 |
| Financial liabilities | | | | | | | |
| Amounts due to banks | 30 | - | - | - | 2,310,742 | 2,310,742 | 2,310,776 |
| Financial liabilities held-for-trading | 19 | 1,305,614 | - | - | - | 1,305,614 | 1,305,614 |
| Hedging derivatives | 20 | 39,897 | - | - | - | 39,897 | 39,897 |
| Amounts due to customers | 31 | - | - | - | 33,936,511 | 33,936,511 | 33,935,951 |
| | | 1,345,511 | - | - | 36,247,253 | 37,592,764 | 37,592,238 |

As at 31 December 2015

| PLN'000 | Note | Held-for-trading | Loans, advances and other receivables | Available-for-sale | Other financial assets/liabilities | Total carrying value | Fair value |
|--|------|------------------|---------------------------------------|--------------------|------------------------------------|----------------------|-------------------|
| Financial assets | | | | | | | |
| Cash and balances with Central Bank | 17 | - | 2,170,237 | - | - | 2,170,237 | 2,170,237 |
| Amounts due from banks | 18 | - | 757,103 | - | - | 757,103 | 757,105 |
| Financial assets held-for-trading | 19 | 6,987,284 | - | - | - | 6,987,284 | 6,987,284 |
| Hedging derivatives | | 1,795 | - | - | - | 1,795 | 1,795 |
| Debt securities available-for-sale | 21 | - | - | 18,351,259 | - | 18,351,259 | 18,351,259 |
| Equity investments valued at equity method | 22 | - | - | - | 7,768 | 7,768 | 7,768 |
| Equity investments available-for-sale | 23 | - | - | 67,744 | - | 67,744 | 67,744 |
| Amounts due from customers | 24 | - | 18,975,471 | - | - | 18,975,471 | 19,051,525 |
| | | 6,989,079 | 21,902,811 | 18,419,003 | 7,768 | 47,318,661 | 47,394,717 |

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| PLN'000 | Note | Held-for-trading | Loans, advances and other receivables | Available-for-sale | Other financial assets/liabilities | Total carrying value | Fair value |
|--|------|------------------|---------------------------------------|--------------------|------------------------------------|----------------------|-------------------|
| Financial liabilities | | | | | | | |
| Amounts due to banks | 30 | - | - | - | 6,963,561 | 6,963,561 | 6,963,525 |
| Financial liabilities held-for-trading | 19 | 3,247,523 | - | - | - | 3,247,523 | 3,247,523 |
| Hedging derivatives | | 112,383 | - | - | - | 112,383 | 112,383 |
| Amounts due to customers | 31 | - | - | - | 31,586,303 | 31,586,303 | 31,585,503 |
| | | 3,359,906 | - | - | 38,549,864 | 41,909,770 | 41,908,934 |

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

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

In 2016, the Group did not make any changes in the classification of financial instruments (presented by the fair value method in the consolidated statement of financial position) to categories of fair value assignment (Level I, Level II, Level III).

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

As at 31 December 2016

| PLN'000 | Note | Level I | Level II | Level III | Total |
|--|------|------------|-----------|-----------|------------|
| Financial assets | | | | | |
| Financial assets held-for-trading | 19 | 2,613,789 | 1,167,616 | - | 3,781,405 |
| derivatives | | - | 1,167,134 | - | 1,167,134 |
| debt securities | | 2,604,546 | 482 | - | 2,605,028 |
| equity instruments | | 9,243 | - | - | 9,243 |
| Hedging derivatives | 20 | - | 12,244 | - | 12,244 |
| Debt securities available-for-sale | 21 | 16,766,272 | 2,306,099 | - | 19,072,371 |
| Equity investments available-for-sale | 23 | 1,118 | - | 18,965 | 20,083 |
| Financial liabilities | | | | | |
| Financial liabilities held-for-trading | 19 | 208,305 | 1,097,309 | - | 1,305,614 |
| short sale of securities | | 208,106 | - | - | 208,106 |
| derivatives | | 199 | 1,097,309 | - | 1,097,508 |
| Hedging derivatives | 20 | - | 39,897 | - | 39,897 |

As at 31 December 2015

| PLN'000 | Note | Level I | Level II | Level III | Total |
|-----------------------------------|------|-----------|-----------|-----------|-----------|
| Financial assets | | | | | |
| Financial assets held-for-trading | 19 | 4,307,386 | 2,679,898 | - | 6,987,284 |
| derivatives | | 154 | 2,266,978 | - | 2,267,132 |
| debt securities | | 4,279,640 | 412,920 | - | 4,692,560 |

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| PLN'000 | Note | Level I | Level II | Level III | Total |
|--|------|------------|-----------|-----------|------------|
| equity instruments | | 27,592 | - | - | 27,592 |
| Hedging derivatives | | - | 1,795 | - | 1,795 |
| Debt securities available-for-sale | 21 | 16,842,252 | 1,509,007 | - | 18,351,259 |
| Equity investments available-for-sale | | 1,006 | - | 63,323 | 64,329 |
| Financial liabilities | | | | | |
| Financial liabilities held-for-trading | 19 | 988,485 | 2,259,038 | - | 3,247,523 |
| short sale of securities | | 988,102 | - | - | 988,102 |
| derivatives | | 383 | 2,259,038 | - | 2,259,421 |
| Hedging derivatives | | - | 112,383 | - | 112,383 |

On the 31st of December 2016 the amount of financial assets classified to the Level III includes the share of PLN 18,965 thousand in Visa Inc. As at 31 December 2015 the amount includes value of the share in Visa Europe Limited in amount PLN 63,323 thousands.

In the first half of 2016 the Management Board of Bank Handlowy w Warszawie S.A. has received the information regarding final allocation of settlement transactions of the Visa Europe Limited takeover by Visa Inc. As a settlement transaction results Bank dispose its shareholding in Visa Europe Limited and received:

- (a) 15,838,604.03 EUR in cash;
- (b) 5,751 preference shares Visa Inc. Serie C;
- (c) deferred payments paid after 3 years from the final transaction date.

Amount of deferred payments for Bank will be proportion to the Bank shares in whole payment amount at final transaction date will be 0.1220725995% in amounts of: EUR 1,220,726.00 (part of capital deferred payment) and EUR 152,424.73 (part of interest deferred payment).

Net value share after discount including as at 31 December 2016 is PLN 18,965 thousands.

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

| PLN'000 | 1.01.-31.12.2016 | 1.01.-31.12.2015 |
|------------------------------------|-------------------------------------|-------------------------------------|
| | Financial assets available-for-sale | Financial assets available-for-sale |
| | Equity investments | Equity investments |
| As at January 2016 | 63,323 | - |
| Derecognition valuation of shares | (63,323) | - |
| Recognition of valuation of shares | 17,355 | 63,323 |
| Valuation of shares | 1,610 | - |
| As at December 2016 | 18,965 | 63,323 |

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

In 2016 and 2015, the Group did not make any transfers between levels of financial instruments fair value according to the methods establish fair value.

Fair value measurement

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

Other equity investments

In case of other equity investments, fair value is the purchase price adjusted for impairment losses for both unlisted and listed investments due to the contractual time limit of the possibility of their disposal.

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

In 2016, among all equity investments, where fair value could not be established, the Group sold the shares in Odlewnie Polskie S.A. The carrying/book value of sold shares in Odlewnie Polskie S.A. amounted to PLN 656 thousands and the profit of sales to PLN 2,938 thousands.

In 2015, among all equity investments, where fair value could not be established, the Group sold the shares in Polski Koncern Mięsny DUDA S.A representing 2.81% of the share in the capital and 2.81% of votes at the General Meeting. The balance value of sold shares amounted to PLN 3,517 thousand and the profit on sales to PLN 2,232 thousand.

Amounts due from customers and banks

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

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

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

Amounts due to banks and customers

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

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

40. Contingent liabilities and litigation proceedings

Information on pending proceedings

In 2016, there was no single proceeding regarding receivables and liabilities of the Bank or a subsidiary of the Bank, the value of which would be equal to at least 10% of equity, pending in court, before a public administration authority or an arbitration authority.

The total value of all pending legal proceedings regarding receivables or liabilities with the participation of the Bank and subsidiaries of the Bank did not exceed 10% of the Bank's equity in 2016.

Total value of liabilities of the Bank and its subsidiaries on all pending legal proceedings did not exceed 10% of the Bank's equity in 2016.

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

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

As at 31 December 2016, the Bank was, among others, a party to 18 court proceedings associated directly with derivative transactions that have not been legally terminated: in 12 proceedings the Bank acted as a defendant and in 6 as a plaintiff. The claims and allegations in the individual cases against the Bank are based on various legal bases. The subject of the dispute refers mainly to the validity of the derivative transactions and clients' liabilities demanded by the Bank with respect to those derivative transactions, as well as potential claims regarding potential invalidation of such demands by court decisions. Clients try to prevent the Bank from seeking claims resulting from derivative transactions; they dispute their liabilities towards the Bank, question the validity of the agreements and, in some cases, demand payment from the Bank. In 2016 three cases ended legally binding and in favour of the Bank, regarding term financial transactions, where the Bank was defendant or plaintiff.

The Bank was a party to proceedings initiated by the President of the Office of Competition and Consumer Protection (UOKiK) against the Visa and Europay payment system operators and banks - issuers of Visa cards and Europay/Eurocard/Mastercard cards. The Bank was one of the addressees of the President of UOKiK's decision in the case. The proceedings have concerned alleged practices limiting competition on the payment cards market in Poland consisting in the fixing of interchange fees for transactions made with Visa and Europay/Eurocard/Mastercard cards, as well as limiting access to the market for operators who do not belong to the unions of card issuers, against whom the proceedings were initiated. The President of UOKiK's decision was the subject of legal analyses in appeal proceedings.

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On April 22, 2010, the Appeal Court overturned the verdict of the Court of Competition and Consumer Protection (SOKiK) and referred the case back to the court of first instance. On 21 November 2013 SOKiK, gave a judgment, under which a penalty imposed on the Bank was modified and set in the amount of PLN 1,775,720. On October 6, 2015 the Appeal Court modified the verdict of the Competition and Consumer Protection Court and denied all appeals from the decision of the President of the Competition and Consumer Protection Office, including the changes of amounts of the fines that were imposed upon banks. As a result, the fine in the amount of 10,228,470 PLN that was originally imposed upon the Bank has been reinstated. The verdict is binding and enforceable. On April 28, 2016 the Bank has submitted extraordinary appeal to the Supreme Court, the Bank is awaiting for their considerations.

In 2016 there were no significant settlements due to the court case with final judgement.

Commitments due to granted and received financial and guarantees liabilities

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|-------------------|-------------------|
| Financial and guarantees liabilities granted | | |
| Letters of credit | 145,852 | 160,400 |
| Guarantees granted | 2,131,868 | 2,101,477 |
| Credit lines granted | 13,331,401 | 14,618,126 |
| Underwriting other issuers' securities issues | 1,246,100 | 1,138,000 |
| Other guarantees | 33,944 | 29,531 |
| | 16,889,165 | 18,047,534 |

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--------------------------------------|----------------|----------------|
| Letters of credit by category | | |
| Import letters of credit issued | 144,829 | 160,065 |
| Export letters of credit confirmed | 1,023 | 335 |
| | 145,852 | 160,400 |

The Group makes provisions for financial and guarantees commitments granted. As at 31 December 2016, the provisions created for financial and guarantees commitments granted amounted to PLN 7,215 thousand (31 December 2015: PLN 10,451 thousand).

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|-------------------|-------------------|
| Financial and guarantees liabilities received | | |
| Finance | - | - |
| Guarantees | 18,125,921 | 15,470,264 |
| | 18,125,921 | 15,470,264 |

41. Assets pledged as collateral

Assets are pledged as collateral of the following liabilities:

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|----------------|------------------|
| Collateral liabilities | | |
| Amounts due to banks | | |
| securities sale and repurchase agreements | 212,372 | 1,623,456 |
| credit received | 114,903 | 143,903 |
| Amounts due to customers | | |
| securities sale and repurchase agreements | - | 188,505 |
| | 327,275 | 1,955,864 |

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|----------------|------------------|
| Assets pledged | | |
| Debt securities held-for-trading | 212,143 | 186,373 |
| Debt securities available-for-sale | 336,624 | 1,943,149 |
| Amounts due from banks | | |
| Settlements related to operations in derivative instruments and stock market trading | 159,169 | 286,641 |
| Amounts due from customers | | |
| Stock market trading guarantee funds and settlements | 211,360 | 186,007 |
| | 919,296 | 2,602,170 |

As at 31 December 2016, the debt securities available-for-sale presented in the table constituted a reserve against the funds guaranteed to the Bank Guarantee Fund in the amount of PLN 183,022 thousand (31 December 2015: PLN 208,791 thousand) collateral against credit received: 153,602 thousand (31 December 2015: PLN 274,272 thousand) and as of 31 December 2015 the collateral against securities sold with repurchase agreement in the amount of PLN 1,460,086 thousand.

Debt securities held-for-trading as at 31 December 2016 constitute collateral of the Bank's obligations under securities sold with a repurchase agreement.

For more details on assets covering the Bank's obligations under repo transactions, see Note 36.

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

42. Custodian activities

The Bank offers both custodian services connected with securities accounts for foreign institutional investors and custodian services for Polish financial institutions, including pension, investment and equity insurance funds. As at 31 December 2016, the Bank maintained approx. 9,2 thousand securities accounts (31 December 2015: over 10,8 thousand accounts).

43. Operating leases

Leases where the Group is the lessee

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|---------------|----------------|
| Less than 1 year | 7,036 | 31,629 |
| Between 1 and 5 years | 57,859 | 65,787 |
| More than 5 years | 19,096 | 11,748 |
| | 83,991 | 109,164 |
| Total annual rentals for contracts for an unspecified period of time | 1,117 | 2,522 |

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

Most of the office space lease contracts are signed for 5 years with the option of extension for another three years; however, some contracts have been signed for a period up to 1 year and some for more than 10 years. Lease payments are subject to annual indexation. The total amount of lease payments in 2016 amounted to PLN 29,835 thousand (in 2015: PLN 34,709 thousand).

The car leases are signed for 4 years. Lease payments are based on a fixed interest rate throughout the lease period. In 2016, total amount of leasing fees amounted to PLN 6,337 thousand (in 2015: PLN 4,253 thousand).

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

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Leases where the Group is the lessor

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|---------------|--------------|
| Less than 1 year | 296 | 1,864 |
| Between 1 and 5 years | 5,403 | 1,926 |
| More than 5 years | 6,163 | - |
| | 11,862 | 3,790 |
| Total annual rentals for contracts for an unspecified period of time | 6,911 | 8,502 |

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

Most of the office space lease contracts are signed for an unspecified period of time. Other contracts are signed for a period of between 2 and 10 years. Lease payments are subject to annual indexation. The income related to these contracts amounted in 2016 to PLN 9,009 thousand (in 2015: PLN 9,199 thousand).

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

44. Cash flow statement

Additional information:

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|----------------|------------------|
| Cash related items: | | |
| Cash in hand | 380,757 | 477,105 |
| Nostro current account in Central Bank | 283,587 | 1,693,132 |
| Current accounts in other banks (nostro, overdrafts on loro accounts) | 8,538 | 184,115 |
| | 672,882 | 2,354,352 |

45. Transactions with the key management personnel

| PLN'000 | 31.12.2016 | | 31.12.2015 | |
|----------------------|---------------------------------|----------------------------------|---------------------------------|----------------------------------|
| | Members of the Management Board | Members of the Supervisory Board | Members of the Management Board | Members of the Supervisory Board |
| Loans granted | 719 | - | 1,103 | - |
| Deposits | | | | |
| Current accounts | 10,078 | 4,216 | 4,000 | 4,481 |
| Term deposits | 5,227 | 1,000 | 10,989 | 8,062 |
| | 15,305 | 5,216 | 14,989 | 12,543 |

As at 31 December 2016 and 31 December 2015, no loans or guarantees were granted to members of the Management Board or the Supervisory Board.

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

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

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

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46. Related parties

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

In the normal course of business activities, Group entities enter into transactions with related parties, in particular with entities of Citigroup Inc.

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

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

Transactions with Citigroup Inc. entities

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|------------|------------|
| Receivables, including: | 102,855 | 174,358 |
| Placements | - | - |
| Liabilities, including: | 1,242,047 | 4,338,922 |
| Deposits | 237,515 | 3,801,172 |
| Loans received | 6,999 | 41,337 |
| Balance-sheet valuation of derivative transactions: | | |
| Assets held-for-trading | 823,853 | 1,337,826 |
| Assets of derivative hedging instruments | 11,912 | 1,795 |
| Liabilities held-for-trading | 669,388 | 1,307,730 |
| Liabilities due to hedging derivatives | 26,482 | 90,464 |
| Contingent liabilities granted | 264,347 | 287,814 |
| Contingent liabilities received | 68,290 | 103,458 |
| Contingent transactions in derivative instruments (nominal value), including: | 77,856,118 | 96,302,028 |
| Interest rate instruments | 68,946,263 | 79,711,721 |
| FRA | 14,745,600 | 12,641,270 |
| Interest rate swaps (IRS) | 33,717,144 | 45,355,519 |
| Currency – interest rate swaps (CIRS) | 19,310,382 | 20,628,005 |
| Interest rate options | 1,085,269 | 172,638 |
| Futures contracts | 87,868 | 914,289 |
| Currency instruments | 8,439,712 | 15,964,479 |
| FX forward/spot | 1,215,512 | 1,229,628 |
| FX swap | 4,549,027 | 10,916,585 |
| Foreign exchange options | 2,675,173 | 3,818,266 |
| Securities transactions | 195,488 | 184,842 |
| Securities purchased pending delivery | 102,785 | 93,569 |
| Securities sold pending delivery | 92,703 | 91,273 |
| Commodity transactions | 274,655 | 440,986 |
| Swaps | 208,760 | 406,492 |
| Options | 65,895 | 34,494 |
| PLN'000 | 2016 | 2015 |
| Interest and commission income | 53,269 | 65,996 |
| Interest and commission expense | 64,824 | 61,563 |

The Group incurs costs and receives income on derivative transactions with Citigroup Inc. entities to hedge the Bank's position in market risk. These derivative transactions are opposite (back-to-back) to derivative transactions with other Group clients or close the proprietary position of the Group. The net carrying amount of financial derivative transactions as at 31 December 2016 amounted to PLN 139,895 thousand (as at 31 December 2015: PLN (58,573) thousand). The Bank runs a compression of derivative transaction portfolios periodically. It is one of the risk-mitigation techniques recommended by "Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories" and the implementing regulations (EMIR Regulation). In

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accordance with the EMIR Regulations this in particular applies to the portfolios exceeding 500 derivative transactions.

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

The costs arising and accrued (including VAT, reflected in the Group's costs) under concluded agreements in 2016 and 2015 mainly related to the cost of services provided to the Group for the maintenance of the banking IT systems and advisory support and are included in general administrative expenses; income was mainly related to the provision of data processing services by the Group to such entities and is presented in other operating income.

| PLN'000 | 2016 | 2015 |
|---------------------------------|---------|---------|
| General administrative expenses | 175,489 | 183,754 |
| Other operating income | 9,905 | 8,968 |

In 2016 the capitalization of investments regarding functionality modification of retail banking IT systems took place. Total payments for Citigroup Inc. entities amounted to PLN 11,229 thousand (in 2015: PLN 11,301 thousand).

47. Employee benefits

Employee benefits are divided into the following categories:

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

A provision is created for future retirement allowances that is shown in the consolidated statement of financial position in "Other liabilities." An independent actuary periodically verifies the provision in accordance with IFRS. The Group's pension plan is a defined contribution program in accordance with IAS 19. The Group pays contributions for its staff to a separate organization and, after they are paid, has no other payment liabilities. Premiums are shown as employee benefit expenses in the period they concern.

Description of the Employee Pension Plan

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

The basic contribution paid by the employer is defined as a percentage of salary of the Plan member. The basic contribution rate amounts to 7%. The additional contribution – voluntary, is paid by an employee – the Plan participant. The minimum amount of the monthly additional contribution is PLN 10,00 and the maximum amount of the additional contribution is limited to the amount resulting from Announcement of Minister of Labour and Social Policy regarding value of corresponding sum of additional contributions made by participant Plan in concerned year, based on articles 25 item 4a Act of 20 April 2004 regarding employee pension plan (Journal of Law of 2014 position 710 and 2015 position 1844). The basic contribution is the Plan participant's income, from which he is obligated to pay the personal income tax (articles 12 and 13 of the Act on the income tax from individuals of 26 July 1991, Official Journal from 2000. no 90, item 416 with amendments).

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

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

- other long-term employee benefits – jubilee and other long service awards and deferred cash awards. Information about jubilee awards is described in Note 2. Information on jubilee awards paid to employees is presented in Note 2. From 1 of January 2015, employees with long-term work-experience (10, 20, 30 years etc.) are entitled to rewards in kind.

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- employee equity benefits – in the form of common stock under stock award programs based on shares of Citigroup common stock in the form of deferred stock and also in the form of phantom shares of Bank Handlowy w Warszawie S.A. Valuation and presentation principles of these programs are described in Note 2 in “Share-based payments.” Detailed information concerning the employee equity benefits are presented in the further part of this Note.

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|----------------|----------------|
| Provision for remuneration | 61,217 | 66,424 |
| Provisions for unused leave | 14,698 | 19,789 |
| Provision for employees' retirement and pension benefits | 41,936 | 38,084 |
| Provision for employees' equity compensation | 18,034 | 21,546 |
| Provision for workforce restructuring | 4,171 | 680 |
| | 140,056 | 146,523 |

The provision for retirement and pension benefits is created individually on the basis of an actuarial valuation performed periodically by an external independent actuary. The valuation of the employee benefit provisions is performed using actuarial techniques and assumptions. The calculation of the provision includes all retirement and pension benefits expected to be paid in the future. The Bank performed a reassessment of its estimates as at 31 December 2016, on the basis of calculation conducted by an independent external actuary. The provisions calculated equate to discounted future payments, taking into account staff turnover, and relate to the period ending on the balance sheet date. An important factor affecting the amount of the provision is the adopted financial discount rate which was adopted by the Bank at the level of 3.25%.

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

| PLN'000 | 2016 | | 2015 | |
|--------------------------------------|-------------------------------------|--------------------------------|-------------------------------------|--------------------------------|
| | Provision for retirement allowances | Provision for jubilee payments | Provision for retirement allowances | Provision for jubilee payments |
| As at 1 January | 38,084 | - | 40,677 | 268 |
| Increases (due to): | 6,178 | - | 3,478 | - |
| Actuarial profit/loss on revaluation | (342) | - | (1,093) | - |
| Including those resulting from: | | | | |
| Change of economic assumptions | (175) | - | (1,088) | - |
| Change of demographic assumptions | (1) | - | - | - |
| Experience adjustment | (166) | - | (5) | - |
| Remuneration cost | 206 | - | 3,450 | - |
| Interest cost | 45 | - | 1,172 | - |
| Past employment cost | 274 | - | - | - |
| Establishment of provisions | 5,944 | - | - | - |
| Other increases | 51 | - | (51) | - |
| Decreases (due to): | (2,326) | - | (6,071) | (268) |
| Past employment cost | - | - | (3,680) | - |
| Provisions utilisation | (2,326) | - | (2,391) | (268) |
| As at 31 December | 41,936 | - | 38,084 | - |

More information about specific services programs and their estimation can be found in note 2.

In 2016, the Group's expenses in respect of premiums for the employee pension plan amounted to PLN 24,679 thousand (in 2015: PLN 25,286 thousand).

Employment in the Group:

| FTEs | 2016 | 2015 |
|------------------------------------|-------|-------|
| Average employment during the year | 3,782 | 4,146 |
| Employment at the end of the year | 3,640 | 3,986 |

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Description and principles of employee stock benefit schemes

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

Within the framework of the CAP, eligible employees receive so-called "deferred shares" of Citigroup. "Deferred shares" within the framework of the CAP are granted at the NYSE average closing price as at the 5 days prior to the grant date. "Deferred shares" give the right to equivalents of dividends, but without voting rights, and must not be sold prior to their conversion into stocks. "Deferred shares" are converted into stocks after the end of a period that is determined in the Program Rules. As a general rule, the employee has a right to options revoked at the moment of employment termination in the Citigroup, provided the termination of said contract "Capital Accumulation Program – Prospectus" for granted options. Deferred shares granted in 2012- 2015 will be transferred partially in 25% every year for the next four years, starting from the first anniversary of the option to acquire.

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

In 2012 Bank introduced "Variable Remuneration Components Policy For Managerial Staff At Bank Handlowy w Warszawie S.A." ("Policy"), according to requirements described in the Resolution 258/2011 of Komisja Nadzoru Finansowego (Polish Financial Supervisory Authority) dated 4-th of October 2011. According to the Policy, the Management Board of the Bank and other managerial staff having a significant influence on the Bank's risk profile receive variable remuneration in relation to individual performance and the Bank's financial results.

A portion of the Variable Remuneration of persons covered by the Policy will be paid in tranches during in the next 3,5 years.

Variable Remuneration – Phantom shares

| | |
|--|---|
| Transaction as per IFRS | Transactions share-based payments settled in cash in accordance with IFRS 2 |
| Phantom Shares grant date | 20 of January 2014 20 of January 2015 18 of January 2016 16 of January 2017 |
| Number of Phantom Shares granted | The number of shares was set on grant date |
| Date of maturity | At least 6, 18, 30 and 42 months after grant date |
| Vesting date | At least 6, 12, 24 and 36 months after grant date |
| Terms and conditions for acquiring rights to the award | Satisfying the conditions on the Bank's results, individual performance of the employee and employment in the Group in 2014-2017 in relation to the award from 2014, and in 2015-2018 in relation to the award from 2015 and in 2016-2019 and in relation to 2016 reward and in 2017-2020 in respect of reward from 2017. |
| Program settlement | At the settlement date, the participants will get an amount of cash being the product held by a participant phantom shares and the arithmetic mean of the lowest and highest prices of shares of the Bank notified on WSE at the maturity date. Acquisition of rights to every tranche will be confirmed by a decision of the Supervisory Board of the Bank in relation to the Management Board and by a decision of the Management Board in relation to other employees covered by the Policy. According to a decision of the above mentioned Bank Management, the amount of payment may be partially or fully reduced according to conditions given in the Policy. These terms and conditions relate to Bank's results, individual performance and employment status and will relate to the vesting period of each tranche. |

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

Variable Remuneration – Deferred Cash Award

| | |
|---------------------------------------|--|
| Transaction as per IFRS | Other long-term employee benefits in accordance with IAS 19 |
| Grant date of the Deferred Cash Award | 20 of January 2014 20 of January 2015 18 of January 2016 16 of January 2017 |
| Granted amount | The amount was settled on the Deferred Cash Award grant date |

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Variable Remuneration – Deferred Cash Award

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

In 2015 the Bank adopted a policy for the remuneration of key persons in the Bank Handlowy w Warszawie S.A. specifying rules of payment for the members of the Board and other persons performing key functions, including persons with a significant influence over the Bank's risk profile. This policy implements the provisions related to formulation of the remuneration principles in banks in accordance with legal regulations, Principles of Institutional Governance Rules for Supervised Institution adopted by the Polish Financial Supervision Authority and Best Practices of WSE Listed Companies 2016.

Assumptions of valuation of the employee equity benefit schemes

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

| CAP Program | Grant date | Exercise price/stock price at grant date [USD] | Number of eligible employees | Number of options/ shares |
|-------------|------------|--|------------------------------|---------------------------|
| 1 | 19.02.2013 | 43.93 | 7 | 1,190 |
| 2 | 18.02.2014 | 49.66 | 8 | 3,107 |
| 3 | 16.02.2015 | 50.07 | 2 | 750 |
| 4 | 16.02.2016 | 37.05 | 1 | 802 |

| Phantom Shares Program | Grant Date | Exercise price/stock price at grant date [PLN] | Number of eligible employees | Number of options/ shares |
|------------------------|------------|--|------------------------------|---------------------------|
| 1 | 20.01.2014 | 104.86 | 24 | 21,111 |
| 2 | 20.01.2015 | 103.98 | 33 | 39,744 |
| 3 | 18.01.2016 | 72.71 | 50 | 62,739 |

| | CAP Program | Phantom Shares Program |
|--|---------------------------------------|---|
| Period to acquire the title (in years) | 25% after each of the following years | 40% after 0.5 of a year and 20% after each of the following years or 60% after 0.5 of a year and 13.33% after each of the following years |
| Expected average life cycle of the instrument | At the time of rights acquisition | At the time of rights acquisition |
| Probability of premature termination of employment (annual staff turnover for awarded employees) | 6.15% | 6.15% |
| Fair value of one instrument* (in USD) | 60.04 (USD) | 75.78 (PLN) |

*Varies depending on the date of exercise

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

| | 31.12.2016 | | 31.12.2015 | |
|--------------------------------|------------|------------------------------------|------------|------------------------------------|
| | Number | Weighted average share price [USD] | Number | Weighted average share price [USD] |
| At the beginning of the period | 26,026 | 39.33 | 53,658 | 33.11 |
| Allocated in the period | 802 | 37.05 | 1,000 | 50.07 |
| Transfers | - | - | 3,250 | 43.89 |
| Redeemed/expired in the period | 20,978 | - | 31,882 | - |
| At the end of the period | 5,850 | 46.82 | 26,026 | 39.33 |

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

| | 31.12.2016 | | 31.12.2015 | |
|--------------------------------|------------|------------------------------------|------------|------------------------------------|
| | Number | Weighted average share price [PLN] | Number | Weighted average share price [PLN] |
| At the beginning of the period | 136,611 | 102.23 | 132,876 | 100.24 |
| Allocated in the period | 137,763 | 72.21 | 116,484 | 103.98 |
| Executed in the period | 150,777 | 69.05 | 112,749 | 91.86 |
| At the end of the period | 123,597 | 88.00 | 136,611 | 102.23 |

On 31 December 2016, the book value of liabilities from the phantom share and CAP programs amounted to PLN 29,359 thousand (31 December 2015: PLN 30,686 thousand). The costs recognized in this respect in 2016 amounted to PLN 8,801 thousand (in 2015: 9,816 including the costs of SOP programs).

48. Risk management

RISK MANAGEMENT ORGANIZATION STRUCTURE AND PROCESS

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

The concept of risk management, taking into account the shared responsibility, is based on model of three lines of defense i.e.:

- Business Units engaged in activities connected with risk taking,
- Risk Units that establish standards for the risk management, processes defining and methodological support, risk acceptance as well as valuation, mitigation, control, monitoring and reporting of risk and Compliance,
- Internal Audit that provide an independent assessment of risk management processes and performance in the process control/control efficiency of these processes.

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

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

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

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

- approves the organizational structure of the Group, with well-defined, transparent and consistent roles and responsibilities adequate for the size and risk profile, ensuring that the functions of risk measurement, monitoring and control are independent from risk taking activities;
- defines the Bank's Risk's Profile by determining significant types of risk, at the same time providing implementation of processes to manage them and/or allocation of interior equity;

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- establishes the principles of prudent and stable risk management which constitute, together with the ICAAP Document, the risk management strategy, including operational risk strategy;
- approves the acceptable risk level ("Overall risk appetite"), within the document summarizing the process of assessing and internal capital allocation in subsequent years (ICAAP) and is responsible for the development, implementation and updating of written policies, strategies and procedures for risk management, internal control system and internal capital assessment and review process as well as internal capital and policy related to variable components of remuneration.

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

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

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

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

In the risk management area there are following Committees:

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

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

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

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

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

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

Significant Risks

The Bank manages all significant risks arising from the implementation of its business strategy. In the process of significant risks identification in 2016, the Management Board considered the following type of risk as significant:

- Credit risk and counterparty risk,

- Liquidity risk
- Market risk in the trading book,
- Interest rate risk in the banking book,
- Operational risk
- Compliance risk

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

Credit risk, including also counterparty credit risk, results from credit exposure or other exposure related to concluding and clearing below listed transactions, and is defined as the potential for financial loss resulting from the failure of a borrower or counterparty to honor its financial or contractual obligations.

Credit risk arises in many of the Group's business activities, hereinafter "products," including:

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

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

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

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

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

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people, or technical systems, or from external events. It includes reputation and franchise risks associated with operational risk events and business practices or market conduct. It also includes legal risk and compliance risk (defined below). Operational Risk does not cover strategic risks or the risk of loss resulting solely from authorized judgments made with respect to taking credit, market, liquidity or insurance risk.

CREDIT RISK

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

Principles of the Credit Risk Management Policy

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

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

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

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

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

- Joint business and independent risk management responsibility for the quality of the credit portfolio and process as well as for credit loss;
- Adherence to portfolio guidelines to ensure diversification and maintain risk/capital alignment;
- Credit authorities system assuming that credit authority can be given to authorized, trained and experienced staff based upon their professional experience and tested qualifications concerning the risk assessment and making credit decisions.
- A minimum of two authorized credit approvers with delegated credit authority required for all significant exposures;
- Dependence of approval level from the risk taken – exposures with a higher risk (including size and risk assessment) require approval at a higher decision-making level;
- Diverse risk rating standards, adequate to every obligor and exposure, including remedial actions;
- Risk rating of every obligor and exposure in a consistent rating process using risk rating models and scorecards (scoring);
- Periodic monitoring of customers' business results and identification of negative changes in their standing which require immediate reclassification of exposure or remedial actions;
- Exceptions to Credit Policies are approved at higher levels within the organization to ensure control over risk policy implementation by higher level managers in accordance with internal Bank's normative acts and generally applicable laws and regulations issued by the appropriate regulators.

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

Credit risk in this area is managed by means of:

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

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

Credit risk assessment and rating

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

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

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

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

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

- At a facility level, which may include one or more contracts, disposals or transactions;
- At an obligor level, if there are multiple facilities approved for an obligor where the risk associated with an obligor default can be assessed;

- At a group level, considering the group structure of connected clients;
- At a portfolio level where Portfolio Risk Rating is calculated as the average rating of individual facility exposure ratings weighted with the size of exposure.

In case of the amount of exposure, the measurement methods vary from the most simple, such as the value of the asset, to complex, such as estimating potential replacement cost on a derivative contract. The processes required for these measurements also vary considerably, from a simple feed of balances to a complex, multiple simulation engine. With reference to exposures resulting from counterparty credit risk (pre-settlement) for the purpose of risk management, the Bank uses PSE measure (Pre-Settlement Exposure) reflecting future potential exposure of the counterparty. PSE reflects maximum expected exposure of the counterparty during the life of the transaction (or transaction portfolio) at a specific confidence level depends on market factors determining the values for particular transactions in the customer portfolio. In the case of a lack of sufficient data for simulation of transaction portfolio value, more simplified methods are used, which also apply to measurement of exposure for internal capital purposes.

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

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

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

Credit risk monitoring

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

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

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

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

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

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

Risk mitigation

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

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

Policy of collateral acceptance

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

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

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

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

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

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

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

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

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

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

The principal type of collateral in GCB is an entry in the land and mortgage register for mortgage-secured loans. The Group also uses bridge insurance to mitigate the risk of the borrower's default between the time of disbursement of a loan and the time of making an entry in the land and mortgage register. The value of collateral is measured at each time on the basis of an expert valuation of real estate commissioned by the Group. Expert valuations are reviewed by an independent valuation division according to valuation guidelines for real estate used as collateral of real estate loans for individuals who are GCB customers. The quality of the division's performance is monitored.

As at 31 December 2016, the financial effect of receivables recovered from collateral for receivables from customers with recognized impairment based on individual measurement in the Group amounted to PLN 50,744 thousand (31 December 2015: PLN 42,387 thousand). This is how much higher the required impairment write-offs of the portfolio would be if the estimation of the write-offs did not include cash flows from such collateral.

Concentration of exposure

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

In its credit risk management, the Group defines exposure concentration limits related to the maximum exposure (as per internal reporting):

- against one obligor (including CCP) or a group of connected clients;
- against particular industries (based on the Group's internal classification);
- against entities in the same geographical region (country level - risk of geographical concentration)
- in a foreign currency;

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- resulting from transactions generating counterparty credit risk (pre-settlement);
- against mortgage-secured exposures;
- against retail credit exposures of the Consumer Bank Risk Division,
- against entities belonging to the Capital Group of the Bank particular products,
- particular products and currencies.

In the obligor exposure management process, the Group also monitors the limits defined by the Banking Act and other supervisory resolutions to ensure compliance, including an additional capital requirement determined for these exposures when needed.

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

In addition to current concentration levels monitoring in accordance to set limits; Bank monitors also potential concentration resulting from indirect commitments – however, in accordance with the Bank's portfolio profile there were no limits set for this type of concentration.

Obligor exposure concentration risk

The Group limits the concentration of its exposure to a single customer or a group of customers with common ownership or organization. As at 31 December 2016, the Group's exposure in bank portfolio transactions with groups of customers whose aggregate exposure exceeded 10% of the Group's equity (as defined below in this report) amounted to PLN 7,221,065 thousand, i.e., 151% of equity (31 December 2015: PLN 6,199,373 thousand, i.e., 130%). In 2016 and 2015 the Group complied with the provisions on limits of concentration of exposure.

Concentration of exposure to the top non-banking borrowers of the Group:

| PLN'000 | 31.12.2016 | | | 31.12.2015 | | |
|--------------|-------------------------|---|------------------|-------------------------|---|------------------|
| | Balance sheet exposure* | Granted financial and guarantee liabilities | Total exposure | Balance sheet exposure* | Granted financial and guarantee liabilities | Total exposure |
| CLIENT 1 | 564,798 | 500,185 | 1,064,983 | 360,285 | 700,722 | 1,061,007 |
| CLIENT 2 | 1,000,000 | - | 1,000,000 | - | - | - |
| GROUP 3 | 115,751 | 763,725 | 879,476 | 120,987 | 791,637 | 912,624 |
| CLIENT 4 | 316,900 | 433,100 | 750,000 | 500,000 | 250,000 | 750,000 |
| GROUP 5 | 14 | 641,332 | 641,346 | 125,146 | 502,862 | 628,008 |
| GROUP 6 | 396,000 | 205,445 | 601,445 | 3 | 601,358 | 601,361 |
| CLIENT 7 | 600,000 | - | 600,000 | 700,000 | - | 700,000 |
| GROUP 8 | 431,855 | 156,716 | 588,571 | 447,882 | 84,545 | 532,427 |
| GROUP 9 | 531,149 | 53,370 | 584,519 | 158,540 | 55,057 | 213,597 |
| GROUP 10 | 187,415 | 323,310 | 510,725 | 200,692 | 173,763 | 374,455 |
| GROUP 11 | - | - | - | 419,442 | 94,426 | 513,868 |
| CLIENT 12 | - | - | - | - | 500,078 | 500,078 |
| CLIENT 13 | - | - | - | 450,000 | - | 450,000 |
| Total | 4,143,882 | 3,077,183 | 7,221,065 | 3,482,977 | 3,754,448 | 7,237,425 |

*Excluding investment in shares and other securities

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

As at 31 December 2016, the Group had an exposure to one entity exceeding the statutory exposure concentration limits. The excess exposure resulted from trade portfolio transactions. As a consequence, an additional capital requirement for excess exposure was factored into the calculation of the Group's total capital requirement as at 31 December 2016.

*Concentration of exposure in individual industries**

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

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| Sector of the economy according to the Polish Classification of Economic Activity (PKD)* | 31.12.2016 | | 31.12.2015 | |
|---|-------------------|---------------|-------------------|---------------|
| | PLN'000 | % | PLN'000 | % |
| Wholesale trade, excluding trade in vehicles | 4,122,906 | 17.3% | 4,416,137 | 17.8% |
| Manufacture and supply of electricity, gas, steam, hot water and air conditioning | 2,526,268 | 10.6% | 2,661,946 | 10.7% |
| Financial intermediation, excluding insurance and pension funds | 2,492,605 | 10.5% | 1,842,100 | 7.4% |
| Retail trade, excluding retail trade in vehicles | 1,313,366 | 5.5% | 1,413,278 | 5.7% |
| Production of food and beverages | 1,169,614 | 4.9% | 1,290,045 | 5.2% |
| Metal ore mining | 1,064,982 | 4.5% | 1,061,007 | 4.3% |
| Production and processing of coke and petroleum products | 936,473 | 3.9% | 848,866 | 3.4% |
| Production of metal goods, excluding machines and equipment | 615,380 | 2.6% | 689,814 | 2.8% |
| Production of basic pharmaceutical substance, medicaments and other pharmaceutical products | 600,599 | 2.5% | 229,606 | 0.9% |
| Telecommunication | 595,110 | 2.5% | 438,956 | 1.8% |
| 10 business sectors | 15,437,303 | 64.8% | 14,891,755 | 60.1% |
| Other sectors | 8,380,065 | 35.2% | 9,899,052 | 39.9% |
| Total | 23,817,368 | 100.0% | 24,790,807 | 100.0% |

*Gross balance-sheet and off-balance-sheet exposure to institutional customers (including banks).

Gross amounts due from customers and banks by type of business

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|-------------------|-------------------|
| Gross amounts due from economic entities and banks | | |
| Financial | 2,264,443 | 2,713,279 |
| Production | 4,395,330 | 4,323,731 |
| Services | 4,411,674 | 1,034,349 |
| Other | 2,242,082 | 5,811,927 |
| | 13,313,529 | 13,883,285 |
| Gross amounts due from individual customers | 6,697,209 | 6,436,445 |
| | | |
| (see Note 18, 24) | 20,010,738 | 20,319,730 |

Management of impaired exposures

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

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

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

The following events or evidences are identified, which might result in impairment:

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

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

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

Customers in the classifiable portfolio (individual assessment)

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

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

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

Customers in the delinquency managed portfolio (portfolio assessment)

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

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

Additional criteria of impairment include:

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

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

| <i>PLN'000</i> | <i>Note</i> | 31.12.2016 | 31.12.2016 |
|--|-------------|-------------------|-------------------|
| Receivables due from Central Bank | 17 | 3,587 | 1,693,132 |
| Gross receivables due from banks | 18 | 587,264 | 758,853 |
| Gross receivables due from institutional customers | 24 | 12,726,265 | 13,124,432 |
| Gross receivables due from individual customers | 24 | 6,697,209 | 6,436,445 |
| Debt securities held-for-trading | 19 | 2,605,028 | 4,692,560 |
| Derivative instruments | 19 | 1,167,134 | 2,267,132 |
| Hedging derivatives | 20 | 12,244 | 1,795 |
| Debt securities available-for-sale | 21 | 19,072,371 | 18,351,259 |
| Other financial assets | 29 | 219,105 | 204,430 |
| Contingent liabilities granted | 40 | 16,889,165 | 18,047,534 |
| | | 59,979,372 | 65,577,572 |

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

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

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

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

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

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

Commitment due to customers in terms of credit risk:

| PLN'000 | 31.12.2016 | | | 31.12.2015 | | |
|---------------------------------|--|---------------------------------------|------------------------|--|---------------------------------------|------------------------|
| | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks |
| Impaired receivables | | | | | | |
| Individual receivables | | | | | | |
| Gross amount | 300,772 | 11,873 | - | 337,170 | 11,349 | - |
| Impairment write-off | 249,373 | 6,232 | - | 290,809 | 5,523 | - |
| Net amount | 51,399 | 5,641 | - | 46,361 | 5,826 | - |
| Portfolio receivables | | | | | | |
| Gross amount | 14,988 | 305,513 | - | 23,889 | 327,216 | - |
| Impairment write-off | 9,840 | 218,241 | - | 11,203 | 212,903 | - |
| Net amount | 5,148 | 87,272 | - | 12,686 | 114,313 | - |
| Not impaired receivables | | | | | | |
| by risk rating | | | | | | |
| Risk rating 1-4- | 9,142,799 | - | 580,651 | 9,640,258 | - | 591,378 |
| Risk rating +5-6- | 3,071,547 | - | 6,613 | 2,915,852 | - | 167,475 |
| Risk rating +7 and greater | 196,159 | - | - | 207,263 | - | - |
| by delinquency | | | | | | |
| no delinquency | - | 6,099,137 | - | - | 5,847,336 | - |
| 1-30 days | - | 233,240 | - | - | 202,475 | - |
| 31-90 days | - | 47,446 | - | - | 48,069 | - |
| Gross amount | 12,410,505 | 6,379,823 | 587,264 | 12,763,373 | 6,097,880 | 758,853 |
| Impairment | 19,426 | 60,309 | 177 | 19,478 | 45,490 | 1,750 |
| Net amount | 12,391,079 | 6,319,514 | 587,087 | 12,743,895 | 6,052,390 | 757,103 |
| Total net amount | 12,447,626 | 6,412,427 | 587,087 | 12,802,942 | 6,172,529 | 757,103 |

| PLN'000 | 31.12.2016 | | | 31.12.2015 | | |
|---|--|---------------------------------------|------------------------|--|---------------------------------------|------------------------|
| | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks |
| Impairment write-offs for impaired receivables | | | | | | |
| Impairment write-offs for individual receivables | 249,373 | 6,232 | - | 290,809 | 5,523 | - |
| Impairment write-offs for portfolio receivables | 9,840 | 218,241 | - | 11,203 | 212,903 | - |

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| PLN'000 | 31.12.2016 | | | 31.12.2015 | | |
|------------------------------------|--|---------------------------------------|------------------------|--|---------------------------------------|------------------------|
| | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks |
| IBNR provisions | | | | | | |
| by risk rating | | | | | | |
| Risk rating 1-4- | 3,322 | - | 88 | 2,716 | - | 131 |
| Risk rating +5-6 | 9,027 | - | 89 | 10,124 | - | 1,619 |
| Risk rating +7 and greater | 7,077 | - | - | 6,638 | - | - |
| by delinquency | | | | | | |
| no delinquency | - | 21,992 | - | - | 16,993 | - |
| 1-30 days | - | 15,227 | - | - | 11,083 | - |
| 31-90 days | - | 23,090 | - | - | 17,414 | - |
| | 19,426 | 60,309 | 177 | 19,478 | 45,490 | 1,750 |
| Total impairment write-offs | 278,639 | 284,782 | 177 | 321,490 | 263,916 | 1,750 |

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|------------------|------------------|
| Receivables due from individual customers not impaired and without delay in payment, including: | 6,099,137 | 5,847,335 |
| receivables at least once have exceeded 30 days of delay in payment (but have not exceeded 90 days) | 365,690 | 344,435 |
| receivables at least once have exceeded 90 days of delay in payment | 5,498 | 5,824 |

Receivables not impaired by delinquency

| PLN'000 | 31.12.2016 | | | 31.12.2015 | | |
|---|--|---------------------------------------|------------------------|--|---------------------------------------|------------------------|
| | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks | Amounts due from institutional customers | Amounts due from individual customers | Amounts due from banks |
| Receivables with incurred but not recognized (IBNR) losses | | | | | | |
| Regular receivables | 12,396,864 | 6,099,137 | 587,264 | 12,716,875 | 5,847,335 | 758,853 |
| Overdue receivables, including: | 13,641 | 280,686 | - | 46,498 | 250,545 | - |
| 1-30 days | 6,312 | 233,240 | - | 44,897 | 202,475 | - |
| Gross amount | 12,410,505 | 6,379,823 | 587,264 | 12,763,373 | 6,097,880 | 758,853 |

Structure of derivatives in terms of credit risk:

| PLN'000 | 31.12.2016 | | | 31.12.2015 | | |
|-----------------------------------|---|--|-------------------------|---|--|-------------------------|
| | Transactions with institutional customers | Transactions with individual customers | Transactions with banks | Transactions with institutional customers | Transactions with individual customers | Transactions with banks |
| Derivatives by risk rating | | | | | | |
| Risk rating 1-4- | 96,107 | 6,141 | 1,053,076 | 157,940 | 2,176 | 2,071,473 |
| Risk rating +5-6- | 14,650 | - | 8,242 | 14,696 | - | 21,581 |
| Risk rating +7 and greater | 1,162 | - | - | 1,061 | - | - |
| Total | 111,919 | 6,141 | 1,061,318 | 173,697 | 2,176 | 2,093,054 |

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

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| PLN'000 | 31.12.2016 | | 31.12.2015 | |
|--------------------------------------|----------------------------------|------------------------------------|----------------------------------|------------------------------------|
| | Debt securities held-for-trading | Debt securities available-for-sale | Debt securities held-for-trading | Debt securities available-for-sale |
| Issuer rating by Fitch agency | | | | |
| A (including from A to AAA) | 2,605,028 | 19,072,371 | 4,330,816 | 18,351,259 |
| BBB+ | - | - | 361,744 | - |
| Total | 2,605,028 | 19,072,371 | 4,692,560 | 18,351,259 |

Other financial assets in the amount of PLN 219,108 thousand at the end of 2016 (PLN 204 430 thousand at the end of 2015) include receivables with delinquency over 90 days in the amount of PLN 1,709 thousand (PLN 1,824 thousand at the end of 2015).

Structure of granted contingent liabilities in terms of credit risk

| PLN'000 | 31.12.2016 | | 31.12.2015 | |
|--|--|--------------------------|--|--------------------------|
| | Liabilities due to institutional customers | Liabilities due to banks | Liabilities due to institutional customers | Liabilities due to banks |
| Granted contingent liabilities by risk rating | | | | |
| Risk rating 1-4- | 7,701,340 | 276,957 | 9,737,033 | 260,594 |
| Risk rating+5-6- | 2,828,993 | 9,024 | 2,342,319 | 5,531 |
| Risk rating +7and greater | 33,266 | - | 117,362 | - |
| Total | 10,563,599 | 285,981 | 12,196,714 | 266,125 |

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|--|------------------|------------------|
| Granted contingent liabilities due to individual customers, including: | 6,039,585 | 5,584,695 |
| contingent liabilities at least once have exceeded 30 days of delay in payment (but have not exceeded 90 days) | 319,995 | 307,782 |
| contingent liabilities at least once have exceeded 90 days of delay in payment | 1,584 | 1,748 |

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

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|-------------------|-------------------|
| Gross amount | | |
| Receivables with recognized impairment, including: | 633,146 | 699,624 |
| Individual receivables | 312,645 | 348,519 |
| Portfolio receivables | 320,501 | 351,105 |
| Receivables without recognized impairment | 19,377,592 | 19,620,106 |
| Total gross amount | 20,010,738 | 20,319,730 |
| Impairment write-offs | | |
| Receivables with recognized impairment, including: | 483,686 | 520,438 |
| Individual receivables | 255,605 | 296,332 |
| Portfolio receivables | 228,081 | 224,106 |
| Receivables without recognized impairment | 79,912 | 66,718 |
| Impairment write-offs in total | 563,598 | 587,156 |
| Net amount | | |
| Receivables with recognized impairment, including: | 149,460 | 179,186 |
| Individual receivables | 57,040 | 52,187 |
| Portfolio receivables | 92,420 | 126,999 |
| Receivables without recognized impairment | 19,297,680 | 19,553,388 |
| Total net amount | 19,447,140 | 19,732,574 |
| Ratio of impairment write-offs to receivables with recognized impairment | 76.4% | 74.4% |

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“Forbearance” practices

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

The Group considers exposures as “forborne” that are in the process of troubled debt restructuring. This is a situation when the debtor is experiencing financial difficulties and Bank grants preferential financing conditions to the debtor that it would not otherwise consider (i.e., off-market terms).

Preferential financing conditions are considered situations in which for example the yield of the modified facility is lower than the contractual yield prior to the restructuring and/or the yield on the modified loan is below a market yield for the relevant tenor and credit risk.

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

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

The process of assigning “forborne” status for exposures is closely related to the credit risk management process, including the impairment recognition process for exposures. According to the implemented process of impairment recognition, exposure status change to “forborne” constitutes an evidence of impairment and such exposure is in the portfolio of impaired loans.

The Group assumes, that exposures will remain in “forborne” status until they are entirely paid off.

The “forborne” exposures are serviced by a specialized unit where the documented processes to ensure the correct identification (“forborne” exposures are indicated in the Bank accounting system), accounting, valuation, reporting and monitoring of these exposures are in place. Exposure values in “forborne” status are insignificant, that is why Group monitors them at a total level, without further portfolio splits.

| w tys. zł | As of | |
|---|-------------------|-------------------|
| | 31.12.2016 | 31.12.2015 |
| Receivables without recognized impairment, including | 18,790,328 | 18,861,253 |
| non-financial sector entities | 17,099,400 | 16,827,402 |
| Institutional customers | 10,719,577 | 10,729,522 |
| Individual customers | 6,379,823 | 6,097,880 |
| Receivables with recognized impairment, including: | 633,146 | 699,624 |
| non-financial sector entities | 616,010 | 682,490 |
| Institutional customers, including: | 298,624 | 343,925 |
| „forborne” | 78,766 | 74,991 |
| Individual customers, including: | 317,386 | 338,565 |
| „forborne” | 24,273 | 31,979 |
| Total gross amount, including: | 19,423,474 | 19,560,877 |
| non-financial sector entities | 17,715,410 | 17,509,892 |
| Institutional customers, including: | 11,018,201 | 11,073,447 |
| „forborne” | 78,766 | 74,991 |
| Individual customers, including: | 6,697,209 | 6,436,445 |
| „forborne” | 24,273 | 31,979 |
| Impairment write-off | (563,421) | (585,406) |
| On „forborne” receivables | (56,959) | (62,073) |
| Total net amounts due from customers, including: | 18,860,053 | 18,975,471 |
| „forborne” receivables | 46,080 | 44,897 |

“Forborne” exposures by period of overdue

| PLN'000 | As of | |
|----------------------|------------|------------|
| | 31.12.2016 | 31.12.2015 |
| Not past due | 49,435 | 54,634 |
| Past due, including: | 53,604 | 52,336 |

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| PLN'000 | As of | |
|----------------------------|----------------|----------------|
| | 31.12.2016 | 31.12.2015 |
| Past due less than 30 days | 2,125 | 2,635 |
| Past due 31 - 90 days | 6,576 | 4,565 |
| Past due over 90 days | 44,903 | 45,136 |
| Total gross amount | 103,039 | 106,970 |

LIQUIDITY RISK

The processes and organization of liquidity risk management

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

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

Liquidity risk management is based on:

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

taking into account the best market practice.

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

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

Liquidity management

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

The Group analyses and manages liquidity risk in several time horizons while distinguishing current, short-, mid- and long-term liquidity, to which appropriate risk measurement methods and limits apply.

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

Mid-term liquidity management, in the one-year time horizon, is the responsibility of ALCO and is based on the process of the Annual Funding and Liquidity Plan defining the size of internal limits taking into account the business plans for assets and liabilities changes prepared by business units of the Group as part of financial plans for the next budget year.

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

Current liquidity management is the responsibility of the Treasury Division and comprises the management of the balances on the Group's nostro accounts and especially the mandatory reserve account with NBP while applying available money market products and central bank facilities.

Liquidity management with accordance to "Risk management principals" in Group entities is a part of the entities, management board responsibilities. ALCO is the supervisor of the Group's entities liquidity supervision.

Funding and Liquidity Plan

The Head of the Group's Treasury Division is responsible for preparing an annual Funding and Liquidity Plan ("Plan") for the Group and obtaining the ALCO approval for the Plan. The Plan addresses all funding or liquidity issues resulting

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from business plans, especially in the customer deposits and loans area, as defined in annual budgets of particular business entities, as well as any material changes in regulatory requirements and market dynamics.

Liquidity risk management tools

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

Internal liquidity risk management tools

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

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

Stress scenarios

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

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

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

Contingency Funding Plan

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

The Contingency Funding Plan defines:

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

The levels of the cumulative liquidity gap in stress conditions and the level of liquid assets as at 31 December 2016 and 31 December 2015.

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

| <i>PLN'000</i> | <i>Up to 1 month</i> | <i>More than 1 to 3 months</i> | <i>More than 3 months to 1 year</i> | <i>More than 1 year to 2 years</i> | <i>More than 2 years</i> |
|--|----------------------|--------------------------------|-------------------------------------|------------------------------------|--------------------------|
| Assets | 19,726,589 | 563,913 | 417,261 | - | 24,615,552 |
| Liabilities and equity | 7,899,170 | 4,190,501 | 64,445 | 46,014 | 33,123,185 |
| Balance sheet gap in the period | 11,827,419 | (3,626,588) | 352,816 | (46,014) | (8,507,633) |
| Conditional derivative transactions – inflows | 10,159,711 | 3,370,020 | 6,341,294 | 4,169,771 | 17,095,176 |
| Conditional derivative transactions – outflows | 10,123,268 | 3,346,658 | 6,365,283 | 4,227,780 | 17,276,599 |
| Off-balance-sheet gap in the period | 36,443 | 23,362 | (23,989) | (58,009) | (181,423) |

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| <i>PLN'000</i> | Up to 1 month | More than 1 to 3 months | More than 3 months to 1 year | More than 1 year to 2 years | More than 2 years |
|---|---------------|-------------------------|------------------------------|-----------------------------|-------------------|
| Potential use of the granted credit lines | 696,104 | 1,351,335 | - | - | (2,047,439) |
| Cumulative gap | 11,167,758 | 6,213,197 | 6,542,024 | 6,438,001 | (203,616) |

The cumulative liquidity gap as at 31 December 2015 in real terms:

| <i>PLN'000</i> | Up to 1 month | More than 1 to 3 months | More than 3 months to 1 year | More than 1 year to 2 years | More than 2 years |
|--|---------------|-------------------------|------------------------------|-----------------------------|-------------------|
| Assets | 20,838,740 | 313,024 | 410,630 | 196,967 | 27,747,431 |
| Liabilities and equity | 12,603,752 | 2,682,201 | 87,424 | 59,609 | 34,073,806 |
| Balance sheet gap in the period | 8,234,988 | (2,369,177) | 323,206 | 137,358 | (6,326,375) |
| Conditional derivative transactions – inflows | 17,752,619 | 6,507,815 | 8,138,631 | 4,750,096 | 10,799,649 |
| Conditional derivative transactions – outflows | 17,618,109 | 6,565,980 | 8,125,367 | 4,761,800 | 10,976,369 |
| Off-balance-sheet gap in the period | 134,510 | (58,165) | 13,264 | (11,704) | (176,720) |
| Cumulative gap | 8,369,498 | 5,942,156 | 6,278,626 | 6,404,280 | (98,815) |

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

| <i>PLN'000</i> | 31.12.2016 | 31.12.2015 | Change |
|---|--------------|--------------|-------------|
| Liquid assets, including: | 22,190,847 | 24,951,511 | (2,760,664) |
| nostro account in NBP and stable part of cash | 513,448 | 1,907,692 | (1,394,244) |
| debt securities held-for-trading | 2,605,028 | 4,692,560 | (2,087,532) |
| debt securities available-for-sale | 19,072,371 | 18,351,259 | 721,112 |
| Cumulative liquidity gap up to 1 year | 6,542,024 | 6,278,626 | 263,398 |
| Coverage of the gap with liquid assets | Positive gap | Positive gap | - |

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

As at 31 December 2016

| <i>PLN'000</i> | Note | Total | Up to 1 month | 1 to 3 months | 3 months to 1 year | 1 to 5 years | More than 5 years |
|---|------|-------------------|-------------------|----------------|--------------------|------------------|-------------------|
| Amounts due to banks | 30 | 2,310,743 | 2,140,203 | 20,897 | 34,627 | 114,977 | 39 |
| Financial liabilities held-for-trading | | | | | | | |
| Short positions in financial assets | 19 | 208,106 | 208,106 | - | - | - | - |
| Amounts due to customers, including: | 31 | 33,936,512 | 32,905,272 | 748,865 | 264,652 | 17,651 | 72 |
| Deposits from financial sector entities | 31 | 4,696,126 | 4,650,565 | 41,909 | 3,633 | - | 19 |
| Deposits from non-financial sector entities | 31 | 29,122,882 | 28,190,973 | 689,494 | 226,188 | 16,174 | 53 |
| Other liabilities | 31 | 117,504 | 63,734 | 17,462 | 34,831 | 1,477 | - |
| Financial liabilities held-for-trading | | | | | | | |
| Derivative financial instruments (settled on a net basis) | 19 | 750,866 | 27,175 | 38,182 | 121,727 | 365,330 | 198,452 |
| Hedging derivatives | 20 | 39,897 | - | - | - | 18,549 | 21,348 |
| Unused credit lines liabilities | 40 | 13,331,401 | 11,333,111 | 49,282 | 312,309 | 1,128,776 | 507,923 |
| Guarantee lines | 40 | 2,165,812 | 2,165,812 | - | - | - | - |
| | | 52,743,337 | 48,779,679 | 857,226 | 733,315 | 1,645,283 | 727,834 |
| Derivatives settled on a gross basis | | | | | | | |
| Inflows | | 40,526,382 | 10,536,899 | 3,070,489 | 6,175,871 | 10,721,726 | 10,021,397 |
| Outflows | | 40,462,467 | 10,486,275 | 3,055,881 | 6,153,208 | 10,693,570 | 10,073,533 |
| | | 63,915 | 50,624 | 14,608 | 22,663 | 28,156 | (52,136) |

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As at 31 December 2015

| PLN'000 | Note | Total | Up to 1 month | 1 to 3 months | 3 months to 1 year | 1 to 5 years | More than 5 years |
|---|------|-------------------|-------------------|------------------|--------------------|------------------|-------------------|
| Amounts due to banks | 30 | 6,963,564 | 5,986,217 | 750,000 | 69,848 | 157,468 | 31 |
| Financial liabilities held-for-trading | | | | | | | |
| Short positions in financial assets | 19 | 988,102 | 988,102 | - | - | - | - |
| Amounts due to customers, including: | 31 | 31,586,315 | 30,689,306 | 632,011 | 252,599 | 12,329 | 70 |
| Deposits from financial sector entities | 31 | 3,381,143 | 3,263,116 | 112,616 | 4,755 | 639 | 17 |
| Deposits from non-financial sector entities | 31 | 27,894,398 | 27,191,129 | 483,580 | 208,016 | 11,620 | 53 |
| Other liabilities | 31 | 310,774 | 235,061 | 35,815 | 39,828 | 70 | - |
| Financial liabilities held-for-trading | | | | | | | |
| Derivative financial instruments (settled on a net basis) | 19 | 1,797,159 | 63,520 | 102,212 | 208,112 | 955,916 | 467,399 |
| Hedging derivatives | 20 | 112,383 | - | - | - | 53,684 | 58,699 |
| Unused credit lines liabilities | 40 | 14,618,126 | 12,272,291 | 175,606 | 376,411 | 1,089,615 | 704,203 |
| Guarantee lines | 40 | 2,131,008 | 2,131,008 | - | - | - | - |
| | | 58,196,657 | 52,130,444 | 1,659,829 | 906,970 | 2,269,012 | 1,230,402 |
| Derivatives settled on a gross basis | | | | | | | |
| Inflows | | 47,262,699 | 17,657,248 | 6,433,442 | 8,035,146 | 10,778,834 | 4,358,029 |
| Outflows | | 47,181,855 | 17,544,078 | 6,418,020 | 8,076,504 | 10,768,844 | 4,374,409 |
| | | 80,844 | 113,170 | 15,422 | (41,358) | 9,990 | (16,380) |

MARKET RISK

The processes and organization of market risk management

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

The objective of market risk management is to ensure that the extent of risk accepted within the Group corresponds to the level acceptable to the shareholders and banking supervision authorities and to ensure that all exposures to market risk are properly reflected in the calculated risk measures, communicated to relevant persons and bodies responsible for the management of the Group.

Market risk management in the Group is based on:

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

taking into account best market practice.

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

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

Market risk management

Scope of risk

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

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

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

Measurement of the pricing risk of the bank portfolios

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

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

Interest rate gap analysis uses the schedule of maturities or revaluations of balance-sheet positions and of derivative instruments used in hedge accounting or qualified as economic hedge for the purpose of establishing the differences between positions whose maturity or interest rate revaluation fall within a given time range.

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

It is assumed that:

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

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

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

The table below presents the IRE measures for the Group as at 31 December 2016 and 31 December 2015. The list has been broken down into the main currencies, i.e., PLN, USD and EUR, which jointly account for over 90% of the Group's balance-sheet.

| PLN'000 | 31.12.2016 | | 31.12.2015 | |
|---------|------------|----------|------------|----------|
| | IRE 12M | IRE 5L | IRE 12M | IRE 5L |
| PLN | 35,351 | 176,849 | 27,809 | 60,086 |
| USD | 17,212 | 36,974 | (14,093) | (70,011) |
| EUR | (3,349) | (20,704) | 14,002 | 18,278 |

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

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

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

- management of the liquidity;
- hedging against the risk transferred to the Treasury Division from other organizational units of the Bank or the Group's entities;
- opening of own interest rate risk positions on the Group's books by the Treasury Division.

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

Hedge accounting program

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

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

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

| PLN'000 | 31.12.2016 | | | 31.12.2015 | | | Total in the period 1.01.2016 – 31.12.2016 | | |
|---------|------------|------------|-------|------------|------------|-------|---|---------|---------|
| | Total | Securities | IRS | Total | Securities | IRS | Average | Maximum | Minimum |
| PLN | (1,491) | (2,637) | 1,146 | (2,730) | (4,123) | 1,393 | (2,161) | (1,053) | (3,457) |
| USD | (49) | (358) | 309 | (933) | (1,365) | 432 | (290) | (48) | (955) |
| EUR | (430) | (430) | - | (208) | (208) | - | (572) | (208) | (808) |

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

Measurement of the market risk of the trading portfolios

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

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

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

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

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

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

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

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

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

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

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

| PLN'000 | 31.12.2016 | 31.12.2016 | In the period 1.01.2016 – 31.12.2016 | | |
|---------|------------|------------|--------------------------------------|---------|---------|
| | | | Average | Maximum | Minimum |
| PLN | 267 | (66) | 126 | 870 | (576) |
| EUR | (123) | (63) | (118) | 85 | (395) |
| USD | 9 | 96 | (28) | 109 | (106) |

Average exposures to the interest rate risk in the local currency in 2016 was higher comparing to the level from the previous year and amounted to PLN 255 thousand. Average exposure to the interest rate risk in EUR were higher than in 2015 (DV01 amounted to PLN 126 thousand, compared to PLN 82 thousand in the previous year). Average exposure in EUR were lower as in 2015 (DV01 amounted to PLN 32 thousand, compared to PLN 63 thousand in 2015). The maximum exposure in PLN of the biggest exposures accepted by the Treasury Division was PLN 870 thousand compared to PLN 875 thousand in 2015 and the position in EUR amounted to PLN 395 thousand compared to PLN 411 thousand in the previous year.

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

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

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| PLN'000 | 31.12.2016 | 31.12.2015 | In the period 1.01.2016– 31.12.2016 | | |
|--------------------|--------------|--------------|-------------------------------------|---------------|--------------|
| | | | Average | Maximum | Minimum |
| Currency risk | 287 | 96 | 958 | 6,600 | 24 |
| Interest rate risk | 6,280 | 4,147 | 5,673 | 17,443 | 1,631 |
| Spread risk | 5,046 | 4,576 | 3,656 | 6,507 | 296 |
| Total risk | 8,333 | 6,061 | 7,210 | 18,737 | 3,493 |

The overall average level of the market risk of the trading portfolios was 17% lower in 2016 than the average level in 2015, representing an increase by over PLN 1,514 thousand, mainly as a result of lower exposures to interest rates. The maximum price risk level was PLN 18,737 thousand, compared to PLN 18,375 thousand in 2015.

Equity instruments risk

Dom Maklerski Banku Handlowego S.A. ("DMBH") is the Group's key company trading in equity instruments. In its core business, DMBH has been authorized to accept pricing risk of the trading portfolio of shares, or rights to shares, traded or likely to be traded on the Warsaw Stock Exchange ("WSE"), or BondSpot, WIG20 index futures and Indexed Participation Units, as well as shares of companies dual-listed on the WSE which are traded on international stock exchanges. The pricing risk of DMBH's portfolios of instruments is managed by means of volume limits applicable to specific types of financial instruments and concentration warning thresholds applicable to instruments of specific issuers. Moreover, DMBH uses warning thresholds of potential loss under stress scenarios and the cumulative realized loss on the trading portfolio.

The Group's FX exposure

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

31.12.2016

| PLN'000 | Balance-sheet transactions | | Contingent derivative transactions* | | Net position |
|------------------|----------------------------|------------------|-------------------------------------|-------------------|----------------|
| | Assets | Liabilities | Assets | Liabilities | |
| EUR | 3,164,418 | 4,545,892 | 17,289,321 | 15,769,761 | 138,086 |
| USD | 2,924,954 | 2,887,135 | 7,839,769 | 7,904,888 | (27,300) |
| GBP | 12,336 | 353,722 | 380,457 | 38,651 | 420 |
| CHF | 302,191 | 147,687 | 1,422,369 | 1,579,560 | (2,687) |
| Other currencies | 1,840 | 266,477 | 1,833,809 | 1,569,944 | (772) |
| | 6,405,739 | 8,200,913 | 28,765,725 | 26,862,804 | 107,747 |

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

31.12.2016

| PLN'000 | Balance-sheet transactions | | Contingent derivative transactions* | | Net position |
|------------------|----------------------------|------------------|-------------------------------------|-------------------|----------------|
| | Assets | Liabilities | Assets | Liabilities | |
| EUR | 3,116,186 | 4,241,177 | 16,721,542 | 15,477,990 | 118,561 |
| USD | 5,456,076 | 3,469,607 | 9,206,843 | 11,198,528 | (5,216) |
| GBP | 28,907 | 380,021 | 437,048 | 46,580 | 39,354 |
| CHF | 310,154 | 123,080 | 656,060 | 845,258 | (2,124) |
| Other currencies | 106,768 | 251,291 | 2,970,751 | 2,839,821 | (13,593) |
| | 9,018,091 | 8,465,176 | 29,992,244 | 30,408,177 | 136,982 |

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

OPERATIONAL RISK

Assumptions of the operational risk system

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

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

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

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

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

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

Operational risk definition

Operational Risk is the risk of loss resulting from inadequate or deficient internal processes, people, or technical systems, or from external events. Operational Risk includes reputation and franchise risk associated with operational risk events and business practices or market conduct. It also includes legal risk and compliance risk (further defined). Operational Risk does not cover strategic risk or the risk of loss resulting solely from authorized judgments made with respect to taking credit, market, liquidity or insurance risk.

Definition of Operational Risk covers: Technological and technical risk, Outsourcing risk, Misappropriation risk, Money Laundering risk, Information Security risk, External Events risk (Continuity of Business), Tax and Accounting risk, Product risk, Compliance risk, Legal risk, Models risk, Staffing risk, concentration risk and conduct risk.

Rules of operational risk identification

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

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

Operational Risk Profile

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

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

Measurement and assessment

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

Risk tolerance framework, risk control and mitigation

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

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

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

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

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

Monitoring and reporting

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

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

The Supervisory Board supervises and assesses the adequacy and effectiveness of operational risk management. The Supervisory Board is supported by Committees of Supervisory Board - Audit Committee, Risk and Capital Committee and Remuneration Committee.

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

Assumptions of internal control of operational risk

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

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

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

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

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

Arrangement and execution of an effective operational risk management process in the Bank's subsidiaries rests with Management Boards. Management Boards of those subsidiaries assure adequacy of organizational structures and implementation of processes and procedures aligned with undertaken operational risk. Supervisory Boards of subsidiaries maintain surveillance over operational risk management system and assess its effectiveness and adequacy. Cohesion of operational risk management standards is provided by relevant units in subsidiaries, supported by the Bank operational risk management unit. Effectiveness of operational risk management in the Bank's subsidiaries and the Bank is audited and assessed against consistent criteria.

The Audit Department (IA-Internal Audit) is responsible for independent assessment of the effectiveness of operational risk management processes and assessment of adequacy and effectiveness of operational risk management system, as well as for its regular reviews. Results of internal and external audits are considered in the management information system, the process of decision making with regard to risk management and management of the Bank.

EQUITY MANAGEMENT

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

The Group's equity amounted to PLN 6,790,450 thousand as at 31 December 2016 (as at 31 December 2015: PLN 6,850,656 thousand). Regulatory capital, which included increases and decreases required by the Polish Financial Supervision Authority (KNF), amounted to PLN 4,796,869 thousand (as at 31 December 2015: PLN 4,781,008 thousand). Such a capital level is considered sufficient for conducting business activity. The capital level is regularly monitored by using the capital adequacy ratio.

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

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

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

Capital adequacy ratio*

| PLN'000 | 31.12.2016 | 31.12.2015 |
|---|------------------|------------------|
| I Common Equity Tier 1 Capital | 4,796,869 | 4,781,008 |
| II Total capital requirements, including: | 2,199,922 | 2,238,956 |
| credit risk capital requirements | 1,687,217 | 1,685,320 |
| counterparty risk capital requirements | 65,908 | 78,682 |
| Credit valuation correction capital requirements | 63,927 | 34,059 |
| excess concentration and large exposures risks capital requirements | 1,792 | 16,418 |
| total market risk capital requirements | 74,357 | 86,544 |
| operational risk capital requirements | 306,721 | 337,933 |
| Common Equity Tier 1 Capital ratio | 17.4% | 17.1% |

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

In 2016, as well as in 2015, the Group complied with all the regulatory prudential standards on capital adequacy.

49. Subsequent events

On January 27th, 2017 the Bank placed the offer to purchase remaining performing leasing assets portfolio from Handlowy Leasing Sp. z o.o. The transaction will be executed with effect as of end of the first quarter 2017.

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Signatures of Management Board Members

| | | | |
|---------------|---------------------|---|--------------------|
| 21.03.2017 | Sławomir S. Sikora | President of the Management Board | |
| Date | Name | Position/function | Signature |
| 21.03.2017 | Maciej Kropidłowski | Vice-President of the Management Board | |
| Date | Name | Position/function | Signature |
| 21.03.2017 | David Mouillé | Vice-President of the Management Board | |
| Date | Name | Position/function | Signature |
| 21.03.2017 | Barbara Sobala | Vice-President of the Management Board | |
| Date | Name | Position/function | Signature |
| 21.03.2017 | Witold Zieliński | Vice-President of the Management Board Chief Financial Officer | |
| Date | Name | Position/function | Signature |
| 21.03.2017 | Katarzyna Majewska | Member of the Management Board | |
| Date | Name | Position/function | Signature |
| 21.03.2017 | Czesław Piasek | Member of the Management Board | |
| Date | Name | Position/function | Signature |