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citi handlowy

Bank Handlowy w Warszawie S.A.

2018 Annual Report

March 2019

SELECTED FINANCIAL DATA	PLN'000		EUR'000**	
	2018	2017	2018	2017
Interest and similar income	1,303,310	1,350,155	292,616	318,080
Fee and commission income	603,439	609,283	141,423	143,540
Profit before tax	842,273	700,340	197,397	164,992
Net profit	653,119	537,102	153,066	126,535
Total comprehensive income	745,025	742,580	174,606	174,943
Increase/decrease of net cash	6,960,340	(158,277)	1,631,240	(37,288)
Total assets	49,242,024	42,863,964	11,451,633	10,276,910
Amounts due to banks	1,402,124	1,568,261	326,075	376,001
Amounts due to customers	38,395,885	32,172,441	8,929,276	7,713,549
Shareholders' equity	7,007,052	6,874,618	1,629,547	1,648,234
Share capital	522,638	522,638	121,544	125,306
Number of shares (in pcs)	130,659,600	130,659,600	130,659,600	130,659,600
Book value per share (PLN/EUR)	53.63	52.61	12.47	12.61
Capital adequacy ratio (in %)	16.8	17.6	16.8	17.6
Earnings per share (PLN/EUR)	5.00	4.11	1.17	0.97
Diluted net earnings per share (PLN/EUR)	5.00	4.11	1.17	0.97
Declared or paid dividends per share (PLN/EUR)*	3.74	4.11	0.87	0.99

**The presented ratios are related to declared dividend from the appropriation of the 2018 profit and dividend paid in 2018 from the appropriation of the 2017 profit.*

***The following foreign exchange rates were applied to convert PLN into EUR: for the statement of financial position - NBP mid exchange rate as at 31 December 2018 - PLN 4.3000 (as at 31 December 2017: PLN 4.1709); for the income statement, statement of comprehensive income and cash flow statement - the arithmetic mean of NBP end-of-month exchange rates in 2018 – PLN 4.2669 in 2017: PLN 4.2447).*

TRANSLATION

The Annual Financial Statements of Bank Handlowy w Warszawie S.A. for the Financial Year Ended 31 December 2018

March 2019

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Income statement

For the period		2018	2017*
PLN'000	Note		
Interest income	4	1,248,565	1,275,507
Similar income	4	54,745	74,648
Interest expense and similar charges	4	(198,231)	(271,234)
Net interest income	4	**1,105,079**	**1,078,921**
Fee and commission income	5	603,439	609,283
Fee and commission expense	5	(76,148)	(67,760)
Net fee and commission income	5	**527,291**	**541,523**
Dividend income	6	**23,778**	**32,939**
Net income on trading financial instruments and revaluation	7	**361,546**	**343,910**
Net gain/(loss) on debt investment financial assets measured at fair value through other comprehensive income[a]	38	**112,631**	**35,772**
Net gain/(loss) on equity and other instruments measured at fair value through income statement[b]		**6,276**	**3,377**
Net gain on hedge accounting	8	**3,682**	**10,261**
Other operating income	9	37,990	28,642
Other operating expenses	9	(29,189)	(31,389)
Net other operating income	9	**8,801**	**(2,747)**
General administrative expenses	10	**(1,084,387)**	**(1,094,472)**
Depreciation expense	11	**(70,678)**	**(72,456)**
Profit/loss on sale of other assets	12	**(834)**	**437**
Net impairment on financial assets and provisions for contingent commitments[c]	13	**(63,562)**	**(99,491)**
Tax on some financial institutions		**(87,350)**	**(77,634)**
Profit before tax		**842,273**	**700,340**
Income tax expense	14	**(189,154)**	**(163,238)**
Net profit		**653,119**	**537,102**
Weighted average number of ordinary shares (in pcs)	15	130 659 600	130,659,600
Net earnings per share (PLN)	15	5.00	4.11
Diluted net earnings per share (PLN)	15	5.00	4.11

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

a. Corresponds to the 'Net gain on debt investment securities available-for-sale' in accordance with IAS 39.
b. Corresponds to the 'Net gain on equity investment instruments available-for-sale' in accordance with IAS 39.

c. Corresponds to the 'Net impairment due to financial assets and provisions for granted financial liabilities and guarantees' in accordance with IAS 39.

Explanatory notes on pages 11-96 are an integral part of the annual financial statements.

Statement of comprehensive income

For the period		2018	2017*
PLN'000	Note		
Net profit		**653,119**	**537,102**
Other comprehensive income, that might be subsequrently reclassified to profit or loss:			
Change in net value of financial assets measured at fair value through other comprehensive income[d]	16	94,544	205,685
Other comprehensive income, that cannot be subsequrently reclassified to profit or loss:			
Net actuarial profits (losses) on specific services program valuation	16	(2,638)	(207)
Total comprehensive income for the period		**745,025**	**742,580**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

d. Corresponds to the 'Net value of available-for-sale financial assets' in accordance with IAS 39.

Explanatory notes on pages 11-96 are an integral part of the annual financial statements.

Statement of financial position

PLN'000	As at Note	31.12.2018	31.12.2017*
ASSETS			
Cash and balances with the Central Bank	17	7,272,193	462,126
Amounts due from banks	18	1,333,816	836,166
Financial assets held-for-trading	19	2,213,849	2,162,040
Debt financial asstes measured at fair value through other comprehensive income[e]	20	14,241,363	17,439,439
Shares in subsidiaries[f]	21	106,075	106,368
Equity and other instruments [f]	21	48,511	26,171
Amounts due from customers	22	21,853,349	19,766,803
Tangible fixed assets	23	363,002	375,673
Intangible assets	24	1,417,506	1,351,583
Deferred income tax asset	26	205,165	176,979
Other assets	27	187,195	158,688
Non-current assets held-for-sale		-	1,928
Total assets		**49,242,024**	**42,863,964**
LIABILITIES			
Amounts due to banks	28	1,402,124	1,568,261
Financial liabilities held-for-trading	19	1,606,189	1,351,031
Hedging derivates		-	50,191
Amounts due to customers	29	38,395,885	32,172,441
Provisions	30	29,984	17,871
Current income tax liabilities		66,297	52,340
Other liabilities	31	734,493	777,211
Total liabilities		**42,234,972**	**35,989,346**
EQUITY			
Share capital	33	522,638	522,638
Supplementary capital	33	2,944,585	2,944,585
Revaluation reserve	33	84,372	(9,376)
Other reserves	33	2,877,122	2,879,669
Retained earnings		578,335	537,102
Total equity		**7,007,052**	**6,874,618**
Total liabilities and equity		**49,242,024**	**42,863,964**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

e. Corresponds to the 'Debt securities available-for-sale' in accordance with IAS 39.

f. Corresponds to the 'Equity investments available for sale' in accordance with IAS 39.

Explanatory notes on pages 11-96 are an integral part of the annual financial statements.

Statement of changes in equity

PLN'000	Share capital	Supplementary capital	Revaluation reserve	Other reserves	Retained earnings	Total equity
Balance as at 1 January 2018	**522,638**	**2,944,585**	**(9,376)**	**2,879,669**	**537,102**	**6,874,618**
Impact of adopting IFRS 9**	-	-	(796)	-	(74,784)	(75,580)
Restated balance as at 1 January 2018	**522,638**	**2,944,585**	**(10,172)**	**2,879,669**	**462,318**	**6,799,038**
Total comprehensive income, including:	-	-	94,544	(2,638)	653,119	745,025
net profit	-	-	-	-	653,119	653,119
net valuation of financial assets measured at fair value through other comprehensive income[g]	-	-	94,544	-	-	94,544
net actuarial profits/(losses) on specific services program valuation	-	-	-	(2,638)	-	(2,638)
Dividends	-	-	-	-	(537,011)	(537,011)
Transfer to capital	-	-	-	91	(91)	-
As at 31 December 2018	**522,638**	**2,944,585**	**84,372**	**2,877,122**	**578,335**	**7,007,052**

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

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

*** Impact of the accounting principles amendments resulting from implementation of IFRS 9 was shown in note 2.*

g. Corresponds to the 'Net valuation of available-for-sale financial assets' in accordance with IAS 39.

Explanatory notes on pages 11-96 are an integral part of the annual financial statements.

Cash flow statement

For the period	2018	2017*
PLN'000		
A.Operating activities		
Net profit	**653,119**	**537,102**
II. Adjustments:	**5,934,744**	**(1,022,845)**
Current and deferred income tax recognized in income statement	189,154	163,238
Share in net profits/(losses) of entities valued at equity method	70,678	72,456
Depreciation expense	73,017	100,034
Net impairment due to financial assets value loss	(10,475)	3,526
Net provisions (recoveries)	(1,105,079)	(1,078,921)
Net interest income	(23,778)	(32,939)
Dividend income	844	(501)
Profit/loss on sale of fixed assets	(8,964)	8,155
Net unrealized exchange differences	(6,276)	-
Equity and other investment measured at fair value though the income statement	2,895	4,242
Other adjustments	(349,128)	(203,705)
Change in amounts due from banks	(2,265,272)	(1,064,950)
Change in amounts due from customers	3,199,537	1,743,917
Change in debt securities measured at fair value through other comprehensive income[h]	-	635
Change in equity and other instruments measured at fair value through income statement[i]	(52,669)	1,590,396
Change in financial assets held-for-trading	-	12,244
Change in derivative securities	(28,249)	6,667
Change in other assets	(130,856)	(650,236)
Change in amounts due to banks	6,220,405	(1,857,478)
Change in amounts due to customers	255,158	45,417
Change in liabilities held-for-trading	(50,191)	10,294
Change in amounts due to hedging derivatives	(46,007)	104,664
Change in other liabilities	**1,438,607**	**1,498,028**
Interest received	**(195,101)**	**(273,294)**
Interest paid	**(206,443)**	**(123,810)**
Income tax paid	**7,624,926**	**615,181**
III. Net cash flows from operating activities		
B. Investing activities		
Inlows	16	9,396
Disposal of tangible fixed assets	1,068	-
Disposal of fixed assets/liabilities held-for-sale	23,505	32,939
Received dividends	-	50
Outflows		
Purchase of tangible fixed assets	(17,323)	(91,916)
Purchase of intangible assets	(108,430)	(38,786)
Net cash flows from investing activities	**(101,164)**	**(88,317)**
C. Financing activities		
Outflows		
Drawing of long-term loans from financial sector (see note 28)	-	31,292
Inflows		
Paid dividends	(537,011)	(591,888)
Repayment of long-term loans from financial sector(see note 28)	(35,936)	(112,116)
Net cash flows from financing activities	**(572,947)**	**(672,712)**
D. Exchange rates differences resulting from cash and cash equivalent calculation	**9,525**	**(12,429)**
E. Net increase/(decrease) in cash and cash equivalent	**6,960,340**	**(158,277)**
F. Cash and cash equivalent at the beginning of reporting period	**514,477**	**672,754**
G. Cash and cash equivalent at the end of reporting period (see note 43)	**7,474,817**	**514,477**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*
h.Corresponds to the 'Change in debt securities available-for-sale' in accordance with IAS 39.
i. Corresponds to the'Change in equity investment available-for-sale' in accordance with IAS 39.

Explanatory notes on pages 11-96 are an integral part of the annual financial statements.

Additional information including the description of adopted accounting principles and other explanatory information

1. General information about the Bank

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

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

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

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

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

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

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

2. Significant accounting policies

Declaration of conformity

The annual unconsolidated financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("IFRS EU") and in respect to matters that are not regulated by the above standards, in accordance with the requirements of the Accounting Act dated 29 September 1994 (Official Journal from 2018, item 395), respective operating regulations and regulations relating to issuers of securities admitted or sought to be admitted to trading on the official stock exchange quotation market.

The financial statement of the Bank were prepared on the assumption that the Bank will continue as a going concern for at least 12 months from balance sheet day. As at the date of signing this financial statement, the Management Board of the Bank does not state any facts or circumstances that would indicate a threat to the Bank's ability to continue as a going concern for at least 12 months from the balance sheet date as a result of an intentional or forced discontinuance or material limitation of the Bank's existing business.

The annual unconsolidated financial statements of the Bank have been approved by the Management Board of the Bank for publication on 22 March 2019. The financial statements will be finally approved by the General Shareholders' Meeting of the Bank.

The annual consolidated financial statements were approved by the Management Board of the Bank for publication on 22 March 2019. The financial statements will be finally approved by the General Shareholders' Meeting of the Bank.

Basis of preparation

These annual financial statements of the Bank have been prepared as at 31 December 2018 and the comparable financial data are presented as at 31 December 2017.

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

The financial statements have been prepared on the fair-value-basis for financial assets and financial liabilities measured at fair value through profit and loss including derivatives and capital investments (minority shareholdings) and financial assets measured at fair value through other comprehensive income. Other financial assets are presented at at cost decreased by depreciation/ amortization and impairment losses. Other financial liabilities are presented at amortized cost.

The preparation of annual financial statement of the Bank in accordance with IFRS requires management to estimate and make assumptions that affect the amounts presented in financial statement. The most important accounting policies, estimations and assesments applied in the preparation of this annual financial statement, were applied by the Bank in all the presented years on a continuous basis, except for changes resulting from the implementation since 1 January 2018 of IFRS 9 'Financial instruments' and IFRS 15 'Consumer contract income', which impact is provided in later part of report.

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

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

Standards and interpretations approved but not obligatory asa at 31 December 2018 that may have an impact on financial statements of the Bank:

- IFRS 16 „Leasing", endorsed by the European Union for application starting from 1 January 2019 r., will replace IAS 17.
- The new standard introduces amended comprehensive approach to lease contract identification and their recognition in financial statements of lessors and lessees. IFRS 16 introduces control model, which is a method of distinguishment of lease contracts from service agreements. The distinguishment focuses on assessment whether within the contract a specified asset controlled by customer can be identified.
- Standard introduces significant changes in lessee accounting - no longer will there be a separation of operating and finance lease. It is also necessary to recognize right of use asset and corresponding lease liability.
- Additional information about the impact of adoption is provided in later part of the report.
- IFRS 9 'Financial instrumets' amendment. It clarifies situations in which prepayment of receivable results in repayment of significantly lower amount than outstanding one; in cases when it is reasonable, it does not impact SPPI test – the amendment won't have a significant impact on the financial statement,
- IFRIC 23 'Uncertainty relating to the recognition of income taxes' specifying measurement of uncertainties resulting from solutions applied for use of IAS 12 „Income taxes" when it is not clear if they are appropriate from perspective of tax authorities. Bank does not expect the Interpretation to have a significant impact on the financial statements as there are no significant uncertainties related to the recognition of income tax,
- amendments to IAS 28 'Investments in associates and joint ventures' regarding measurement of the long-term share in affiliate companies and joined ventures in accornadce with IFRS 9 'Financial instruments' - the amendment won't have a significant impact on the financial statement.

Other standard amendments awaiting endorsement by the European Union:

- IFRS 17 „Insurance" replacing IFRS 4 „Insurance contracts" and introducing comprehensive regulations for accounting of insurance contracts, in particular the measurement of relevant liabilities. Standard eliminates differences in accounting of insurance contracts depending on local jurisdictions, allowed by IFRS 4,
- standard amendments cycle 2015-2017 including: IFRS 3 'Business combinations' and IFRS 11 'Joint Arrangements' in respect of measurement of interest in case of taking control over joint arrangements, IAS 12 'Income tax' in respect of recognition of tax on dividends in profit and loss, IAS 23 'Borrowing costs' for borrowing costs treatment,
- IAS 19 'Employee Benefits' amendment stating that if a plan amendment, curtailment or settlement occurs, it is mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement.
- amendments in the conceptual framework implementing comprehensive financial reporting rules, including measurement and its grounds, presentation and disclosures, derecognition of assets and liabilities from the balance sheet and also updates and explanations of specific terms,
- IFRS 3 'Business combinations' amendment - introducing a clarification of the definition of a project that helps to distinguish between acquisitions as a group of assets or a project,
- IAS 1 'Presentation of financial statements' and IAS 8 'Accounting policies, changes in accounting estimates and errors' to clarify the definition of the term 'significant' and to align it with the definition used in the conceptual assumptions.

will not impact the financial statement significantly.

Standards applicable from 1 January 2018:

- IFRS 9 'Financial instruments'. Described further.
- IFRS 15 'Revenues from contracts with customers'. Described further.
- IFRIC 22 'Foreign currency transactions and advance consideration' specifying rules for currency exchange rate setting for recognition of nonmonetary assets and liabilities in case of advance payments received or paid before recognition of relevant assets, expense or income. No significant impact on the financial statement.
- Amendment to IAS 40 'Investment property' specifying classification of investment property. No significant impact on the financial statement.
- Standard amendments cycle 2014-2016 including: IFRS 1 'Presentation of financial statements' in respect to exemptions for first time adoption of IFRS. No significant impact on the financial statement.
- Amendments to IFRS 2 'Share-based payment' regarding classification and measurement of share based payment, in particular equity settled share based payment. No significant impact on the financial statement.
- Amendment to IFRS 4 'Insurance Contracts' that allows temporary exemption from IFRS 9 for entities that mainly originate contracts under IFRS 4, resulting in reduction of profit volatility. No impact on the financial statement.

IFRS 9 "Financial instruments"

Since 1 January 2018 Bank has been using IFRS 9 „Financial instruments" adopted for use by European Union on 22 November 2016 (European Union Regulation no. 2016/2067/EU), which replaced IAS 39 "Financial instruments: Recognition and Measurement".

Classification and measurement of financial instruments

IFRS 9 introduces in this respect the following significant amendments from Bank perspective:

- Standard introduces three financial instruments categories:

  - financial assets measured at amortized cost,

  - financial assets measured at fair value through other comprehensive income,

  - financial assets measured at fair value through profit and loss.

- Bank classifies financial assets to specific categories on initial recognition considering 2 criteria:

  - **business model** for management of assets, which determines, whether cash flows will result from collecting contractual cash flows, selling financial assets or both

  - **features of contractual cash flows** for an asset, which is estimated by using SPPI test (solely payment of principal and interest), under which it is determined if contractual cash flows are solely payments of principal and interest on the principal amount. The test is passed if above-mentioned cash flows are consideration for the time value of money, credit risk, other basic lending risks (for example liquidity risk), costs (for example administration) associated with holding the financial asset for a particular period of time and profit margin.

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

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

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

The Bank identifies relevant and irrelevant modifications for contracts at amortized cost, which are explained in the later part of the note.

Business model

In respect to business model, based on current and planned management approach to financial asset portfolios in respect of method of cash flow collection from groups of assets, Bank originates loans and other financing instruments so far classified as loan and receivables under IAS 39 in order to collect principal and interest. Loan sales are rare and concern deteriorated exposures. As a result, the Bank did not change in the valuation of instruments in this portfolio as compared to IAS 39 and they are measured at amortized cost.

Debt instruments in held for trading portfolio are managed under business model of frequent sales and purchases with expectations to take advantage of short-term market fluctuations and profit making patterns. As a result Bank measures such instruments at fair value through profit or loss similar to IAS 39 regulation.

Debt instruments available for sale under IAS 39 are managed under business model of contractual cash flows and sales, so according to IFRS 9 they are classified as assets measured at fair value through other comprehensive income.

Contractual cash flows features

Bank analyzed thoroughly contractual stipulations and practices in respect of consideration formulas in order to conclude whether contractual cash flows are solely payments of principal and interest (SPPI test). In result, in specific cases using benchmark test (analysis of mismatch of interest rate type and its reset frequency), Bank, substantially, has not identified financial assets that failed SPPI test. However, Bank is in the possession of credit cards for which interest formula contains a multiplier. For credit cards interest rate is based on analysis of similar products and it reflects consideration for time value of money, credit risk related with unpaid principal within specified time period, and other basic lending risks, as well as profit margin. Rates used by Bank with multiplier higher than 1 results from current and past level of maximum acceptable interest set by law. Considering the above , Bank presents such exposures as measured at amortized cost. The Bank made changing contract documentation to establish documentation for current customers, internal maximum rate which applies and is used regardless of statutory rate and restrictive to the variability of contract cash flows in accordance with IFRS 9.

As a result of above analysis, the Bank did not identify changes in the way of valuation of financial assets resulting from contractual cash flows features.

Equity and other investments measured at fair value though the profit or loss

According to IFRS 9 minority shareholdings shall be measured at fair value. IFRS 9 provides that further changes in fair value, after initial application, are recognized in profit and loss. However, it allows an irrevocable option to record such changes in OCI without recycling to profit and loss. If such option is elected, dividends are generally recorded in profit and loss. Bank decided to record changes in fair value in profit and loss.

Hedge accounting

In hedge accounting IFRS 9 extends the scope of instruments than can be considered as hedged or hedging instruments. The condition of hedge accounting application is economic relation between hedging instrument and hedged item without obligation to measure hedge effectiveness retrospectively. IFRS 9 also allows temporary use of hedge accounting covered by IAS 39 „Financial instruments: recognition and measurement" and Bank followed that approach.

Impairment

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

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

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

As part of customer risk analysis, identification of a significant increase in credit risk and assessment of premises and evidence of impairment are made, taking into account existing and future events, including macroeconomic enviroment.

Institutional Clients Group

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

In order to assess if there has been an increase in credit risk Bank periodically, as per internal classification process and ongoing monitoring process, analyses changes in risk of default by comparing the current assessment of default with the assessment of default in the initial recognition.

Generally, the amendment of customer classification is determinining factor of transfer among Stages. Classification of customer to category – Under supervision is treated as significant slowdown of risk from the moment of initial recognition.

The level of external classification	Classification to Stage
Normal	Stage 1
Normal (internal observation list)	Stage 1
Under supervision	Stage 2
Performing below standard	Stage 2
Non-performing below standard	Stage 3
Questionable	Stage 3
Executed	Stage 3

Assessment of change in risk of default for given credit exposure is conducted during internal classification process and monitoring process and include:

- Qualitative indicators - including Early Warning System (eg. registered dates and amounts of payments, data from the credit bureau, balance and loan utilization, client's financial data, results of trends analysis of the industry in which the client operates, results of customer's inspections including the company's loan needs or changes in the company's management).
- Quantitative information (including among others),
- Expected exposure life period,
- Occurrence of economic or legal reasons related to the borrower's financial difficulties and granting to the borrower a concession to financial conditions that the lender would not otherwise consider, (assuming that those changes does not imply deterioration in future payment flows).

Assignment to stage 1 & 2 is based on the internal classification process, which takes into account, apart from the quantitative factor (PD / rating changes) wide range of qualitative factors - therefore no PD threshold has been set above which exposure is automatically classified into Stage 2.

Stage 1 and 2 impairment allowances for credit exposures and provisions for balance sheet credit exposures is determined monthly for each customer in order to calculate, maintain and report information on impairment and IFRS 9 provisions for ICG clients exposure. The algorithms used depend on the assignment of the client to the Stage in accordance with IFRS 9 and the method of managing the given Client (Clients managed on the basis of classification vs. clients managed on a days past due basis). If the Bank has sufficient data to create homogeneous groups of exposure, it measures them in a group approach, in particular exposures managed on a past due basis are valued in accordance with the group approach.

Stage 3 exposures are assigned if one of the following objective evidence of impairment occurs:

- decrease in client's internal rating to the equivalent of S&P CCC-,
- delay in payment equal to 90 days or more,
- significant financial difficulties of the client,
- reduction of the client credit rating by an accepted by the Bank External Credit Assessment Institution;
- breach of contract conditions, e.g. delay in interest or principal payments;
- occurrence of economic or legal reasons related to the borrower's financial difficulties and granting to the borrower a concession to financial conditions that the lender would not otherwise consider, granting permission for emergency restructuring of credit exposure, if it might result in decreasing financial requirements, reduction of financial liabilities by redeeming a significant part of the principal, interest or, where applicable, fees or deferring their repayment or payment,
- high likelihood of bankruptcy of the client or obtaining information about the opening of bankruptcy proceedings, appearance by the debtor for declaration of bankruptcy or for similar protection or putting the debtor in bankruptcy or granting him similar protection if it would allow him to avoid or delay repayment of credit obligations;
- request of the Bank to initiate enforcement proceedings against the client;
- severe domestic or local economic conditions that may be related to the default of exposures;

Stage 3 losses in respect of impairment / loan exposure reserve are recognized and calculated on the basis of the current value of projected cash flows expected in the loan period. Losses are calculated based on individual cash flow forecasts resulting from, among others, repayment by the borrower or collateral enforcement. The projected cash flows concern repayments of both capital and interest.

For the purpose of ECL calculation, the Bank takes into account the collaterals. Acceptable forms of collateral include primarily mortgages, inventories and receivables. If the value of collateral is not included in the ECL calculation methodology, the provision would increase by 20%.

Global Consumer Banking

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

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

The rules for classifying exposures to the Stages are based on the credit risk management processes existing at the Bank, in particular, as a rule, on a cyclical risk analysis of the client. It includes quantitative criteria related to determining the probability of customer default (PD) within the credit products held and quality criteria. The 12-th months PD value is set at the customer level based on a set of statistical models. These are scoring models: demographic, behavioral and data from the Credit Information Bureau (BIK). These models work on the basis of the so-called integration logic, whose task is to provide the best 12-th months PD value forecast for a set of partial model values available for a given client. Such PD is then scaled, for the purpose of Stage 2 to residual PD Life Time based on assumed survival distribution.

In order to assess whether there was a significant increase in credit risk, the Bank periodically:

- as part of the change of the default risk analysis process for a given credit exposure, compare the current assessment of default risk (actual residual PD) for the credit exposure with the default risk assessment made at the time of initial recognition (expected at that moment of time residual PD for the current age of loan). Assignment to the Stage is taken if the increase of residual PD for particular credit products in the horizon of life exposition of multiplier from 1.7x to 5.1x depending on the kind of product,
- in addition, assessment includes qualitative reasons based on the current length of the credit product overdue period (Days Past Due criterion), the soft restructuring activities carried out and the fact that information about the probability of default is not available.

In the case of installment exposures, this is the period to the contractual maturity date. For revolving exposures, the contractual maturity is not specified, in substitution the so-called behavioral maturity is calculated, resulting from the empirical estimation of the life of the credit product.

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

First application of IFRS 9

Disclosures of the impact of the adoption of IFRS 9

The Bank decided to use the IFRS 9 records, which enable dispensing with the obligation to transform comparative data for the previous periods in the case of changes resulting in classification, valuation and impairment. At the same time the Bank made changes in financial statement in order to adjust financial data presentation to new categories implemented by IFRS 9. Differences in the balance sheet value of assets and financial liabilities resulting from IFRS 9 were included as the part of previous year profit and revaluation reserve in equity as at 1 January 2018.

The impact of IFRS 9 on classification and measurement of financial assets is given below as at 1.01.2018 (data in thousands PLN):

Consolidated financial statement's line as at 31.12.2017	Consolidated financial statement's line as at 01.01.2018	Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39	IFRS 9 implementation impact	Carrying amount IFRS 9
Assets	**Assets**					
Amounts due from banks and customers	Amounts due from banks and customers	Amortised cost	Amortised cost	20,602,969	(87,360)	20,515,609
Equity investments available-for-sale	Equity and other investments measured at fair value through income statement	Purchase price less impairment	Fair value through profit and loss	26,171	16,064	42,235
Deferred income tax asset	Deferred income tax asset	-	-	176,979	31,295	208,274
Total assets				**20,806,119**	**(40,001)**	**20,766,118**

Consolidated financial statement's line as at 31.12.2017	Consolidated financial statement's line as at 01.01.2018	Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39	IFRS 9 implementation impact	Carrying amount IFRS 9
Liabilities	**Liabilities**					
Provisions for granted contingent commitments	Provisions for granted contingent commitments	Amortised cost	Amortised cost	12,789	22,886	35,675
Current income tax liabilities	Current income tax liabilities	-	-	52,340	12,693	65,033
Total liabilities				**65,129**	**35,579**	**100,708**
Bank's Capital				**6,874,618**	**(75,580)**	**6,799,038**

The total impact of adopting of IFRS 9 on the Bank's capital is negative and amounts to PLN 75,580 thousand.

In connection with review of verification to the exposition classification for selected corporate customers to the appropriate stages of impairment. The Bank estimated the impact of adopting IFRS 9 in comparison to the Financial Report for 2017. As a result of amendment of the estimation, the Group's capital was minimized by PLN 13,989 thousand (including tax effect) in comparison to the Standalone Financial Report for 2017.

The impact of application of IFRS 9 for the first time results mainly from:

- Change of impairment calculation for financial assets and off-balance sheet liabilities, described in detail above, from the model of losses incurred prior to 1 January 2018 to the model of expected losses, described in detail above,
- Changes of classification and measurement of minority equity instruments, which according to IFRS 9 requirements were classified to measure them at fair value through financial result profit and loss. Before the IFRS 9 adoption, the Bank classified minority shareholdings as Equity investment available-for-sale and measured them at cost decreased by impairment losses.

The total negative impact of the IFRS 9 standard calculated as of January 1 2018 on Tier 1 and TCR is negative 26 basis points.

The Bank decided that for the needs of capital adequacy assessment, based on Article 1 paragraph 9 of the Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending the Regulation (EU)

575/2013, it will not adopt the transition period in respect of IFRS 9 impact and it has chosen the one-off recognition of the impact of IFRS 9 implementation on own funds.

Additional disclosures related with initial application of IFRS 9

Disclosures of the impact of the adoption of IFRS 9 as at 1 January 2018 are given below.

The measurement category and the carrying amount of financial assets and liabilities in accordance with IAS 39 and IFRS 9 at the time of the first application of IFRS 9 are compared as follows:

PLN '000		Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39	Carrying amount IFRS 9
Consolidated financial statement's line as at 31.12.2017	**Consolidated financial statement's line as at 01.01.2018**				
Financial assets					
Cash and balances with the Central Bank	Cash and balances with the Central Bank	Amortised cost	Amortised cost	462,126	462,126
Amounts due from banks	Amounts due from banks	Amortised cost	Amortised cost	836,166	834,930
Financial assets held-for-trading	Financial assets held-for-trading	Fair value through profit and loss	Fair value through profit and loss (mandatory)	2,162,040	2,162,040
Debt securities available for sale	Debt financial assets measured at fair value through other comprehensive income	Fair value through other comprehensive income	Fair value through other comprehensive income	17,439,439	17,439,439
Equity investments	Equity instruments measured at fair value through income statement	Purchase price less impairment	Fair value through profit and loss	26,171	42,235
Amounts due from customers	Amounts due from customers	Amortised cost	Amortised cost	19,766,803	19,680,679
Other assets (financial)	Other assets (financial)	Amortised cost	Amortised cost	98,110	98,110
Financial liabilities					
Amounts due to banks	Amounts due to banks	Amortised cost	Amortised cost	1,568,261	1,568,261
Financial liabilities held-for-trading	Financial liabilities held-for-trading	Fair value through profit and loss	Fair value through profit and loss (mandatory)	1,351,031	1,351,031
Hedging derivatives	Hedging derivatives	Fair value through profit and loss	Fair value through profit and loss (mandatory)	50,191	50,191
Amounts due to customers	Amounts due to customers	Amortised cost	Amortised cost	32,172,441	32,172,441
Provisions for granted contingent commitments	Provisions for granted contingent commitments	Amortised cost	Amortised cost	12,789	35,675

Changes in presentation of income statement connected with the adoption of IFRS 9 are given below. Changes refer to selected income statement's lines and these are changes of nomenclature without impact on presented values.

PLN '000		Amount – IAS 39	Amount – IAS 39
Consolidated income statement's line for 2017	**Consolidated income statement's line for 2018**	**2017**	**2018**
Net gain on debt investment securities available-for-sale	Net gain on debt investment financial assets measured at fair value through other comprehensive income	35,772	112,631
Net gain on capital investment instruments available-for-sale	Net gain on equity and other investments measured at fair value through profit and loss	3,377	6,276
Net impairment allowances for financial assets and net provisions for financial liabilities and guarantees granted	Net impairment on financial assets and provisions for contingent commitments	(99,491)	(63,562)

The following table presents the reconciliation of the carrying amounts of financial assets by category of measurement under IAS 39 with the carrying amounts of these items according to the category of their valuation under IFRS 9, on the date of the first application of IFRS 9:

PLN '000	Measurement category IAS 39	Reclassifications	Measurements	Measurement category MSSF 9
Financial assets				
Amortised cost				
Amounts due from banks				
Opening balance	836,166			
Measurement		-	(1,236)	
Closing balance				834,930
Amounts due from customers				
Opening balance	19,766,803			
Measurement		-	(86,124)	
Closing balance				19,680,679
Available-for-sale				
Debt securities				
Opening balance	17,439,439			
Reclassification to fair value through other comprehensive income		(17,439,439)	-	
Measurement		-	-	
Closing balance				-
Equity investments and others				
Opening balance	26,171			
Fair value through profit and loss		(26,171)	-	
Measurement		-	-	
Closing balance				-
Fair value through other comprehensive income				
Debt securities				
Opening balance	-			
Reclassification from available for sale		17,439,439	-	
Measurement		-	-	
Closing balance				17,439,439
Fair value through profit and loss				
Equity investments and others				
Opening balance	-			
Reclassification from available for sale		26,171	-	
Measurement		-	16,064	
Closing balance				42,235
Financial liabilities				
Provisions for granted contingent commitments				
Opening balance	12,789			
Measurement		-	22,886	
Closing balance				35,675

'Measurement' in the above table relates to the increase of allowances connected with adopting model of expected losses, in accordance with IFRS 9, for amounts due to bank and customers in total amount of PLN 87,360 thousand and for contingent commitments in amount of PLN 22,886 thousand.

Furthermore, for equity investment in the line of measurement, the Group recognized the gap among book value in accordance with IAS 39 and value in accoradance with IFRS 9 using valuation at fair value.

Moreover, the Bank accomplished reclassification of financial assets to the new categories required by IFRS 9. In particular, reclassification relates to portfolio of debt securites available-for-sale to the category measured at fair value through the other comprehensive income and equity investment classified previously as available-for-sale to the category measured at fair value through the income statement.

In accordance with Transition Resource Group for Impairment of Financial Instruments the value of receivables in Stage 3 shall be presented increased by accrued contract interest in total amount of PLN 433,123 thousand. The result of this presentation of receivables is also the growth of loan provisions by the same amount. This change had no influence on total net value of receivables in Stage 3 and also on own funds as at the date of transition to IFRS 9, 1 January 2018.

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 and provisions calculated in accordance with IAS 37 to the opening balance of expected credit losses in accordance with IFRS 9:

PLN '000	Impairment allowance IAS39/IAS 37	Reclassifications	Measurements	Impairment allowance IFRS 9
Measurement category				
Loans and advances (IAS 39)/ Amortised cost (IFRS 9)				
Amounts due from banks	1,111		1,236	2,347
Amounts due from customers	585,609	(5,178)*	86,124	666,555
	586,720	**(5,178)**	**87,360**	**668,902**
Financial assets avaible for sale (IAS 39)/ Financial assets at fair value through profit and loss (IFRS 9)				
Other equity investments	4,250	(4,250)	-	-,
	4,250	**(4,250)**	**-**	**-**
Financial and guarantees liabilities granted				
Letters of credit	179	-	100	279
Guarantees granted	2,869	-	3,100	5,969
Credit lines granted	9,741	-	19,686	29,427
	12,789	**-**	**22,886**	**35,675**
Provisions (IAS 37)	**5,082**	-	-	**5,082**
Total	**608,841**	**(9,428)**	**110,246**	**709,659**

** The item 'Reclassifications' is connected with the definition change of gross carrying amount to IFRS 9 and includes the difference between impairment allowance established for accrued interest from receivables with recognized impairment to the moment of impairment declaration IAS 39 and the value of allowance for these interest IFRS 9. After adoption of IFRS 9, these interest provide the gross carrying amount with the increase of allowance by the same amount.*

IFRS 15 „Revenue from contracts with customers"

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

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

1. Identifying the contract with a customer- Bank shall account for a contract with a customer that is within the scope of IFRS 15 only when all of the following criteria are met:

   a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
   b) the Bank can identify each party's rights regarding the goods or services to be transferred;
   c) the Bank can identify the payment terms for the goods or services to be transferred;
   d) the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
   e) it is probable that the Bank will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

2. Identifying performance obligations

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

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

3. Determining the transaction price

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

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

The Bank allocates the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the Bank expects to be entitled in exchange for transferring the promised goods or services to the customer.
The stand-alone selling price is the price at which Bank would sell a promised good or service separately to a customer.
If a stand-alone selling price is not directly observable, Bank shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price based on adjusted market assessment approach, expected cost plus margin approach and residual approach.

5. Revenue recognition

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

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

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

a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the Bank performs;

b) the Bank's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or

c) the Bank's performance does not create an asset with an alternative use to it and Bank has an enforceable right to payment for performance completed to date.

In other circumstances, revenue is recognized immediately.

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

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

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

In the process of implementation of the standard, the Bank has not identified differences in the approach to revenue recognition in relation to IAS 18 effective until the end of 2017. Most of the Bank's revenues are recognized using the effective interest rate method, in accordance with the provisions of IFRS 9. In case of the Bank, IFRS 15 applies to part of commissions not related to financial instruments. The revenue recognition method for these commissions complies with the regulations of the new standard and in case of one-off services, revenue is recognized at the time the service is performed, and for services provided over time revenue is recognized using the straight-line method. The Bank has not identified significant costs necessary to obtain contracts that would have to be amortized over time.

The impact of adoption IFRS 15 'Revenue from Contracts with Customers' was immaterial.

IFRS 16 „Leases”

On 1 January 2019 the Bank adopted IFRS 16 “Leases” (hereafter referred to as “IFRS 16”).

The new standard relates to all leasing contracts excluding certain items that are in scope of other IFRS. IFRS 16 contains a holistic approach to leases identification, recognition and measurement in the financial statements of lessees and lessors. Particularly impactful changes were introduced to accounting for leases by lessees by assuming a single accounting model and abandoning a distinction between operating and finance leases.

In order to identify a lease contract, IFRS 16 uses a concept of control over an asset. The standard distinguishes lease contracts from service agreements depending on whether there is a specified asset that is controlled by a lessee. According to IFRS 16 a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

At inception of each lease contract IFRS 16 requires a lessee to recognize a lease liability (resulting from an obligation to make lease payments) and an asset - right of use of a specified asset over a lease term. A lessee may elect not to apply the requirement to:
- short-term leases that at the commencement date, have a lease term of 12 months or less; and
- leases for which the underlying asset is of low value such as office equipment.

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The payments include, *inter alia*:
- fixed payments, less any lease incentives receivable;
- variable lease payments that depend on an index or a rate.

The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. Otherwise, lessee’s incremental borrowing rate is used. Incremental borrowing rates are determined by the Bank taking into account risk-free rate, credit risk spread of the Bank and they reflect lease term as well as a currency of a lease contract.

At the commencement date right-of-use assets are measured at cost, comprising:
- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs incurred by the lessee; and
- an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease.

The Bank recognizes a lease contract as a right-of-use asset and corresponding lease liability at a date when underlying asset available for use by a lessee. Interest expense resulting from a lease liability is recognized in profit and loss during lease in the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. A right-of-use asset is amortized on linear basis until earlier of the end of the useful life of the right-of-use asset or the end of the lease term.
In accordance with the transitional provisions included in IFRS 16, when adopting the new standard, the Bank as a lessee opted to follow a modified retrospective approach based on which comparative information is not restated and cumulative effect is recognized as an adjustment to the opening balance of retained earnings (however no retained earnings adjustment was recognized because right-of-use asset balance was equal to lease liability).

Impact on statement of financial position

As at initial application of IFRS 16, i.e. 1 January 2019, the Bank recognized new asset items, mainly related to right-of-use of real estate linked to the Bank’s branches as well as perpetual usufruct of land. IFRS initial application resulted in an increase in Bank’s assets and liabilities by PLN 146,0 million (equivalent of 0.3% of Bank’s total assets as at 31 December 2018).

Impact on statement of financial performance

IFRS 16 changes the accounting of leases in profit and loss accounts by replacing rental costs by depreciation and interest expense and the timing of cost recognition – under IFRS 16 cost recognition will be faster due to effective interest rate method applied to lease liabilities which was not used with respect to operating leases under principles in force before 31 December 2018. The Bank estimates that the impact is not significant and will be reversed as leases mature.

Impact on capital adequacy

Due to the inclusion of lease contracts in the Bank's balance sheet as at 1 January 2019, the total amount of risk exposures increased, and thus the Bank’s total capital ratio decreased by 8 basis points.

Foreign currency

The values reported in annual standalone financial statement are presented in PLN, which is functional currency and the currency of presentation of the Group.

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 2018	31 December 2017
1	USD	3.7597	3.4813
1	CHF	3.8166	3.5672
1	EUR	4.3000	4.1709

Financial assets and liabilities

Classification

After implementation of IFRS 9 Bank classifies financial instruments to the following categories:

- financial assets measured at fair value through profit and loss,
- financial assets measured at amortized cost,
- financial assets measured at fair value through other comprehensive income,
- financial liabilities measured at fair value through profit and loss,
- other financial liabilities.

Financial assets measured at fair value through profit and loss

The category comprises:

1) financial assets, that were classified neither as measured at amortized cost nor as measured at fair value through other comprehensive income
2) financial assets classified at initial recognition as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases
3) minority shareholdings

An set are included in this category especially if they are held for trading (held for trading model) that is: 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, they are derivatives.

Derivative instruments, excluding hedging instruments, and selected debt securities are classified as held-for-trading and presented in the consolidated financial statement as "Financial assets held for trading"

Minority shareholdings are presented in the consolidated financial statement as "Equity and other investments measured at fair value through income statement".

Financial assets measured at amortized cost (loans and receivables)

A financial asset is measured at amortized cost if both conditions are met:

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

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 interbank deposits and also reverse repo transactions.

The Bank in accordance with Transition Resource Group for Impairment of Financial Instruments presented gross carrying amount of receivables in Stage 3 in the amount increased by accrued contract interest in the note 22 'Amounts due from customers'. The value of credit provisions is increased by the same amount.

In the stand-alone financial statement such assets are presented in 'Amounts due from banks' and 'Amounts due from customers'.

Purchased or originated credit impaired assets (POCI)

Purchased or originated credit impaired assets on initial recognition may be identified when Bank has originated or purchased exposures already impaired at the moment of initial recognition or Bank has modified (significant modification) an impaired exposure and derecognition criterion has been met. POCI assets are recognized at fair value at initial recognition and subsequently at amortized cost using effective interest rate adjusted by expected credit losses. Expected credit losses are considered and recognized as lifetime of those instruments.

Financial assets measured at fair value through other comprehensive income

A financial asset is measured at fair value through other comprehensive income if both conditions are met:

a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and

b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Bank classifies in this category selected debt instruments and presents them in the consolidated financial statement as "Debt investment financial assets measured at fair value through other comprehensive income"

Financial liabilities measured at fair value through profit and loss

The category comprises derivative liabilities which are not hedging instruments and it comprises short sale liabilities presented as 'Financial liabilities held-for trading'.

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 and also liabilities from repo transactions.

Cash

Cash is cash in hand, nostro current account in Central Bank and receivables on current balances in banks described in detail in note 43 'Additional information to the statement of cash flows'.

Recognition, derecognition and insignificant modifications

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

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

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

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

The Bank applies the following criteria, which result in assets derecognition from the balance sheet and obligation to recognize them according to the classification rules:

- contract change that causes change of SPPI test assessment,
- debtor's change,
- currency conversion,
- granting additional loan amount of at least 10% of outstanding loan principal.

At the moment of derecognition, the undepreciated part of the commission is recognized in total in interest income. The newly charged commission is settled in time using the effective interest rate method.

If there is a change in cash flows of financial assets containing the repayment schedule measured at amortized cost that results from annex to the contract, the Bank recalculates gross balance sheet value of financial asset and recognizes modification profit or loss in profit and loss. The gross balance sheet value of that financial asset is calculated as present value of renegotiated or modified contract cash flows, discounted at original effective interest rate of financial assets (or credit risk adjusted effective interest rate for credit risk- for originated or purchased financial assets credit-impaired at initial recognition). All origination costs and fees adjust the balance sheet value of modified asset and are amortized until the maturity date of modified financial asset.

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

Valuation

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

After initial recognition, the Bank measures financial assets including derivatives that are assets at fair value without deducting transactional costs which it may incur in connection with the sale or disposal of assets except for loans and receivables which are measured at amortized cost using the effective interest rate method,

After initial recognition, financial liabilities, excluding financial liabilities that are measured at fair value through profit or loss, are measured at amortized cost using the effective interest rate method. 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 measurement of financial assets classified as measured at fair value through other comprehensive income are recognized in other comprehensive income. Impairment of financial assets measured at fair value through other comprehensive income 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 equity investments are recognized in profit and loss when the entity’s right to receive payment is established. There is a possibility that the entity will get economic benefits connected with dividend and the dividend will be set plausibly.

Derivative instruments

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

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

Hedge accounting

The Bank applies fair value hedge and used the option of IFRS 9 to continue the hedge accounting standard in acoorance with IAS 39 instead of regulations pointed in IFRS 9.

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

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

Offsetting financial instruments

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

Cash pooling

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

Repurchase and resale agreements, repo/ reverse repo transactions

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

Impairment of assets measured at amortized cost

On a commitment basis, the Bank classifies assets measured at amortized cost into the portfolio of assets that are individually significant and the portfolio of assets that are not individually significant (portfolio basis).

For each of the above categories of assets, the Bank makes impairments for expected credit losses, according to the developed internal rules and methodologies for theirs calculation. They are aggregated for each of the three stages:

- Stage 1: Credit exposures that have not had a significant increase in credit risk since initial recognition
- Stage 2: Credit exposures that have experienced a significant increase in credit risk since initial recognition
- Stage 3: Credit exposures with credit loss that has already been suffered on the assets

On the balance sheet date, the Bank assesses if there is objective evidence of impairment of one financial asset or a group of financial assets.

A financial asset or a group of financial assets were impaired and the impairment loss was incurred only when there is an objective evidence of impairment resulting from one or more events taking place after the initial recognition of an asset (the loss event) and the loss event (or events) influences the future expected cash flows resulting from a financial asset or a group of financial assets which may be reliably estimated.

Objective evidence of impairment of a financial asset or a group of assets includes information obtained by the Bank concerning events, which are provided in the later part of the note 47 ‘Risk management’.

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

Forbearance

Forborne exposures are exposures for which concessions were granted due to economic or legal reasons (for financial conditions), resulting from financial difficulties of Obligor, that the lender would not otherwise extend.
The Client’s restructuring and its exposure does not always imply a loss of value (e.g. in the case of obtaining appropriate compensations). Impaired exposures are restructured exposures with forced restructuring.

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 expected credit losses

In order to determine the Stage of reported expected credit loss, exposure should be assessed if there was a credit loss that has already been suffered on the assets (Stage 3) or not (Stages 1 and 2). Choice between Stage 1 and 2 is determined by a significant increase in credit risk since initial recognition.

The impairment allowances for expected credit losses are calculated using statistical parameters for the groups of assets combined in portfolios having similar credit risk characteristics. In the financial statements, the Bank corrects credit exposure with the value of expected credit losses 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 increasesafter 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 liabialities are shown in the liabilities section “Provisions”.

Expected credit losses for financial assets measured at fair value through other comprehensive income

For financial assets measured at fair value through other comprehensive income, the increase or decrease in expected credit losses is recognized in the profit and loss account under the item ‘Net impairment on financial assets and provisions for contingentcommitments’.

In order to calculate the impairment loss for expected credit losses for assets measured at fair value through other comprehensive income, the Bank uses internal methodology to define default probability (PD parameter), loss value at default (LGD parameter) and exposure value at the time of default (EAD parameter).

Impairment of assets other than financial assets

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

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

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

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

Reversal of revaluation write-offs

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

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

Shares in subsidiaries

Subsidiaries are all entities controlled by the Bank. The Bank controls an entity when the Bank 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.

Investments in subsidiaries in the Bank’s separate financial statements are recognized using the cost method in accordance with IAS 27.

Shares in other entities

Shares in entities other than dependent entities (lack of affiliates and joint ventures) are classified as financial assets measured at fair value through income statement.

Goodwill

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

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

Property and equipment and intangible assets (excluding goodwill)

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

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

Depreciation and amortization are calculated using the straight-line method over the expected useful life of an asset on the basis of rates that are approved in the depreciation and amortization plan for 2018.

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

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

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

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

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

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.

Employee benefits

Short-term employee benefits

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

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

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

Share-based payments

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

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

Long-term employee benefits

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

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

Defined contribution plans

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

Provisions

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

Restructuring provision

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

Accruals and prepayments

The Bank records accruals and prepayments of expenses primarily in relation to the Bank's overhead expenses in reporting periods to which they relate. Accruals and prepayments are presented as 'Other liabilities' in the statement of financial position.

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.

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 and similar income

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

The effective interest rate applies for the gross carrying amount of financial asset, except for or originated credit-impaired financial assets or impaired financial assets.

In the case of 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 in respect of purchased or established financial assets with impairment on account of credit risk is determined by effective interest rate adjusted for credit risk.

Line item “Interest income” covers interest income on financial assets measured at amortized cost or financial assets measured at amortized cost through other comprehensive income. Line item “Similar income” as part of net interest income includes interest on financial assets measured at fair value through profit or loss. Interest on financial liabilities are presented in line item “Interest expense”.

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

Fee and commission income and expenses

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

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

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

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.

For other commissions Bank performs:

- Identification of the contract with a customer,
- Identification of performance obligations,
- Determination of transaction price,
- Allocation of the transaction price to performance obligations to identify amounts to be recognized as revenue,
- Revenue recognition when (or as) it satisfies the performance obligation by transferring a promised good or service to a customer (transfer of a promised good or service is when the customer obtains control of the good or service).

If Bank transfers control of service over time and, therefore, satisfies a performance obligation and the customer simultaneously receives and consumes the benefits provided by the Bank’s performance as the Bank performs, then fees are recognised over time in proportion to the completion of the service in fee income, In other cases the fees are recognised at a point in time when services have been completed and are presented in fee income. The above approach corresponds to the manner of meeting the obligations to provide services by the Bank in accordance with IFRS 15. There are no situations of withholding services which would affect the manner of revenue recognition described above in connection with meeting the obligation to provide services. The nature of services provided by the Bank is described in the Statutes, including situations in which the Bank acts as an intermediary. In the area of commission income, the remuneration received is in principle non-refundable.

The Bank considers the terms of the contract to determine the transaction price. The transaction price is the amount of consideration (fixed, variable or both) to which Bank expects to be entitled in exchange for transferring promised services to a customer, excluding amounts collected on behalf of third parties.

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

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

Income and expense from distribution of insurance products

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

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

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

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

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

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

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

Hedge accounting income

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

Other operating income and expenses

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

Income tax

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

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

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

Accounting estimates and judgments

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

Fair value of derivatives

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

The Bank applies the following methods of measurement of particular types of derivative instruments:
- FX forwards – discounted cash flows model;
- options – option market-based valuation model;
- interest rate transactions – discounted cash flows model;
- futures – current quotations.

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

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

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

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

Write-offs for expected credit losses

The Bank estimates the value of impairments for expected credit losses for all financial assets in connection with the classification of these assets to one of three stages determining the value of estimates and depending on the parameters adopted for the calculation.

On the basis of the calculations made, the Bank makes regular allowances for impairment of loan expected losses, whose level is regularly monitored.

At each balance sheet date, the Bank assesses whether there is an objective evidence of impairment of loan exposures. Exposure is assumed to be impacted by a credit impairment, when, because of credit risk, one or more events occurred, that have negative impact on forecasted future cash flow as per this exposure.

If so, the Bank records an impairment loss equal to the difference between the carrying value and the estimated present value of the future cash flows from a given loan exposure.

Exposures that has not been classified as impaired exposures, despite the occurrence of certain conditions require justification and documentation why there was no credit impairment.

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

Impairment of goodwill

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

Employee benefits

Provisions for future payments in respect of employee benefits such as jubilee awards and retirement and pension allowances are subject to periodic actuarial estimation by an independent actuary. The amount of provisions corresponds with the currents value of future longterm liabilities of the Bank 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 Bank's employee, including staff turnover, risk of death and risk of total work incapacity.

Financial assets and liabilities – classification and measurement rules under IAS 39 applied in the financial statement for year 2017, which were changed on 01.01.2018 through implementation of IFRS 9

Classification

The Bank classified 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.

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

(b) Loans and receivables
Loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted on the active market. They arose when the Bank provided funds to the debtor for any purpose except for the generation of short-term profits from trading in such loans or receivables. This category comprised, in the first instance, amounts due in respect of loans, purchased receivables and debt securities that were not quoted on the active market and internal deposits. The purchased receivables contained 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 were those non-derivative financial assets that (i) were classified by the Bank in this category at initial recognition or (ii) were not classified in any other asset category. Selected debt and equity securities were classified in this category.

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

Recognition and derecognition

The principles of recognition and derecognition did not change as a result of transfer from IAS 39 to IFRS 9 except for those explaining significant and minor modifications described in the accounting principles applied in 2018.

Valuation

The principles of initial recognition, amortized cost measurement and fair value measurement methods did not change with transition from IAS 39 to IFRS 9.

Impairment of assets measured at amortized cost

Bank classified assets measured at amortized cost into the portfolio of assets that were individually significant and the portfolio of assets that were not individually significant (portfolio basis). On the balance sheet date, the Bank assessed if there was 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 was 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) influenced the future expected cash flows resulting from a financial asset or a group of financial assets which might be reliably estimated.

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

- significant financial difficulty of the issuer or obligor;
- breach of contract, such as default or delinquency in interest or principal payments;
- granting the borrower a concession that the lender would not otherwise consider due to economic or legal reasons relating to the borrower's financial difficulty;
- high probability of the borrower's bankruptcy or other financial reorganization;
- the disappearance of an active market for this financial asset because of financial difficulties; or

- observable data indicating that there was 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 could not 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 were correlated with defaults on the assets in the group.

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

Forbearance

In case the Bank granted a concession to the debtor, if it did 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 were included in the measurement of the asset using the prior effective interest rate for the instrument.
If the concession granted significantly changed the important terms or expected cash flows, the financial asset was derecognized and the new one was recognized at fair value on the day of initial recognition.

Impairment allowances for incurred but not recognized credit losses

The Bank created impairment allowances for incurred but not recognized credit losses ("IBNR"). The IBNR impairment allowances process covered all receivables for which no evidence of impairment had been found or for which such evidence had been found but the individual assessment of possible impairment had not confirmed the need to write them down. The IBNR impairment allowances reflected the level of credit loss incurred but not reported, which would be identified at the level of exposure in the period of loss recognition adopted by the Bank. The IBNR impairment allowances were calculated using statistical parameters for the assets combined in portfolios having similar credit risk characteristics. In the financial statements, the Bank corrected credit exposure with the value of the IBNR impairment allowances.

Impairment allowances for individually significant assets

The level of the impairment write-off for receivables that were deemed as individually significant and for which evidence of impairment had been detected was 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 were discounted to the present value with the effective interest rate for a given instrument.
If the present value of the estimated cash flows increased after an event occurring after impairment had been identified, the write-off that had been previously made was reversed through profit or loss.

Impairment allowances for individually not significant assets

The level of the impairment allowances for receivables that were deemed as individually not significant, for which evidence of impairment had been detected, was calculated on the basis of a portfolio assessment which was based on the history of losses incurred on assets with similar risk characteristics.
Impairment write-off for amounts due from banks and customers, allowances for impairment of securities and other assets adjusted the value of particular asset categories. Provisions for contingent commitments were shown in the liabilities section "Provisions."

Impairment of financial assets available-for-sale

For financial assets classified as available-for-sale, for which there was objective evidence of impairment, the cumulative loss recognized in equity which was 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, were transferred to the income statement. Impairment losses on equity investments classified as available-for-sale were not reversed through profit or loss. Loss on impairment of debt instruments classified as available-for-sale were reversed through profit or loss, if in subsequent periods the fair value of a debt instrument increased and the increase could be objectively related to an event occurring after the loss.

Impairment of financial assets measured at cost

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

3. Segment reporting

Information on segment reporting is presented in Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2018, which have been approved by the Management Board of the Bank for publication on the same date as Annual Unconsolidated Financial Statements of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2018, i.e. 21 March 2019.

4. Net interest income

PLN'000	2018	2017*
Interest income from:	**1,248,565**	**1,275,507**
financial assets measured at amortized cost	**977,792**	**953,484**
Balances with Central Bank	6,559	16,885
Amounts due from banks	22,940	22,085
Amounts from customers, including:	948,293	914,514
financial sector entities	54,450	48,840
non-financial sector entities, including:	893,843	865,674
credit card	286,435	282,408
Financial assets measured at fair value through comprehensive income	**270,773**	**322,023**
Debt investment financial assets measured at fair value through comprehensive income**	270,773	322,023
Similar income from:	**54,745**	**74,648**
financial assets measured at fair value through financial result	**54,745**	**74,648**
Debt securities held-for-trading	44,802	26,417
Liabilities with negative interest rate	9,943	7,161
Derivatives in hedge accounting	-	41,070
	1,303,310	**1,350,155**
Interest expense and similar charges for		
financial liabilities measured at amortized cost	**(192,361)**	**(205,173)**
Amounts due to banks	(43,021)	(37,943)
Amounts due to customers	(149,094)	(166,730)
Amounts due to financial sector entities	(60,928)	(55,023)
Amounts due to non-financial sector entities	(88,166)	(111,707)
Loans and advances acquired	(246)	(500)
Financial liabilities measured at fair value though profit or loss	**(5,870)**	**(66,061)**
Assets with negative interest rate	(2,161)	(1,240)
Derivatives in hedge accounting	(3,709)	(64,821)
	(198,231)	**(271,234),**
Net interest income	**1,105,079**	**1,078,921**

** On 1st. January 2018 Bank adopted IFRS 9 “Financial instruments” for the first time without restatement of comparative data for earlier periods.*
*** Corresponds to the ‘Interest and similar income from debt securities available-for-sale’ in accordance with IAS 39.*

5. Net fee and commission income

PLN'000	2018	2017*
Fee and commission income:		
Insurance and investment products (agency)*	89,219	106,016
Payment and credit cards	159,205	158,443
Payment services	106,995	105,913
Custody services*	85,086	89,443
Cash management services on customers' accounts	25,610	25,099
Granted guarantee liabilities	19,194	19,289
Granted financial liabilities	7,933	6,406
Other, including:	110,197	98,674

PLN'000	**2018**	**2017***
installment products in credit card	27,483	26,142
	603,439	**609,283**
Fee and commission expense:		
Payment and credit cards	(36,685)	(28,571)
Fees paid to the National Depository for Securities (KDPW)	(18,928)	(19,782)
Brokers fees	(4,516)	(4,412)
Other	(16,019)	(14,995)
	(76,148)	**(67,760)**
Net fee and commission income	**527,291**	**541,523**

**Starting from 1st quarter 2018 the remuneration of the Bank from distribution of structured bonds for customers of Retail Sector in the amount of PLN 25,963 thousand, presented earlier in Custody services was moved to Insurance and investment products distribution. Comparative data was respectively restated (2017: PLN 33,362 thousand).*

The net fee and commission income for 2018 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 194,200 thousand (for 2017: PLN 164,040 thousand) and commission expenses in the amount of PLN 40,911 thousand (for 2017: PLN 28,571 thousand).

6. Dividend income

Dividend income amounted to PLN 23,778 thousand in 2018 (2017: PLN 32,939 thousand) include dividends received and due from the Bank's subsidiaries - PLN 14,672 thousand (in 2017: PLN 24,145 thousand). The remaining amount of dividends was received from entities with no control equity interest of the Bank.

7. Net income on trading financial instruments and revaluation

PLN'000	**2018**	**2017**
Net income on financial instruments measured at fair value through profit of loss from:		
Debt instruments	28,236	15,248
Derivative instruments, including:	(352)	14,293
Interest rate derivatives	(313)	14,161
	27,884	**29,541**
Net profit on foreign exchange		
Net profit on foreign currency derivatives	498,691	(215,674)
Revaluation	(165,029)	530,043
	333,662	**314,369**
Net income on trading financial instruments and revaluation	**361,546**	**343,910**

The net income on trading financial instruments and revaluation for 2018 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 (11,051) thousand (in 2017: PLN 396 thousand), presented as 'Net incomeon financial instruments at fair value through praofit and loss from derivatives'.

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

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

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

8. Hedge accounting income

PLN'000	**2018**	**2017**
Fair value hedge accounting		

Net gain on hedged transaction valuation	14,526	29,469
Net gain on hedging transaction valuation	(10,844)	(19,208)
Hedge accounting income	**3,682**	**10,261**

Detailed information on hedge accounting applied in the Bank is presented in the further part of these Financial Statements in note 36.

9. Net other operating income

PLN'000	2018	2017
Other operating income		
Income from provision of services for related parties	9,277	11,060
Income from office rental	8,398	9,812
Other	20,315	7,770
	37,990	**28,642**
Other operating expenses		
Amicable procedure and vindication expenses	(9,043)	(10,532)
Fixed assets held-for-sale maintenance cost	(87)	(100)
Net provision for litigation	(165)	(4,503)
Other	(19,894)	(16,254)
	(29,189)	**(31,389)**
Net other operating income	**8,801**	**(2,747)**

10. General administrative expenses

PLN'000	2018	2017
Staff expenses		
Remuneration costs, including:	(372,756)	(377,497)
Provisions for retirement allowances	(27,676)	(33,015)
Bonuses and rewards, including:	(79,767)	(78,321)
Payments related to own equity instruments	(8,818)	(7,364)
Rewards for long time employment	(38)	(37)
Social insurance costs	(61,699)	(60,545)
	(514,222)	**(516,363)**
Administrative expenses		
Telecommunication fees and hardware purchases	(182,095)	(182,848)
Costs of external services, including advisory, audit, consulting services	(54,592)	(52,745)
Building maintenance and rent costs	(64,043)	(69,248)
Advertising and marketing costs	(47,179)	(42,643)
Cash management service, KIR service and other transactional costs	(37,634)	(39,076)
Costs of external services related to the distribution of banking products	(40,402)	(33,486)
Postal services, office supplies and printmaking costs	(7,440)	(9,292)
Training and education costs	(1,355)	(1,728)
Banking and capital supervision costs	(3,987)	(3,110)
Bank Guarantee Funds costs	(61,720)	(71,226)
Other expenses	(69,718)	(72,707)
	(570,165)	**(578,109)**
General administrative expenses, total	**(1,084,387)**	**(1,094,472)**

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

PLN'000	**2018**	**2017**
Short-term employee benefits	13,158	12,553
Long-term employee benefits	2,784	1,841
Capital assets	4,550	4,712
	20,492	**19,106**

11. Depreciation expense

PLN'000	**2018**	**2017**
Depreciation of property and equipment	(28,479)	(29,508)
Amortization of intangible assets	(42,199)	(42,948)
Depreciation expense, total	**(70,678)**	**(72,456)**

12. Sale of other assets

PLN'000	**2018**	**2017**
Profits on:		
Sale of tangible fixed assets	26	437
	26	**437**
Losses on:		
Sale of fixed assets held-for-sale	(860)	-
	(860)	**-**
Result on sale of other assets	**(834)**	**437**

13. Net impairment on financial assets and net provisions for contingent commitments

PLN '000	**2018**	**2017***
Net impairment on capital investment		
Write-offs creation	(51)	-
Write-offs reversals	-	3,872
	(51)	**3,872**
Net impairment on amounts due from banks		
Write-offs creation	(5,664)	(1,471)
Write-offs reversals	4,355	512
	(1,309)	**(959)**
Net impairment on amounts due from customers		
Write-offs creation and reversals	**(75,099)**	**(105,048)**
Write-offs creation	(214,504)	(211,430)
Net write-offs creation on receivables on taken instruments transactions	(215)	(155)
Write-offs reversals	140,482	99,634
Net write-offs creation on receivables on taken instruments transactions	208	1,545
Other	(1,070)	5,358
Recoveries from sold debts	**2,373**	**8,219**
	(72,726)	**(96,829)**
Net impairment on debt investment financial assets measured at fair value through other comprehensive income		
Write-offs reversals	1,069	-
	1,069	**-**
Net impairment on financial assets	**(73,017)**	**(93,916)**
Created provisions for granted financial and guarantee commitments	(33,810)	(17,773)
Release of provisions for granted financial and guarantee commitments	43,265	12,198

PLN '000	**2018**	**2017***
Net impairment on provisions for granted contingent commitments	**9,455**	**(5,575)**
Net impairment on financial assets and provisions for contingent commitments	**(63,562)**	**(99,491)**

*** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.***

14. Income tax expense

Recognized in the income statement

PLN'000	**2018**	**2017**
Current tax		
Current year	(206,586)	(188,264)
Adjustments for prior years	(1,120)	(797)
	(207,706)	**(189,061)**
Deferred tax		
Origination and reversal of temporary differences	18,552	25,823
	18,552	**25,823**
Total income tax expense in income statement	**(189,154)**	**(163,238)**

Reconciliation of effective tax rate

PLN'000	**2018**	**2017**
Profit before tax	842,273	700,340
Income tax at the domestic corporate tax rate of 19%	(160,032)	(133,065)
Impairment write-offs not constituting deductible expenses	(2,322)	(4,693)
Deductible income not recognized in the income statement	(1,314)	(1,128)
Non taxable income	4,469	6,219
Tax on some financial institutions	(16,597)	(14,751)
Bank Guarantee Fund	(11,727)	(13,533)
Other permanent differences, including other non-deductible expenses	(1,631)	(2,287)
Total tax expenses	**(189,154)**	**(163,238)**
Effective tax rate	**22,46%**	**23.31%**

Deferred tax recognized directly in equity

Deferred tax recognized directly in equity as at 31 December 2018 is related to financial assets measured at fair value through other comprehensive income and valuation of defined benefit plan and amounted to PLN (18,294) thousand (31 December 2017: PLN 3,367 thousand).

15. Earnings per share

As at 31 December 2018, earnings per share amounted to PLN 5.00 (31 December 2017: PLN 4.11).

The calculation of earnings per share as at 31 December 2018 was based on profit attributable to shareholders of PLN 653,119 thousand (31 December 2017: PLN 537,102 thousand) and the weighted average number of ordinary shares outstanding during the year ended 31 December 2018 of 130,659,600 (31 December 2017: 130,659,600).

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

16. Changes in other comprehensive income

Deferred income tax and reclassification included in other comprehensive income concern the valuation of financial assets measured at fair value 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 2018	**(17,720)**	**3,367**	**(14,353)**
Change in valuation of financial assets measured at fair value through other comprehensive income**	229,455	(43,680)	185,775
Valuation of financial assets measured at fair value through other comprehensive income sold, recognized to income statement***	(112,631)	21,400	(91,231)
Total comprehensive income connected with financial assets measured at fair value through other comprehensive income	**99,104**	**(18,913)**	**80,191**
Net actuarial losses on specific services program valuation	(3,257)	619	(2,638)
As at 31 December 2018	**95,847**	**(18,294)**	**77,553**

PLN'000	Gross amount	Deferred income tax	Net amount
Balance as at 1 January 2017	**(271,396)**	**51,565**	**(219,831)**
Change in valuation of financial assets available-for-sale	289,704	(55,044)	234,660
Valuation of financial assets available-for-sale sold, recognized to income statement	(35,772)	6,797	(28,975)
Total comprehensive income connected with financial assets available-for-sale	**(17,464)**	**3,318**	**(14,146)**
Net actuarial profits on specific services program valuation	(256)	49	(207)
As at 31 December 2017*	**(17,720)**	**3,367**	**(14,353)**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

*** Corresponds to the 'Change in valuation of financial assets available-for-sale' in accordance with IAS 39.*

**** Corresponds to the 'Valuation of financial assets available-for-sale, recognized to income statement ' in accordance with IAS 39.*

17. Cash and balances with the Central Bank

PLN'000	31.12.2018	31.12.2017
Cash in hand	422,064	431,574
Current balances with Central Bank	3,850,088	29,031
Deposits in Central Bank	3,000,041	1,521
Cash and balances with the Central Bank, total	**7,272,193**	**462,126**

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 2018 to PLN 1,271,148 thousand (31 December 2017: PLN 1,270,278 thousand).

18. Amounts due from banks

PLN'000	31.12.2018	31.12.2017*
Current accounts	203,150	54,182
Deposits	386,058	-
Loans and advances	28	1,092
Liabilities due to purchased securities with a repurchase agreement	630,126	276,477
Deposits pledged as collateral of derivative instruments and stock market transactions	118,364	505,526
Total gross amount	**1,337,726**	**837,277**
Impairment write-offs	(3,910)	(1,111)
Total net amounts due from banks	**1,333,816**	**836,166**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

The movement in loss alloance amounts due from banks is as follows:

PLN '000 **Loss allowance - amounts due from banks**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loss allowance as at 31 December 2017	-	-	-	**(1,111)**
Impact of adopting IFRS 9	-	-	-	(1,236)
Loss allowance as at 1 January 2018	**(2,223)**	**(124)**	**-**	**(2,347)**
Transfer to Stage 1	(124)	124	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
(Creation)/Realeses in the period though the income statement	(1,309)	-	-	(1,309)
Foreign exchange and other movements	(254)	-	-	(254)
Loss allowance as at 31 December 2018	**(3,910)**	**-**	**-**	**(3,910)**

PLN '000	**31.12.2017***
As at 1 January	**(177)**
Increases (due to):	
Write-offs creation	(1,471)
Decreases (due to):	
Write-offs release	512
Other	25
As at 31 December	**(1,111)**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

The amandments of gross amounts due from banks that contributed to movements in loss alloance amounts is as follows:

PLN'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross amounts due from banks measured at amortized cost				
Gross amounts due from banks as at 1 January 2018	**831,568**	**5,709**	**-**	**837,277**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Purchased/paid receivables	485,635	(5,700)	-	479,935
Other movements	20,520	(6)	-	20,514
Gross amounts due from banks as at 31 December 2018	**1,337,723**	**3**	**-**	**1,337,726**

19. Financial assets and liabilities held-for-trading

Financial assets held-for-trading

PLN'000	**31.12.2018**	**31.12.2017**
Debt securities held-for-trading		
Bonds and notes issued by:		
Banks*	1	1
Other financial entities	12,943	48,412
Central governments	918,228	1,095,495
	931,172	**1,143,908**
Including:		
Listed on active market	931,172	1,143,908
Derivative financial instruments	**1,282,677**	**1,018,132**
Financial assets held-for-trading, total	**2,213,849**	**2,162,040**

*As at 31 December 2018, the part of securities (bonds) issued by banks in the amount of PLN 1 thousand are covered by Government guarantees (31 December 2017: PLN 1 thousand).

Financial liabilities held-for-trading

PLN'000	31.12.2018	31.12.2017
Short positions in financial assets	348,130	-
Derivative financial instruments	1,258,059	1,351,031
Financial liabilities held-for-trading, total	**1,606,189**	**1,351,031**

As at 31 December 2018 and 31 December 2017, the Bank did not hold any financial assets and liabilities designated at fair value through profit or loss at initial recognition.

Derivative financial instruments as at 31 December 2018

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	**45,235,963**	**51,859,256**	**105,616,028**	**27,776,966**	**230,488,213**	**1,024,561**	**1,116,297**
FRA	35,100,000	25,500,000	250,000	-	60,850,000	6,357	1,592
Interest rate swaps (IRS)	9,265,197	21,472,777	91,351,168	19,067,799	141,156,941	695,772	816,827
Currency-interest rate swaps (CIRS)	842,568	4,886,479	12,135,010	8,662,803	26,526,860	315,904	292,151
Interest rate options	-	-	1,879,850	46,364	1,926,214	5,806	5,727
Futures*	28,198	-	-	-	28,198	722	-
Currency instruments	**32,212,333**	**6,332,761**	**3,488,981**	**96,238**	**42,130,313**	**251,047**	**134,236**
FX forward	2,457,934	1,492,583	500,882	96,238	4,547,637	31,399	17,818
FX swap	28,261,956	3,934,789	2,885,819	-	35,082,564	210,549	107,304
Foreign exchange options	1,492,443	905,389	102,280	-	2,500,112	9,099	9,114
Securities transactions	**310,752**	**-**	**-**	**-**	**310,752**	**1,101**	**1,475**
Securities purchased / sold pending delivery	310,752	-	-	-	310,752	1,101	1,475
Commodity transactions	**29,173**	**107,533**	**72,095**	**-**	**208,801**	**5,968**	**6,051**
Swaps	29,173	107,533	72,095	-	208,801	5,968	6,051
Total derivative instruments	**77,788,221**	**58,299,550**	**109,177,104**	**27,873,204**	**273,138,079**	**1,282,677**	**1,258,059**

**Exchange-traded products*

Derivative financial instruments as at 31 December 2017

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

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
Swap	49,261	107,896	28,219	-	185,376	10,802	10,819
Options	4,084	16,609	-	-	20,693	793	796
Total derivative instruments	**42,324,473**	**23,180,520**	**89,537,398**	**24,851,877**	**179,894,268**	**1,018,132**	**1,351,031**

**Exchange-traded products*

20. Debt investment financial assets measured at fair value through other comprehensive income

PLN'000	31.12.2018	31.12.2017*
Bonds and notes issued by:		
Central bank	-	1,399,713
Other banks, including:	-	32,576
bonds subject to fair value hedge accounting	-	32,576
Other financial entities	224,074	82,192
Central governments, including:	14,017,289	15,924,958
bonds subject to fair value hedge accounting	-	2,492,215
Debt securities measured at fair value through other comprehensive income, total**	**14,241,363**	**17,439,439**
Including:		
Listed on active market instruments	14,241,363	16,039,726
Unlisted on active market instruments	-	1,399,713

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*
*** Corresponds to the 'Debt securities available-for-sale' in accordance with IAS 39.*

For debt investment financial assets measured at fair value through other comprehensive income, the cumulated value of impairment as at 31 December 2018 amounts to PLN 4,524 thousand.

The movement in debt investment financial assets measured at fair value through other comprehensive income is as follows:

PLN'000	2018	2017
As at 1 January	**17,439,439**	**19,072,371**
Increases (due to):		
Purchases	44,485,571	47,305,910
Revaluation	100,274	257,684
Foreign exchange differences	65,153	-
Depreciation of discount, premium and interest	262,038	411,359
Decreases (due to):		
Sale	(47,960,505)	(49,060,934)
Revaluation	-	-
Foreign exchange differences	-	(352,893)
Depreciation of premium	(150,607)	(194,058)
As at 31 December	**14,241,363**	**17,439,439**

21. Shares in subsidiaries and equity and other instruments

Shares in subsidiaries are presented at acquisition cost and equity and other instruments at fair value through income statement.

PLN'000	31.12.2018	31.12.2017
Shares in subsidiaries	115,812	116,054
Impairment	(9,737)	(13,936)
Equity and other instruments measured at fair value through income statement*	48,511	30,421
Equity investments, total	**154,586**	**132,539**

Including:		
Listed on active market instruments	770	987
Unlisted on active market instruments	153,816	131,552

**Corresponds to the 'Shares available-for-sale' in accordance with IAS 39.*

The movement in shares in subsidiaries, equity and other investments is as follows:

PLN'000	Subsidiaries	Other entities	Total
As at 31 December 2017	**106 368**	**26 171**	**132 539**
Reclassification/ Impact of adopting IFRS 9	-	16 064	16 064
As at 1 January 2018	**106 368**	**42 235**	**148 603**
Increases (due to):	-	6 276	6 276
Revaluation	-	6 276	6 276
Decreases (due to):	(293)	-	(293)
Revaluation	(51)	-	(51)
Settlement due to payments	(242)	-	(242)
As at 31 December 2018	**106 075**	**48 511**	**154 586**

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

Financial information on subsidiaries, 31.12.2018

PLN'000

Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]*	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit/loss
HANDLOWY – LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	97.47	15,720	22,154	248	21,906	294	(524)
DOM MAKLERSKI BANKU HANDLOWEGO S.A.	Warsaw	Brokerage	Subsidiary	100	70,950	364,086	265,309	98,777	49,021	1,250
PPH SPOMASZ Sp. z o.o. w likwidacji	Warsaw	-	Subsidiary	100	13,502	Entity under liquidation				
HANDLOWY INVESTMENTS S.A.	Luxembourg	Investment activity	Subsidiary	100	5,231	18,393	306	18,097	257	(304)
HANDLOWY – INWESTYCJE Sp. z o.o. 1/	Warsaw	Investment activity	Subsidiary	100	672	10,856	43	10,813	129	(22)
					106,075					

**direct share*

The explanation of indirect relationships:

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

Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]*	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit
HANDLOWY - LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	2.53	414	22,154	248	21,906	294	(524)

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 2019, which is the entity's balance sheet date.

Financial information on subsidiaries, 31.12.2017

PLN'000

Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]*	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit/Loss
HANDLOWY – LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	97.47	15,720	23,134	704	22,430	865	(678)
DOM MAKLERSKI BANKU HANDLOWEGO S.A.	Warsaw	Brokerage	Subsidiary	100.00	70,950	433,070	320,816	112,254	73,538	14,669
PPH SPOMASZ Sp. z o.o. w likwidacji	Warsaw	-	Subsidiary	100.00	13,502	Entity under liquidation				
HANDLOWY INVESTMENTS S.A.	Luxembourg	Investment activity	Subsidiary	100.00	5,282	18,298	429	17,869	432	61
HANDLOWY – INWESTYCJE Sp. z o.o. 1/	Warsaw	Investment activity	Subsidiary	100.00	914	11,118	41	11,077	446	242
					106,368					

direct share

The explanation of indirect relationships:

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

Name of subordinate	Location	Activity	Capital relationship	Share in equity [%]	Book value of shares	Assets	Liabilities	Equity	Revenues	Profit
HANDLOWY - LEASING Sp. z o.o.	Warsaw	Leasing	Subsidiary	2.53	414	23,134	1,228	21,906	865	(678)

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

22. Amounts due from customers

PLN'000	31.12.2018	31.12.2017*
Amounts due from financial sector entities		
Loans and advances	401,223	444,777
Debt financial assets unlisted**	1,156,233	1,200,636
Receivables due to purchased securities with a repurchase agreement	182,613	-
Guarantee funds and deposits pledged as collateral	312,695	286,432
Total gross amount	**2,052,764**	**1,931,845**
Impairment write-offs	(1,391)	(17,473)
Total net amount	**2,051,373**	**1,914,372**
Amounts due from non-financial sector entities		
Loans and advances	18,047,445	16,722,365
Unlisted debt financial assets**	568,024	496,125
Purchased receivables	1,830,937	1,193,041
Realized guarantees	481	1,038
Other receivables***	18,084	7,998
Total gross amount	**20,464,971**	**18,420,567**
Impairment write-offs	(662,995)	(568,136)
Total net amount	**19,801,976**	**17,852,431**
Total net amounts due from customers	**21,853,349**	**19,766,803**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*
*** Corresponds to the 'Unlisted debt securities' in accordance with IAS 39.*

The gross value of receivables does not include contractual interest accrued from the time the exposure is classified in Stage 3. The impact of including such interest on the gross carrying amount is presented below.

In amounts due from customers presented on the line Unlisted debt financial assets are securities assets covered by the Bank. Deciding to invest in securities based on economic calculation, measuring return on investment against the potential risks. The Bank that owns the portfolio (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. Unitl now the Bank acted as investor and acquired the senior tranche in the amount of PLN 1,199,611 thousand. Securities purchased by the Bank are not traded on the market. The Bank intends to maintain investments until the maturity date. The main risk of securitisation transactions is credit risk. Bank's maximum exposure to loss from involment in these entities is equal to their carrying gross value, as at 31 December 2018 in the of amount PLN 1,156,233 thousand (31 December 2017: PLN 1,200,636 thousand). The carrying value of assets relating in Bank participation in unconsolidated structured entities as at 31 December 2018 in the amount of PLN 1,155,554 thousand (31 December 2017: PLN 1,200,576 thousand).

In accordance with Transition Resource Group for Impairment of Financial Instruments the value of receivables in Stage 3 shall be presented increased by accrued contract interest in total amount of PLN 411,529 thousand. The result of this presentation of receivables is also the growth of loan provisions by the same amount. This change had no influence on total net value of receivables in Stage 3.

PLN '000	**31.12..2018**
Gross total value including contract interest in Stage 3	22,929,264
Impairment write-downs including contract interest in Stage 3	(1,075,915)
Net total value	**21,853,349**

Movement in loss allowance - amounts due from customers presents as follows:

PLN '000 **Loss allowance - amounts due from customers**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loss allowance as at 31 December 2017	**-**	**-**	**-**	**(585,609)**
Impact of adopting IFRS 9	-	-	-	(86,124)
Reclassification	-	-	-	5,178
Loss allowance as at 1 January 2018	**(54,767)**	**(76,847)**	**(534,941)**	**(666,555)**
Transfer to Stage 1	(1,460)	1,460	-	-
Transfer to Stage 2	1,040	(1,040)	-	-
Transfer to Stage 3	-	270	(270)	-
(Creation)/Realeses in the period though the income statement	(697)	1,569	(75,971)	(75,099)
Decrease in write-downs due to write-offs	-	-	57,158	57,158
Decrease in write-downs in connection with the sale of receivables			21,292	21,292
Foreign exchange and other movements	(226)	(188)	(768)	(1,182)
Loss allowance as at 31 December 2018	**(56,110)**	**(74,776)**	**(533,500)**	**(664,386)**

As at 31 December 2018, the Bank did not identify POCI assets (purchased or originated credit-impaired assets).

		2017*	
PLN '000	**Institutional customers**	**Retail customers**	**Total**
As at 1 January	**(274,435)**	**(284,782)**	**(559,217)**
Increases (due to):			
Creation of write-offs	(90,419)	(121,011)	(211,430)
Decreases (due to):			
Restating receivables	24,358	13,470	37,828
Net write-offs on receivables on taken instruments transactions	1,390	-	1,390
Write-offs release	45,749	53,885	99,634
Sale of receivables	-	42,458	42,458
Other	3,287	441	3,728
As at 31 December	**(290,070)**	**(295,539)**	**(585,609)**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods*

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

PLN'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross amounts due from customers measured at amortized cost				
Gross amounts due from customers as at 1 January 2018	**17,896,120**	**1,715,751**	**740,541**	**20,352,412**
Transfer to Stage 1	361,300	(358,736)	(2,564)	-

PLN'000	Stage 1	Stage 2	Stage 3	Total
Transfer to Stage 2	(495,485)	497,527	(2,042)	-
Transfer to Stage 3	(76,263)	(69,223)	145,486	-
Purchased/paid receivables	2,365,053	(149,595)	(51,815)	2,163,643
Recognized recivables	-	-	(57,158)	(57,158)
Disposed recivables	-	-	(42,375)	(42,375)
Other movements	100,585	6,386	(5,758)	101,213
Gross amounts due from customers as at 31 December 2018	**20,151,310**	**1,642,110**	**724,315**	**22,517,735**

The gross value of amounts due from customers does not include contractual interest accrued from the moment the exposure is classified in Stage 3. The impact of including such interest on the gross carrying amount is presented above.

For amounts due from customers which changed Stages during the period, transfers are presented as the change between the Stage as of 1 Janaury 2018 or at the moment of initial recognition and as of 31 December 2018.

Dues from financial leasing

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

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

PLN'000	31.12.2018	31.12.2017
Receivables (gross) based on financial leasing	-	1,808
Impairment of finance lease receivables	-	(2)
Unrealized financial income	-	-
Receivables (net) based on financial leasing total	**-**	**1,806**

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

PLN'000	31.12.2018	31.12.2017
Less than 1 year	-	1,808
	-	**1,808**

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

PLN'000	31.12.2018	31.12.2017
Less than 1 year	-	1,808
Impairment of finance lease receivables	-	(2)
	-	**1,806**

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

23. Tangible fixed assets

Movements of tangible fixed assets in 2018

PLN'000	Land and buildings	Vehicles	Other	Under construction	Total
Gross amount					
As at 1 January 2018	**572,135**	**10,645**	**255,950**	**70,640**	**909,370**
Increases:					
Purchases	-	13,334	877	3,112	17,323
Other increases	-	-	254	-	254
Decreases:					
Disposals	-	-	(1,805)	-	(1,805)

PLN'000	Land and buildings	Vehicles	Other	Under construction	Total
Liquidation	(7,037)	-	(21,572)	-	(28,609)
Other decreases	(3)	-	(50)	(696)	(749)
Transfers	21,589	-	1,140	(22,729)	-
As at 31 December 2018	**586,684**	**23,979**	**234,794**	**50,327**	**895,784**
Depreciation					
As at 1 January 2018	**302,132**	**634**	**230,931**	**-**	**533,697**
Increases:					
Amortization change for the period	16,207	1,981	10,291	-	28,479
Other increases	-	-	253	-	253
Decreases:					
Disposals	-	-	(1,805)	-	(1,805)
Liquidation	(6,343)	-	(21,445)	-	(27,788)
Other decreases	-	-	(54)	-	(54)
As at 31 December 2018	**311,996**	**2,615**	**218,171**	**-**	**532,782**
Carrying amount					
As at 1 January 2018	270,003	10,011	25,019	70,640	375,673
As at 31 December 2018	**274,688**	**21,364**	**16,623**	**50,327**	**363,002**

Movements of tangible fixed assets in 2017

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

24. Intangible assets

Movements of intangible assets in 2018

PLN'000	Goodwill	Patents, licenses etc.	Software	Other intangible assets	Prepayments	Total
Gross amount						
As at 1 January 2018	**1,245,976**	**735**	**440,055**	**18,242**	**19,826**	**1,724,834**
Increases:						
Purchases	-	-	1,175	-	107,256	108,431
Decreases:						
Liquidation	-	-	(35,804)	-	-	(35,804)
Other decreases	-	-	-	-	(309)	(309)
Write-offs		(735)		(18,242)		(18,977)
Transfers	-	-	62,410	-	(62,410)	-
As at 31 December 2018	**1,245,976**	**-**	**467,836**	**-**	**64,363**	**1,778,175**
Depreciation						
As at 1 January 2018	**-**	**735**	**354,274**	**18,242**	**-**	**373,251**
Increases:						
Amortization charge for the period	-	-	42,199	-	-	42,199
Decreases:						
Liquidation	-	-	(35,804)	-	-	(35,804)
Write-offs		(735)		(18,242)		(18,977)
As at 31 December 2018	**-**	**-**	**360,669**	**-**	**-**	**360,669**
Carrying amount						
As at 1 January 2018	1,245,976	-	85,781	-	19,826	1,351,583
As at 31 December 2018	**1,245,976**	**-**	**107,167**	**-**	**64,363**	**1,417,506**

In 2018 Bank analysed intangible assets in respect of their utilization and as a result Bank no longer expects inflow of economic benefits from patents, licenses and other intangible assets, so they were written down.

Movements of intangible assets in 2017

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

PLN'000	Goodwill	Patents, licenses etc.	Software	Other intangible assets	Prepayments	Total
As at 31 December 2017	**1,245,976**	**-**	**85,781**	**-**	**19,826**	**1,351,583**

As at 31 December 2018, 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.

25. Impairment test for goodwill

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

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

Book value of goodwill allocated to unit

PLN'000	31.12.2018	31.12.2017
Institutional Bank	851,944	851,944
Consumer Bank	394,032	394,032
	1,245,976	**1,245,976**

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

The discount rate is assessed on the basis of the capital assets pricing model (CAPM) using a beta coefficient for the banking sector, a risk premium and Treasury bond yield curves. In 2018, the discount rate amounted to 8.80% (9.00% at the end of 2017).

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 2018.

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.

26. Deferred income tax asset

PLN'000	31.12.2018	31.12.2017
Deferred income tax asset	539,359	370,308
Deferred income tax liability	334,194	193,329
Deferred income tax net asset	**205,165**	**176,979**

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

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

Deferred income tax asset is attributable to the following:

PLN'000	31.12.2018	31.12.2017
Interest accrued and other expense	10,244	9,483
Revaluation impairment write-offs	81,383	48,321
Unrealized premium from securities	81,285	58,436
Negative valuation of derivative financial instruments	285,916	164,972
Negative valuation of securities held-for-trading	280	688
Income collected in advance	30,700	29,480
Valuation of shares	(4,735)	779

PLN'000	31.12.2018	31.12.2017
Commissions	5,877	6,137
Debt and equity securities measured at fair value through other comprehensive income*	(927)	2,199
Staff expenses and other cost due to pay	45,325	45,136
Other	4,011	4,677
Deferred income tax asset	**539,359**	**370,308**

*Corresponds to the 'Debt and equity securities available-for-sale' in accordance with IAS 39.

Deferred income tax liability is attributable to the following:

PLN'000	31.12.2018	31.12.2017
Interest accrued (income)	40,001	37,733
Positive valuation of derivative financial instruments	246,146	115,419
Unrealized securities discount	2,312	7,097
Income to receive	2,748	3,243
Positive valuation of securities held-for-trading	722	568
Debt and equity securities measured at fair value through other comprehensive income*	25,490	10,833
Investment relief	10,453	11,401
Other	6,322	7,035
Deferred income tax liability	**334,194**	**193,329**
Net asset for deferred income tax	**205,165**	**176,979**

*Corresponds to the 'Debt and equity securities available-for-sale' in accordance with IAS 39.

Movement in temporary differences during the year 2018

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

PLN'000	As at 31 December 2017	Impact of adopting IFRS 9	As at 1 January 2018	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2018
Interest accrued and other expense	9,483	-	9,483	761	-	10,244
Revaluation impairment write-offs	48,321	33,037	81,358	25	-	81,383
Unrealized premium from securities	58,436	-	58,436	22,849	-	81,285
Negative valuation of derivative financial instruments	164,972	-	164,972	120,944	-	285,916
Negative valuation of securities held-for-trading	688	-	688	(408)	-	280
Income collected in advance	29,480	-	29,480	1,220	-	30,700
Valuation of shares	779	(3,052)	(2,273)	(2,462)	-	(4,735)
Commissions	6,137	-	6,137	(260)	-	5,877
Debt and equity securities available-for-sale	2,199	-	2,199	859	(3,985)	(927)
Staff expenses and other costs due to pay	45,136	-	45,136	(430)	619	45,325
Other	4,677	-	4,677	(666)	-	4,011
	370,308	**29,985**	**400,293**	**142,432**	**(3,366)**	**539,359**

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

PLN'000	As at 31 December 2017	Impact of adopting IFRS 9	As at 1 January 2018	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2018
Interest accrued (income)	37,733	(1,310)	36,423	3,578	-	40,001
Positive valuation of derivative financial instruments	115,419	-	115,419	130,727	-	246,146
Unrealized securities discount	7,097	-	7,097	(4,785)	-	2,312
Income to receive	3,243	-	3,243	(495)	-	2,748
Positive valuation of securities held-for-trading	568	-	568	154	-	722
Debt and equity securities available-for-sale	10,833	-	10,833	(3,348)	18,005	25,490
Investment relief	11,401	-	11,401	(948)	-	10,453
Other	7,035	-	7,035	(1,003)	290	6,322

PLN'000	As at 31 December 2017	Impact of adopting IFRS 9	As at 1 January 2018	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2018
	193,329	**(1,310)**	**192,019**	**123,880**	**18,295**	**334,194**
Change in net assets for deferred income tax	**176,979**	**31,295**	**208,274**	**18,552**	**(21,661)**	**205,165**

Movement in temporary differences during the year 2017

The movement in temporary differences relating to deferred tax assets:

PLN'000	As at 1 January 2017	Adjustments recognized in income	Adjustments recognized in equity	As at 31 December 2017
Interest accrued and other expense	10,763	(1,280)	-	9,483
Revaluation impairment write-offs	39,680	8,641	-	48,321
Unrealized premium from securities	46,370	12,066	-	58,436
Negative valuation of derivative financial instruments	158,447	6,525	-	164,972
Negative valuation of securities held-for-trading	2,938	(2,250)	-	688
Income collected in advance	26,455	3,025	-	29,480
Valuation of shares	2,039	(1,260)	-	779
Commissions	8,181	(2,044)	-	6,137
Debt and equity securities available-for-sale	50,446	-	(48,247)	2,199
Staff expenses and other costs due to pay	57,155	(12,068)	49	45,136
Other	2,998	1,679	-	4,677
	405,472	**13,034**	**(48,198)**	**370,308**

The movement in temporary differences relating to deferred tax liability:

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

27. Other assets

PLN'000	31.12.2018	31.12.2017
Interbank settlements	2,981	3,495
Income to receive	53,284	53,256
Staff loans out of the Social Fund	17,350	16,912
Sundry debtors	106,026	77,703
Prepayments	7,554	7,322
Other assets, total	**187,195**	**158,688**
Including financial assets*	126,357	98,110

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

28. Amounts due to banks

PLN'000	31.12.2018	31.12.2017

Current accounts	912,992	1,108,686
Term deposits	162,631	248,261
Loans and advances received	1,326	36,467
Liabilities due to sold securities under repurchase agreements	115,208	9,085
Other liabilities, including:	209,967	165,762
margin deposits	208,901	163,769
Amounts due to banks, total	**1,402,124**	**1,568,261**

Movements in loans received:

w tys. zł	**2018**	**2017**
As at the beginning of the period	**36,467**	**121,026**
Increase (due to):		
drawing of loans	-	31,292
interest on loans	246	500
FX differences	549	-
Decrease (due to):		
repayment of loans	(35,866)	(111,713)
interest repayment	(70)	(403)
FX differences	-	(4,235)
As at the end of the period	**1,326**	**36,467**

29. Amounts due to customers

PLN'000	**31.12.2018**	**31.12.2017**
Deposits from financial sector entities		
Current accounts	768,907	571,248
Term deposits	6,444,881	4,406,480
	7,213,788	**4,977,728**
Deposits from non-financial sector entities		
Current accounts, including:	24,858,172	22,027,628
institutional customers	11,913,676	10,758,084
individual customers	9,267,737	8,442,804
public sector units	3,676,759	2,826,740
Term deposits, including:	6,087,028	4,975,540
institutional customers	3,498,273	3,073,215
individual customers	2,519,049	1,805,359
public sector units	69,706	96,966
	30,945,200	**27,003,168**
Total deposits	**38,158,988**	**31,980,896**
Other liabilities		
Other liabilities, including:	236,897	191,545
liabilities due to deposits	121,416	112,611
margin deposits	66,583	40,671
Total other liabilities	**236,897**	**191,545**
Total amounts due to customers	**38,395,885**	**32,172,441**

30. Provisions

PLN'000	**31.12.2018**	**31.12.2017**
Litigation	3,221	3,154

Granted financial and guarantee commitments	26,481	12,789
Restructuring of the branch network	282	1,928
Provisions, total	**29,984**	**17,871**

The movement in provisions is as follows:

PLN'000	**2018**	**2017**
As at 1 January	**17,871**	**22,068**
Provisions for:		
Litigation	3,154	3,823
Granted financial and guarantee commitments	12,789	7,215
Workforce restructuring	-	3,383
Restructuring of the branches network	1,928	7,647
Impact of adopting IFRS 9	22,886	n/a
Granted financial and guarantee commitments	22,886	n/a
Increases:		
Charges to provisions in the period:	34,430	23,347
litigation	359	5,574
granted financial and guarantee commitments	34,071	17,773
Decreases:		
Release of provisions in the period:	(44,644)	(13,612)
litigation	(194)	(1,071)
granted financial and guarantee commitments	(43,265)	(12,198)
restructuring of the branch network	(1,185)	(343)
Provisions used in the period, including:	(559)	(13,864)
litigation	(98)	(5,104)
workforce restructuring	-	(3,383)
restructuring of the branch network	(461)	(5,377)
Other, including	-	(68)
litigation	-	(68)
As at 31 December	**29,984**	**17,871**
Including		
litigation	3,221	3,154
granted financial and guarantee commitments	26,481	12,789
restructuring of the branch network	282	1,928

** Additional information concerning provisions for* granted financial and guarantee commitments *are presented in note 39.*

31. Other liabilities

PLN'000	**31.12.2018**	**31.12.2017**
Staff benefits	35,459	37,590
Interbank settlements	120,783	293,405
System settlements	1,197	4,728
Settlements related to securities trading	284	-
Settlements with Tax Office and National Insurance (ZUS)	24,239	20,020
Sundry creditors	295,373	172,067
Accruals, including:	237,597	231,089
Provision for employee payments	81,284	81,652
Provision for employee retirement payments	55,849	49,832
IT services and bank operations support	36,145	29,449
Consultancy services and business support	5,774	9,273
Other	58,545	60,883
Deferred income	19,561	18,312
Other liabilities, total	**734,493**	**777,211**
Including financial liabilities*	690,693	738,879

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

Classic payment condition in the frames of Bank liabilities implementation resulting in rising the balance sheet liability is receiving in advance compensation for providing services in specified time. In accordance with this, the balance of liabilities is decreased on the time proportion basis and recognized as income. This procedure, in the best way, reflects implementation of liabilities to provision of providing services on time.

There is no remuneration not calculated in transaction price.

Within the range of liabilities to provision of providing services on time, the Bank uses a method of income on the time proportion in the time of providing services. According to the bank, this method reflects the procedure of providing services.

In the case of liabilities implement at the time, there is no subjective assesments within the range of setting the moment of control under the service by the client.

Within the area of methods, input data and assumptions adoptted to estimate variable remuneration, the Bank uses approach most likely values in accordance to the remuneration received for achievement of the objectives, whereas within the range of remuneration reimbursements in insurance mediation, statistical methods are used. The Bank addresses all issues setting the level of income subject to identified variables (remuneration under specified objectives, expected reimbrusemenrs, all discunts).

For the remuneration for mediation in distribution of incurance products, in particular with the insurance connected with Bank's credit product, the model of relative fair value is used. According to this model, using the fair value of the credit product and the sell services of the insurance product, the Bank divides into remuneration being part of interest income and remuneration for provided services connected with the distribution and operation of these products.

32. Financial assets and liabilities by contractual maturity

As at 31 December 2018

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**	**1,337,726**	**812,485**	**-**	**296,245**	**228,996**	**-**
Financial assets held-for-trading							
Debt securities held-for-trading	19	931,172	32,546	-	17,948	648,758	231,920
Financial assets measured at fair value through other comprehensive income							
Debt financial assets measured at fair value through other comprehensive income*	21	14,241,363	121,044	-	-	11,499,980	2,620,339
Amounts due from customers (gross)							
Amounts due from financial sector entities	23	2,052,764	498,115	-	1,454,649	100,000	-
Amounts due from non-financial sector entities	23	20,464,971	7,702,096	1,492,378	2,510,333	6,886,074	1,874,090
Amounts due to banks	**28**	**1,402,124**	**1,384,456**	**2,668**	**15,000**	**-**	**-**
Amounts due to customers							
Amounts due to financial sector entities	29	7,277,289	7,274,771	446	2,072	-	-
Amounts due to non-financial sector entities	29	31,118,596	29,587,137	1,075,410	434,847	21,202	-

As at 31 December 2017*

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**	**837,277**	**568,693**	**1,044**	**-**	**267,540**	**-**
Financial assets held-for-trading							
Debt securities held-for-trading	19	1,143,908	3,037	-	30,104	624,158	486,609
Financial assets available-for-sale							
Debt securities available-for-sale	21	17,439,439	1,399,713	-	-	11,589,050	4,450,676
Amounts due from customers (gross)				-			
Amounts due from financial sector entities	23	1,931,845	431,845		-	1,500,000	-
Amounts due from non-financial sector entities	23	18,420,567	6,535,495	1,586,969	1,402,874	6,833,854	2,061,375
Amounts due to banks	**28**	**1,568,261**	**1,512,791**	**6,624**	**42,594**	**6,252**	**-**
Amounts due to customers							
Amounts due to financial sector entities	29	5,015,317	4,835,998	174,350	4,957	12	-
Amounts due to non-financial sector entities	29	27,157,124	26,016,689	750,293	358,935	31,207	-

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods*

33. 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 2018, 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 2017.

The Bank has not issued preferred shares.

Both in 2018 and 2017 there was no increase in the share capital by shares issuance.

Principal shareholders

The following table presents the shareholders who, as at 31 December 2018 and 31 December 2017, held at least 5% of the total number of votes at the General Meeting or at least 5% of the Bank's share capital:

	Value of shares (PLN'000)	Number of shares	% shares	Number of votes at GM	% votes at GM
Citibank Overseas Investment Corporation, USA	391,979	97,994,700	75.0	97,994,700	75.0
Other shareholders	130,659	32,664,900	25.0	32,664,900	25.0
	522,638	**132,258**	**.100,00**	**130,659,600**	**.100,00**

During 2018 and during the period from the publication of the previous interim quarterly report for Q3 2018 until the day of the publication of this annual unconsolidated financial statements for 2018, the structure of major shareholdings of the Bank has not changed.

Supplementary capital

As at 31 December 2018, supplementary capital was PLN 2,944,585 thousand (31 December 2017: PLN 2,944,585 thousand). Supplementary capital is designated for offsetting the Bank's financial losses or for other purposes including payment of dividends to the shareholders. The General Shareholders' Meeting decides upon the utilization of supplementary capital, but a portion of its balance amounting to one third of total share capital may be used exclusively for offsetting losses shown in the financial statements.

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

Revaluation reserve

PLN'000	31.12.2018	31.12.2017
Revaluation of financial assets measured at fair value through other comprehensive income*	84,372	(9,376)

**Corresponds to the 'Revaluation of financial assets available-for-sale' in accordance with IAS 39.*

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

Other reserves

PLN'000	**31.12.2018**	**31.12.2017**
Reserve capital	2,344,537	2,344,446
General risk reserve	540,200	540,200
Net actuarial losses on specific services program valuation	(7,615)	(4,977)
Other reserves, total	**2,877,122**	**2,879,669**

On 8 June 2018 the Ordinary General Meeting of Shareholders of Bank Handlowy w Warszawie S.A. adopted a resolution on distribution of the net profit for 2017, deciding to appropriate the amount of PLN 91 thousand for reserve capital.

Reserve capital

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

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

General risk reserve

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

Dividends

Dividends paid for 2017

At the meeting on June 8, 2018, 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 2017. The WZ resolved to appropriate the amount of PLN 537,010,956.00to the dividend payment, which means that the dividend per one ordinary share is PLN 4.11. 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 June 18, 2018 (day of dividend) and the day of the dividend payment for June 25, 2018 (day of the dividend payment).

Declared dividends

On 13 March 2019, the Bank's Management Board adopted a resolution on the proposed distribution of profit for 2018. The Bank's Management Board has proposed to allocate the amount of PLN 488,666,904.00 for the dividend payment. The dividend has a cash character. This means that the dividend per share amounts to PLN 3.74. The number of shares covered by dividends is 130,659,600. The dividend record date was designated as 13 June 2019 and the dividend payment date was designated as 24 June 2019. 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.

34. Repurchase and reverse repurchase agreements

Repurchase agreements

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

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

As at 31 December 2018, 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	113,972	115,208	Up to 1 week	115,224

** including interest*

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

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

** including interest*

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

As at 31 December 2018 and 31 December 2017, assets sold through repo cannot be further traded.

In 2018, the total interest expense on repurchase agreements was PLN 8,592 thousand (in 2017: PLN 12,981 thousand).

Reverse repurchase agreements

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

As at 31 December 2018, 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	115,203	114,155	Up to 1 week	115,214
	284,064	338,962	Up to 1 yaer	286,245
	227,282	238,833	Up to 3 years	228,996
Amounts due from other financial sector entities	182,613	183,090	Up to 1 week	182,627
	809,162	**875,040**		**813,082**

**including interest*

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

PLN'000	Carrying amount of receivable*	Fair value of assets held as collateral	Resale date	Resale price
Amounts due from banks	9,085	8,974	Up to 1 week	9,086
	266,522	342,810	Up to 2 years	267,540

**including interest*

As at 31 December 2018 and 31 December 2017, the Bank held the option to pledge or sell the assets acquired through reverse repo.

In 2018, the total interest income on reverse repurchase agreements was PLN 9,908 thousand (in 2017: PLN 12,488 thousand).

As at 31 December 2018 the liabilities due to short sale of securities purchased in reverse repo transactions amounted to PLN 348,130 thousand (as at 31 December 2017: PLN 0 thousand).

35. Offsetting of financial assets and financial liabilities

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

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

	31.12.2018		31.12.2017	
	Financial assets	Financial liabilities	Financial assets	Financial liabilities
Fair value of derivatives	1,299,582	1,254,047	1,064,803	1,365,131
Value of collateral received/placed	(181,981)	(224,316)	(166,550)	(528,493)
Assets and liabilities subject to offsetting under the master agreement	**1,117,601**	**1,029,731**	**898,253**	**836,638**
Maximum amount of potential offset	(1,007,304)	(1,007,304)	(778,682)	(778,682)
Assets and liabilities subject to offsetting under the master agreement considering the maximum amount of potential offset	**110,297**	**22,427**	**119,571**	**57,956**

36. Hedge accounting

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

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

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

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

As at 31 December 2018, Bank did not possess any active hedging instruments. The cumulated amount of fair value hedging adjustments of the hedged positions in the statement of financial position where the adjustment to gains and losses on fair value hadging, as at 31 December 2018 amounted to PLN 39,399 thousand.

Fair value of instruments within fair value hedge accounting of securities

PLN'000	31.12.2017	
	Nominal value	Fair value
Hedged instruments		
Debt securities available-for-sale		
Treasury bonds	2,290,000	2,492,215
Bonds issued by banks	30,000	32,76
Hedging instruments		
Derivative instruments		
Interest rate swaps – negative valuation	-	-
Interest rate swaps – negative valuation	2,320,000	50,191

37. 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 2018

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	-	7,272,193	-	-	7,272,193	7,272,193
Amounts due from banks measured at amortized cost	18	-	1,333,816	-	-	1,333,816	1,333,735
Financial assets held-for-trading measured at fair value	19	2,213,849	-	-	-	2,213,849	2,213,849
Debt investment financial assets measured at fair value through other comprehensive income	20	-	-	14,241,363	-	14,241,363	14,241,363
Shares in subsidiaries		-	-	-	106,075	106,075	149,815
Equity and other instruments measured at	21	-	-	-	48,511	48,511	48,511

PLN'000	Note	Held-for-trading	Loans, advances and other receivables	Available-for-sale	Other financial assets / liabilities	Total carrying value	Fair value
fair value through income statement							
Amounts due from customers	22		21,853,349	-	-	21,853,349	21,801,583
		2,213,849	**30,459,358**	**14,241,363**	**154,586**	**47,069,156**	**47,061,049**
Financial liabilities							
Amounts due to banks	28	-	-	-	1,402,124	1,402,124	1,402,217
Financial liabilities held-for-trading	19	1,606,189	-	-	-	1,606,189	1,606,189
Amounts due to customers	29	-	-	-	38,395,885	38,395,885	38,394,319
		1,606,189	**-**	**-**	**39,798,009**	**41,404,198**	**41,402,725**

As at 31 December 2017*

PLN'000	Note	Held-for-trading	Loans, advances and other receivables	Available-for-sale	Other financial assets / liabilities	Total carrying value	Fair value
Financial assets							
Cash and balances with Central Bank	17	-	462,126	-	-	462,126	462,126
Amounts due from banks	18	-	836,166	-	-	836,166	836,166
Financial assets held-for-trading	19	2,162,040	-	-	-	2,162,040	2,162,040
Debt securities available-for-sale	20	-	-	17,439,439	-	17,439,439	17,439,439
Equity investments	21	-	-	26,171	106,368	132,539	201,002
Amounts due from customers	22	-	19,766,803	-	-	19,766,803	19,727,148
		2,162,040	**21,065,095**	**17,465,610**	**106,368**	**40,799,113**	**40,827,921**
Financial liabilities							
Amounts due to banks	28	-	-	-	1,568,261	1,568,261	1,568,359
Financial liabilities held-for-trading	19	1,351,031	-	-	-	1,351,031	1,351,031
Hedging derivatives		50,191	-	-	-	50,191	50,191
Amounts due to customers	29	-	-	-	32,172,441	32,172,441	32,171,614
		1,401,222	**-**	**-**	**33,740,702**	**35,141,924**	**35,141,195**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

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

- Level I: financial assets / liabilities valued directly on the basis of prices from an active market where the regular quotations and turnover are available.

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

In 2018, the Bank did not make any changes in the classification of financial instruments (presented by the fair value method in the statement of financial position) to categories of fair value assignment (Level I, Level II, Level III).

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

As at 31 December 2018

PLN'000	Note	Level I	Level II	Level III	Total
Financial assets					
Financial assets held-for-trading	19	931,893	1,281,956	-	2,213,849
derivatives		722	1,281,955	-	1,282,677
debt securities		931,171	1	-	931,172
Debt investment financial assets measured at fair value through other comprehensive income	20	14,241,363	-	-	14,241,363
Equity and other instruments measured at fair value through income statement	21	770		47,741	48,511
Financial liabilities					
Financial liabilities held-for-trading	19	348,130	1,258,059	-	1,606,189
short sale of securities		348,130	-	-	348,130
derivatives		-	1,258,059	-	1,258,059

As at 31 December 2017*

PLN'000	Note	Level I	Level II	Level III	Total
Financial assets					
Financial assets held-for-trading	19	1,144,095	1,017,945	-	2,162,040
derivatives		188	1,017,944	-	1,018,132
debt securities		1,143,907	1	-	1,143,908
Debt securities available-for-sale	20	16,007,151	1,432,288	-	17,439,439
Equity investments available-for-sale	21	987	-	23,062	24,049
Financial liabilities					
Financial liabilities held-for-trading	19	65	1,350,966	-	1,351,031
derivatives		65	1,350,966	-	1,351,031
Hedging derivatives		-	50,191	-	50,191

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

On the 31st of December 2018 the amount of financial assets classified to the Level III includes the share of 28,520 thousand in Visa Inc. and the share of PLN 19,221 thousand in other minority shareholding.

As of 31st of December 2017 the amount of financial assets classified to the Level III includes the share of PLN 23,062 thousand in Visa Inc.

The fair value valuation method takes into account the value of shares of Visa Inc. as well as corrections resulting from legal cases (actual and potential) a party of which could be Visa or the Bank. Minority shareholdings in partnerships of Biuro informacji Kredytowej S.A. and Krajowa Izba Rozliczeniowa S.A. were measured to fair value based on book value of net assets based on financial statements of Partnerships.

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

Changes in financial assets and liabilities in, measured at a fair value that was defined by using relevant parameters not-market based are presented below:

PLN '000	01.01.-31.12.2018 Equity and other investments measured at fair value through income statement
As at 31 December 2017	**23,062**
Reclassification/ Impact of adopting IFRS 9	18,186
As at 1 January 2018	**41,248**
Revaluation	6,493
As at the end of period	**47,741**

	01.01.-31.12.2017*

PLN '000	Financial assets available-for-sale Equity investments
As at 1 January 2017	**18,965**
Revaluation	4,097
As at the end of period	**23,062**

***** *On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

In 2018 and 2017 the Bank did not make any transfers between levels of financial instruments' fair value according to method of establishing fair value.

Fair value measurement

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

Shares in subsidiaries

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

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. 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 mentionedabove are classifies to the third of the level fair value financial hierarchy: assets valued on the basis of valuation techniques using relevant parameters not market-based.

Amounts due to banks and customers

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

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

38. Derecognition of financial assets

In accordance with the amendments to IAS 1 'Presentation of financial statement', which result from adopting IFRS 9, the Bank is obligated to disclose net gain/(loss) on derecognition of financial assets. That amount in Bank comes down to gain on debt investment financial assets measured at fair value through other comprehensive income and amounted to 112,631 thousand PLN in 2018.

That gain resulted from sale of debt investment financial assets measured at fair value through other comprehensive income, according to description in note 2, section "Recognition, derecognition and insignificant modifications". In the separate income statement such gain is presented in item net gain/(loss) on debt investment financial assets measured at fair value through other comprehensive income (befora IFRS 9 application in item Net gain on debt investment securities available-for-sale").

Due to specific activity of the Bank, changes in debt investment financial assets measured at fair value through other comprehensive income are presented in operating activities in cash flow statement.

39. Contingent liabilities and litigation proceedings

Information on pending proceedings

In 2018, there was no single proceeding regarding the Bank's receivables or liabilities, the value of which would be equal to at least 10% of equity, pending in court, before a public administration authority or an arbitration authority.

The total value of all pending legal proceedings regarding receivables with the participation of the Bank did not exceed 10% of the Bank's equity in 2018.

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 2018.

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

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

As at 31 December 2018, the Bank was among others a party to 19 court proceedings associated directly with derivative transactions that have not been legally terminated: in 12 proceedings the Bank acted as a defendant and in 7 as a plaintiff. Additionally, during this time, the Bank was involved in two closing proceedings that were legally terminated, both resolved in the Banks favor (one in which the Bank was a plaintiff and one as a defendant). The claims and allegations in the individual cases against the Bank are based on various legal bases. The subject of the dispute refers mainly to the validity of the derivative transactions and clients' liabilities demanded by the Bank with respect to those derivative transactions, as well as potential claims regarding potential invalidation of such demands by court decisions. Clients try to prevent the Bank from seeking claims resulting from derivative transactions; they dispute their liabilities towards the Bank, question the validity of the agreements and, in some cases, demand payment from the Bank.

The Bank was a party to proceedings initiated by the President of the Office of Competition and Consumer Protection (UOKiK) against the Visa and Europay payment system operators and banks - issuers of Visa cards and Europay/Eurocard/Mastercard cards. The Bank was one of the addressees of the President of UOKiK's decision in the case. The proceedings have concerned alleged practices limiting competition on the payment cards market in Poland consisting in the fixing of interchange fees for transactions made with Visa and Europay/Eurocard/Mastercard cards, as well as limiting access to the market for operators who do not belong to the unions of card issuers, against whom the proceedings were initiated. The President of UOKiK's decision was the subject of legal analyses in appeal proceedings. On April 22, 2010, the Appeal Court overturned the verdict of the Court of Competition and Consumer Protection (SOKiK) and referred the case back to the court of first instance. On 21 November 2013 SOKiK gave a judgment, under which a penalty imposed on the Bank was modified and set in the amount of PLN 1,775,720. On October 6, 2015 the Appeal Court modified the verdict of the Competition and Consumer Protection Court and denied all appeals from the decision of the President of the Competition and Consumer Protection Office, including the changes of amounts of the fines that were imposed upon banks. As a result, the fine in the amount of 10,228,470 PLN that was originally imposed upon the Bank has been reinstated. The verdict is binding and enforceable. Due to the Banks submitted extraordinary appeal on the 25 October 2017 the Supreme Court has overturned the Appeal Court's verdict and the case has been returned to the Appeal Court for a second review. The appeals proceedings has begun again. In the first quarter of 2018, the Bank received the reimbursed of the fine which was recognized in the profit and loss. During the trial on October 24, 2018 no significant settlements were made. The trial is postponed for an indefinite period.

On Janury 2019, the Bank became aware of the filing of lawsuits by two prevous agentes, Rigall Arteria Management Ltd. with registered office in Warsaw and Rotsa Sales Direct Ltd. with registered office in Katowice.The lawsuits concerned claims related to agency agreements which in the past merged agents with the Bank and which expired as a result of termination by the Bank in 2014.

As at the date of this report, these claims have not been delivered to the Bank.

In the Bank's opinion, lawsuits may relate to claims on account of commission from agreements concluded during the term of the agency agreement with customers, acquired by agents for agreements of the same type (cross-sell commission) and for payment of compensatory benefit.

In the Bank's opinion, the amount of claims filed by companies is not justified. The Bank's position is confirmed by legally binding resolutions of legal actions taken by the companies against the Bank, which are beneficial for the Bank.

In 2018, there were no significant settlements on account of court cases which ended with a final judgment.

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	**31.12.2018**	**31.12.2017**
Financial and guarantees liabilities granted		
Letters of credit	137,669	167,983
Guarantees granted	2,589,013	2,312,023
Credit lines granted	14,103,607	14,373,084
	16,830,289	**16,853,090**

PLN'000	31.12.2018	31.12.2017
Letters of credit by category		
Import letters of credit issued	137,669	148,607
Export letters of credit confirmed	-	19,376
	137 669	**167,983**

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

The Bank makes provisions for granted financial and guarantees commitments. As at 31 December 2018, the provisions created financial and guarantees commitments amounted to PLN 26,481 thousand (31 December 2017: PLN 12,789 thousand).

Movement in loss allowance - contingent liabilities and guarantees granted presents as follows:

PLN '000	Stage 1	Stage 2	Stage 3	Total
Loss allowance - contingent liabilities and guarantees granted				
Loss allowance as at 31 December 2017	-	-	-	**12,789**
Impact of adopting IFRS 9	-	-	-	22,886
Loss allowance as at 1 January 2018	**19,061**	**10,837**	**5,777**	**35,675**
Transfer to Stage 1	149	(149)		-
Transfer to Stage 2	(278)	278	-	-
Transfer to Stage 3	-	-	-	-
(Creation)/Realeses in the period though the income statement	(5,086)	(676)	(3,693)	(9,455)
Foreign exchange and other movements	237	28	(4)	261
Loss allowance as at 31 December 2018	**14,083**	**10,318**	**2,080**	**26,481**

As at 31 December 2018, the Bank did not identify POCI assets (purchased or originated credit-impaired assets).

Movements in contingent liabilities granted that contribute to movements in loss allowance to presents as follows:

PLN'000	Stage 1	Stage 2	Stage 3	Total
Gross amount of contingent liabilities granted				
Gross amount of contingent liabilities granted as at 1 January 2018	**15,320,016**	**1,495,682**	**37,392**	**16,853,090**
Transfer to Stage 1	28,287	(28,287)	-	-
Transfer to Stage 2	(548,835)	548,835	-	-
Transfer to Stage 3	-	(156,025)	156,025	-
Increase/Decrease	404,636	(343,928)	(161,049)	(100,341)
Other movements	88,212	(10,694)	22	77,540
Net amount of contingent liabilities granted as at 31 December 2018	**15,292,317**	**1,505,582**	**32,390**	**16,830,289**

PLN'000	31.12.2018	31.12.2017
Financial and guarantees liabilities received		
Finance	-	-
Guarantees	19,278,757	18,142,380
	19,278,757	**18,142,380**

40. Assets pledged as collateral

Assets are pledged as collateral of the following liabilities:

PLN'000	31.12.2018	31.12.2017
Collateral liabilities		
Amounts due to banks		
securities sale and repurchase agreements	115,208	9,085
liabilities on credit received	1,668	36,970
	116,876	**46,055**

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

PLN'000	31.12.2018	31.12.2017*
Assets pledged		
Debt securities held-for-trading	88,806	9,079
Debt investment financial assets measured at fair value through other comprehensive income**	170,908	334,396
Financial assets measured at amortized cost (reverse repo)	25,166	-
Amounts due from banks		
Settlements related to operations in derivative instruments and stock market transactions	118,364	505,526
Amounts due from customers		
Stock market trading guarantee funds and settlements	312,695	286,432
	715,939	**1,135,433**

** On 1st. January 2018 Bank adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*
***Corresponds to the 'Debt securities available-for-sale' in accordance with IAS 39.*

As at 31 December 2018, 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 168,106 thousand (31 December 2017: PLN 183,843 thousand), the collateral against loan received in the amount of PLN 2,802 thousand (31 December 2017: PLN 150,553 thousand).

Debt securities held-for-trading as at 31 December 2018 constitute collateral of the Bank's obligations under securities sold with a repurchase agreement.

Financial assets measured at amortized cost 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 34.

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

41. Custodian activities

The Bank offers both custodian services connected with securities accounts for foreign institutional investors and custodian services for Polish financial institutions, including pension, investment and equity insurance funds. As at 31 December 2018, the Bank maintained over 14.3 thousand securities accounts (31 December 2017: approx. 9.2 thousand accounts).

42. Operating leases

Leases where the Bank is the lessee

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

PLN'000	31.12.2018	31.12.2017
Less than 1 year	3,234	4,399
Between 1 and 5 years	28,154	28,734
More than 5 years	27,331	18,974
	58,719	**52,107**
Total annual rentals for contracts for an unspecified period of time	**173**	**341**

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

Most of the office space lease contracts are signed for 5 years with the option of extension for another three years; however, some contracts have been signed for a period up to 1 year and some for more than 10 years. Lease payments are subject to annual indexation. The total amount of lease payments in 2018 amounted to PLN 21,074 thousand (in 2017: PLN 21,548 thousand).

The car leases are signed for 3 years. Lease payments are based on a fixed interest rate throughout the lease period. In 2018, total amount of leasing fees amounted to PLN 2,030 thousand (in 2017: PLN 4,951 thousand).

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

Leases where the Bank is the lessor

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

PLN'000	31.12.2018	31.12.2017
Less than 1 year	41	28
Between 1 and 5 years	6,976	2,958
More than 5 years	-	3,363
	7,017	**6,349**
Total annual rentals for contracts for an unspecified period of time	**5,780**	**6,974**

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

Most of the office space lease contracts are signed for an unspecified period of time. Other contracts are signed for a period of between 2 and 5 years. Lease payments are subject to annual indexation. The income related to these contracts amounted in 2018 to PLN 8,431 thousand (in 2017: PLN 9,919 thousand).

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

43. Additional information to the statement of cash flows statement

Cash

PLN'000	31.12.2018	31.12.2017
Cash related items:		
Cash in hand	422,064	431,574
Nostro current account in Central Bank	6,850,088	29,031
Current accounts in other banks (nostro, overdrafts on loro accounts)	202,665	53,872
	7,474,817	**514,477**

44. Transactions with the key management personnel

PLN'000	31.12.2018		31.12.2017	
	Members of the Management Board	Members of the Supervisory Board	Members of the Management Board	Members of the Supervisory Board
Loans granted	**165**	**-**	**174**	**48**
Deposits				
Current accounts	8,969	2,307	9,246	3,508
Term deposits	7,695	380	7,935	450
	16,664	**2,687**	**17,181**	**3,958**

As at 31 December 2018 and 31 December 2017, no loans or guarantees were granted to members of the Management Board or the Supervisory Board.

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

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

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

45. Related parties

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

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

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

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

Transactions with subsidiaries

The receivables and liabilities towards subsidiaries are as follows:

PLN'000	31.12.2018	31.12.2017
Receivables		
Overdraft facilities	-	21
	-	**21**
Receivables		
Opening balance	21	5
Closing balance	-	21
Deposits		
Current accounts	111,354	80,094
Term deposits	151,486	141,895
	262,840	**221,989**
Deposits		
Opening balance	221,989	256,593
Closing balance	262,840	221,989
Contingent liabilities granted		
Credit lines granted	80,550	80,550

PLN'000	31.12.2018	31.12.2017
Interest and commission income	7,287	11,607
Interest and commission expenses	1,748	2,846
Other operating income	2,185	2,593

As at 31 December 2018 and 31 December 2017, no receivables or contingent liabilities granted to subsidiaries were subject to impairment write-offs.

Transactions with other related entities

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

PLN'000	31.12.2018	31.12.2017
Receivables, including:	172,180	347,515
Placements	-	-
Liabilities, including:	722,185	1,032,018
Deposits*	179,854	220,304
Balance-sheet valuation of derivative transactions:		
Assets held-for-trading	449,183	446,178
Liabilities held-for-trading	379,293	716,669
Liabilities due to hedging derivatives	-	17,507
Contingent liabilities granted	439,748	373,018
Contingent liabilities received	34,834	71,587
Contingent transactions in derivative instruments (nominal value), including:	57,380,600	40,741,781
Interest rate instruments	28,293,455	25,946,494
Interest rate swaps (IRS)	6,740,216	9,456,993

PLN'000	**31.12.2018**	**31.12.2017**
Currency – interest rate swaps (CIRS)	20,561,934	15,566,804
Interest rate options	963,107	894,863
Futures contracts	28,198	27,834
Currency instruments	28,881,240	14,591,578
FX forward/spot	605,006	745,294
FX swap	26,994,552	11,687,926
Foreign exchange options	1,281,682	2,158,358
Securities transactions	101,504	100,674
Securities purchased pending delivery	48,266	79,250
Securities sold pending delivery	53,238	21,424
Commodity transactions	104,401	103,035
Swaps	104,401	92,688
Options	-	10,347

**including deposits from parent company in the amount of PLN 9 thousand (31 December 2017: PLN 7 thousand)*

PLN'000	**31.12.2018**	**31.12.2017**
Interest and commission income*	28,029	39,598
Interest and commission expense*	30,061	42,914
General administrative expenses	168,913	182,785
Other operating income	7,092	8,467

** including interest and commission income in amount of PLN 1,505 thousand (2017: PLN 1,431 thousand) and interest and commission expense in amount of PLN 2 thousand (2017 : PLN 5 thousand) refer to the parent company*

The Bank incurs costs and receives income on derivative transactions with Citigroup Inc. entities to hedge the Bank's position in market risk. These derivative transactions are opposite (back-to-back) to derivative transactions with other Bank clients or close the proprietary position of the Bank. The net carrying amount of financial derivative transactions with related entities as at 31 December 2018 amounted to PLN 69,890 thousand (as at 31 December 2017: PLN (287,998) thousand). The Bank runs a compression of derivative transaction portfolios' periodically. It is one of the risk-mitigation technique recommended by "Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories" and the implementing regulations (EMIR Regulation). In accordance with the EMIR Regulations this in particular applies to the portfolios exceeding 500 derivative transactions.

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

The costs arising and accrued (including VAT, reflected in the Bank's costs) under concluded agreements in 2018 and 2017 mainly related to the cost of services provided to the Bank for the maintenance of the banking IT systems and advisory support and are included in general administrative expenses; income was mainly related to the provision of data processing services by the Bank to such entities and is presented in other operating income.

In 2018 capitalization of investment regarding functionality modification of Bank's IT systems took place. Total payments for Citigroup entities amounted to PLN 32,912 thousand (in 2017: PLN 79,805 thousand).

46. Employee benefits

Employee benefits are divided into the following categories:

- short-term benefits, which include salaries, social insurance contributions, paid leave and benefits in kind (such as medical care, company apartments, company cars and other free or subsidized benefits). The costs of short-term benefits are expensed in the income statement in the period to which they relate. At the end of a given reporting period, if there is a balance payable which equals the expected undiscounted value of short-term benefits for that period, the Bank will record it as an accrued expense;

- benefits after termination of employment – including retirement allowances (see Note 2) and pension plans presented below offered by the Bank to its staff.

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

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

Description of the Employee Pension Plan

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

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

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

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

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

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

PLN'000	**31.12.2018**	**31.12.2017**
Provision for remuneration	54,795	53,233
Provision for unused leave	11,480	13,535
Provision for employees' retirement and pension allowances	55,849	49,832
Provisions for employees' equity compensation	15,010	14,885
	137,134	**131,485**

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 2018, on the basis of calculation conducted by an independent external actuary. The provisions calculated equate to discounted future payments, taking into account staff turnover, and relate to the period ending on the balance sheet date.The discount rate was set at 3.00% and wage growth rate at 2.5%.

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

PLN'000	**2018**	**2017**
	Provision for retirement and pension allowances	**Provision for retirement and pension allowances**
As at 1 January	**49,832**	**40,290**
Increases (due to):	8,919	11,379
Actuarial profit/loss of revaluation	3,257	256
Including those resulting from:		
Change of economic assumptions	4,448	1,885
Change of demographic assumptions	92	216
Adjustments of actuarial assumptions ex post	(1,283)	(1,845)
Salary expenses	4,042	3,006
Interest expenses	1,620	1,410

PLN'000	2018 Provision for retirement and pension allowances	2017 Provision for retirement and pension allowances
Cost of past employment	-	6,707
Decreases (due to):	(2,902)	(1,837)
Provisions utilisation	(2,902)	(1,837)
As at 31 December	**55,849**	**49,832**

Analysis of sensitivity for significant actuarial assumptions

w tys. zł	2018 Provision for retirement and pension allowances	2017 Provision for retirement and pension allowances
Central value	55,849	49,832
Decrease of growth salary to 1 p.p.	49,165	44,150
Increase of growth salary to 1 p.p.	63,709	56,524
Decrease of rotation by 10%	58,563	56,524
Increase of rotation by 10%	53,367	47,693
Decrease of discount rate by 0.5 p.p., including:	57,611	51,388
Falling to benefits paid within 1 year	3,772	5,034
Increase of discount rate by 0.5 p.p., including:	54,087	48,343
Falling to benefits paid within 1 year	3,770	5,034

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

In 2018, the Bank's expenses in respect of premiums for the employee pension plan amounted to PLN 23,752 thousand (in 2017: PLN 23,485 thousand).

Employment at the Bank:

FTEs	2018	2017
Average employment during the year	3,364	3,511
Employment at the end of the year	3,227	3,438

Description and principles of employee stock benefit schemes

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

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

In 2018 no employees were rewarded as part of this program.

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

As of 22 December 2017 the Bank implemented the employee remuneration Policy of Bank Handlowy w Warszawie S.A., replacing the prior policy for the remuneration of key persons in the Bank Handlowy w Warszawie S.A..

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

A portion of the Variable Remuneration awarded conditionally in 2018 for persons covered by the Policy will be paid in tranches during in the next 3,5 years or 5 years to the President of Management Board. The Policy implemented as of 22 december 2017, introducing changes among other to the fields of postponements and retention had an effect on the varying remuneration granted conditionally in 2018.

Variable Remuneration – Phantom shares	
Transaction as per IFRS	Transactions share-based payments settled in cash in accordance with IFRS 2
Phantom Shares grant date	18 of January 2016 16 of January 2017 15 of January 2018
Number of Phantom Shares granted	The number of shares was set on grant date
Date of maturity	• Phantom Shares for the President of the Management Board o in 2016 and 2017 - at least 6, 18, 30 and 42 months after grant date o in 2018 roku – at least 12, 24, 36, 48, 60, 72 • Phantom Shares granted in 2016-2018 for other employees – at least 6, 18, 30, 42 months after grant date
Vesting date	• Phantom Shares for the President of the Management Board o in 2016 and 2017 - at least 6, 12, 24 and 36 months after grant date o in 2018 roku – at least 12, 24, 36, 48, 60 • Phantom Shares granted in 2016-2018 for other employees – at least 6, 12, 24, 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 • 2016: in relation to the award from 2016-2019 • 2017: in relation to the award from 2017-2020 • 2018: o For the President of the Management Board in relation to the award from 2018-2023 o For other employee in relation to the award from 2018-2021
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	18 of January 2016 16 of January 2017 14 of January 2018
Granted amount	The amount was settled on the Deferred Cash Award grant date
Date of maturity	• Deferred Cash Award for the President of the Management Board o in 2016 and 2017 - at least 18, 30 and 42 months after grant date o in 2018 roku – at least 18, 30, 42, 54, 66 • Deferred Cash Award granted in 2016-2018 for other employees – at least 18, 30, 42 months after grant date
Vesting date	• Deferred Cash Award for the President of the Management Board o in 2016 and 2017 - at least 12, 24 and 36 months after grant date o in 2018 roku – at least 12, 24, 36, 48, 60 • Deferred Cash Award granted in 2016-2018 for other employees – at least 12, 24, 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 • 2016: in relation to the award from 2016-2019 • 2017: in relation to the award from 2017-2020 • 2018: o For the President of the Management Board in relation to the

Variable Remuneration – Deferred Cash Award	
	award from 2018-2023 ○ For other employee in relation to the award from 2018-2021
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 2016, 2017 and 2018. 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.

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	16.02.2015	50.07	1	112

Phantom Shares Program	Grant Date	Exercise price / stock price at grant date [PLN]	Number of eligible employees	Number of options / shares
1	18.01.2016	72.21	43	20,202
2	16.01.2017	77.31	43	32,474
3	15.01.2018	83.02	43	59,712

	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 3 following years, 40% after a year and 12% after 5 following years or 60% after 0.5 of a year and 13.33% after 3 following years, 60% after a year and 8% after 5 following years
Expected average life cycle of the instrument	At the time of rights acquisition	At the time of rights acquisition
Probability of premature termination of employment (annual staff turnover for awarded employees)	0,00%	8.70%
Fair value of one instrument* (in USD)	50.24 (USD)	69.30 (PLN)

**Varies depending on the date of exercise*

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

	31.12.2018		31.12.2017	
	Number	Weighted average share price [USD]	Number	Weighted average share price [USD]
At the beginning of the period	1,413	49.73	4,251	48.09
Executed/redeemed/expired in the period	1,301	-	2,838	-
At the end of the period	112	50.07	1,413	49.73

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

	31.12.2018		31.12.2017	
	Number	Weighted average share price [PLN]	Number	Weighted average share price [PLN]
At the beginning of the period	107,713	80.21	118,489	88.03
Allocated in the period	115,643	83.02	114,484	77.31
Executed in the period	110,294	71.55	123,807	68.37
Redeemed/expired in the period	1,570	-	1,453	-
At the end of the period	111,492	79.49	107,713	80.21

On 31 December 2018, the book value of liabilities from the phantom share and CAP programs amounted to PLN

25,457 thousand (31 December 2017: PLN 24,558 thousand). The costs recognized in this respect in 2018 amounted to PLN 8,818 thousand (in 2017: 7,364 thousand, including SOP costs).

47. Risk management

RISK MANAGEMENT ORGANIZATION STRUCTURE AND PROCESS

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

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

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

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

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

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

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

- approves the organizational structure of the Bank with well-defined, transparent and consistent roles and responsibilities, t adequate for the size and risk profile ensuring that the functions of risk measurement, monitoring and control are independent from risk taking activities;
- defines the Bank's Risk's Profile, by establishing significant risk types, simultaneously ensuring introducing processes of managing them and/or allocation of internal capital;
- establishes the principles of prudent and stable risk management which constitute, together with the ICAAP Document, the risk management strategy, including operational risk strategy;
- approves the acceptable risk level in the Bank ("Overall risk appetite"), within the document summarizing the process of assessing and internal capital allocation in subsequent years (ICAAP).

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

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

Moreover, 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 (ALCO),
- Risk and Capital Management Committee (RCMC), including Model Risk Commission and Consumer Bank (GCB) Risk Commission;
- New Products Committee.

Member of the Management Board responsible for Risk Management Sector presents the organizational structure of the Risk Management Sector to the Management Board of the Bank, taking into account the specificity of credit, market, liquidity and operational risk management in the respective customer segments. For this purpose, organizational units have been set up within the Risk Management Sector that are responsible for:
- managing credit risk of the Corporate Bank;
- managing credit risk of the Commercial Bank;
- managing credit risk of the Consumer Bank;
- managing impaired receivables;
- managing market risk, including interest rate risk in banking book;
- managing liquidity risk;
- managing operational risk;
- managing the equity process and model risk;
- model validation;
- supporting risk management in the above areas including in control functions;
- the process of comprehensive and continuous assessment of credit risk (Fundamental Credit Risk Assessment).

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

Risk management in the Bank is supported by a range of IT systems in the following areas:
- obligor and exposure credit risk assessment;
- credit, market and operational risk measurement, reporting and monitoring;
- monitoring and reporting of collateral;
- calculation and reporting of expected credit losses.

Significant Risks

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

- Credit risk and counterparty risk,
- Liquidity risk,
- Market risk,
- Operational risk,
  - Compliance risk,
  - Model risk,
  - Outsourcing risk,
  - Information security risk (including cyber risk).

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

Credit risk including also counterparty credit risk results from credit exposure or other exposure related to concluding and clearing below listed transactions, and is defined as the potential for financial loss resulting from the failure of a borrower or counterparty to honor its financial or contractual obligations. Credit risk arises in many of the Bank’s business activities, hereinafter “products,” including:
- Loans and advances;
- FX and derivatives transactions;
- Securities transactions;
- Financing and handling settlements, including trade (domestic and foreign);
- Transactions in which the Bank acts as an intermediary on behalf of its clients or other third parties.

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

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

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

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

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people, or technical systems, or from external events. It includes reputation and franchise risks associated with operational risk events and business practices or market conduct. It also includes legal risk and compliance risk.

CREDIT RISK

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

Principles of the Credit Risk Management Policy

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

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

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

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

Credit risk in this area is managed by means of:

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

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

Credit risk assessment and rating

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

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

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

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

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

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

For ICG and CCB customers credit exposures, the Bank uses scoring models of the various level of complexity i.e. depending on the size of customer's portfolio and customer's industry.

For retail credit exposures, the Bank uses scoring models developed on the basis of the history of behavior of the Bank's customers. Such models analyze the behavior of customers in the Credit Information Bureau, own data 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 monitored regularly with population stability reports, KS (Kolmogorov-Smirnov) test reports and portfolio quality reports (delinquency and loss ratios). Each scoring model is validated annually.

Credit risk monitoring

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

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

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

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

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

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

Risk mitigation

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

- Customers selection and credit confirmation:
  - Target market and customer selection criteria are determined;
  - Maximum credit exposure against the obligor is determined through obligor limits related to customer risk ratings and/or through risk acceptance criteria;
  - Limits are established and monitored in order to mitigate exposure concentration risk;
  - Robust credit due diligence standards are established and maintained;
  - Credit process standards are established in order to ensure a consistent approach to each segment;
  - Credit documentation standards are applied;
- Collateral is used in order to minimize the risk and to manage residual risk:
  - Establishing acceptable collaterals and their classification in view of regain possibility in case of execution;

- Setting collaterals in right law's form (documentation standards);
- Expected collateral structure or credit value in relation to collateral value is determined;
- The value of collateral on property and equipment is determined by dedicated specialty functions within the Bank using external valuation where required;

- Monitoring and early warning system:
  - Credit exposures periodic monitoring and an early warning system are used;
  - Regular inspection of portfolio ensuring identification of adverse tendencies and concentration;
  - Active portfolio management includes implementation of necessary modifications to the credit strategy based on portfolio reviews or stress testing.

Policy of collateral acceptance

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

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

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

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

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

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

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

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

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

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

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

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

Concentration in credit risk

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

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

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

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

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

Obligor exposure concentration risk

The Bank limits the concentration of its exposure to a single customer or a group of customers with common ownership and/or organization. As at 31 December 2018, the Bank's exposure in bank portfolio transactions with groups of customers whose aggregate exposure exceeded 10% of the Bank's equity (as defined below in this report) amounted to PLN 9,286,610 thousand, i.e., 189 % of equity (31 December 2017: PLN 7,286,844 thousand, i.e., 148%). In 2018 and 2017 the Bank complied with the provisions on limits of concentration of exposure.

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

PLN'000	31.12.2018			31.12.2017		
	Balance sheet exposure*	Exposure due to granted financial commitments and guarantees	Total exposure	Balance sheet exposure*	Exposure due to granted financial commitments and guarantees	Total exposure
GROUP 1	799,072	202,774	1,001,846	828,101	115,658	943,759
CLIENT 2	1,000,000	-	1,000,000	1,000,000	-	1,000,000
CLIENT 3	310,424	628,978	939,402	251,522	475,980	727,502
GROUP 4	332,064	472,010	804,074	261,317	574,317	835,634
CLIENT 5	263,100	486,900	750,000	191,400	558,600	750,000
GROUP 6	537,517	180,813	718,330	557,053	83,530	640,583
GROUP 7	107,523	521,365	628,888	18	618,348	618,366
GROUP 8	369,570	253,147	622,717	140,852	150,639	291,491
CLIENT 9	523,638	81,562	605,200	396,000	205,185	601,185
CLIENT 10	600,000	-	600,000	600,000		600,000
GROUP 11	-	-	-	74,439	495,376	569,815
Total	**4,842,908**	**2,827,549**	**7,670,457**	**4,300,702**	**3,277,633**	**7,578,335**

**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 2018, the Bank had an exposure to one entity exceeding the statutory exposure concentration limits. The excess exposure resulted from trade portfolio transactions. As a consequence, an additional capital requirement for excess exposure was factored into the calculation of the Bank's total capital requirement as at 31 December 2018.

*Concentration of exposure in individual industries**

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

Sector of the economy according to NACE*	31.12.2018		31.12.2017	
	PLN'000	%	PLN'000	%
Wholesale trade, excluding trade in vehicles	4,695,369	17.4%	4,458,077	18.2%
Financial intermediation, excluding insurance and pension funds	3,385,386	12.6%	3,039,423	12.4%
Manufacture and supply of electricity, gas, steam, hot water and air conditioning	2,760,531	10.2%	2,645,822	10.8%
Retail trade, excluding retail trade in vehicles	1,084,312	4.0%	825,311	3.4%
Production of food and beverages	1,065,354	4.0%	1,071,761	4.4%
Activities of head offices; consulting related to the management	1,028,293	3.8%	592,729	2.4%
Metal ore mining	939,402	3.5%	727,502	3.0%
Production of metal goods, excluding machines and equipment	929,839	3.5%	657,375	2.7%
Production and processing of coke and petroleum products	893,827	3.3%	884,023	3.6%
Production of motor vehicles, trailers and semi-trailers, excluding motorcycles	862,454	3.2%	633,978	2.6%
10 business sectors	**17,644,767**	**65.5%**	**15,536,001**	**63.5%**
Other sectors	**9,290,483**	**34.5%**	**8,936,499**	**36.5%**
Total	**26,935,250**	**100.0%**	**24,472,499**	**100.0%**

**Gross balance-sheet and off-balance-sheet exposure to institutional customers (including banks), based on NACE Revision 2 (The Statistical Classification of Economic Activities in the European Community).*

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

PLN'000		31.12.2018	31.12.2017
Gross amounts due from economic entities and banks			
Financial		3,515,374	2,809,513
Production		4,281,519	4,041,837
Services		4,793,637	4,528,131
Other		3,730,136	2,718,123
		16,320,666	**14,097,604**
Gross amounts due from individual customers		**7,534,795**	**7,092,085**
	(see Note 18, 22)	**23,855,461**	**21,189,689**

The gross amounts due does not include contractual interest accrued from the moment the exposure is classified in Stage 3. The impact of including this interest on the gross carrying amount is presented in Note 22.

Determination of Expected Credit Loss

The Bank makes impairments for expected credit losses, for all financial assets, according to developed internal rules and methodologies for calculating impairments.Expected credit loss impairments as per IFRS 9 are established with exposure classification into one of the 3 Stages:

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

Assignment of the exposure to the Stage takes place, depending on the approach to management over the client (individual vs. Bank approach), taking into account the wide range of information obtained as part of standard risk management processes (including the Early Warning process) regarding both current and future events, including macroeconomic factors) and the number of days past due.

The Bank aggregates financial instruments in order to measure expected credit losses in terms of product in the area of retail banking and on a segmented basis for a homogeneous portfolio of micro-enterprises with a minimal share in total amounts due from the Bank.

Overdue payments for more than 30 days for financial assets are taken into account by the Bank in identifying the occurrence of a significant increase in credit risk. In the case of credit exposures from the retail banking area, the overdue criterion of over 30 days is a direct trigger for identifying a significant increase in credit risk. For credit exposures in the area of institutional banking, overdue by more than 30 days is taken into account when assessing the potential occurrence of a significant increase in credit risk, while these are factors supporting the assessment and have an indirect character.

The Bank identified overdue payments of financial assets for more than 30 days and the capability of this measure to indentify significant increase in credit risk. The results of analysis indicated that extended review of customer exposure as part of periodic credit processes and in his results the internal classification is the measure more adequate in relation to days overdue. The process of overdues of Stages for institutional banking portfolio also confirmed this assumption. The analysis of 30 days overdue payments indicated the lack of correlations with abovemensioned credit risk because of the arrears on non-credit products in particular.

The Bank applies the general principle that the creditor's default occurs when one or both of the following events occur:

a) delay in the debtor’s repayment of any material loan obligations to the Bank is 90 days or more,

b) it is unlikely that the debtor fully fulfills his credit obligations towards the Bank, without the institution having to undertake activities such as collateral execution.

In order to assess if there has been an increase in credit risk, for Institutional Banking client, Bank periodically, as per internal classification process and ongoing monitoring process, analyses changes in risk of default by comparing the current assessment of default with the assessment of default in the initial recognition.

Assessment of change in risk of default for given credit exposure is conducted during internal classification process and monitoring process and include:

- Qualitative indicators (including Early Warning System),
- Quantitative information (including among others),
- Occurrence of economic or legal reasons related to the borrower’s financial difficulties and granting to the borrower a concession to financial conditions that the lender would not otherwise consider, (assuming that those changes does not imply deterioration in future payment flows).

In order to assess whether there was a significant increase in credit risk for the Retail Banking portfolio, the Bank periodically, as part of the analysis process changes the default risk for a given credit exposure, compares the current assessment of default risk for the credit exposure, with the risk of default assessment performed by at the time of initial recognition. In addition, quality-based premises are included on the current length of the credit product overdue period, the soft restructuring activities carried out and the fact that information about the probability of default is not available.

The expected loss, which is the basis for determining the level of the provision, is determined throughout the lifetime of the exposure. In the case of installment exposures, this is the period to the contractual maturity date. For revolving exposures, the contractual maturity is not specified, in replacement of the so-called behavioral maturity resulting from the empirical estimation of the life of the credit product.

Write-offs for expected credit losses are calculated on the basis of statistical models for groups of assets combined in portfolios with common credit risk features. In the financial statements, the Bank adjusts the value of credit exposures on the amount of impairment losses on expected credit losses.

In the area of institutional banking, the main sources of parameters included in the methodology of expected credit losses ('ECL') are the results of internal customer assessment processes and the results of loan models.

- The rate of impairment is derived from the client's rating determined based on internal rating models. The ECL methodology describes the process of applying existing migration ratings, expected in a given macroeconomic scenario, to migration schedules. In this way, in the following forecast periods, the probability of migration to a given rating range is obtained.
- The value of the LGD parameter results directly from the dedicated model for impaired clients.
- The exposure value for subsequent forecast periods is based on available repayment schedules as well as (for renewable products) on the expected change in exposure described by the value of the CCF parameter. The basis for estimating this parameter was internal data on amounts used by customers before the Bank identified impairment of value.
- The assignment to the stage is based on the customer assessment process used in the Bank to manage the client. This process includes both quantitative factors (e.g. customer rating) and a number of qualitative factors (e.g. Early Warning Signals).
- The maturity dates adopted by the Bank result directly from agreements with customers and periods in which the Bank is exposed to possible risks.

In the area of retail banking, the basis of parameters included in the ECL methodology are the existing internal models of the client's creditworthiness assessment in the Bank, information about the stage of debt collection proceedings and information from the Bank's data warehouse.

- The rate of impairment is the submission of a number of models of customer creditworthiness assessment, connected to each other by process called integration logic. The ECL methodology, based on macroecomic forecasts transforms the results of integration logic so that the result reflects the expected changes in the economy. The parameters thus obtained are then applied to the loss vectors during the life of the product, estimated on the basis of historically observed loss rates.

- Recovery value vectors are the result of the analysis of the amount of historically collected receivables for homogeneous populations. The populations were segmented against similar features such as product type, time from write-down, type of restructuring carried out or historically observed repayments.
- The value of the EAD parameter is based on installment products on the expected repayment schedules generated based on the length of the contract and the interest rate on the product. For renewable products, EAD is based on the internally estimated CCF vector, which reflects changes in the exposure volume expected in subsequent periods.

In retail area of the Bank is used, except from the 30 days criterion of arrears and foreborne categories, the quantitative criterion is applied - analysis of the change in PD level since the exposure was created. In accorance with the standard, the Bank doos not use the a fixed threshold above which an increase in risk would automatically be considered significant. It results from the fact that the same increse of PD in absolute terms would be more significant for exposures with lower initial risk than for those with the higher initial risk. So in Bank there is used the designed model which target is to setting a threshold above which an increase in risk will be considered to be significant. In order to determine the relative growth, the Bank uses a variable being the quotient of the probability of default on the current reporting date and the contingent probability calculated for the same period at the time of initial recognition. A threshold is defined as the cut-off point, where the probability of a default event occurring when the value of an explanatory variable increases is maximised.

At each balance sheet date, the Bank assesses whether there is objective evidence of impairment of a financial asset or a group of financial assets.

A financial asset or a group of financial assets lost their value was incurred only when there is objective evidence of impairment resulting from one or more events taking place after the initial recognition of the asset (event causing the loss) and the event (or events) causing a loss has an impact on the expected future cash flows resulting from a financial asset or a group of financial assets whose reliable estimation is possible.

In the institutional banking area, materialization of credit exposure value loss takes place if there is an objective evidence of impairment, which can be a result of, among others, events as below:

- Significant financial difficulties of the client, which are described in detail in ICG / CCB / Micro Credit Procedures;
- Reduction of the client credit rating by an accepted by the Bank External Credit Assessment Institution[1];
- Breach of contract conditions, e.g. delay in interest or principal payments;
- Occurrence of economic or legal reasons related to the borrower's financial difficulties and granting to the borrower a concession to financial conditions that the lender would not otherwise consider, granting permission for emergency restructuring of credit exposure, if it might result in decreasing financial requirements, reduction of financial liabilities by redeeming a significant part of the principal, interest or, where applicable, fees or deferring their repayment or payment (forborne exposure);
- high likelihood of bankruptcy of the client or obtaining information about the opening of bankruptcy proceedings, appearance by the debtor for declaration of bankruptcy or for similar protection or putting the debtor in bankruptcy or granting him similar protection if it would allow him to avoid or delay repayment of credit obligations;
- request of the Bank to initiate enforcement proceedings against the client;
- severe domestic or local economic conditions that may be related to the default of exposures;
- delay in payment equal to 90 days or more.

and other events that may have an impact on the estimated future cash flows from the financial asset that can be reliably estimated.

Objective evidence of impairment of a financial asset or a group of assets in the Retail Banking area includes the fulfillment of even one of the following conditions by any of the customer's exposures:

- occurrence of delays in repayment of principal and interest , the minimum amount to be paid, commission or exceeding the permitted limit. For the purpose of recognizing impairment, it is assumed that the delay in repayment is equal to or exceeds 90 days at the moment of calculating the write-down (regardless of the amount of exposure and the amount of overdue);
- granting modifications to the terms of the agreement (restructuring), as a result of which the current value of cash flows falls below the book value before the modification;
- termination of the contract for reasons other than a delay in the repayment of mortgage products;
- occurrence of qualitative circumstances:
    - death,
    - bankruptcy,
    - permanent disability or serious illness,
    - fraud,
    - obtaining information about initiating bankruptcy proceedings of the client or announcing bankruptcy by the client,
    - impairment or threat of collateral impairment,
    - the client's stay in custody or prison,

[1] Below risk level corresponding to internal 7- rating (i.e. to CCC- for Standard & Poors, Caa3 Moody's)

- partial capital write-off,
- agreement termination,
- the Bank's request to initiate enforcement proceedings against the client.

In the case of clients who do not meet the restructuring criteria, and in particular, for which the legal path has been implemented (bankruptcy, enforcement, court dispute) without the prospects of returning the repayment formula from the client's core operations, the debt collection process is carried out and the receivables are written off. The main goal of this process is to maximize the amount of outstanding exposures recovered by the Bank. In the debt collection process, the Bank will develop a cooperation formula with the client, in the course of which the Bank's activity is not limited only to legal actions, but also, if possible, ongoing cooperation. In the event that the repayment of the exposure is jeopardized due to the poor financial standing of the debtor or by the transfer of assets beyond the scope of recovery, the exposures can be sold in exceptional cases.

The Bank uses the macroeconomic scenarios including explanatory variables in models used to measure impairment. Scenarios are prepared by the Chief Economist of the Bank min. once a quarter in the three years horizon in division into quarters (based scenario with 60% weight and positive and negative variation from scenario with 20% weight).

In the area of institutional banking, the Bank divided the loan portfolio into industries in terms of their sensitivity to macroeconomic conditions, identified macroeconomic variables that best explained the historical changes in credit quality and analyzed the dependence on macroeconomic factors using statistical methods. Finally, the Bank has built a model for each of the established industry sensitivity classes allowing for the dependence of the coefficient determining the level of client migration between ratings from these factors.

Macroeconomic scenarios in the area of institutional icluding two variables:

- the reference rate NBP,
- annual amandment of index WIG20,

However retail banking uses three variables in modeling the expected credit losses:
- unemployment rate,
- unemployment rate „BAEL",
- annual amandment of index WIG.

In the area of institutional banking, the Bank divided the loan portfolio into industries in terms of their sensitivity to macroeconomic conditions, identified macroeconomic variables that best explained the historical changes in credit quality and analyzed the dependence on macroeconomic factors using statistical methods. Finally, the Bank Bank has built a model for each of the established industry sensitivity classes allowing for the dependence of the coefficient determining the level of client migration between ratings from these factors.

In the area of Retail Banking, at the level of homogeneous product portfolios, the Bank, using statistical methods, built equations making the level of annual loss rates dependent on macroeconomic factors. The models allow for dynamic shaping of the provision for impairment losses depending on the expected changes in the economy.

Scenarios and macroeconomic variables are updated on a quarterly basis.

As part of the assessment of the adequacy of the methodology used to determine impairment and provision, the Bank regularly, at least annually, carries out an analysis to verify to which extent the revaluation write-offs were reflected in actual losses. In addition, the models used for determining reserves are subject to evaluation by an independent Model Validation Office.

The Bank recognizes and manages counterparty credit risk in transactions in financial instruments based on internal limits for pre-settlement and settlement engagement. The exposures also include credit ratings.

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

PLN'000	Note	**31.12.2018**	**31.12.2017***
Gross receivables due from the Central Bank	17	6,850,129	30,552
Gross receivables due from banks	18	1,337,726	837,277
Gross receivables due from institutional customers**	22	14,982,940	13,260,327
Gross receivables due from individual customers**	22	7,534,795	7,092,085
Debt securities held-for-trading	19	931,172	1,143,908
Derivative instruments	19	1,282,677	1,018,132
Debt investment financial assets measured at fair value though other comprehensive income***	20	14,241,363	17,439,439
Other financial assets	27	126,357	98,110
Contingent liabilities granted	39	16,830,289	16,853,090
		64,117,448	**57,772,920**

** As at January 1, 2018, the Bank applied IFRS 9 "Financial Instruments" for the first time and did not use the option of converting data relating to earlier periods.*
*** As at December 31, 2018, the value of collateral diminishing the maximum exposure to credit risk for receivables from institutional clients amounted to PLN 2,708,768 thousand (31 December 2017: PLN 2 279 820 thousand).*
**** As at December 31, 2018, the value of collateral to reduce the maximum exposure to credit risk for receivables from individual clients amounted to PLN 1,676,541 thousand (31 December 2017: PLN 1 481 839 thousand).*
**** Corresponds to the item 'Debt securities available for sale' according to IAS 39.*

The gross amounts due does not include contractual interest accrued from the moment the exposure is classified in

Stage 3. The impact of including this interest on the gross carrying amount is presented in Note 22.

Modification of financial assets

The impact on value of financial assets, whose cash flows resulting from the contract were modified however were not discontinued recognition, as at 31 December 2018 amouted to PLN 36 thousand and net modification loss in 2018 amounted to PLN 4 thousand.

Gross value of financial assets, that since the start of recognition were modified at the moment, when the provision for losses were measured at amount corresponding to expected credit loss throughout the life period, and in case of provisions for losses was affected in 2018 at amount corresponding to 12 months expected credit losses as at December 31, 2018 amounted to PLN 63 thousand.

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

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

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

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

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

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

Commitment due to customers in terms of credit risk:

PLN '000	31.12.2018		
	Receivables from institutional customers	Receivables from individual customers	Receivables from banks
Impaired receivables (Stage 3)			
Gross amount	**345,865**	**378,450**	**-**
Impairment write-downs	(242,015)	(291,485)	-
Net amount	**103,850**	**86,965**	**-**
Not impaired receivables (Stage 2)			
By risk rating			
Risk rating 1-4-	56,158	-	2
Risk rating +5-6-	632,681	-	-
Risk rating +7 and greater	143,279	-	-
By delinquency			
No delinquency	-	657,366	-
1-30 days	-	105,640	-
31-90 days	-	46,976	-
Gross amount	**832,118**	**809,982**	**2**
Impairment write-downs	(16,387)	(58,389)	-
Net amount	**815,731**	**751,593**	**2**
Not impaired receivables (Stage 1)			
By risk rating			
Risk rating 1-4-	11,480,608	-	822,767
Risk rating +5-6-	2,324,349	-	514,957
By delinquency			
No delinquency	**-**	6,140,736	**-**
1-30 days	**-**	205,627	**-**
31-90 days	**-**	-	**-**
Gross amount	**13,804,957**	**6,346,363**	**1,337,724**
Impairment write-downs	(28,882)	(27,228)	(3,910)

PLN '000	31.12.2018		
	Receivables from institutional customers	Receivables from individual customers	Receivables from banks
Net amount	**13,776,075**	**6,319,135**	**1,333,814**
Total gross value	**14,982,940**	**7,534,795**	**1,337,726**
Impairment write-downs	(287,284)	(377,102)	(3,910)
Total net value	**14,695,656**	**7,157,693**	**1,333,816**

The gross amounts due does not include contractual interest accrued from the moment the exposure is classified in Stage 3. The impact of including this interest on the gross carrying amount is presented in Note 22.

The structure of the portfolio of exposures to banks and clients from the point of view of credit risk as at 31 December 2017:

PLN'000	31.12.2017		
	Amounts due from institutional customers	Amounts due from individual customers	Amounts due from banks
Impaired receivables			
Individual receivables			
Gross amount	**376,854**	**10,897**	**-**
Impairment write-off	(254,975)	(6,633)	-
Net amount	**121,879**	**4,264**	**-**
Portfolio receivables			
Gross amount	**23,258**	**309,418**	**-**
Impairment write-off	(17,632)	(227,001)	-
Net amount	**5,626**	**82,417**	**-**
Not impaired receivables			
by risk rating			
Risk rating 1-4-	9,634,012	-	805,754
Risk rating+ 5-6-	3,070,022	-	31,523
Risk rating+7and greater	156,181	-	-
by delinquency			
no delinquency	-	6,436,616	-
1–30 days	-	283,109	-
31–90 days	-	52,045	-
Gross amount	**12,860,215**	**6,771,770**	**837,277**
Impairment	(17,463)	(61,905)	(1,111)
Net amount	**12,842,752**	**6,709,865**	**836,166**
Total net amount	**12,970,257**	**6,796,546**	**836,166**

Structure of derivatives in terms of credit risk

PLN'000	31.12.2018			31.12.2017		
	Transactions with institutional customers	Transactions with retail customers	Transactions with banks	Transactions with institutional customers	Transactions with retail customers	Transactions with banks
Derivatives by risk rating						
Risk rating 1-4-	579,490	5,006	676,910	234,724	4,632	753,408
Risk rating+5-6-	7,178	-	14,088	25,090	-	2
Risk rating +7 and greater	5	-	-	276	-	-
Total	**586,673**	**5,006**	**690,998**	**260,090**	**4,632**	**753,410**

The classification of exposures in the portfolio of debt securities held for trading and portfolio of debt securities measured at fair value though other comprehensive income by ratings agency Fitch is presented below:

PLN '000	31.12.2018		31.12.2017	
	Debt securities held-for-trading*	Debt securities measured at fair value though the income statement*	Debt securities held-for-trading	Debt securities available-for-sale
Issuer rating by Fitch agency				
A (including: from A- to AAA)	931,172	14,241,363	1,143,908	17,439,439
Total	**931,172**	**14,241,363**	**1,143,908**	**17,439,439**

Structure of granted contingent liabilities in terms of credit risk as at 31 December 2018:

PLN '000	31.12.2018		
	Liabilities due to institutional customers	Liabilities due to individual customers	Liabilities due to banks
Contingent liabilities granted (Stage3)	**30,988**	**1,401**	**-**
by risk rating			
Risk rating +7and greater	30,988	**-**	-
Contingent liabilities granted (Stage 2)	**410,128**	**1,095,455**	**-**
by risk rating			
Risk rating 1-4-	17,754	-	-
Risk rating+5-6-	380,297	-	-
Risk rating +7and greater	12,077	-	-
Contingent liabilities granted (Stage 2)	**10,037,725**	**4,798,669**	**455,923**
by risk rating			
Risk rating 1-4-	8,457,729	-	449,124
Risk rating+5-6-	1,579,996	-	6,799
Total	**10,478,841**	**5,895,525**	**455,923**

Structure of granted contingent liabilities in terms of credit risk as at 31 December 2017:

PLN'000	31.12.2017*	
	Liabilities due to institutional customers	Liabilities due to banks
Granted contingent liabilities by risk rating		
Risk rating 1-4-	7,261,959	383,555
Risk rating+5-6-	2,696,078	6,326
Risk rating +7and greater	58,102	-
Total	**10,016,139**	**389,881**

* As at January 1, 2018, the Bank applied IFRS 9 "Financial Instruments" for the first time and did not use the option of converting data relating to earlier periods.

"Forbearance" practices

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

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

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

- receipt of assets;
- granting a new or restructured facility in partial or full satisfaction of a facility;

- modification of the terms of the existing facility, including rescheduling of future payments (e.g. extension of financing tenor), change of interest rate or methods of repayment, reduction of amount to be repaid (principal or accrued interest).

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

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

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

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

Exposures with modified conditions according to forbearance rules (forborne exposures) are subject to regulatory and internal reporting.
Exposure values in the "forborne" status as at December 31, 2018:

PLN ‘000	As of 31.12.2018
Receivables without recognized impairment,	21,793,420
Receivables without recognized impairment (Stage1), including	20,151,320
non-financial sector entities	18,098,556
Institutional customers	11,752,193
Individual customers	6,346,363
Receivables without recognized impairment (Stage2), including	1,642,100
non-financial sector entities	1,642,100
Institutional customers	832,118
Individual customers	809,982
Receivables with recognized impairment(Stage 3), including:	724,315
non-financial sector entities	724,315
Institutional customers, including:	345,865
„forborne”	78,281
Individual customers, including:	378,450
„forborne”	19,791
Total gross amount, including:	**22,517,735**
non-financial sector entities	20,464,971
Institutional customers, including:	12,930,176
„forborne”	78,281
Individual customers, including:	7,534,795
„forborne”	19,791
Impairment write-off	**(664,386)**
On „forborne” receivables	(59,555)
Total net amounts due from customers, including:	**21,853,349**
„forborne” receivables	38,517

The gross amounts due does not include contractual interest accrued from the moment the exposure is classified in Stage 3. The impact of including this interest on the gross carrying amount is presented in Note 22.

Exposure values in “forborne” status as at 31 December 2017:

PLN’000	As of 31.12.2017*
Receivables without recognized impairment, including	19,631,985
non-financial sector entities	17,717,273
Institutional customers	10,945,503
Individual customers	6,771,770
Receivables with recognized impairment, including:	720,427
non-financial sector entities	703,293
Institutional customers, including:	382,978
„forborne”	77,706

PLN'000	As of 31.12.2017*
Individual customers, including:	320,315
„forborne"	19,556
Total gross amount, including:	**20,352,412**
non-financial sector entities	18,420,567
Institutional customers, including:	11,328,482
„forborne"	77,706
Individual customers, including:	7,092,085
„forborne"	19,556
Impairment write-off	**(585,609)**
On „forborne" receivables	(58,855)
Total net amounts due from customers, including:	**19,766,803**
„forborne" receivables	38,407

* As at January 1, 2018, the Bank applied IFRS 9 "Financial Instruments" for the first time and did not use the option of converting data relating to earlier periods.

LIQUIDITY RISK

The processes and organization of liquidity risk management

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

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

Liquidity risk management is based on:

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

taking into account best market practice.

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

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

Liquidity management

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

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

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

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

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

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

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

In 2018 the Bank has not implemented any changes significant in liquidity risk management processes, procedures, systems and policies.

Funding and Liquidity Plan

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

Liquidity risk management tools

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

The supervisory liquidity measures

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

	31.12.2018	31.12.2017	Change
M1 - Short-term liquidity gap (PLN)	6,517,776	8,380,500	(1,862,724)
M2 - Short-term liquidity ratio	1.18	1.37	(0.19)
M3 - Coverage of illiquid assets with regulatory capital	6.08	9.78	(3.70)
M4 - Coverage of illiquid assets and assets of limited liquidity with regulatory capital and stable external funds	1.44	1.54	(0.10)
LCR	167%	145%	22 pp

Internal liquidity risk management tools

In addition to the regulatory liquidity measures, the Bank applies a range of liquidity risk management tools including:
- Gap analysis –MAR/S2;
- Stress scenarios;
- Liquidity ratios;
- Market Triggers;
- Significant Funding Sources;
- Contingency Funding Plan.

Stress scenarios

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

The Bank conducts the stress tests monthly. The scenarios assume material changes in the underlying funding parameters, i.e.:
- Concentration event;
- Highly Stressed Market Disruption ("S2");
- Local market event.

Contingency Funding Plan

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

The Contingency Funding Plan defines:
- Circumstances / symptoms of contingency events;
- Responsibilities for executing the action plan;
- Sources of liquidity, and in particular the principles of maintenance of a liquid assets portfolio to be used in the case of a liquidity contingency;

- Rules for assets disposal and balance sheet restructuring;
- Procedures for restoring customer confidence.

The levels of the cumulative liquidity gap in stress conditions and the level of liquid assets as at 31 December 2018 and 31 December 2017.

The cumulative liquidity gap as at 31 December 2018 in real terms:

PLN'000	Up to 1 month	More than 1 to 3 months	More than 3 months to 1 year	More than 1 year to 2 years	More than 2 years
Assets	20,949,048	424,245	928,496	-	26,940,235
Liabilities	8,842,965	4,852,306	20,039	-	35,526,714
Balance-sheet gap in the period	12,106,083	(4,428,061)	908,457	-	(8,586,479)
Conditional derivative transactions – inflows	22,005,562	9,318,228	10,587,090	7,196,028,	17,354,174
Conditional derivative transactions – outflows	21,989,621	9,329,696	10,812,183	7,219,376,	17,308,080
Off-balance-sheet gap in the period	15,941	(11,468)	(225,093)	(23,348)	46,094
Potential utilization of credit lines granted	693,740	861,272	591,626	-	(2,146,676)
Cumulative gap	11,428,284	6,127,483	6,219,221	6,195,873	(197,836)

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

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

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

PLN'000	31.12.2018	31.12.2017*	Change
Liquid assets, including:	22,229,407	18,805,370	3,424,037
nostro account, deposits in NBP and stable part of cash	7,056,872	222,023	6,834,849
debt securities held-for-trading	931,172	1,143,908	(212,736)
debt financial assets measured at fair value through other comprehensive income**	14,241,363	17,439,439	(3,198,076)
Cumulative liquidity gap up to 1 year	6,219,221	4,327,117	1,892,104
Coverage of the gap with liquid assets	Positive gap	Positive gap	

**As at January 1, 2018, the Bank applied IFRS 9 "Financial Instruments" for the first time and did not use the option of converting data relating to earlier periods.*
***Corresponds to the 'Debt securities available-for-sale' in accordance with IAS 39.*

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

As at 31 December 2018

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	28	1,402,124	1,384,456	2,668	15,000	-	-
Financial liabilities held-for-trading							
Short positions in financial assets	19	348,130	348,130	-	-	-	-
Amounts due to customers, including:	29	**38,395,886**	**36,861,909**	**1,075,856**	**436,919**	**21,202**	**-**

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
Deposits from financial sector entities	29	7,213,788	7,211,320	396	2,072	-	-
Deposits from non-financial sector entities	29	30,945,201	29,500,233	1,061,639	363,370	19,959	-
Other liabilities	29	236,897	150,356	13,821	71,477	1,243	-
Financial liabilities held-for-trading							
Derivative financial instruments (settled on a net basis)	19	1,404,897	31,043	36,410	55,593	864,397	417,454
Hedging derivatives							
Unused credit lines liabilities	39	14,103,607	11,214,127	7,008	578,036	2,132,056	172,380
Guarantee lines	39	2,589,013	2,589,013	-	-	-	-
		58,243,657	**52,428,678**	**1,121,942**	**1,085,548**	**3,017,655**	**589,834**
Derivatives settled on a gross basis							
Inflows		65,735,761	22,003,732	9,558,726	10,313,851	15,521,711	8,337,741
Outflows		65,529,703	21,987,856	9,546,774	10,300,415	15,373,789	8,320,869
		206,058	**15,876**	**11,952**	**13,436**	**147,922**	**16,872**

As at 31 December 2017

PLN'000	Note	Total	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	More than 5 years
Amounts due to banks	28	**1,568,261**	**1,512,791**	**6,624**	**42,594**	**6,252**	**-**
Financial liabilities held-for-trading							
Short positions in financial assets	19	-	-	-	-	-	-
Amounts due to customers*, including:	29	**32,172,442**	**30,852,688**	**924,643**	**363,892**	**31,219**	**-**
Deposits from financial sector entities	29	4,977,728	4,798,459	174,300	4,957	12	-
Deposits from non-financial sector entities	29	27,003,168	25,950,649	696,794	325,734	29,991	-
Other liabilities	29	191,546	103,580	53,549	33,201	1,216	-
Financial liabilities held-for-trading							
Derivative financial instruments (settled on a net basis)	19	749,655	11,601	32,601	62,037	406,488	236,928
Hedging derivatives		**50,191**	**-**	**-**	**-**	**49,392**	**799**
Unused credit lines liabilities	39	**14,373,083**	**11,461,259**	**2,174**	**176,805**	**2,231,647**	**501,198**
Guarantee lines	39	**2,312,023**	**2,312,023**	**-**	**-**	**-**	**-**
		51,225,655	**46,150,362**	**966,042**	**645,328**	**2,724,998**	**738,925**
Derivatives settled on a gross basis							
Inflows		42,812,185	12,660,817	4,245,328	6,358,651	12,219,978	7,327,411
Outflows		43,030,215	12,663,748	4,310,234	6,370,062	12,391,474	7,294,697
		(218,030)	**(2,931)**	**(64,906)**	**(11,411)**	**(171,496)**	**32,714**

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

MARKET RISK

The processes and organization of market risk management

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

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

Market risk management in the Bank is based on:

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

taking into account best market practice.

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

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

Market risk management

Scope of risk

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

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

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

Measurement of the pricing risk of the bank portfolios

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

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

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

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

It is assumed that:

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

- transactions insensitive to changes of interest rates, including cash, fixed assets, equity, other assets/liabilities, are classified into the longest revaluation band;
- transactions executed directly by the Financial Markets and Corporate Banking Sector for the purpose of management of interest rate risk and liquidity risk (Financial Markets and Corporate Banking Sector own portfolio) are always classified into appropriate revaluation bands in accordance with the contracted dates.

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

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

The table below presents the IRE measures for the Bank as at 31 December 2018 and 31 December 2017. The list has been broken down into the main currencies, i.e., PLN, USD and EUR, which jointly account for over 90% of the Bank's balance-sheet.

PLN'000	**31.12.2018**		**31.12.2017**	
	IRE 12M	**IRE 5L**	**IRE 12M**	**IRE 5L**
PLN	10,444	87,021	29,217	163,736
USD	16,798	31,102	18,002	32,083
EUR	(3,103)	1,973	(409)	(6,467)

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

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

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

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

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

Hedge accounting program

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

The hedged item was part of a portfolio of securities measured at fair value though other comprehensive income 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	31.12.2018			Total in the period 01.01.2018 – 31.12.2018		
	Total	Securities	IRS	Average	Maximum	Minimum
PLN	(2,538)	(2,538)	-	(2,471)	(1,461)	(3,032)
USD	-	-	-	(14)	-	(18)
EUR	(316)	(316)	-	(392)	(316)	(450)

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

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

Measurement of the market risk of the trading portfolios

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

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

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

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

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

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

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

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

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

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

The values of significant exposures to the interest rate risk of the trading portfolios in terms of DV01 in 2018 are presented in the table below:

PLN'000	31.12.2018	31.12.2017	In the period 01.01.2018 – 31.12.2018		
			Average	Maximum	Minimum
PLN	671	313	194	1,106	(710)
EUR	100	73	56	168	(61)
USD	54	9	53	384	(21)

Average exposures to the interest rate risk in the local currency in 2018 was higher comparing to the level from the previous year and amounted to PLN 433 thousand. Average exposure to the interest rate risk in EUR was lower than in 2017 (DV01 amounted to PLN 70 thousand, compared to PLN 57 thousand in the previous year). Average exposure in USD was higher than in 2017 (DV01 amounted to PLN 68 thousand, compared to PLN 46 thousand in 2017). The maximum exposure in PLN of the biggest exposures accepted by the Treasury Division was PLN 1,106 thousand compared to PLN 839 thousand in 2017 and the position in EUR amounted to PLN 168 thousand compared to PLN 127 thousand in the previous year.

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

The table below presents the levels of risk measured by VaR (net of economic hedges of the portfolio of securities measured at fair value through other comprehensive income) broken down by FX risk and interest rate risk position in 2018:

PLN'000	31.12.2018	31.12.2017	In the period 1.01.2018 – 31.12.2018		
			Average	Maximum	Minimum
FX risk	174	289	738	3,592	105
Interest rate risk	6,889	3,499	5,609	14,274	1,682
Spread risk	2,612	6,202	4,294	7,509	1,619
Overall risk	7,334	7,347	7,780	15,043	40,371

The overall average level of the market risk of the trading portfolios was 4% lower in 2018 than the average level in 2017, representing a decrease by over PLN 300 thousand, mainly as a result of higher exposures to credit spread changes. The maximum price risk level was PLN 15,043 thousand, compared to PLN 15,198 thousand in 2017.

Equity instruments risk

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

The Bank's FX exposure

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

31.12.2018

PLN'000	Balance-sheet transactions		Contingent derivatives transactions*		Net position
	Assets	Liabilities	Assets	Liabilities	
EUR	4,623,988	4,574,873	15,661,387	15,672,613	37,890
USD	1,530,170	3,765,163	22,219,596	19,954,563	30,040
GBP	12,269	445,558	894,004	461,895	(1,180)
CHF	607,154	215,197	2,352,073	2,748,500	(4,470)
Other currencies	88,204	234,376	2,046,088	1,892,725	7,191
	6,861,785	**9,235,167**	**43,173,148**	**40,730,296**	**69,471**

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

31.12.2017

PLN'000	Balance-sheet transactions		Contingent derivatives transactions*		Net position
	Assets	Liabilities	Assets	Liabilities	
EUR	3,739,727	4,465,703	15,467,548	14,648,480	93,092
USD	1,103,587	3,751,783	11,883,166	9,222,515	12,455
GBP	14,450	396,013	412,574	31195	(184)
CHF	339,293	223,461	1,685,061	1,791,647	9,246
Other currencies	38,542	211,370	1,872,809	1,680,813	19168
	5,235,599	**9,048,330**	**31,321,158**	**27,374,650**	**133,777**

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

OPERATIONAL RISK

Strategic goals and assumptions of the operational risk management system

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

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

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

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

Operational risk management system in the Bank is built in a way that ensures proper risk management at every stage, i.e.: identification, assessment/measurement, mitigation, control, monitoring and reporting.

The implementation of the strategy by the Management Board shall be assessed by the Supervisory Board, assisted by Audit Committee and Risk and Capital Management Committee based on synthetic reports submitted by the Management Board with frequency correlated with the committees' meetings, determining the scale and types of operational risk that the Bank is exposed to, methods of operational risk management, probability of risk's occurrence, assessment of potential negative impact of operational risk management methods, as well as results of operational risk profile and operational risk appetite monitoring. If necessary, after evaluation the Supervisory Board may request revision of the entire or partial internal control system.

Operational risk definition

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

It includes reputation and franchise risks associated with operational risk events and business practices or market conduct. It also includes legal risk and compliance risk.
Operational Risk does not cover strategic risks or the risk of loss resulting solely from authorized judgments made with respect to taking credit, market, liquidity or insurance risk.

Definition of Operational Risk covers: Compliance risk, Technological risk, Outsourcing risk, Misappropriation risk, Money Laundering risk, Information Security risk, External or internal events risk (Continuity of Business), Tax and Accounting risk, Product risk, Legal risk, Models risk, Staffing risk, Concentration risk, Conduct risk.

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

Rules of operational risk identification

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

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

Operational Risk Profile

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

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

Measurement and assessment

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

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

Risk tolerance framework, risk control and mitigation

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

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

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

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

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

Monitoring and reporting

The Risk and Capital Management Committee and Operational Risk, Control and Compliance Committees, are 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 upon committees' meeting, prepared based on data resulting from operational risk monitoring, covering scale and types of operational risk the Bank is exposed at, probability of its occurrence, dimension of its possible negative impact, operational risk management principles and the operational risk profile, 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 – Member of the Management Board responsible for Risk Management Sector – supervises Independent Control and Operational Risk Department.

The Management Board is supported by Operational Risk, Control and Compliance Committees and the Risk and Capital Management Committee.

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

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

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

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

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

EQUITY MANAGEMENT

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

The Bank's equity amounted to PLN 7,007,052 thousand as at 31 December 2018 (as at 31 December 2017: PLN 6,874,618 thousand). Regulatory capital, which included increases and decreases required by the Polish Financial Supervision Authority (KNF), amounted to PLN 4,907,581 thousand (as at 31 December 2017: PLN 4,916,526 thousand) Such a capital level is considered sufficient for conducting business activity. The capital level is regularly monitored by using the capital adequacy ratio.

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

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

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

Capital adequacy ratio*

PLN'000	31.12.2018	31.12.2017
Common Equity Tier 1 Capital	**4,907,581**	**4,916,526**
Total capital requirements, including:	**2,373,377**	**2,237,431**
credit risk capital requirements	1,910,386	1,759,541
counterparty risk capital requirements	50,713	57,098
Credit valuation correction capital requrements	28,466	49,033
excess concentration and large exposures risks capital requirements	14,469	5,353
total market risk capital requirements	94,799	81,813
operational risk capital requirements	274,544	284,593
Common Equity Tier 1 Capital ratio	**16,5%**	**17,6%**

**Total capital 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 2018, as well as in 2017, the Bank complied with all the regulatory prudential standards on capital adequacy.

48. Subsequent events

As from 1 February 2019 by the decision of the Supervisory Board of Bank from 7 December, 2018, James Foley was appointed to perform the function of a member of the Management Board of Bank for a three-year term of office. James Foley within the division of his competences will be responsible for the transactional banking area.

After 31 December 2018 there were no other major events undisclosed in these financial statements, that could have a significant influence on the net result of the Bank.

Signatures of Management Board Members

21.03.2019	Sławomir S. Sikora	President of the Management Board
....	....	....
Date	Name	Position/function
21.03.2019	Natalia Bożek	Vice-President of the Management Board
....	....	....
Date	Name	Position/function
21.03.2019	Maciej Kropidłowski	Vice-President of the Management Board
....	....	....
Date	Name	Position/function
21.03.2019	David Mouillé	Vice-President of the Management Board
....	....	....
Date	Name	Position/function
21.03.2019	Barbara Sobala	Vice-President of the Management Board
....	....	....
Date	Name	Position/function
21.03.2019	James Foley	Member of the Management Board
....	....	....
Date	Name	Position/function
21.03.2019	Katarzyna Majewska	Member of the Management Board
....	....	....
Date	Name	Position/function