

The Report has been approved by the Bank Handlowy w Warszawie S.A. Supervisory Board's Resolution dated 18<sup>th</sup> May 2009.

# **Information on capital adequacy of Bank Handlowy w Warszawie SA as at 31 December 2008**

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## INTRODUCTION

This document has been laid down to execute The Disclosure Policy of Bank Handlowy w Warszawie S.A. on capital adequacy<sup>1</sup>, to meet the disclosure requirements of Resolution no. 6/2007 of the Commission for Banking Supervision of 13 March 2007 *on detailed principles related to and the manner of publishing disclosures by banks with regard to qualitative and quantitative information regarding capital adequacy and the scope of information subject to disclosure*, as well as of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 *relating to the taking up and pursuit of the business of credit institutions*.

The objective of the document is presenting to the third parties, especially customers of the Bank and financial market participants, the Bank's risk management strategy and processes, information on the capital structure, exposure to risk and capital adequacy, which enable thorough assessment of the Bank's financial stability, in order to make economic decisions as well as keeping market discipline. This document complements information included in Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ended 31 December 2008 and refers to it wherever it is relevant.

Pursuant to the Resolution no. 6/2007 of the Commission for Banking Supervision of 13 March 2007 *on detailed principles related to and the manner of publishing disclosures by banks with regard to qualitative and quantitative information regarding capital adequacy and the scope of information subject to disclosure*, Bank publishes disclosures on capital adequacy on the basis of consolidated data as of 31 December 2008.

When the disclosures required by the Resolution no. 6/2007 of the Commission for Banking Supervision are published in The Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. as at 31 December 2008, this document refers to the number of explanatory note, which discloses required information.

The terms used in the document shall mean the following:

**Resolution on capital adequacy** - Resolution No. 1/2007 of the Commission for Banking Supervision of March 13, 2007 *on the scope of the capital requirements against particular risks and the detailed principles to be applied in determining those requirements, including but not limited to the scope and conditions of applying statistical methods and the scope of information attached to an application for authorization to apply them, principles and conditions of taking account of contracts on debt assignment, subparticipation, credit derivative and contracts other than those on debt assignment, subparticipation, in calculating the capital requirements, terms and conditions, scope and manner of making use of the ratings assigned by external credit assessment institutions and the export credit agencies, manner and specific principles of calculating the solvency ratio of a bank, the scope and manner of taking account of banks conducting their activities in groups in calculating their*

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<sup>1</sup> The Disclosure Policy of Bank Handlowy w Warszawie S.A. on capital adequacy laid down by the Management Board and approved by the Supervisory Board are available at the Bank's website [www.citihandlowy.pl](http://www.citihandlowy.pl) in the "Investor Relations" section.

*capital requirements as well as establishing additional items of bank balance sheets included in bank regulatory own funds in the capital adequacy account, the amount thereof and the conditions to be used in calculating them,*

**Resolution on banks' own funds** - Resolution No. 2/2007 of the Commission for Banking Supervision of 13 March 2007 *on other deductions from a bank's core capital, amount thereof, scope and conditions of such deductions from the core capital of a bank, other balance sheet items included in the supplementary capital, the amount and scope thereof, and the conditions of including them in a bank's supplementary capital, deductions from a bank's supplementary capital, the amount and scope thereof and conditions of performing such deductions from the banks' supplementary capital, the scope and manner of taking account of the business of banks conducting their activities in groups in calculating their own funds.*

## **RISK MANAGEMENT OBJECTIVES AND POLICIES**

The risk management process in the Capital Group of Bank Handlowy in Warsaw S.A. (hereinafter referred to as: Group) balances strong corporate oversight with well-defined independent risk management functions within each business. This process is consistent within the Group, including Bank Handlowy in Warsaw S.A. and its Subsidiaries (Dom Maklerski Banku Handlowego S.A., Handlowy Leasing S.A.), and exclude special purpose vehicles (i.e. investment vehicles), companies in the process of liquidation or bankruptcy, as well as units not conducting current, statutory activity.

Strategies and processes of credit risk management (including the counterparty risk and concentration risk), liquidation risk, market and operational risk, as well as the structure and organization of units managing the appropriate risks and solutions used by the Group on measurement and reporting of those risks is presented in detail in the note 44 „Risk management” to the Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ended 31 December 2008.

Bank oversees and manages the risk of non compliance, which is defined as any effects of non-compliance with laws, including international regulations or laws of another jurisdiction which are relevant to the Bank’s operation, internal regulations and the Bank’s conduct standards.

The Bank’s compliance and compliance risk monitoring policy is set out in the *Compliance and Compliance Risk Management Policy of Bank Handlowy w Warszawie S.A.* as approved by the Bank’s Management and Supervisory Boards.

Compliance with laws, internal regulations, corporate regulations, ethical standards and good practice standards is an integral element of professional duties of each employee of the Bank.

It is the responsibility of the Bank's Management Board to effectively manage compliance risk, develop a compliance policy and ensure that it is followed, and take corrective or disciplinary action in the event of any irregularities in applying the Bank’s compliance policy.

Compliance is the Bank’s unit, which supports the Bank’s Management Board and business units, and monitors the Bank’s subsidiaries, to ensure compliance of the Bank’s operation with laws, internal standards, regulations and Citigroup policies.

The compliance function which is performed by Compliance is an independent function comprising compliance risk identification, assessment, monitoring, testing, reporting and consulting, and ensuring compliance with laws, internal regulations of the Bank, and its conduct and good practice standards.

Compliance, as the compliance process coordination and monitoring unit of the Bank, reviews and assesses the Bank's compliance risk management process on an annual basis as part of the Annual Compliance Plan, and submits relevant information to the Bank’s Management and Supervisory Boards.

## **DETAILED INFORMATION ON CAPITAL ADEQUACY**

### **1. Information related to the use of prudential norms**

#### **1) name of the bank**

BANK HANDLOWY W WARSZAWIE S.A. („Bank”)

#### **2) brief description of entities that are:**

##### ***a) fully consolidated***

The following entities are fully consolidated:

- Dom Maklerski Banku Handlowego S.A.,
- Handlowy Leasing Sp. z o.o.,
- Handlowy Investments S.A.,
- PPH Spomasz Sp. z o.o. under liquidation.

The Capital Group of Bank Handlowy w Warszawie S.A. provides leasing services through Handlowy-Leasing Sp. z o.o., the Bank’s wholly-owned subsidiary. The subsidiary was formed through merger of Handlowy Leasing S.A. with Citileasing Sp. z o.o. in 2006.

The Group offers brokerage services on the capital market through Dom Maklerski Banku Handlowego S.A. (DMBH), a wholly-owned subsidiary of the Bank.

Handlowy - Investments S.A. seated in Luxembourg, belongs to special purpose investment entities, through which the Bank and the Capital Group conduct capital transactions. The entities activities are financed with refundable additional capital contributions, subordinated debt, loans and net profits earned. Due to intention to reduce the investment activities, Handlowy - Investments S.A. and similar holdings will be gradually sold or liquidated. As at 31 December 2008 Handlowy Investments S.A. had the portfolio composed of the following shares: Handlowy Investment II S.a.r.l. i Pol-Mot Holding S.A.

PPH Spomasz Sp. z o.o. under liquidation, seated in Warsaw, fully owned by the Bank is one of the holdings deemed for sale<sup>2</sup>. Its liquidation is highly advanced.

##### ***b) ) proportionally consolidated***

There are no proportionally consolidated entities.

##### ***c) deducted from own funds***

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<sup>2</sup> According to information in point 10 of this chapter, equity investments of the Capital Group of Bank Handlowy w Warszawie S.A. are classified into strategic and divestments portfolios.

The following entities are deducted from consolidated own funds:

- Handlowy Inwestycje Sp. z o.o.
- Handlowy Investments II S.a.r.l
- Bank Rozwoju Cukrownictwa S.A.

Handlowy Inwestycje Sp. z o. o. seated in Warsaw and Handlowy Investments II S.a.r.l seated in Luxembourg are special purpose investment entities, through which the Bank conducts capital transactions. Handlowy-Inwestycje Sp. z o.o. has in its portfolio shares of Handlowy Leasing Sp. z o.o. Activities of the entities are financed by refundable capital contributions, subordinate loans, loans as well as retained earnings. Handlowy Inwestycje Sp. z o.o. belongs to the portfolio of strategic entities.

Handlowy Investments II S.a.r.l seated in Luxembourg is in the portfolio of companies earmarked for sale. Currently Handlowy Investments II S.a.r.l. has in its portfolio shares of Handlowy Investments S.A. Due to intention to reduce the investment activities, Handlowy - Investments II S.a.r.l it is expected that it will be sold or liquidated in the near future.

Bank Rozwoju Cukrownictwa S.A. seated in Poznan („BRC”) - a subsidiary of Bank Handlowy w Warszawie S.A. (100% share), has a banking license but does not run active operations. On March 2, 2009 Extraordinary General Meeting of Shareholders of Bank Rozwoju Cukrownictwa S.A. adopted a resolution regarding dissolution of the company and voluntary liquidation. The beginning of the liquidation process BRC is dependent on adaptation of voluntary liquidation plan by the Commission for Banking Supervision.

***d) neither consolidated nor deducted***

There are no entities that are neither consolidated nor deducted.

**3) information regarding any current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries**

All the transactions within Group, including repayments of intercompany liabilities and transfers of funds, are concluded according to law, including Code of Commercial Law and statutory stipulations. Within the Group, according to the best knowledge, there are no and it is expected that there will be no significant obstacles of legal or practical nature to fast fund transferring or repayment of liabilities between the parent and the subsidiaries.

**4) any aggregate amount by which the actual own funds are less than the required minimum in all subsidiaries not included in the consolidation, and the names of such subsidiaries**

In Bank Rozwoju Cukrownictwa, subsidiary of Bank Handlowy w Warszawie S.A. not included in the consolidation, the actual funds are above the required minimum.

## 2. Information regarding own funds

### 1) summary information on the key terms and conditions of the features of all own funds items and components thereof

According to art. 127 of the Banking Act, the bank's own funds comprise:

- core funds,
- supplementary funds in the amount not surpassing core funds.

*Core funds* of the Bank comprise:

- a) base funds, which in Bank Handlowy w Warszawie S.A. comprises paid in and registered share capital, supplementary capital and reserve capital,
- b) additional items of core funds, composed of:
  - general risk fund for identified risk of banking activity
  - retained earnings and
- c) items reducing core funds, which are:
  - intangible assets measured at carrying amount and
  - other deductions of core funds determined by KNF

*Supplementary funds* of the Bank comprise:

- a) other items determined by KNF in order to secure banking activity and manage risk properly – unrealized profits on debt instruments classified as available for sale up to 60% of their value (before income tax),
- b) deductions of supplementary funds determined by KNF.

Deductions of core and supplementary funds, determined by KNF in the above mentioned Act comprise:

- for core funds – unrealized loss on debt instruments classified as available for sale,
- for core and supplementary funds – capital exposure of the Bank in financial institutions, lending institutions, domestic banks, foreign banks disclosed in the form of shares or other capital exposure in items classified as own funds or capital of those entities, including capital contributions in limited liability companies, in carrying amount (balance sheet amount), in case when such an exposure exceeds 10% of own funds of that entity.

### 2) the amount of own funds and the value of their individual components and deductions from core capital and supplementary capital set out in art. 127 of the Banking Act and the resolution on banks' own funds

<b>Own funds</b>	<b>in PLN '000</b>
Core funds	3 675 517
- base funds	4 791 443
share capital	522 638
supplementary capital	3 029 703

reserve capital together with retained earnings	1 239 102
- general risk fund	390 000
- deductions of core funds	(1 505 926)
intangible assets	(1 283 326)
unrealized loss on debt instruments classified as available for sale	(160 593)
retained loss, current period net loss	(17 965)
capital exposures in financial institutions	(44 042)
Supplementary funds	-
- other items	12 426
unrealized profits on debt instruments classified as available for sale	11 716
unrealized profits on equity instruments classified as available for sale	710
- deductions of supplementary funds	(12 426)
capital exposures in financial institutions	(12 426)
<b>Total core funds</b>	<b>3 675 517</b>

Information about the components of equity are presented in details in supplementary note 33 „Equity and Reserves” to the Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ending 31 December 2008.

**3) the amount of short-term capital and components included in short-term capital in accordance with § 5 para 1 of the resolution on bank’s capital adequacy**

The Group does not use short-term capital.

**4) items listed in § 2 art. 1 point 3 and 4 of the resolution on capital adequacy**

The Group neither uses the internal ratings approach nor has any securitization exposures.

**5) for banks referred to in § 5 para 4 of the resolution on banks’ capital adequacy – the sum of own funds and short-term capital**

The Group does not use short-term capital.

**3. Information regarding the compliance with capital requirements referred to in art. 128 of Banking Act**

**1) the description of the bank’s approach to assessing the adequacy of its internal capital to support current and future activities**

Bank identifies and manages different types of risks in its activity. For purposes of internal capital adequacy assessment Bank identified the following significant risks:

- risk of default or delinquency (covers credit risk and counterparty credit risk),
- operational risk (covers legal risk, loss of reputation and system risk),

- market risk in the trading book,
- interest rate risk in the banking book.

Capital requirements covering those risks were estimated based on the financial plan, adopting conservative assumptions and considering stress tests.

Capital requirement regarding credit risk was assessed using the standardised approach. The total capital requirement regarding credit risk, in this method, is calculated as the total of risk weighted exposures multiplied by 8%. In case of assets, the value of exposure is equal to its carrying amount, and in case of off-balance sheet liabilities granted it is equal to its balance sheet equivalent. For the calculation of amounts of risk weighted exposures, the risk weights are attributed according to resolutions of the Commission for Banking Supervision

Capital requirement regarding counterparty credit risk is calculated as 8% of the total of risk weighted exposures in the trading portfolio. For the purpose of calculation of risk weighted exposures, the risk is applied to all expositions according to resolutions of the Commission for Banking Supervision.

Capital requirement regarding operational risk was assessed according to the standardised approach based on average income attributed to Regulatory Business Lines.

<b>Business line</b>	<b>Calculation factor</b>
Investment banking	18%
Dealer activity	18%
Retail brokerage activity	12%
Commercial banking	15%
Retail banking	12%
Payments and settlements	18%
Intermediary services (agencies)	15%
Asset management	12%

Capital requirement regarding market risk was estimated based on maximum risk level calculated on the basis of VaR (Value at Risk), which is the main aggregated measure of risk of trading portfolios. VaR is a measure determining a potential decline in value (loss) of financial instruments portfolio within specified period at specified confidence (probability) level. Both these factors determine the scale of changes in market prices (or other market parameters) used to assess the change in the value of portfolio. For the calculation of VaR the Bank adopts 1 day long period of position holding and 99% confidence level. Because VaR calculated this way determines risk in normal operating conditions, in order to reflect risk in stress operating conditions it was transformed based on statistical assumptions. In case of internal capital the confidence level was increased to 99.97% and the position holding period was prolonged from 1 day to 1 year.

Capital requirement for interest rate risk in the banking book was estimated based on the potential decline of the value of available for sale securities portfolio in stress conditions. For

the purpose of calculation of the potential decline of the value of available for sale securities portfolio in stress conditions, the sensitivity indices DV01 of this portfolio are used and anticipated growth of interest rates by 200 base points for all currencies for which DV01 limits were set, that is PLN, USD and EUR.

**2) for a bank applying the standardised approach to calculate risk-weighted exposures in accordance with annex 4 to the resolution on banks' capital adequacy - amounts representing 8% of the risk-weighted exposure amounts, separately for each exposure class specified in § 20 para 1 of annex 4 to the resolution on bank's capital adequacy**

<b>Exposure classes</b>	<b>Capital requirements (in PLN '000)</b>
Governments and central banks	7 945
Regional governments and local authorities	1 833
Administrative bodies and non-commercial undertakings	1 289
Multilateral development banks	-
International organizations	-
Institutions- banks	197 987
Corporations	1 074 379
Retail	443 321
Secured on real estate property	9 816
Past due items	38 185
Items belonging to regulatory high-risk categories	4 128
Covered bonds	-
Short-term claims on banks and corporations	-
Collective investment undertakings	-
Other	82 771
<b>Total</b>	<b>1 861 654</b>

**3) for a bank applying internal ratings-based approach to calculate risk-weighted exposures in accordance with annex 5 to the resolution on bank's capital adequacy - 8% of the risk-weighted exposure, separately for each exposure class specified in § 6 para 1 of annex 5 to the resolution on bank's capital adequacy**

The Group does not use the internal ratings approach.

**4) the amount of minimum capital requirements referred to in § 6 para 1 subpara 2 - 5 of the resolution on banks' capital adequacy, disclosed jointly or separately for each risk type**

<b>Capital requirement regarding</b>	<b>Requirement value (in PLN '000)</b>
credit risk	1 589 432
counterparty credit risk	272 222
settlement risk - delivery	11 534
equity securities prices risk	110
debt instruments prices specific risk	2 342
currency risk	7 930
operational risk	347 112
general risk of interest rates	121 931
exceeding exposure concentration limit and large exposures limit	82 135
exceeding capital concentration level	-
other types of risks	-
<b>Capital requirements - total</b>	<b>2 435 448</b>

**5) the amount of minimum capital requirements for operational risk set out in annex 14 to the resolution on bank's capital adequacy – disclosed separately for each of the applied approaches**

On 31st December 2008 the capital requirement regarding operational risk using the standardised approach amounts to 347 112 479 PLN.

**4. Information regarding exposure to credit risk and dilution risk**

**1) the definitions of 'past due' and 'impaired' - for accounting purposes**

Receivables impaired comprise exposures for which objective evidence of impairment was identified and for which present value of expected future cash flows is less than the receivable carrying value. Objective evidence of impairment is described in the Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. as at 31 December 2008, in explanatory note no. 2 "Significant accounting policies".

Allowances for impairment of receivables are made depending on the approach to credit risk management:

- for individually significant receivables - the amount is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows resulting from anticipated repayments by the debtor, collateral or sale of receivable. Future cash flows are discounted to present value at the asset's effective interest rate,
- for individually insignificant receivables – impairment allowance is calculated on the basis of portfolio assessment considering experience with historical losses incurred on assets with similar risk profiles.

For the accounting purposes the Group assumes that past due receivables comprise all the exposures for which there was a delay in principal or interest repayment compared to those agreed in the contract.

## 2) a description of the approaches and methods adopted for determining value adjustments and provisions

The description of the approach and methods used for calculation of adjustments and provisions is provided in the Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. as at 31 December 2008, in explanatory note no. 2 "Significant accounting policies".

## 3) the total amount of exposures according to balance-sheet valuation (after accounting offsets) and without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes

Exposure classes	Net exposures after adjustments and provisions in PLN* ('000)	Average exposure after adjustments and provisions ** in PLN ('000)
Governments and central banks	14 425 107	10 059 317
Regional governments and local authorities	278 317	274 426
Administrative bodies and non-commercial undertakings	42 205	27 317
Multilateral development banks	33	146
International organizations	0	0
Institutions- banks	5 351 426	10 123 218
Corporations	19 240 250	18 508 203
Retail	9 552 733	9 107 961
Secured on real estate property	196 701	175 847
Past due items	395 473	295 643
Items belonging to regulatory high-risk categories	37 913	27 296
Covered bonds	0	0
Short-term claims on banks and corporations	0	0
Collective investment undertakings	0	0
Other	9 551 889	7 151 875
<b>Total</b>	<b>59 072 048</b>	<b>55 751 249</b>

\* Out of which PLN 13 434 862 due to off-balance sheet commitments.

\*\* *Arithmetical average calculated on quarterly balances in 2008.*

**4) the geographic distribution of the exposures, broken down into significant areas by material exposure classes, and further detailed if appropriate**

The Group conducts its operations solely in the territory of Poland and no significant differences in risk were identified as regards the geographical location of its outlets. Therefore exposures have not been presented by geographical area.

**5) the distribution of the exposures by industry or counterparty type, broken down by exposure classes, and further detailed if appropriate**

The structure of balance sheet exposures and off balance sheet liabilities granted broken down by counterparty type and exposure class is presented below.

<b>Counterparty type</b>	<b>Exposure class</b>	<b>Net value in PLN ('000)</b>
<b>Banks</b>	Institutions-banks	5 351 426
	Multilateral development banks	33
<b>Retail clients</b>	Retail	9 427 998
	Secured on real estate property	196 701
	Past due items	81 351
<b>Other assets</b>	Other	9 551 889
<b>Corporations</b>	Corporations	19 240 250
	Past due items	314 121
	Retail	124 735
	Items belonging to regulatory high-risk categories	37 913
<b>Budget sector</b>	Governments and central banks	14 425 107
	Regional governments and local authorities	278 317
	Administrative bodies and non-commercial undertakings	42 205
<b>Total</b>		<b>59 072 048</b>

**6) the residual maturity breakdown of all the exposures, broken down by exposure classes, and further detailed if appropriate**

The table below presents balance sheet credit receivables gross without interest and fees

<b>Maturity</b>	<b>Exposure class</b>	<b>Value of credit exposures in PLN ('000)</b>
up to 1 month	Administrative bodies and non-commercial undertakings	4 590
	Governments and central banks	3 021 054
	Corporations	4 954 995
	Institutions- banks	107 536
	Multilateral development banks	1
	Past due items	196 695
	Retail	1 646 696
	Secured on real estate property	207
Total for up to 1 month		9 931 774
1-3 months	Administrative bodies and non-commercial undertakings	200
	Corporations	324 987
	Institutions- banks	47 497
	Past due items	11 161
	Retail	7 404
Total for 1-3 months		391 249
3-6 months	Administrative bodies and non-commercial undertakings	1 260
	Corporations	160 325
	Institutions- banks	13 054
	Past due items	30 154
	Retail	28 935
Total for 3-6 months		233 728
6-12 months	Administrative bodies and non-commercial undertakings	125
	Corporations	873 441
	Institutions- banks	370 225
	Past due items	80 532
	Retail	143 338
Total for 6-12 months		1 467 661

<b>Maturity</b>	<b>Exposure class</b>	<b>Value of credit exposures in PLN ('000)</b>
above 12 months	Administrative bodies and non-commercial undertakings	2 690
	Governments and central banks	2 400
	Corporations	2 905 541
	Institutions- banks	653 684
	Past due items	794 275
	Retail	3 445 507
	Secured on real estate property	196 206
	Regional governments and local authorities	70 752
Total for above 12 months		8 071 055
<b>Total</b>		<b>20 095 467</b>

7) by significant industry or counterparty type, the amount of:

a) *impaired exposures and past due exposures, provided separately,*

b) *balance of value adjustments and provisions at the beginning and at the end of the period.*

**Gross value of impaired exposures by counterparty type as at 31 December 2008**

<b>Counterparty type</b>	<b>Gross value of exposures in PLN ('000)</b>
Corporations	1 765 574
Retail clients	344 294
<b>Total</b>	<b>2 109 869</b>

*Balance sheet exposures with interest*

**Gross value of past due exposures by counterparty type as at 31 December**

<b>Counterparty type</b>	<b>Gross value of exposures in PLN ('000)</b>
Corporations	1 686 332
Retail clients	338 434
<b>Total</b>	<b>2 024 766</b>

*Balance sheet exposures with interest – total exposure, where at least one installment is overdue over 90 days.*

#### **Provisions as at 31 December 2008 and 31 December 2007**

<b>Counterparty type</b>	<b>Provisions in PLN ('000)</b>	
	<b>2008-12-31</b>	<b>2007-12-31</b>
Corporations	1 186 683	1 169 150
Retail clients	314 934	273 056
Banks	1 469	34
Budget sector	55	24
<b>Total</b>	<b>1 503 141</b>	<b>1 442 264</b>

*The above table presents provisions for balance sheet receivables, without interest.*

#### **8) the amount of the impaired exposures and past due exposures, provided separately, broken down by significant geographic areas including, if practical, the amounts of value adjustments and provisions related to each geographic area**

The Group conducts its operations solely in the territory of Poland and no significant differences in risk were identified as regards the geographical location of its outlets. Therefore results of the Group have not been presented by geographical area.

#### **9) the reconciliation of changes in the value adjustments and provisions for impaired exposures**

The reconciliation of adjustments and provisions regarding exposures impaired is provided in the Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. as at 31 December 2008, in explanatory note no. 23 “Impairment of loans and advances”.

### **5. Information regarding exposure to counterparty credit risk**

Counterparty risk is incurred from a wide range of trading and capital market transactions. It has been defined by the Group as pre-settlement risk and settlement risk.

**Pre-settlement** exposure is an estimate of how much counterparty might owe in a trading transaction over a life of a transaction. Pre-settlement risk is determined using nominal transaction value, credit exposure factor and Market to Market.

**Settlement risk** arises when the Bank exchanges securities or cash payments to a counterparty on a value date and is unable to verify that payment or securities have been received in exchange.

### **1) a description of the methodology used to assign internal capital and credit limits for counterparty credit exposures**

The pre-settlement risk is managed by setting pre-settlement limits and is an integral part of credit approval process. Pre-settlement limits for counterparty specify, among others, tenors and product families (e.g. FX, forwards, options, interest rate derivatives) and depend on the customer creditworthiness, his financial standing and customer needs.

The settlement risk is managed in BHW by setting settlement limits and is an integral part of credit approval process.

Information regarding methodology used to attribute internal capital are covered in point 3 section 1 of this chapter, “the description of the bank’s approach to assessing the adequacy of its internal capital to support current and future activities”.

### **2) a description of policies for securing collateral and establishing credit reserves as well as a description of policies with respect to specific wrong-way risk exposures**

As a general rule the Bank does not require collateral in transactions involving pre-settlement risk. In some cases BHW mitigates the risk through margining arrangements requiring counterparties to post cash deposits. Adopting ISDA Master Agreements mitigates the risks further.

Further mitigation of settlement risk may be achieved through not paying the counterparty until BHW confirms receipt of the payment, i.e. DVP (delivery versus payment).

### **3) gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held and net derivatives credit exposure. Net derivatives credit exposure is the credit exposure on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements**

	<b>in PLN (‘000)</b>
Gross positive fair value	6 608 273
Netting benefits (change in value of balance sheet equivalent)	3 318 971
Net value of credit exposure (value of balance sheet equivalent)	4 963 218
Current credit exposure	5 109 185

### **4) measures for exposure value under the adopted methods whichever method is applicable**

Bank measures exposures of derivative transactions using methods of market valuation in compliance with Annex no. 16 to Resolution no. 1/2007 on capital adequacy for banks.

### **5) the notional value of credit derivative hedges, and the distribution of current credit exposure by types of credit exposure**

Bank does not use credit derivative hedges.

**6) credit derivative transactions (notional), segregated between use for the bank's own credit portfolio, including unfunded credit protection, as well as in its intermediation activities and speculative transactions, broken down further by protection bought and sold within each product group**

Bank does not use credit derivative hedges.

**7) the estimate of  $\alpha$ , if the bank has received the approval of the supervisory authorities to estimate  $\alpha$**

The Bank does not estimate  $\alpha$ .

**6. Information regarding application of standardised approach to calculate risk-weighted exposure amounts (for each of the exposure classes)**

**1) the names of External Credit Assessment Institutions (ECAIs) and Export Credit Agencies (ECAs) whose credit assessments are used by the bank and the reasons for any changes in this respect**

The KNF Resolution no 1/2007 and Bank's Credit Policies describe in details which external ratings issued by which external agencies can be used in normal credit process in Bank. Currently there are Moody's and Standard & Poors as well as Fitch. Ratings from this three mentioned agencies are used in calculation and reporting process of Capital Requirements for Credit Risk according to standardize method. Currently Bank does not use ratings issued by Export Credit Agencies.

**2) the exposure classes for which each ECAI or ECA is used**

Exposure classes for which Bank uses external ratings issued by approved external agency:

- 1) exposures or contingent exposures to central governments and central banks;
- 2) exposures or contingent exposures to local governments and local authorities;
- 3) exposures or contingent exposures to administrative bodies and non-commercial undertakings;
- 4) exposures or contingent exposures to multilateral development banks;
- 5) exposures or contingent exposures to institutions;
- 6) exposures or contingent exposures to corporates;
- 7) short-term exposures to institutions and corporates;

**3) a description of the process used to transfer the issuer and issue credit assessments onto items not included in the trading book**

The Bank applies issuer and issue credit assessment according to rules set forth in KNF Resolution no 1/2007. Consequently for given exposure where a credit assessment exists for a specific issuing programme or facility to which the exposure belongs, this credit assessment is used to determine the risk weight, which is then assigned to that exposure. Otherwise, BHW

uses a credit assessment that exists for a specific issuing programme or facility to which the exposure does not belong or a general credit assessment that exists for this issuer, provided that it produces a higher risk weight than that which would be applied to exposures without a credit assessment or if it produces a lower risk weight and the exposure in question ranks pari passu or senior to the specific issuing programme or facility or to senior unsecured exposures of that issuer, as relevant.

4) the association of the external rating of each ECAI and ECA with the credit quality steps prescribed in annex 4 to the resolution on banks' capital adequacy, taking into account that this information needs not be disclosed, if the bank complies with the standard association set out in annex 4 to the resolution on banks' capital adequacy and the resolution of the Commission for Banking Supervision issued pursuant to art. 128 para 6 subpara 6 of the Banking Act

The association of the external rating of each ECAI and ECA with the credit quality steps:

Rodzaj Ratingu	Agencja Ratingowa	Rating	Stopień jakości kredytowej	Agencja Ratingowa	Rating	Stopień jakości kredytowej	Agencja Ratingowa	Rating	Stopień jakości kredytowej
Ratingi Długoterminowe	S&P(0002)	AAA	1	Fitch(0004)	AAA	1	Moody's(0001)	Aaa	1
	S&P	AA+	1	Fitch	AA+	1	Moody's	Aa1	1
	S&P	AA	1	Fitch	AA	1	Moody's	Aa2	1
	S&P	AA-	1	Fitch	AA-	1	Moody's	Aa3	1
	S&P	A+	2	Fitch	A+	2	Moody's	A1	2
	S&P	A	2	Fitch	A	2	Moody's	A2	2
	S&P	A-	2	Fitch	A-	2	Moody's	A3	2
	S&P	BBB+	3	Fitch	BBB+	3	Moody's	Baa1	3
	S&P	BBB	3	Fitch	BBB	3	Moody's	Baa2	3
	S&P	BBB-	3	Fitch	BBB-	3	Moody's	Baa3	3
	S&P	BB+	4	Fitch	BB+	4	Moody's	Ba1	4
	S&P	BB	4	Fitch	BB	4	Moody's	Ba2	4
	S&P	BB-	4	Fitch	BB-	4	Moody's	Ba3	4
	S&P	B+	5	Fitch	B+	5	Moody's	B1	5
	S&P	B	5	Fitch	B	5	Moody's	B2	5
	S&P	B-	5	Fitch	B-	5	Moody's	B3	5
	S&P	CCC+	6	Fitch	CCC+	6	Moody's	Caa1	6
	S&P	CCC	6	Fitch	CCC	6	Moody's	Caa2	6
	S&P	CCC-	6	Fitch	CCC-	6	Moody's	Caa3	6
	S&P	CC	6	Fitch	CC	6	Moody's	Ca	6
S&P	C	6	Fitch	C	6	Moody's	C	6	
S&P	D	6	Fitch	D	6				
				Fitch	RD	6			
Ratingi Krótkoterminowe	S&P	A-1+	1	Fitch	F1+	1			
	S&P	A-1	1	Fitch	F1	1	Moody's	P-1	1
	S&P	A-2	2	Fitch	F2	2			
	S&P	A-3	3	Fitch	F3	3	Moody's	P-2	2
	S&P	B	4	Fitch	B	4	Moody's	P-3	3
	S&P	B-1	4	Fitch	C	4	Moody's	NP	4
	S&P	B-2	4	Fitch	D	4			
	S&P	B-3	4	Fitch	RD	4			
	S&P	C	4						
	S&P	D	4						

5) the exposure values before and after credit risk mitigation associated with each credit quality step as set for the standardized approach as well as items deducted from own funds

Credit quality step	Exposure values before credit risk mitigation in PLN ('000)	Exposure values after credit risk mitigation in PLN ('000)
1	516 059	516 059
2	6 549 034	6 548 611
3	562 401	562 401
4	11 336	11 336
5	396	67
6	37 366	37 366
no rating	51 395 455	51 277 375
<b>Total</b>	<b>59 072 048</b>	<b>58 953 216</b>

#### Deductions from own funds (in PLN '000)

Deductions from core funds		1 283 326
	- intangible assets measured at carrying amount	<b>1 283 326</b>
	including company value	1 245 976
Deductions from core and supplemental funds		56 468
	- capital exposure in financial institutions	<b>56 468</b>
	including:	
	Capital exposure of the Bank in financial institutions, lending institutions, domestic banks, foreign banks disclosed in the form of shares or other capital exposure, in case when such exposure exceeds 10% of own funds of that entity.	<b>52 565</b>
	Bank Rozwoju Cukrownictwa S.A.	40 046
	Handlowy Inwestycje Sp. z o.o.	5 395
	Handlowy Investments II S.a.r.l.	7 124
	Capital exposure of the Bank in financial institutions, lending institutions, domestic banks, foreign banks disclosed in the form of other capital exposure in items classified as own funds or capital of those entities, including capital contributions in limited liability companies, in carrying amount (balance sheet amount), in case when such an exposure does not exceed 10% of own funds of that entity.	<b>3 903</b>
	Handlowy Inwestycje Sp. z o.o. - Contributions to subsidiaries	3 903
<b>Total</b>		<b>1 339 794</b>

## **7. Information regarding calculating the risk-weighted exposure amounts using internal ratings-based approach**

The Group does not use internal ratings-based approach.

## **8. Information regarding application of value-at-risk approach to calculate the capital requirements**

Bank does not use value-at-risk approach to calculate the capital requirements.

## **9. Information regarding operational risk**

### **1) the approaches to the calculation of capital requirement for operational risk**

Bank uses the standardised approach to calculate the capital requirement for the coverage of operational risk.

### **2) in the case of applying advanced measurement approach in accordance with § 34-67 of annex 14 to the resolution on bank's capital adequacy - a description of the methodology, including a discussion of relevant internal and external factors considered in the measurement approach. In the case of partial use, a discussion and scope of the different methodologies used**

The Bank does not apply the advanced measurement approach.

## **10. Information regarding the exposures in equities not included in the trading book**

### **1) the differentiation between exposures based on their objectives (capital gains relationship and strategic reasons), and an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices**

Bank's equity investments are broken down into strategic portfolio and divestment portfolio. Strategic portfolio includes entities in the financial sector that help in expansion of products offered by the Bank, increase prestige and reinforce Bank's position in the competing financial services Polish market. Strategic portfolio includes infrastructure providers conducting business for financial sector, which are not controlled by the Bank, but provide strategic value for the Bank due to conducted operations. Divestment portfolio contains entities directly and indirectly owned by the Bank that have no Bank's strategic commitment. Some companies held for sale are restructured commitments, which originate from debt-to-equity swap transactions.

Detailed information on how the Group's equity investment portfolio is broken down based on purchase reasons are described in chapter „Bank's equity investments” of the Report on Activities of the Capital Group of Bank Handlowy w Warszawie S.A. for 2008.

A description of accounting techniques applied as well as capital commitments valuation methodologies is in explanatory note 2 „Significant accounting policies” to the consolidated

financial report of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ending 31 December 2008.

**2) the balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price where it is materially different from the fair value**

Information on balance sheet value and the fair value of capital expositions not included in the trading book is in explanatory note 35 „Fair value information” to the Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ending 31 December 2008

**3) the types, nature and amounts of equity exposures, broken down into: listed equity exposures, sufficiently diversified portfolios of securities not admitted to trading in the regulated equity market, and other exposures**

The value of equity exposures, broken down into listed equity exposures and portfolios of securities not admitted to trading in the regulated equity market is provided in explanatory note 20 „Equity investments accounted for under the equity method” and note 21 „Other equity investments” to the Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ending 31 December 2008.

**4) the cumulative realised gains or losses arising from sales and liquidations in the period**

The value of realized gains or losses from sales and liquidations of equity investments not included in Bank’s trading portfolio is provided in explanatory note 9 “Net gain on investment (capital) securities” to the Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ending 31 December 2008.

**5) the total unrealised gains or losses, the total latent revaluation gains or losses, and any of these amounts included in the core or supplementary funds**

All items included in core and supplementary funds pursuant to article 127 of the Banking Act and the Resolution on Bank’s own funds are provided in details in point 2 subpoint 2 of this report.

**11. Information shall be disclosed by banks on their exposure to interest rate risk on positions included in the banking book**

**1) the nature of the interest rate risk and the key assumptions (including assumptions regarding loan prepayments and behavior of non-maturity deposits), and frequency of measurement of the interest rate risk**

**2) the variation in earnings, discounted economic value or other relevant measure used for the assessment of upward and downward rate shocks according to the bank’s method for measuring the interest rate risk, broken down by currency**

The information regarding the interest rate risk of the Bank's portfolio are disclosed in explanatory note 44 "Risk Management" to the Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ending 31 December 2008 .

## **12. Information regarding calculation of risk-weighted securitisation exposure amounts**

There are no securitization exposures within the Group.

## **13. Information regarding credit risk mitigation techniques**

### **1) the policies and processes for, and an indication of the extent to which the bank makes use of, on- and off-balance sheet netting**

For the purpose of calculating the balance sheet equivalent of derivative transactions the Bank makes use of off-balance sheet netting of derivative transactions with Citibank N.A. (London Branch) within main product groups. Such transactions are covered by frame agreement ISDA Master Agreement between Bank Handlowy w Warszawie S.A. and Citibank N.A..

The basis for use of compensation was to fulfill the legal and formal terms referred to in par. 75 of Annex 16 to Resolution 1/2007 of 13 March 2007, which must be met in order to consider the contractual compensating as risk limiting.

The Bank has introduced process to monitor regulations in regards to compensation in order to ensure proper monitoring of changes in current regulations in regards to requirements set in the above mentioned annex.

### **2) the policies and processes for collateral valuation and management**

Information regarding the policies and processes for collateral valuation and management are presented in details in supplementary note 44 „Risk Management” to the Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the period ending 31 December 2008.

### **3) the main types of guarantor and credit derivative counterparty and their creditworthiness**

The Group does not make use of guarantees as credit risk mitigation techniques for the purpose of capital adequacy assessment. Also there are no credit derivatives in Group's portfolio.

### **4) information about market or credit risk concentrations within the credit mitigation taken**

The Group does not make use of guarantees as credit risk mitigation techniques for the purpose of capital adequacy assessment. Also there are no credit derivatives in Group's portfolio.

### **5) for banks calculating risk-weighted exposure amounts on the basis of the standardised approach in accordance with annex 4 to the resolution on bank's capital adequacy or the IRB approach in accordance with annex 5 to the resolution on bank's capital adequacy,**

**but not providing own estimates of LGDs or conversion factors in respect of the exposure class - separately for each exposure class, the total exposure value (after, where applicable, on- or off-balance sheet netting) that is covered - after the application of volatility adjustments - by eligible financial collateral, and other eligible collateral**

Total exposure value covered by eligible financial collateral or other eligible collateral by exposure classes after the application of volatility adjustments.

<b>Exposure class</b>	<b>Cash collateral in PLN ('000)</b>
Administrative bodies and non-commercial undertakings	1 021
Governments and central banks	425
Corporations	103 450
Past due items	13 937
<b>Total</b>	<b>118 832</b>

**6) for banks calculating risk-weighted exposure amounts on the basis of the standardised approach or IRB approach - separately for each exposure class - the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees or credit derivatives; for the equity exposure class, this requirement applies to each of the approaches provided in § 45-59 of annex 5 to the resolution on bank's capital adequacy**

The Group does not make use of guarantees as credit risk mitigation techniques for the purpose of capital adequacy assessment. Also there are no credit derivatives in Group's portfolio.

Signatures of all Management Board Members

12.05.2009	Sławomir Sikora	President of the Management Board	
..... Date	..... Name	..... Position / function	..... Signed on Polish original
12.05.2009	Michał H. Mrozek	Vice-President of the Management Board	
..... Date	..... Name	..... Position / function	..... Signed on Polish original
12.05.2009	Peter Rossiter	Vice-President of the Management Board	
..... Date	..... Name	..... Position / function	..... Signed on Polish original
12.05.2009	Sonia Wędrychowicz-Horbatowska	Vice-President of the Management Board	
..... Date	..... Name	..... Position / function	..... Signed on Polish original
12.05.2009	Witold Zieliński	Vice- President of the Management Board	
..... Date	..... Name	..... Position / function	..... Signed on Polish original